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Think twice

Investing in your hospital shortly before a sale makes sense only in certain situations. Needless spending can depress the practice valuation.

With so many veterinarians considering a practice sale, either to an associate or a corporate consolidator, some owners wonder whether making further investments in the hospital or new equipment will yield a higher price. The answer? It depends.

Your Facility

Is now the right time for new construction or a remodel? If you plan to retire in the next year or two, the answer is probably not. Buying or building a facility is a significant investment that should provide a strong return in the years to come.

Generally, when a veterinary practice moves into a larger facility, the practice leaves space it has outgrown. Frequently, the old building has neared capacity for the number of patients who can be seen during normal business hours, typically because of a shortage of exam rooms or no room to put a new doctor.

Unless your practice is overcapacity to the point that your doctors see appointments in the parking lot, investing in capital improvements soon before you expect to sell does not allow enough time to recoup the investment. While you might wish that you had extra space, your rent payment is likely near the bottom of the normal percentage of income, or even below that level.

When the practice moves to larger quarters, the business might need time to grow into the new space. Although extra elbow room is nice, the facility costs will take a huge jump. Instead of being below industry norms, the rent will be above normal for a few years while the practice grows. The facility rent will have increased, and so will real estate taxes, utility expenses and insurance premiums. All these contribute to reduced profits in the short term.

On the other hand, if the practice is outdated, has non-functioning equipment, isn't fully computerized or was last painted during the Clinton administration, a minor face-lift might lead to a higher sales price or less time on the market. Start with a deep cleaning of every room, then move outside and rid the parking lot of weeds, and cigarette butts, and straighten the flower beds and other plantings. In other words, make things look like somebody cares. A coat of paint and updated pictures on the walls are part of a quick, inexpensive face-lift.

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Will You Remain the Landlord?

If you own the building or land, one way to offset the costs of capital improvements is to retain ownership of the real estate. Becoming a landlord allows you to maintain an income stream beyond the sale of the practice. However, you also will be responsible for the property upkeep and any damage that might occur because of a storm, fire, flood or other natural occurrence.

Buyers will want a long-term lease with at least one extension, and possibly the right of first refusal to buy the property. Long-term leases also protect you, the seller. You want to lock the buyer in as a long-term tenant so that your property does not sit empty.

Your Equipment

Buying a new piece of equipment represents a much smaller investment than a facility purchase or expansion. If equipment breaks or becomes quirky, replacing it is a no-brainer. Do it. Your doctors and staff need the equipment to provide care to patients.

However, don't buy something new just to attract a buyer. Do you really need an underwater treadmill when you plan to retire in six months? Not unless the existing treadmill is broken. Again, consider how quickly the equipment will pay for itself. Something as large as an underwater treadmill will require an investment beyond the equipment itself. Consider the costs of installation, staff training and maintenance and the need to educate clients about the benefits.

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Sales reps are experts at making an equipment investment sound appealing, and you might be tempted by potential tax savings. Buying equipment or other depreciable assets is a common tax strategy. The principle behind it is that the allowable accelerated depreciation expense taken on new equipment will reduce your taxable income and therefore, the amount you must pay in income taxes.

Remember that you will not have a dollar-for-dollar reduction in income taxes. A $50,000 piece of equipment, assuming you can deduct the entire cost on this year's tax return, does not mean your tax bill is reduced by $50,000. It means that you will have $50,000 less in taxable income. Take the decision making beyond the desire to simply lower taxes. Will you use the equipment immediately and at full capacity?

By no means should you enter into a new, long-term equipment lease unless you are fully prepared to make the lease payments yourself. This advice applies both to equipment that is leased outright as well as relationship leases — those agreements that provide equipment at little or no cost provided certain usage levels are maintained. Any agreement that requires a practice buyer to continue payments after the sale should be avoided because these payments reduce the price a buyer can pay for your hospital.

Liabilities such as these are frequently paid in their entirety by the sellers with the proceeds they receive from the practice sale. Occasionally, and assuming the loan can be assigned, the buyer will agree to pay off the loan. However, consider this large caveat: For every dollar in equipment loans the buyer assumes, there is a dollar-for-dollar reduction in the amount they can pay for your practice. Think about it. Buyers can buy the practice on a debt-free basis, meaning the only loans they have relate to the acquisition, or they can pay less for the practice and take over the balance of other loans.

Your Software

One piece of equipment that you need to evaluate is your practice management software. Has the program kept up with your current practice needs? Is it expandable to accommodate a growing practice? If you use an older program that is no longer supported, a buyer will have to upgrade or replace it. Also, the use of paper charts signifies to a potential younger buyer that your practice has not kept up with the times.

Before you put more money into your practice, evaluate how quickly the investment will contribute to the bottom line. Invest in things that fit with the practice as it is now, not what a potential buyer might wish to do with it. ■

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