Corporate Consolidators
A Survival Guide for Owners

Simmons
Veterinary Practice Sales & Appraisals

Introduction

It is well known that today's veterinary practice ownership is undergoing major change. Currently sole proprietorships and single owner corporations comprise the major model of ownership. However, a rapidly increasing ownership paradigm is the large corporate consolidators each owning upwards of several hundred practices and growing.

In our communication with practice owners, we have become aware that many owners, despite reluctance, end up completing a consolidator sale because they were unaware of the vast amount of commercial financing availability for private buyers (and at very favorable terms) along with the huge demand for ownership of large practices by the private buyer market.

For some owners, a sale to a corporate consolidator may indeed be the best exit. However, there are many corporate buyers with equally as many purchasing scenarios and terms. An owner may not be aware of the many corporate buyer opportunities and may "sell themselves short" accepting the first offer by the first corporate consolidator.

Once the corporate buyer is identified, there are many provisions of the transaction that should be negotiated and included or excluded in the sale contract. Such examples are real estate lease agreements, "earn outs", "hold backs", price allocation for tax purposes, and employment agreements. Most importantly is to establish an accurate Fair Market Value for your practice and the Corporate Investment Value the consolidators are able and willing to pay. (The two figures are typically different in a corporate consolidator transaction.)

It is for these reasons that it should be incumbent upon you as a large practice owner to engage a consultant to assist in the myriad of details necessary to create a mutually satisfactory corporate sale transaction. At Simmons we bring in our knowledge and experience in these matters along with an affiliation with legal and accounting teams that are familiar with corporate contracts and transactions.

Simmons
Veterinary Practice Sales & Appraisals

Are You A Candidate For Corporate Purchase?

Although the range is wide regarding desired corporate revenues, they are most interested in small animal, multi-doctor practices grossing over $1,500,000 located in a major metropolitan area.

Most of the older corporations have a foothold in many areas and seek to expand their holdings, competing to purchase all the practices in the area that meet their qualifications. In areas where corporate ownership has not become an issue, competition is stiff to gain and hold a leading edge in market share. As a result of this competition, there is often a bidding war amongst corporate buyers, which can drive the price of a practice above its Fair Market Value*.

> *Fair Market Value is the price that a practice will typically sell for under normal market conditions, between private parties, under normal financing parameters. Corporate consolidators often pay in excess of Fair Market Value, with offer prices commonly exceeding the practice's most recent year's gross revenue. In the past, receiving an offer equivalent to "one year's gross (revenue)" was considered a compliment. In today's highly competitive corporate consolidator market it may be considered just a starting point.*

Although some corporates will purchase 100% ownership, some offer joint ventures or partnership opportunities. Joint ventures are popular with veterinary corporations because a practice owner who retains an ownership stake in the practice is still invested (both literally and figuratively) in the practice. This may be an interesting option for owners who wish to work for a number of years in the future and prefer to maintain some degree of ownership. For others it's simply a loss of a large portion of the profit and compromises with management decisions.

What Is The Underlying Goal In Corporate Practice Ownership?

In a single word, practice ownership is driven by the "profit" motive. However, profit comes in many flavors. Corporate consolidators may pay as much as 8 to 13 times earnings, or more since their stock may sell for many times that in three to seven years.

Secondary profit centers include laboratory services for some of the corporations that also own laboratory equipment and/or service companies and have a secondary vested interest in your practice. They will convert in-house lab services to their sister lab service company, saving thousands of dollars each year. You may be even more attractive if you commonly use a competing lab service provider. Economy of scale leverages their drugs and supplies purchasing as well.

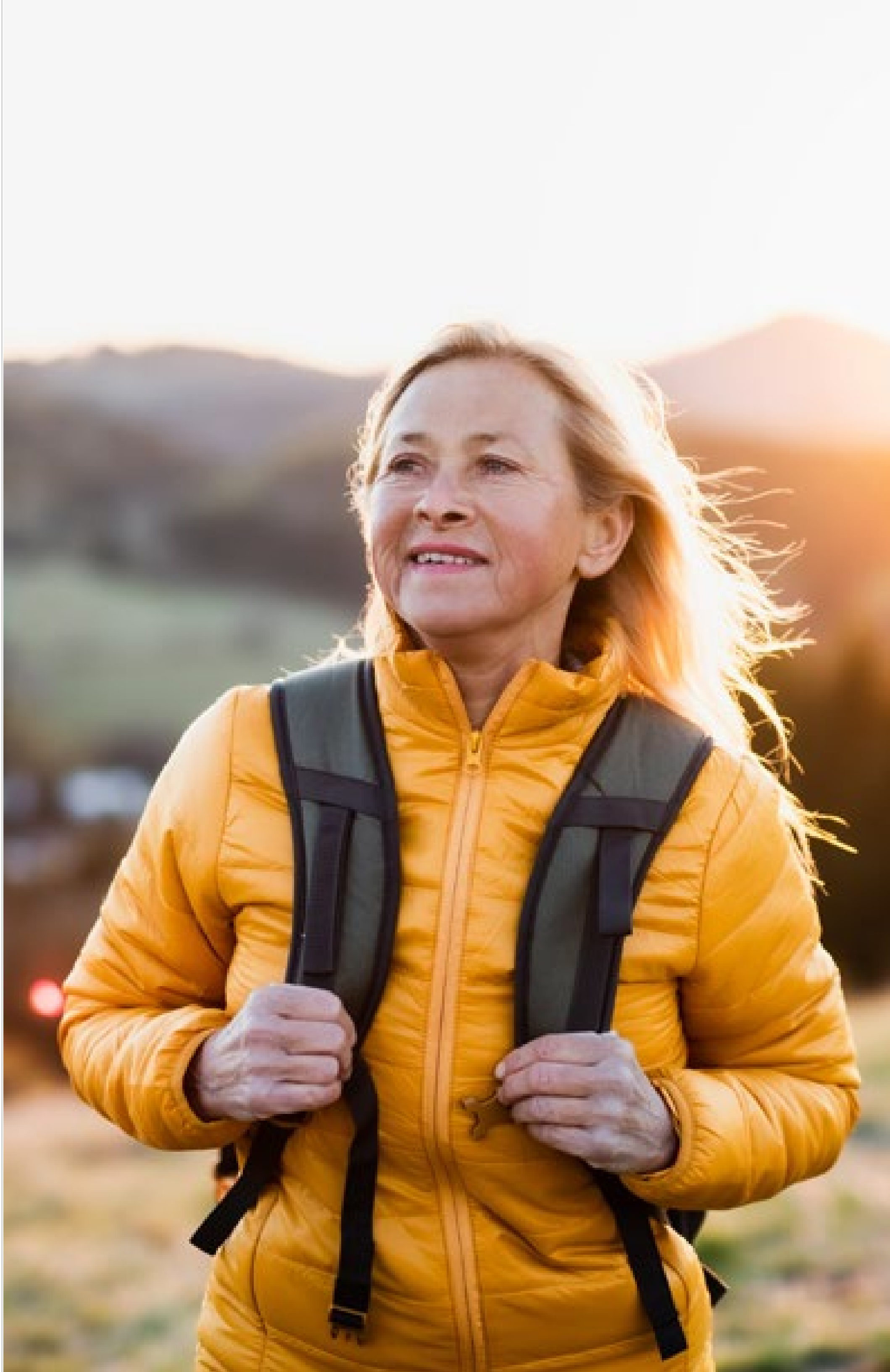
What Do They Want From You?

Corporate consolidators do not have their own professional staff. Across the board, they require some degree of doctor stability typically requiring owner continuity after the purchase. The more doctors in the practice and more diverse the involvement in management affairs, the less becomes their reliance on the current owner.

Nevertheless, owner post-sale employment often includes some sort of requirement for continued practice revenue production. This is typically in the form of an "earn-out" attached to an owner carry back note financing a portion of the purchase. In the event revenues fall below a certain point, it will trigger a reduction in the owner's promissory note. This can be especially problematic if the owner has both a reduced presence in the practice, and in essentially all cases loses management control of the practice.

Another form of owner "guarantee" is a hold-back whereby a portion of the cash transaction is held back in an escrow account ensuring certain provisions are met by the owner after the sale. These provisions can be tied to revenue production or some contract contingency.

Although you may be a candidate for purchase in the minds of the corporate world, are you in your own mind? The carrot may be sweet, but are you willing to accept the strings attached?



The Transaction: What's Involved?

A key point to emphasize and always keep in the back of your mind is that the practices corporations want are also eagerly sought after by the mass market of private buyers - the attractive high grossing, multi-dvm practices in suburban USA. However, one thing that differentiates the consolidator from the private buyer is that the former typically will require some post-sale full time employment from the seller to maintain productivity and doctor stability. Your personal income at that point will become that of a chief associate so to speak, and you will lose the joy of profit distributions or an "owner's" salary far in excess of what one would expect as a chief associate. While this may be an ideal situation for some, most sellers are on the road to retirement with the goal of less work and management stress at the point of sale. Although this is a good method to convert a largely intangible asset (your practice value is almost all in goodwill) to a cash asset and still retain attractive income for a few more years. Of course, the private buyer will welcome having the owner stay on in some part-time, non-managerial role after the sale, but it will likely not be a requirement, and in almost all cases it will be short term rather than years.

If it appears that this avenue of exit dovetails with your goals, you should realize that there are many prospective corporate buyers, and if one is courting you, there are others who should and will be if presented the opportunity. The first offer from the first prospect may appear attractive but may not at all be the best and most attractive that you can negotiate if you seek out more bidders. You may want to pause and reflect on this and bring in an agent who is experienced in these matters. Most owners can name a few consolidators, but can you name over 40? This number is always changing through mergers and larger consolidators acquiring smaller ones.

While their offer may be very attractive, there are many factors that may offset the practice price. For example, most corporate buyers are not interested in the real estate, and they may attempt to negotiate a lease payment significantly less than a fair market figure in exchange for the higher practice price. What happens to your special use real estate if the corporate tenant does not renew the lease but relocates the practice? Would you be able to continue the facility with another veterinary practice tenant? Will your non-compete allow it? Would a private veterinarian want to lease a facility recently vacated by the big corporate practice that relocated just down the street?

Another example may be some sort of owner financing disguised as a "hold back", or "earn out" but tied as a contingency for some level of seller productivity benchmark. What happens to your financing "note" if the benchmark is not met? How difficult might it be to meet the benchmark if you no longer control management policy, and clients are driven away by new policy, fees, staffing, etc? And more---How is your non-compete structured as to your rights in the event of a default on your owner "financing"? Can you reclaim the practice and continue in your facility?

To address all these issues and more, it would be wise to engage Simmons as we are familiar with corporate transactions and contract nuances. We can successfully guide you through the difficult process and assure that you receive maximum value for your practice and real estate.

Options to Corporate Sale: What Are My Choices?

We continue to hear from practice owners that their exit preference is to a private individual instead of a corporation. The refrain is always the same–that they are concerned over the future of our profession becoming all corporate ownership with the evaporation of the personally owned, personal culture and personality of privately owned practices in favor of the impersonal culture of the corporate structure.

Owners of large practices, the classic corporate targets, are led to believe that corporate exit is the only choice–that the private buyer market "cannot afford" your practice–they have no money and cannot raise the purchase capital. Of course this myth is far from reality. Today, there are fewer practices on the open market available for private ownership. Accordingly private competition is heavy for veterinary practices, especially the same ones targeted by the consolidators. Furthermore, commercial funds are readily available for the private purchasers. For many owners, a sale to private buyers can be equally if not more attractive than to the corporate world.

As to qualification, it's simply a twofold matter. First the buyer must qualify at the personal level. This is nothing more than a good credit score, perhaps a small amount of liquidity and a demonstration of prudent financial stewardship, all being common characteristics of the typical young private veterinarian. The second aspect of qualification is done by the practice broker or appraiser who performs a cash flow analysis and feasibility check to ensure that the practice cash flow is adequate to support the price. Meaning that the buyer can service acquisition debt and still have a reasonable personal income remaining from adjusted net cash flow. There are earnings to debt service ratio parameters common to the commercial lenders, and the broker/appraiser will ensure these are met as a purchase qualification factor.

As to the universally enormous student debt albatross, it is absolutely no factor as long as it is being serviced responsibly as with all other living expenses. It is no surprise that these lenders will acknowledge that the quickest way out of debt is practice ownership.

Another great surprise and myth-buster is that very little or no down payment at all is required to purchase even the largest practice and real estate. As long as the buyer and practice qualify, loans are available for a purchase price commonly up to 90% of gross and often exceeding gross revenues. Loans are also available for 100% of the real estate appraised value. For example, a 2-3 million dollar (or more) practice transaction with a million or two (or more) in real estate value can be accomplished with all cash to the seller and with less than $25,000 down payment from the buyer. Interest rates today are typically hovering around 5% to 6% with 10-15 year financing terms on the practice and 25 years on the real estate. A common benchmark at Simmons is that the buyer's pre-tax personal income availability exceeds 15% of gross after debt service and that this figures commonly exceeds $100,000.

This is a remarkable testimony to the enormous creditworthiness of our profession. Lenders will acknowledge that as veterinarians we are THE most creditworthy of all professionals, and according to the SBA, "second only to chicken farmers".

Many practice owners would like for their practice to stay in the hands of private ownership thus continuing the legacy and culture they have worked so hard to build over their lifetime. This is certainly possible and occurs successfully every day.

How We Can Help You?

Considering the magnitude of your transaction and the impact it will have on your financial future, it is advisable that you have an experienced consultant and tough negotiator on your team. One who has been around this profession for a long time, whose entire thrust is exclusive to veterinary practice ownership transition and who knows the parties and "knows the ropes".

At the outset we will advise you of the many exit options available to you. It may very well be that a corporate sale is the best way to accommodate your personal goals–or perhaps not. Many sales are made to consolidators with a degree of trepidation but with the misunderstanding that this is the only choice. "No private buyer has enough money nor can he/she afford my practice". This is far from reality as discussed in Chapter Three. There are many private buyers eager for your practice, and obtaining purchase cash loans under attractive terms is not an obstacle.

If it appears that the corporate world is best for you, we are able to advise you of the many facets of this type of transaction. An example is to first provide a fair market value for your practice as if it were to be sold to a typical, fair market private buyer off the street. However, there is a second figure that you should know. And that is the Corporate Investment Value that can be sustained and achieved from the corporate buyer considering their respective viewpoints and profit motives. This may be much greater than the fair market value. There are motives such as lab services, equipment rental and OTC product sales that drive some corporates' purchase price decision. At Simmons, we know who they are and how they think.

If you've decided you are interested in pursuing a corporate sale further and wonder if you would benefit from our help, simply ask yourself these questions:

- How many sales have I been through personally? Were any of them corporate sales? ▪ Do I have the time and resources to negotiate all aspects of the deal?
- What is a fair deal? What are my colleagues getting? Where did they win, where did they lose?
- Can I devote a number of hours a week, and sometimes a number of hours a day, to this project and still run my practice efficiently?
- Who are the best attorneys and accountants that have corporate sale experience, and which ones fit which consolidators best?

For those considering a corporate sale, there may be one who will provide more suitable exit terms and after-sale provisions as opposed to one that may have offered a larger price but with an unattractive aftermath. We know the corporate consolidators and will bring in those most suitable for you. Only then are you able to make an intelligent exit choice after reviewing all the options.

In the legal realm, the party who originates the contract may have a slight advantage in any transaction. In a practice ownership transition the buyer typically originates the contract. As mentioned above, there are a myriad of issues to be resolved, and you need Simmons on your side. Good legal advice coupled with a well-structured plan by Simmons assures your best deal.

Although we are not licensed to provide legal or taxation advice, Simmons commonly works with a seller's professional advisors regarding tax matters. We can pass along the procedures others have utilized to defer and sometimes avoid the significant income tax impact of the sale.

Succinctly put if you engage our services, we ease the burden of the immense points of communication required to explore all options from all corporate consolidators. We become your focal point of all communication with other parties. We make sure all issues are brought to light for your consideration. You will need to communicate only with us, your attorney and CPA.

More research. Greater detail. Better results. It's what we do.

- Do I fully understand the difference between the fair market value price I can achieve from a private buyer and the corporate investment value I should be negotiating with the consolidator?
- Speaking of corporate consolidators, how many do I know? Am I missing talking to the very one that would provide me the best price and the best terms?
- Can I complete logical and clear financial pro-forma justifying the price?
- What deal structure is right for me? What are the pros and cons of 100% sale versus Joint Venture/Partnership?
- What usually goes wrong during the due diligence stage of the purchase? What issues kill the deal 90% of the time?