



WUTCHIETT TUMBLIN AND ASSOCIATES

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How Can an Associate Afford a Practice - 2011

In today's economy, is it still viable to purchase a practice? Practice owners question if the younger generation wants to be owners. Are they happy and satisfied being associates? And, with the current levels of student loan debt, will this next generation of doctors be willing and able to take on additional debt related to buying a practice? Associates question if the risk and potential hassle of ownership are worth the cost and wonder if they'll have the money to buy.

Sixty-five percent of the participants in *Benchmarks 2010* by Wutchiett Tumblin and Associates and *Veterinary Economics* say they're planning to sell their practice to a current or future associate. Forty-eight percent of the associates in these same practices report they want to own a practice but aren't sure it will be financially feasible. So, whether you're the seller or the buyer, it's time to answer the question, "Can I afford to buy a practice?"

The affordability of a practice depends on three things: 1) the earnings available to the owner after all practice expenses have been paid, 2) the after-tax cost of the annual loan payments, and 3) the personal financial resources of the buyer.

Bottom line, if the practice has been valued fairly, the loan terms are reasonable, the buyer has a sufficient down payment (10 to 20 percent), and the buyer is conservative with their personal spending, then the earnings available to the owner should be sufficient to cover the loan payments and tax liability from the additional income earned as an owner. Here's how it works.

Dr. Seller's practice generates \$1,500,000 of revenue and is valued at \$1,100,000, comprised of \$200,000 net asset value and \$900,000 goodwill value. The earnings available to the owner (ROI) are \$208,000 after paying the operating expenses and fair market veterinary compensation for all the doctors and management compensation (3 percent of revenue) for the owner.

Dr. Buyer is purchasing 100 percent of the practice, has a 10 percent down payment (\$110,000), and will finance the balance (\$990,000) over 7 years at an interest rate of prime plus 3 percent (6.25%). Dr. Buyer's annual loan payments (principal and interest) will be \$175,000.

In order to answer the affordability question, Dr. Buyer's advisor completed an Affordability Analysis that shows how her income and expenses will change over the loan term assuming a conservative 3 percent growth rate in revenue, owner earnings, and asset value. (See **Figure 1**)

The analysis assumes that Dr. Buyer's veterinary salary covers her normal living expenses and she'll continue her current levels of personal spending (i.e., she can't go out and buy a Maserati and take extended vacations to Europe anytime soon!). The increased income from her management



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compensation and ROI will go towards making her loan payments and paying the taxes on her increased income from ownership.

Dr. Buyer is also ensuring her future financial security by building equity in an asset that she'll sell down the road. The analysis shows that the value of the practice is projected to grow to ~ \$1,356,000 by the end of the loan term of 7 years. (See **Figure 2**).

The analysis also clearly shows that this purchase is affordable. Dr. Buyer's financial position improves dramatically by becoming an owner and will improve further when she sells the practice – a win-win all around.

Of course, the financial risks aren't the only consideration when buying a practice. Other risks include personnel-related issues, the management responsibility and the added time commitment. I asked a group of my clients, "Knowing what you know now, would you choose to own a practice again?" All but a few responded with a resounding yes. Here's a sampling of their comments.

"Absolutely! I knew that owning a veterinary practice was going to be a lot of hard work, but I had reached a point in my career where I was no longer satisfied with being an associate. The satisfaction of building a great team who works well together and provides great care for our clients and patients makes the hard work and sacrifices worth it. I started working in veterinary medicine 24 years ago as a high school student, was an associate veterinarian for 9 years, and now have been an owner for 6 years. During all of this time, I have had wonderful role models and mentors. Without the faith and encouragement of Dr. Davy Harkins and Dr. James Sachtjen, both of whom think that being a doctor of veterinary medicine is the best job in the world, I don't know that I would be an owner today."

Dr. Kristi DeLeon – 6 year owner, Mt. McKinley Animal Hospital, Fairbanks, AK

"Knowing what I know now, I can't imagine *not* being a practice owner. In my opinion, practice ownership, despite its headaches, heartaches, and hassles, is the best way for a veterinarian to develop financial security."

Dr. Darren Williams - 16 year owner, Mayde Creek Animal Health Center, Katy, TX

"I never planned to be an owner when I got out of vet school - certainly it wasn't my dream to do so - it just happened. I am glad so far, although I am not sure if I will be in 10 years when I want to retire! I like being able to make choices and make changes without begging for permission or meeting with stonewalling for new ideas or equipment."

Dr. Elizabeth D Callahan, DABVP Equine Practice – 18 year owner, Veterinary Medical Center
Easton, MD



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“While there are times when I think it would be easier to be an employee, I can't imagine ever working solely for someone else again without having any say.”

Ronald B. Gaeta, DVM – 20 year owner, Dunbarton Equine, Brookfield, CT

“Prior to 2008, I would have said unequivocally that I'd be a practice owner again, were I to do it over. Having gone through this recession, now I'm not so sure. I've had to use a significant sum of my personal savings to pay bills in the last 3 months, even as I made part time employee layoffs to trim expenses. When you lose that annual practice growth of even a modest 10% the rewards of ownership diminish.”

Dr. Bob Baratt – 27 year owner, Salem Valley Veterinary Clinic, Salem, CT

“Yes, knowing what I know now I would choose to be an owner. There are days that aren't all that romantic, but both the financial rewards and the personal rewards make ownership more than worth it.”

Dr. William Armbruster – 20 year owner, Greenhaven Animal Clinic, San Jose, IL

“Absolutely!! I know the headaches and angst of owning a practice are many but after 29 years of ownership I would NEVER have traded it in for being an associate. Besides the financial rewards of ownership the ability to have control over how I want to run a practice and not be a subordinate to someone's else's practice style was tantamount to me.”

Dr. Richard Jacobson – 29 year owner, Farmingville Animal Hospital, Farmingville, New York

Only you can determine if practice ownership is right for you after weighing all the pluses and minuses. Do your homework. Educate yourself about the business side of your profession by attending practice management sessions at continuing education meetings. Attend hands-on workshops that delve into the specifics of business like the Progress in Practice workshops. Read veterinary publications like *Veterinary Economics* and other non-veterinary publications and books. The opportunities that practice ownership provides are exciting – and you just might find that you get what you need.



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Figure 1 – Cash Flow from Buying

	<u>Year 1</u>	<u>Year 3</u>	<u>Year 5</u>	<u>Year 7</u>
Sources of Cash				
ROI	\$214,200	\$227,300	\$241,100	\$255,800
Mgmt. Comp.	<u>46,300</u>	<u>49,200</u>	<u>52,200</u>	<u>55,300</u>
Net Sources Cash	\$260,600	\$276,500	\$293,300	\$311,200
Uses of Cash				
Down Payment	(\$110,000)			
Purchase Payments	(175,000)	(\$175,000)	(\$175,000)	(\$175,000)
Tax on additional Income	<u>(47,600)</u>	<u>(57,900)</u>	<u>(69,300)</u>	<u>(81,800)</u>
Net Uses Cash	(\$332,500)	(\$232,900)	(\$244,300)	(256,800)
Cash Flow	(\$71,900)	\$43,500	\$49,000	\$54,400

Figure 2 – Equity from Buying

	<u>Year 1</u>	<u>Year 3</u>	<u>Year 5</u>	<u>Year 7</u>
Practice Value	\$1,135,500	\$1,204,600	\$1,278,000	\$1,355,800
Loan Balance	<u>(873,600)</u>	<u>(617,900)</u>	<u>(328,200)</u>	<u>(0)</u>
Buyer's Equity	\$261,900	\$586,800	\$949,800	\$1,355,800



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Sidebar: Steps an associate can take to better position themselves to be approved for a practice purchase loan

Who will finance your practice purchase? In some cases, the seller is willing to finance part or all of the purchase. Often though, buyers plan to borrow from outside lending institutions. Here's what some of the top lenders in the veterinary industry pay attention to when deciding whether they'll approve a loan.

1. Personal cash reserves. Do you have cash available for a down payment when you're ready to buy a practice? Save, save, save. In today's banking and lending environment, liquidity is king.
2. A good credit history. As a rule of thumb, credit scores above 675 are necessary to be approved for a loan. Poor personal credit is the one thing that can stop ownership ambitions cold! To receive your free annual credit report, visit www.annualcreditreport.com.
3. Pursue a conservative personal life style with minimal debt. Lenders understand student loan debt, and it's not always a huge factor.
4. Educate yourself about the business side of your profession, and in particular gain an understanding about cash flow. Purchasing a practice is one of the largest investments of your career, and cash flow is the language of this investment.
5. A strong resume - gain at least 3 to 5 years of clinical experience before becoming an owner and at least 1 year of experience at the practice you want to purchase.
6. Track your success – production reports provide insight into the volume an associate has handled in the past, which is useful for a lender's consideration of the loan.

Thank you to the following sources for the above information:

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To obtain additional information:

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