What are you buying exactly?

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If you're considering practice ownership, learn the differences between an equity purchase and an asset purchase.

One of the most important aspects to understand when you buy a veterinary practice is whether you are getting the business's assets or equity in the existing company. I know I'm asking you to understand accounting terms, but this is important and pretty easy to grasp.

When you buy the assets, you get all the equipment, inventory, furniture and goodwill. (More about goodwill in a moment.) When you buy equity, or stock, you get all these assets, a few additional assets such as working capital and accounts receivable, and all the liabilities, such as facility or equipment loans, and balances in accounts payable and on the hospital's credit cards. The table at right shows some of the differences between asset and equity purchases.

A note about accounts receivable (A/R) balances: Many equine and large-animal practices carry large A/R balances, or money that clients owe. Traditionally, the seller has retained these balances. In contrast, most companion animal practices carry small balances in accounts receivable.

Category	Asset Purchase	Equity Purchase
Cash in the bank	N	Y
Accounts receivable	Y/N	Y
Inventory	Y	Y
Employee advances	N	Y
Medical equipment	Y	Y
Office equipment	Y	Y
Furniture	Y	Y
Goodwill	Y	Y
Rent or utility deposits	N	Y
Credit card balances	N	Y
Equipment loans / leases	N	Y
Remodeling loans	N	Y

The seller sometimes will keep the A/R and collect the balances due. Another option is for the buyer to collect the money but run the client's credit card on a machine connected to the seller's bank account. The tricky part comes when the client wants to pay a balance to the seller and current charges to the buyer. Staff members need to be diligent about running separate charges on separate machines.

A third option that is easier on both clients and practice staff is for the buyer to buy the accounts receivable as part of the purchase, usually at a discount. This way, the seller gets cash upfront, clients are not asked to pay two providers, the staff doesn't have to keep track of amounts owed to the buyer and the seller, and the buyer doesn't have to maintain a potentially cumbersome and confusing list of money that needs to be forwarded to the seller.

Equity Purchase

When you're buying a portion of a practice, an equity purchase is the most common. This is true whether a new owner is acquiring a minority interest or an existing owner is buying out another owner. However, there is a difference. The price paid by a minority buyer, who does not have control of the business, will be lower than the price needed to gain a controlling interest. A practice's equity could have two different values for two different buyers.

In an equity purchase, the buyer acquires an undivided interest in all assets and liabilities. In other words, a buyer with a 20% interest in the practice effectively owns 20% of every asset and 20% of every liability. The buyer doesn't pick the items to be bought or exclude certain items.

There are a few exceptions. For example, when a large bank balance is present, the seller might choose to withdraw a portion of the money before the sale date. The buyer and seller agree to the terms. The seller also might write off employee loans or old accounts receivables if any of them are personal or uncollectible. Other exceptions can include a personal loan that the practice made to the seller or a practice-owned vehicle used as the seller's family car. The seller would work with the practice's accountant to remove such items from the hospital's financial statements before the sale.

Asset Purchase

An asset purchase commonly occurs when a new buyer acquires

100% of the business. As the buyer, you create a new business entity, meaning you choose a new company name and register it with the federal and state governments. Talk with an accountant about the best type of business entity — an LLC or an S-corp, for instance — as the selection has tax consequences.

Don't worry that the new company name is different from the hospital's because one of the assets you are buying is the hospital's trade name. After the sale, you can change the legal name of the new company, or you can keep the legal name and use the hospital name as the name under which the business operates. (For example: Kelly Johnson, DVM, LLC, doing business as Southside Veterinary Clinic.)

Under an asset purchase, you buy the equipment, inventory and furnishings (the tangible assets) as well as the goodwill (intangible assets) associated with the business.

Goodwill describes:

- The practice's reputation in the community.
- The practice's relationship with clients.
- Client loyalty to the practice.
- The business name and website.
- The systems in place.
- The team of skilled employees.

Goodwill gives the buyer a leg up compared with a brand-new practice. A start-up begins with a blank slate, and the owner chooses the location, equipment, technology, decor and services. What's missing are the clients, patients and appointments.

When you buy an existing practice, you acquire someone else's business that might not meet all your ideals. But you're purchasing the clients, patients, medical records and community trust. Your first day as owner begins with a full appointment schedule, one of the most significant benefits of buying an existing practice.

When you buy assets, you do not assume the business's debts, such as outstanding loans. The seller pays off these loans using the sale proceeds. Sometimes, buyers are asked to take over relationship leases, meaning commitments for equipment or service usage, or supplies purchased in exchange for points or rebates. If you agree to take on the remaining payments on equipment loans or honor a usage agreement, you must understand the obligations. In some cases, the purchase price should be reduced by the balances transferred to you.

Buying assets and creating a new business entity protects the buyer from anything that occurred under previous ownership. In other words, any liabilities that arise from something that happened before the practice was sold will be dealt with by the seller. Examples include employee grievances, disgruntled clients and payroll taxes. Given society's litigious nature, starting with a clean slate makes sense.

Occasionally, a seller will insist on selling stock instead of the practice assets. Sellers generally prefer to sell stock in the business because income taxes related to stock sales are typically lower than the income taxes on asset sales. If you encounter this situation, consult an attorney to understand the risks.

This brings us to an important point. The valuation of the hospital must reflect what you are buying. If you are buying part of an existing practice (equity purchase), you can't use an asset valuation as the basis for the purchase price. An asset valuation does not include the cash in the bank, and it does not subtract the practice liabilities.

Let's look at an example. Say the asset value of a practice is $2 million. The value includes the tangible and intangible assets, but none of the deposits or employee advances, and no liabilities. To convert this asset value to represent an equity value, we need to do a little math.

Asset value	$2,000,000
Additions	
Bank balances	+250,000
Employee advances	+2,500
Utility deposit	+5,000
Subtractions	
Credit card balance due	–35,000
Laser loan	–65,000
Remodel loan	–695,000
Equity value	$1,462,500

As you can see, a significant difference exists between the two values, all dependent on what is included. Be clear about what has been valued and whether you are buying under the same assumptions used in the appraisal. Someone who is buying an equity interest but agrees to a price determined by an asset valuation could be overpaying. The reverse is also true.

Whether you are a buyer or a seller, verifying that the valuation you have been given reflects the anticipated change in ownership makes sense. As a buyer, closely review what liabilities, if any, you are asked to assume. Hire someone to review the numbers and make sure the price is fair. Paying a consultant a few thousand dollars to advise you could save you hundreds of thousands of dollars in the purchase price. As a seller, if you decide to sell 100% of your practice but the valuation was done for the sale of a minority interest, talk to your valuation expert about updating the report. If you don't, you could be leaving money on the table. ■

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