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The value of waiting

Should you sell your veterinary practice while prices are high, or does a better option exist?

Ten years ago, the U.S. economy was beginning to recover from the Great Recession. If you wanted to sell your veterinary practice back then, finding a buyer was time-consuming and sales prices were stagnant. Today, the market has changed entirely. Hospital owners are inundated with inquiries from consolidators large and small offering higher prices than we ever could have imagined in 2010. With the lure of a big payoff and concern that the current bubble will burst, does it make sense to sell now while prices are high, or is it better to wait until you are closer to retirement age?

If you own a profitable hospital and are not ready to retire, your best financial decision is to keep the clinic as long as possible. That's right. You will earn a much higher return and still get a good price when you sell. Just keep doing what you are doing. Don't believe me? Keep reading for specifics.

Owners have the right to run their businesses however they choose. They also have the right to profits. Those profits are what distinguishes an owner from an employee. As an employee, the only way you receive money is through the work you do for the business. In other words, wages, bonuses and benefits like health insurance, dues and continuing education. Owners receive all that plus the profits in exchange for assuming the risks associated with owning the business.

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You receive a return on your investment in practice ownership in two ways:

- Annual earnings (profits).
- The sales price when you sell.

Stating the obvious, once you sell your practice, you give up those earnings. Corporate consolidators and venture capital firms interested in a veterinary hospital are motivated by the profits the practice generates. Are you ready to give up your share of earnings in order to reduce the business demands?

Let's look at two examples.

Example 1

You are 64 and the sole owner of a practice that grossed $2.5 million in 2019 and had 12% profitability. As an owner, in addition to your salary and benefits, you would have as much as $300,000 in earnings ($2.5 million multiplied by 12%) to distribute to yourself. Savvy business owners know that they can't always take home 100% of those earnings. Some years the money is needed to update the hospital, upgrade equipment or pay off notes. If you can take home 80% of the profits each year, you would have $240,000.

Along comes a buyer who is willing to pay $3 million for your practice. That price equals a 10x multiple, where "x" is practice earnings. The sales agreement would require you to stay on for two years after the sale. What do you do? At 64, if you want to work just a few more years, this might be a perfect exit plan. In essence, you would give up two years' worth of earnings in exchange for a 10x sales price.

Example 2

Instead of being 64, you are 54 and you plan to work an additional 10 years. How attractive is a 10x offer now? If you don't sell now, could you still get a good offer later? Yes, as long as your practice continues to grow and remains profitable. Will the offer 10 years from now be at a 10x multiple? Does it matter? Not as much as you might think.

Let's look at how long you would need to keep your practice to make the same amount of money if, when you do sell it, the multiples are lower. The calculation included here considers the sales price and the earnings you will continue to receive while you own the business. (Caution: This example uses simple math and does not incorporate the time value of money, the return on investment you might achieve in the stock market, or the taxes you will owe on the proceeds. For that calculation, you need specific input from your tax accountant or your financial adviser.)

Do the Math

Using the same assumptions as in Example 1, let's say you keep the practice and receive a 6x multiple when you decide to sell. How long would you have to keep the practice in order to make up the difference? 5 years? 10? Nope, less than four years. If the multiple is 8x, it takes less than two years to earn as much as you would if you sell today.

Here's why: Every year, your hospital's gross revenue should rise. Let's use a minimal increase of 3%. (See the table on the next page.)

The first year you keep your practice, revenue increases from $2.5 million to $2.575 million, earnings increase from $300,000 to $309,000, and using 80 as the percentage of earnings you can withdraw, you take home $247,200. By the end of the second year, the cumulative earnings are equal to $501,816. At that point, if you sold your practice at an 8x multiple, or $2.55 million, you essentially would come out even.

IF YOU INCREASE REVENUE BY 3% A YEAR

	Current	Year 1	Year 2	Year 3	Year 4
Gross	$2,500,000	$2,575,000	$2,652,250	$2,731,818	$2,813,772
Earnings	$300,000	$309,000	$318,270	$327,818	$337,653
Profitability	12.0%	12.0%	12.0%	12.0%	12.0%
Distribution	$240,000	$247,200	$254,616	$262,254	$270,122
Cumulative Distributions	0	$247,200	$501,816	$764,070	$1,034,193
Practice Value at 10x	$3,000,000	$3,090,000	$3,182,700	$3,278,181	$3,376,526
Practice Value at 8x	$2,400,000	$2,472,000	$2,546,160	$2,622,545	$2,701,221
Practice Value at 6x	$1,800,000	$1,854,000	$1,909,620	$1,966,909	$2,025,916
Total of distributions plus practice sale					
at 10x	$3,000,000	$3,337,200	$3,684,516	$4,042,251	$4,410,719
at 8x	$2,400,000	$2,719,200	$3,047,976	$3,386,615	$3,735,414
at 6x	$1,800,000	$2,101,200	$2,411,436	$2,730,979	$3,060,108

In this example, profitability remains constant at 12%. If you can increase that by one percentage point, from 12% to 13%, less time is necessary to make as much money — or more — than you would if you sold today for a high multiple.

This example is a bit of an oversimplification because it doesn't reflect what you could earn by investing the sales proceeds in the stock market. But consider this: Over the past 20 years, the S&P 500 index averaged an annual return of 8.6%. You have no control over the stock market, but you have tremendous control over your practice. If your practice generates earnings of 12%, keeping those earnings for as long as possible yields the best outcome.

Key Takeaways

From a financial perspective, your best bet is to own the hospital for as long as possible. But recognize that you are assuming the risk that current profits will continue into the future. Carefully evaluate your tolerance for risk because future profits are never guaranteed.

The impact on your personal life is another critical piece. Owning a business isn't all sunshine and rainbows. When problems arise, the buck stops with you. If you are tired of the additional stress, the drama and the long hours, and if you feel like the business owns you, selling the hospital might be the best decision. Before you do, make sure the buyer will take the weight off your shoulders. If the buyer works in your practice, she will shoulder the ownership mantle. If you sell to a consolidator, you might end up keeping more responsibility than you bargained for.

The take-home message is this: If you have a profitable practice and enjoy being an owner, keeping the business until closer to the time you are ready to sell makes sense. Yes, you assume the same risks — doctors will leave, staff will quit, clients will move away, equipment will break. But you are managing those risks now. It's also true that your doctors practice quality medicine, staff members provide excellent client service and patient care, your clients love you, and your business grows.

While you remain an owner, you make all the decisions to run the business in the way the showcases your values. That's why you became a veterinary practice owner in the first place. If you enjoy being an owner, there is no reason to sell now just to get the best price possible. ■

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