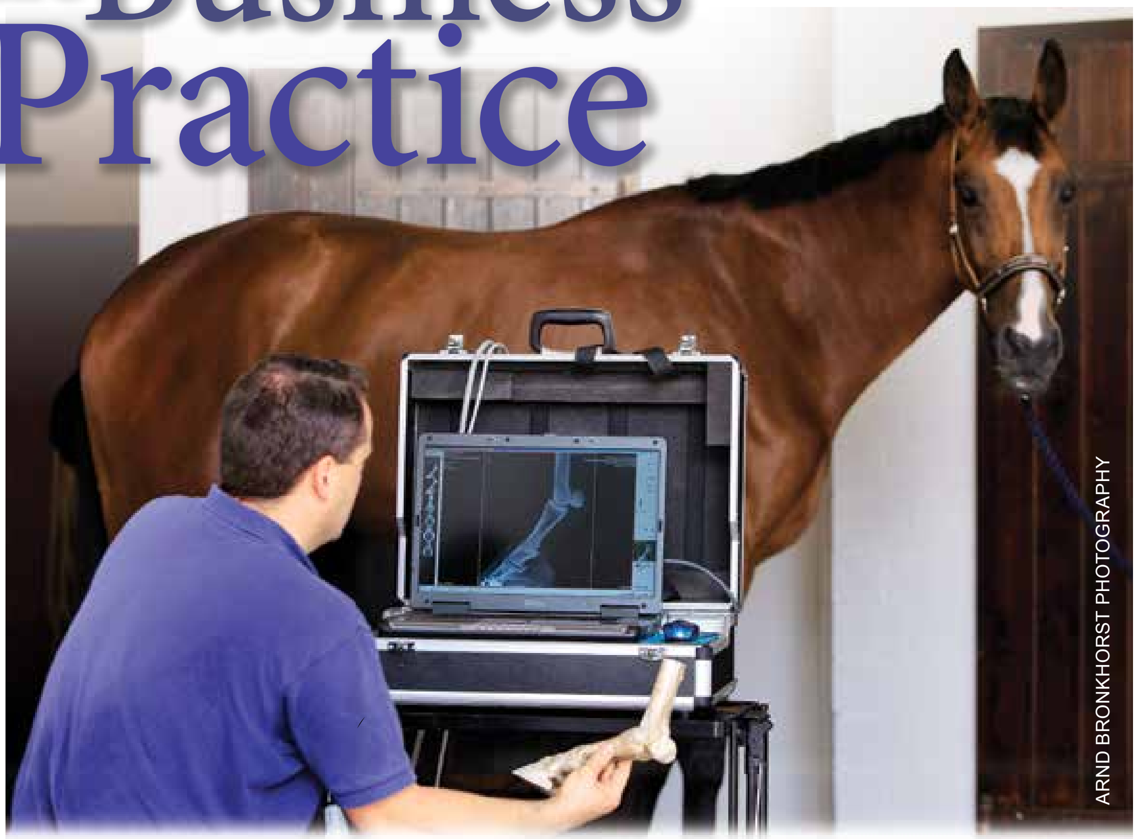
The Business of Practice



at the 62ND AAEP Convention

Veterinarians attending the convention had a plethora of educational events from which to choose.

By Amy L. Grice, VMD, MBA

The AAEP Convention Business New Hour is a popular event that was patterned after the Kester News Hour. Panelists this year were Drs. Lisa Kivett, Mary Beth Whitcomb and Ernie Martinez, who headed up this popular kick-off to the Business Education sessions at the convention.

First up was a look at the current conditions in the Thoroughbred racing and breeding industries. Martinez reported that the prices at the 2016 Keeneland September Sale were stable, with the average price on opening day of $319,731, rising 7.43 percent above the $297,613 average from the opening session of the 2015 September Sale. The median price of $267,500 was up slightly over last year's $265,000. Another positive indicator was the sale of 25 yearlings for $500,000 or more, compared to just 19 during the first session in 2015. Meanwhile, the 25 highest-priced yearlings were purchased by 16 different entities, representing major domestic and international buyers.

He also reported that The Jockey Club is projecting a 2017 foal crop of 22,500, which is a stable number relative to 2016. The Breeders Cup reported increased attendance by fans, an indication that interest in Thoroughbred racing is still robust. In the Standardbred world, sales averages have increased 15%, but this is most likely due to scarcity, as 50% fewer foals have been produced since 2004.

In the world of the sporthorse, North Carolina's new Tryon International Equestrian Center will host the World Equestrian Games (WEG) in 2018, with a $200-million impact on the local economy.

The AAEP Convention Business News Hour covered many topics, including the health of the Thoroughbred racing and breeding industries.

The team reported that over the next few years, we will also learn more about current conditions in the equine industry, as well as in the equine veterinary industry. The American Horse Council will conduct a new economic impact study in 2017, with a focus on learning more about youth participation, rescue organizations and the use of horses in therapeutic settings. The AHC's last study was done in 2005. In addition, the recently completed AVMA AAEP Economic Impact Survey will provide a wealth of information about the lives of equine veterinarians, with a full report coming at next year's AAEP convention.

Next, advances in technology were highlighted in the News Hour by Kivett. She reported that virtual reality immersion sets are becoming widely used in medicine. Virtual reality is being utilized for exposure therapy to treat phobias and anxieties, as well as to help soldiers with post-traumatic stress disorder (PTSD). One of the most exciting applications might be in surgical training, as virtual reality immersion can enable the acquisition of skills without any risk to real patients. HoloLens is currently being used in medical training, and a 360° live stream of operations called Medical Realities is available on YouTube or on Google cardboard.

An article in the October 2016 issue of the *Harvard Business Review* postulated that technology will increasingly take the place of professionals. While this might seem preposterous, in five years, it is projected that 1 in 3 surgeries will be performed robotically. Indeed, robots are taking the stage in many venues; for example, LoBot has debuted at Lowe's, performing the functions of scanning inventory and answering customer questions.

Changing gears, Whitcomb reported on the kerfuffle with the AVMA's Salary Calculator, which directed females to subtract $2,406.97 from the calculator's result to account for the discrepancy in female salaries versus males with similar qualifications. After media attention, a modification was applied. In a recent article in "The Upshot," a venture of The New York Times, it was reported that as the feminization of a profession occurs, there is a decrease in perceived value of that profession.

In other news in the veterinary industry, mergers are increasing due to a push for diversification of cash flow. In the companion animal sector, VCA has acquired 80% of CAPNA for 10.7 times EBITDA. This acceleration of corporate acquisitions of veterinary businesses is beginning to extend to the equine sector. In addition, the well-capitalized Zayat Stable recently announced a desire to create a national brand of equine veterinary services. (To read more about this proposed venture, do a Google search for "Zayat Stable veterinary services.")

Climbing 'Mount Debt'

The presenter of this focused session, Dr. Tony Bartels, is a veterinarian who works for the Veterinary Information Network. He and his wife collectively have more than $400,000 of veterinary school debt, which drove him to become well-versed in the federal income-driven repayment plans.

His current work focuses on providing guidance to students and veterinarians about minimizing and managing their debt. About 75 veterinarians gathered to hear how to build a personal financial wellness plan.

Bartels began by counseling attendees: "You can't manage what you can't measure." He recommended that debtors create a list of all their debts, with interest rates and terms, so that they understand the extent of their obligations. He emphasized that the common approach of repeating "It'll be fine" to assuage anxiety will work only until it isn't fine at all, and one is in a financial crisis. He related his own experience with good financial planning as a veterinary student, which was unexpectedly upended by increases in tuition over the course of his education.

To begin an assessment of one's debt situation, Bartels suggested utilizing the National Student Loan Data System (nslds.ed.gov) to see a list of your loan types, disbursement dates, loan amounts, interest rates and amount of current principle and interest. A download of your data is available under the MyStudentData tab. Unfortunately, private loans, HPSL and LDS loans are not listed here, he explained, but this site is a good starting place for creating your comprehensive list of debts. How and when you borrowed matters, because FFELS, Perkins, HPSL and LDS loans can all affect your eligibility for loan repayment programs, as well as your ability to pay the amounts you owe.

Calculating your debt-to-income

Dr. Tony Bartels spoke on Climbing "Mount Debt." He was focused on providing guidance to students and veterinarians about minimizing and managing student debt.

ratio (DIR) is also important, according to Bartels. Average starting salaries across the *entire* veterinary industry are roughly around $75,000, while there is a highly variable range of debt among new veterinarians. The median DIR is currently 2:1, but some graduates have a DIR as much as 4:1.

For newly graduating *equine* veterinarians, the 2016 average initial salary of $45,000 coupled with $195,000 of debt would calculate as a DIR of 4.33. Three to four years after veterinary school, with a median salary of $65,000 and a debt of $195,000, the DIR decreases to 3. Fifteen years into a career as an equine veterinarian, with a median salary of $100,000, the DIR decreases to 1.95. There are often significant savings using an income-based repayment plan versus more traditional methods if you have a DIR of greater than 2, said Bartels.

A robust loan repayment simulator is available at vinfoundation.org. It will allow you to see what will happen to your balances over 25 years, and show the total cost of your loans to you under the various available loan repayment programs, Bartels counseled. A multitude of scenarios—such as marriage to an indebted veterinarian, adding children, changes in income or changes in tax filing status—are all available on the simulator. Bartels emphasized that simulation results can vary greatly for each situation, and the plan should be reassessed annually or whenever there is a change in your family or financial situation.

Bartels discussed how many new veterinarians are dismayed that income-based repayment plans continue to accrue interest because the payments are so low, resulting in an increasing loan balance even as payments are made regularly. Capitalization of interest occurs when you enter repayment or when you change repayment plans, he said. This adds unpaid interest to your principal balance, causing you to pay interest on interest. This can be very depressing, but he counseled that it is important to think about your loans from a purely mathematical perspective. Trying to pay down the debt in a traditional way (which, according to Bartels, will likely be the advice of most parents and older mentors) will create an inability to have a full range of life choices, such as having children, buying a house or replacing a car.

In addition, in income-based repayment plans, the amount of your loan that is forgiven after 25 years will be taxable to you, and another decision you must make is how to save the funds for the tax bill that you will have in the future. Because there is a significant timeline, Bartels suggested considering regularly investing funds in equities over 20 years to get the greatest return possible.

Determining the best plan and navigating the system are difficult. The necessary analysis is complicated. Bartels recommended using electronic submissions when possible, and to document everything you submit by using screen shots and certified mail, as well as printing copies of everything you submit. He suggested that loan officers do not understand the programs very well because of their complexity, and therefore might give incorrect advice. VIN members can access additional resources and consulting services through the VIN information service.

In summary, Bartels emphasized that taking responsibility and control of your student debt is essential and involves three steps. First, understand the repayment plans for which you are eligible and the full details of your loans. Second, analyze which loan repayment option is the most financially advantageous for your situation. Third, re-evaluate your plan regularly or whenever your family or life circumstances change.

Lessons in Succession Planning

Keynote speakers Drs. Kelly Tisher, Scott Toppin, Charles Vail and Terry Swanson of Littleton Equine Medical Center shared the model of succession used at their practice, which has had several successful transitions of ownership interest. They empha-

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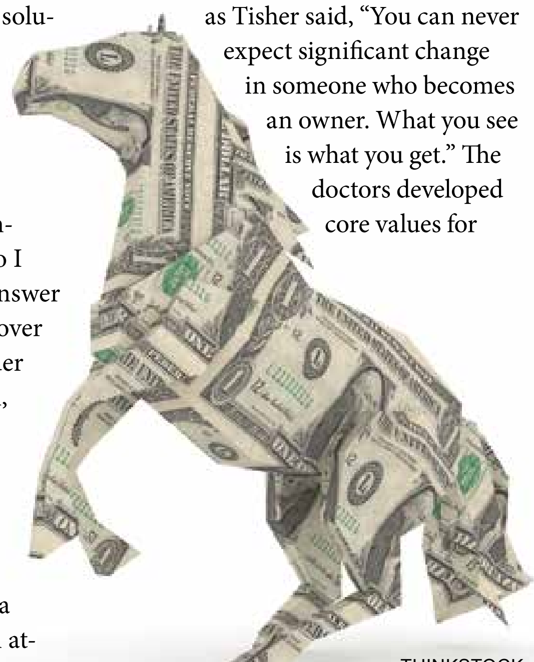
Several speakers emphasized that people are the biggest expense of any business, including a veterinary practice, so make sure you have the right people on your team.

sized that the friendships they developed with each other were important in building trust, which they said is a key component of a successful transition. The group stated that, "Successful succession is not a formula; it is a set of behaviors and a commitment to get it done."

While over the years new shareholders have used a combination of inside and outside financing, the group stated that the most important advantage of inside financing was flexibility and being committed to the good of the practice. For instance, during the recession of 2008, Toppin's practice purchase loan was adjusted to reflect the decrease in practice earnings; without this help, he would have been unable to make his payments. This solution was only possible because the senior partners were the holders of the debt and were dedicated to doing what was best for the practice.

The doctors shared that it was important to ask themselves: "Why do I want to be an owner?" Often, the answer was control over their destiny and over the direction of the practice. In order for the partnership to be successful, they reported, it was essential that they shared goals, ethics, values, mutual respect and a desire for a continued relationship with the senior partners. In addition, utilizing resources and advisors such as a management consultant, a CPA, an attorney, a financial advisor and industry leaders was a key component in their successful transitions.

The Littleton team also created a strong organization with solid business practices that emphasized the practice's vision, goals and values. A key part of this action was the institution of the Monday-morning meeting. Participation in this 7 a.m. meeting at Littleton is a litmus test for partnership interest, because as Tisher said, "You can never expect significant change in someone who becomes an owner. What you see is what you get." The doctors developed core values for the practice and shared ethical standards that guide the behavior of the entire team, noting that "although all of our veterinarians don't have the same style, they share the same ethical standard of care."



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Compensation is only one part of the puzzle when trying to determine successful transitions of ownership.

In closing, the Littleton ownership team recommended the following steps for the successful transfer of ownership:

- Leave your ego at the door.
- Compensate veterinary associates fairly.
- Transfer professional equity to your practice colleagues from the beginning of their employment by sharing clients, mentoring, showing respect, giving trust, sharing expertise and providing training opportunities.
- Make sure everyone has quality of life and a good balance between work and play.
- Never throw a colleague "under the bus."
- Avoid kingdom-building by individuals.
- Foster a deep and abiding respect and commitment to professional organizations such as the AAEP.
- Regularly seek to identify candidates for future ownership roles.
- Recognize the importance of business education for both buyers and sellers.
- Be transparent and fair.
- Communicate early and often.
- Always appreciate the opportunity to be an owner of a practice.

Mentoring for Career Success

Dr. Betsy Charles presented evidence for the success of mentoring in improving the satisfaction, retention and recruitment of veterinarians from the Millennial generation. This generation typically values this type of coaching and support even more than they value monetary compensation, she reported. "Because the Millennial generation makes up the majority of current graduates, it is imperative that seasoned practitioners pay attention to their needs and understand the characteristics that lead to a successful mentorship experience," she said.

The five characteristics of an effective mentoring relationship, according to Charles, include:

- reciprocity—a mutually sustainable and satisfying relationship
- mutual respect for the time, effort and qualifications of both mentor and mentee
- clear expectations for the relationship that are defined at the outset, with both mentor and mentee being held accountable
- personal connection between the mentor and mentee
- shared values for approaches to research, clinical work and personal lives

She also said that failed mentoring often results from poor communication, lack of commitment, personality differences, perceived or actual competition, conflicts of interest or a mentor's lack of experience. Because equine practitioners are typically very busy, these lapses might occur not from a lack of interest, but from a lack of time to invest. Because of this, mentoring relationships should not be entered into lightly.

Charles also spoke about what mentees need to bring to the relationship. This includes being open to feedback, being non-defensive, being a good listener and being respectful of the mentor's time. The mentee should take responsibility for "driving the relationship" and planning meeting topics for discussion. In other words, a mentee should know what issues he or she needs help with, analyze the situation from his or her perspective prior to the meeting,

Don't enter lightly into a mentorship with a young veterinarian. You need to have the time and commitment to make it work for both parties.

then ask for the mentor's perspective.

The characteristics required of mentors were also discussed by the speaker. She indicated that they need to be altruistic, honest, trustworthy and good listeners. More mentoring experience generally creates more effective mentorship, especially when the mentor has a wide network of professional colleagues that can be tapped by the mentee. Being accessible and analytic are also important traits.

The best mentorship relationships occur when the mentee has a clear objective for the relationship and the chosen mentor has the resources to provide what is needed. The most important goals include career guidance, emotional support and facilitating the development of a full and balanced life.

Parenting in Practice

Dr. Anne Marie Wilson and Dr. Cassandra Shores shared their experiences in starting and expanding their families while in practice. Both doctors spoke to the fact that there is never a perfect time to have a child, and that there are many paths that can be chosen in providing care for children.

Wilson suggested you will have no control over many health outcomes for either you or your baby, so it is important to keep a flexible attitude. How much time you will need for maternity leave might not be evident before your delivery, but you should be familiar with the maternity policy of your practice, if such a policy exists. You might be the first veterinarian to become pregnant at your practice, and in that case you will be paving the way for others that follow. Determining how much time to take off for maternity leave will depend on practice policy, financial considerations and client pressures.

After your baby arrives, your career path will vary depending on how much family you have available to help with childcare, the kind of practice at which you work (solo versus group), and how accommodating your boss is, said Wilson. The economics of childcare will also influence your career decisions. It is important to remember that your career might change directions multiple times as your responsibilities as a parent change. The many "hats" you wear as a veterinarian, parent, spouse and adult child will challenge you to find a personal solution to the balance you need in your life to fulfill all these roles.

Shores highlighted the precautions needed when practicing while pregnant. The obvious challenge of working around a quick, powerful and unpredictable animal while being physically unwieldy in late pregnancy was called out, along with the potential health risks to the fetus posed by radiographic studies, inhalant anesthesia and euthanasia. Fortunately, many guidelines are in place within OSHA and NIOSH to make the workplace a safer environment.

In conclusion, pregnancy and parenting while practicing are becoming commonplace, and with thoughtful planning and good communication, the transition can cause a minimum of stress.

Succession Planning and Practice Purchase

John Chalk, an accountant, attorney and financial advisor based in Texas, shared his expertise on practice ownership transitions in a presentation entitled "The Nuts and Bolts of Succession Planning and Financing a Practice Purchase."

Financing a practice purchase can be through cash, external financing or internal financing, said Chalk.

External financing means the buyer finds a source other than the seller to finance the sale. This is typically a bank or family member, he said. Internal financing means the seller of the practice provides financing. Typically in equine practice sales, the debt is held internally. Currently, typical terms are a 10-year note at 4-5% interest, with a 10-20% down payment. Payments can be made monthly, quarterly or annually, according to Chalk.

With internal financing, the seller holds the practice as collateral and has a vested interest in seeing the buyer succeed. In the event of a severe economic downturn or the failure of the new owner to pay the loan, the seller can offer leeway in terms, re-negotiate the price or take the practice back from the buyer. While there is obviously more risk to the seller in holding the note, the buyer might prefer this type of financing as it motivates the seller to assist in the practice's continued success.

Chalk stated that regardless of the financing method, the cash flow from the practice will be used as the source of repayment of the loan. This means that buyers must be sure that due diligence is done to determine the amount of cash produced by the veterinary business, and assure that it is sufficient to service the debt.

With external financing, the bank will require the potential transaction to meet its criteria. Financial institutions

Financing a practice purchase can be through cash, external financing or internal financing, said John Chalk, an accountant, attorney and financial advisor based in Texas.

will require that the after-tax cash flow of the business fully fund all the future payments of the note within the term of the note. In transactions by internal financing, it behooves the buyer to be sure that this type of objective analysis is completed. Because the financial statements of veterinary practices are often complex and potentially inaccurate, in most instances buyers should seek professional guidance to determine available cash flow, according to Chalk.

Although internal financing can seem simpler, and has the advantage of motivating the seller to work for the practice's continued success, problems can arise with determining a value satisfactory to both the seller and buyer, said Chalk. Because no outside, disinterested party is evaluating the asking price, this will exaggerate differences that the seller and buyer might have regarding the value of the practice. Typically the seller has founded the practice and subsequently has a strong emotional attachment and identification with the business, he stated. It is also common for the seller to have done little preparation for succession, and to feel the need to maximize his or her return on the practice sale in order to feel secure about retirement. If a buyer is not careful, the transaction can be a financial mistake. Involvement of an outside advisor is recommended, said Chalk.

When external financing is sought, Chalk recommended getting an offer from a large national bank such as Bank of America or Wells Fargo, followed by a quote from a smaller local bank. "Always get more than one offer," he said. Although many potential buyers worry about the impact of their student debt, qualifying for a loan is more often based on credit score and a cash flow that will easily satisfy the practice purchase loan payments. If the cash flow is robust, many banks will even finance additional amounts for the purchase of new equipment, he said.

Chalk cautioned that many veterinarians do not understand the difference between compensation for effort and compensation for equity. Banks will lend on compensation for equity, but not on compensation for effort. Compensation for effort is the money you earn for being a veterinarian, which should be determined by essentially the same formula that is used to pay an associate. Compensation for equity is the money that you receive for your ownership share. It is this amount that must service the debt on the practice purchase.

Succession planning is defined as the process of planning for the successful transfer of control/ownership from one generation of owners to the next, according to Chalk. Shockingly, he reported that more than 66% of small businesses started in the U.S. never make it to the next generation of ownership. In fact, he reported, fewer than 10% of small businesses make it to the third generation of owners. Planning for succession increases the probability of a successful transfer. Chalk stated that succession planning requires intentional preparation. This includes preparation of the practice, the seller and the buyer.

Preparation of the practice requires the financial records to be accurate, with strong processes and systems in place, and that the employees be competent and self-starting. The financial statements should be prepared quarterly, according to Chalk, and include an income statement, cash-flow statement and balance sheet. These records need to present an accurate description of the practice, so personal expenses of the owner should be clearly reported. Compensation of the owners must often be "teased out" due to the blending of payments for effort and equity. Determination of value requires clear separation of these distributions, said Chalk.

Succession planning can be a long process that requires a lot of work, but if done properly, all the effort can result in a successful transition of a profitable veterinary practice.

Preparation of the seller includes contemplating the answers to the question "Why should I sell?" said Chalk. The seller should expect that the buyer will be motivated to "grow the pie" and increase the overall revenue of the practice, which should increase the practice's value. Another positive to a sale of practice equity is to diversify the seller's assets, as often a large percentage of net worth is tied up in the practice. If the practice employs several high-producing associates, it might be advantageous to "lock them in" with an equity share. Because being emotionally attached to the practice can complicate a sale, owners should thoroughly evaluate this aspect of their "readiness," as well as their financial requirements, as they contemplate a sale, according to Chalk.

The buyer must be prepared by investing time in business education in order to be prepared for practice ownership. Chalk also suggested asking the question "Why should I buy?" Answers could include creating additional wealth, "putting down roots" to increase long-term stability, increasing control over working life and enhancing one's professional stature.

The different phases of practice ownership can be termed buy-in, stay-in and get-out, said Chalk. Each of them requires specific documents and actions. The buy-in phase requires financial due diligence and an assessment of cultural fit, followed by a purchase agreement and promissory note. Stay-in requires an employment agreement for each veterinarian describing compensation for effort and the parameters of the work; a shareholder/partner operating agreement that includes triggers for sale and a formula for valuation, as well as terms; and a management agreement that spells out how decisions are made. The get–out phase requires a buy-sell agreement (often a part of the shareholder agreement) and specifies the terms of different types of departures. Failing to have these documents in place complicates each of the phases of equity, according to Chalk.

To summarize, Chalk explained the succession process. He said that the process of an orderly succession typically takes three to five years. However, if the books are clean and a successor has already been identified, it may take only 12-18 months. The first step, he said, is to prepare the practice for sale by updating books, records, processes and systems, as well as writing down all the processes performed by each non-licensed employees. The next step is to identify a buyer, whether an associate, competitor or a private equity corporate entity looking to "roll up" practices. The third step, according to Chalk, is to transfer goodwill and ownership.

In closing, Chalk stated that the factors involved in a great succession include preparation, transparency, good communication, excellent financial management and a passion for excellence. Succession planning is a process that takes time and a significant amount of preparation. All of the parties involved must be a part of this preparation in order for the transition to be smooth and successful. EM

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