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# How uncertainty affects valuations

**Buyers of veterinary hospitals prize the stability of earnings over time and the seller's ability to successfully deliver goodwill.**

**What is the impact on a practice's valuation during a crisis like COVID-19 when hospitals change how** they manage clients and patients and when the usual daily grind is anything but usual? Honestly, not much — at least not yet.

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The two primary influencers of business value are cash flow and risk, both of which can be negatively affected during a temporary situation like a COVID-19 shutdown. Other conditions, like being unable to attract associate veterinarians to your practice or a competitor opening a bright, shiny hospital across the street, might present a greater long-term risk.

## Cash Flow or Earnings

Ultimately, what every buyer of a veterinary hospital wants is cash from the business. Any time a major business disruption occurs, cash flow takes a hit. In the best circumstances, that hit is mild and temporary. For example, if business operations return to normal in a few months, the impact on a practice's valuation will be minimal. However, if the disruption continues into the following year, or if a "new normal" of lowered earnings is created, the business value could decrease.

## Risk

Earnings and risk are equally important aspects of business value. The biggest risk factors for veterinary practices are:

- Stability of earnings.
- Ability to transfer goodwill to the buyer.

Let's look first at the stability of earnings. Notice that the description is "stability," not "size" of earnings. In fact, many veterinary clinics with low levels of profit that are consistent from year to year have less risk than similar-sized practices where earnings are higher but fluctuate between highs and lows from year to year.

Think about it. A potential buyer wants reassurance that the practice will continue to generate earnings on a level similar to that of the past. If you are buying the future of the hospital, are you buying more highs than lows? Or more lows than highs? Even when the highest earnings occurred in the most recent year, unless a sustainable change was made, there is no guarantee that next year's earnings won't swing low again.

Some changes can be anticipated. Examples are doctors and staff members taking parental leaves, doctors planning sabbaticals, and equipment or software becoming obsolete. When you expect that a change, such as fewer available appointments, will directly impact revenue or profit, you can take corrective actions. To cover doctor or staff leaves, you can work more hours yourself, bring in relief help, modify staff schedules or conduct cross-training. When a big expense is planned, other spending can be delayed or reduced to minimize the impact on earnings. In other words, when you know a change will occur, you have time to lessen its effect on your business.

Of course, some events, like the COVID-19 crisis, are unforeseen and can have dramatic and immediate results. When responding to a crisis, remain true to your vision and core values. Be as transparent as possible when decisions affect your staff, clients or patients. Involve doctors and staff in decisions whenever possible to maintain trust and convey consistency to clients.

How can you ensure stable earnings, especially in times of uncertainty? So much depends on being proactive. Read industry news articles published by state and national sources. Stay abreast of business activity by reviewing year-to-date or month-to-date comparative financial, production and payroll reports. The faster you notice and respond to change, the lower its impact on your business.

## Transfer of Goodwill

The second dominant factor relating to the risk of owning a veterinary practice is the transfer of the seller's goodwill to the buyer. Goodwill refers to the advantage a business has acquired through its branding, its position in the community, and the reputation of the doctors and staff. The ability to acquire goodwill is the reason buying an existing practice usually is less risky than starting one from scratch. With an existing hospital, the employees are hired, the practice has a client base and medical records, appointments have been scheduled, and reminders have been sent.

Much of the value of an existing practice relates to goodwill. Therefore, effectively transferring that goodwill to a buyer is essential.

In a single-doctor practice, goodwill is related in large part to that doctor. When the business is sold, the doctor should help transfer the goodwill to the buyer. This is often done through personal introductions to clients and communication from both buyer and seller about the transition and how the seller is confident that the new owner will continue the care that clients have come to expect.

The worst possible situation occurs in a one-doctor practice when the owner becomes disabled or dies. When that happens, the uncertainty that goodwill can be transferred is very high and increases by the day. Without a doctor present, appointments must be canceled and clients cannot be seen. With each passing day, more clients look for a different provider. Under this scenario, the surviving spouse or family members must work quickly to hire relief doctors so that the business can remain open.

The second priority in these cases is to find a buyer. The seller's family and hospital employees need to rally around the practice and convey trust in the buyer, even when they don't know the buyer well. Retaining long-term staff members who know each client by name will inspire confidence that even though the seller is no longer with the practice, things are carrying on as usual. Clients want to know that the practice caring for their pets will continue unchanged.

Multidoctor practices have much less risk of losing goodwill if the seller leaves. In those cases, the practice's reputation is spread across several doctors as long as they remain after the sale.

All this means that the less your hospital relies on you, the better the continuity and business value. That fact can be a hit to one's ego as many practice owners think their businesses can't operate without them. Frankly, owners and managers should work together to ensure that operations can and will continue successfully without the owner. This might mean compiling how-to instructions, lists of account numbers and passwords, contact information for bankers, repair shops and account reps, and anything else the owner can think of. You needn't share the information now, but be certain that people know where to look for it.

If the past few months taught us anything, it's that the future is unpredictable. The impact of major business disruptors on veterinary practice valuations is impossible to calculate. We can't predict how long disruptions will last or predetermine the effect.

If in this COVID-19 year business is back to normal by late December or sooner, the uncertainty over ongoing practice revenue and earnings will be resolved. Assuming that happens, most business valuators will decide that 2020 does not represent how the practice will operate in the future and will disregard the impact when determining business value.

Every investment carries a measure of uncertainty. Bank deposits earn very little interest today but carry almost no risk. At the other end of the spectrum are hedge funds, which offer the possibility of high returns but at significant risk to the original investment. A veterinary hospital is somewhere between those extremes.

The more predictable your practice and the more certain a buyer is that earnings will not fluctuate and that goodwill can be transferred, the higher the sales price of your hospital. ■

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