18 Tips for a Healthy Hospital Transaction

There has been a recent increase in the buying/selling activity in the veterinary hospital market. This increase is being driven by consolidators, retiring practitioners, and associate transitions to ownership.

There are many factors to consider when beginning the process of buying or selling a hospital, along with a variety of terms and methodologies when evaluating the value of a hospital. Increasing your familiarity with this vital vocabulary will help ensure you get the most from your transaction.

COMMONLY USED VALUATION APPROACHES

1. The income approach uses normalized earnings for one or more periods, multiplied by a risk rate (multiple of earnings).

2. The market approach uses market, public company, or private transactions to determine multiples.

3. The asset approach uses net asset value or liquidation value (i.e., assets less liabilities).

Seeking the advice of not just a credentialed professional, but a credentialed professional with specific veterinary experience, is essential during the process of buying or selling a hospital. Having an experienced negotiator is invaluable in determining a hospital's purchase or selling price.

TIP 1. Decide how to structure the deal: asset or stock sale.

TIP 2. Look at the seller's willingness to finance all or a portion of the sale.

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TIP 4. Determine if the seller owns the building and/or if it will be included in the transaction.

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TIP 8. Execute confidentiality agreements before exchanging any financial information.

TIP 9. Look at state laws regarding seller and associate veterinary (if applicable) noncompete agreements.

TIP 11. Sellers: Consider the tax consequences of selling the hospital. Taxes may impact the sale price or even the willingness to sell.

TIP 13. Sellers: Request that the buyer have the capital or get financing preapproval to eliminate accruing expenses related to the valuation process and agreed-upon purchase price in a letter of intent.

TIP 15. Consider the hospital's culture when evaluating the purchase price. If the culture differs from the buyer's, it could directly impact the financial result post purchase. Buyers should consider working as a relief veterinarian to evaluate the culture and start building a relationship with the existing staff.

TIP 17. Is the hospital a turnkey operation? If not, evaluate the necessity of keeping the seller on staff for a period of time post purchase to facilitate the transition. But do not overlook the corresponding expense.

TIP 3. Many banks require a certain ratio of debt service to cash flow. The asking price, bank terms, and cash flow analysis can help determine if the hospital's cash flows can support the asking price and debt structure.

> TIP 5. Figure out the best entity structure for the hospital and real estate (if applicable).

> > TIP 7. Consider the

liabilities. Will it

be included in the

terms and interest

purchase or paid off

TIP 6. Review debt covenants, if owner-occupied real estate will be leased to the buyer. The seller should have the building appraised to assist in the determination of rent and/or sale.

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TIP 10. Consider customer and former employee nonsolicitation TIP 12. Buyers: agreements.

TIP 16. Sellers: Help

facilitate the post-

purchase transition

introductions to

base and the staff.

both the client

by making

Seek preapproval for financing to reduce the amount of time needed to obtain financing.

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TIP 14. Sellers: Have a hospital appraisal done prior to listing.

TIP 18. Buyers: Always consider business, financial and liquidity risks.

GLOSSARY OF 7 USEFUL TERMS

There are many terms to which hospital owners will be exposed during the valuation process. Having a general understanding of these terms will help facilitate the process.

1. Normalized Earnings: hospital's earnings, allowing for adjustments for owner compensation, owner family members on the payroll, owner fringe benefits and discretionary expenses, owner-occupied rent, depreciation and amortization, nonrecurring expenses, and interest

2. Capitalization of Earnings: earnings used for valuation, based on most recent year, a simple or weighted average

3. Simple Average: gives equal weight to each year included in the valuation

4. Weighted Average: assigns different weights to each year included in a valuation before averaging

5. Minority Discount: discount applied to a purchase or sale to account for the value of noncontrolling ownership

6. Fair Market Value: cash or cash equivalent price at which a property would change hands between the buyer and the seller, assuming neither party is compelled to buy or sell and both parties have reasonable knowledge of the relevant facts (Rev. Rul. 59-60)

7. Goodwill: purchase price above value of assets in the purchase

hospital's outstanding

by the seller? Payment

rates can impact how to handle any liabilities.