

Things We've Been Told

Scrutinizing Management Trends
Over the Past 30 Years

PowerPoint Available at :
www.bdvaluation.com/events.php

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Quantitative Analysis of the Trends

- Need to be able to quantitatively assess the influence of a management change
- You can't get there if you don't know where you are at now
 - Need historical data to compare
- Use historical data to estimate the financial affect of the management change
 - Estimate changes in revenue and expenses to estimate the change in profit



What We Want to Do

- Scrutinize Management Trends
 - Why
 - Determine why trends may have helped or hindered your practice
- Provide the tools necessary to scrutinize past and future trends



What is a Veterinary Practice?

- A veterinary practice is a collection of physical assets, financial resources and human resources that are used to engage in an economic activity within a market place.
- How these assets and resources participate in the market place is extremely different from practice to practice.
- Two seemingly similar practices can have extremely different management, operations and financial success



What Trends

- Every Practice Needs a Practice Manager
- High Density Appointments
- Utilization of In House Lab
- One Stop Shopping
- High Tech Equipment/Toys
- Don't Have a Veterinarian do Anything That a Technician can do
- Managing to Industry Statistics
- Planning Excess Capacity (Bigger is Better)
- Longer appointments



Profit – Net Income – Bottom Line

- Maximizing profit is a matter of optimizing revenues and costs
- The process can be made simpler when revenue sources and expenses are broken into small components that are more readily comprehended

If the process were simple, every business would be much more profitable



Time is of the Essence

- Accountant prepared Financial Statements
 - are available on an annual basis and are typically not available until 4 to 6 months after the fiscal period
 - many expenses are grouped into a rather limited number of categories
 - The income statement lumps 12 months of practice performance into a single summary report
- Practice generated data (**Chart of Accounts**)
 - Much greater detail
 - Data required is available on a month-to-month basis



Comparisons

- This organization simplifies the process of identifying changes that occur within a given practice over time as well as simplifies the comparison of one practice to another
- First scan is at the level of categories
- Discrepancies identified in a given category can be scrutinized at the level of the subcategories



Mature Practice Profile	
Income Statement	
Revenue	
Sales	\$850,000
Cost of Sales	\$212,500
Gross Profit	\$637,500
Operating Expenses	
Salary / Benefits	\$153,000
Associate Salaries / Locums	\$70,000
Rent	\$38,000
Common Fees	\$15,000
Insurance	\$2,400
Utilities (heating/lighting)	\$7,000
Telephone	\$3,600
Office / Computer Supplies	\$17,000
Bank Charges / Commissions	\$14,875
Professional Dues	\$2,400
Continuing Education	\$4,000
Marketing	\$4,250
Repairs & Supplies	\$4,000
Accounting	\$4,620
Bad Accounts	\$2,550
Total Operating Expenses	\$340,695
Operating Profit	\$296,805

% of Total Revenue

	Revenue	% of Revenue
Outpatient Services	268,589.68	27.65%
Exams	72,368.54	
Vaccines	170,883.08	
Euthanasia	25,338.06	
Laboratory Services	173,483.67	17.86%
Surgical Services	87,864.36	9.05%
Surgery	34,850.92	
Dental	15,734.07	
Anesthesia	37,279.37	
Hospitalization	106,094.42	10.92%
Hospitalization	72,321.47	
VPS	33,772.95	
Emergency Fees		



Categories and Subcategories

- Revenues and expenses are divided into small constituent components (subcategories) that collectively comprise a larger major component (category)

Category	Subcategory
Occupancy Costs	Rent
	Business Taxes
	Property Taxes
	Gas/Water
	Hydro
	Property Insurance
	Waste Disposal
	Repairs
	Janitorial Services



Revenue

Outpatient Services & Immunizations	Dentistry	Revenue
Consultation		
Vaccines	X-Ray	Professional Services
Euthanasia	Film	Product Sales
Crement	Developing Supplies	
Laboratory Service	Ancillary Services	
Laboratory In	Boarding	
Laboratory Out	Grooming	
Surgical Services	Retail Sales	
General Surgery	Diet Sales	
Spays	-----	
Neuters	-----	
Anesthesia	-----	
Gases	-----	
Injectables	-----	
Sedatives / Pain Meds.	-----	
Inpatient Services	-----	
Hospitalization	Pharmacy	
Medications Administered	General Medications	
Intravenous Fluids	Preventative Medications	



Revenue Growth

- Increase clientele
 - Quality Service
 - Advertising
- Additional Services
 - Professional Services
 - Additional Equipment
 - New Skills
 - New Ancillary Services
 - Diets
 - Grooming
 - Boarding
- Pricing



Change in Profit

Number Clients Lost	40
Annual Revenue Per Client	550
Cost of Sales	27.0%
Loss per Client	402
Lost Profit	16,060

Change in Profitability	
Price Increase	50,337
Lost Profit	16,060
Profit Gain	34,277




Price Increase

	Historic Revenue	Price Increase	New Revenue
EXAMINATION	151,381	5.0%	158,950
HOSPITALIZATION	33,270	6.0%	35,266
LABORATORY	103,751	10.0%	114,126
SURGERY	45,995	6.0%	48,755
ANESTHESIA	73,359	6.0%	77,760
DENTISTRY	19,561	5.0%	20,539
X-RAY	14,308	5.0%	15,024
ELECTIVE SURGERY	96,009	6.0%	101,769
VACCINES	210,248	5.0%	220,760
GROOMING	65,000	5.0%	68,250
I. V. FLUIDS	24,964	5.0%	26,212
DIETS	124,689	0.0%	124,689
MEDS DISP	214,108	0.0%	214,108
PREVENTATIVE MEDS	127,663	0.0%	127,663
CREMATION	15,409	5.0%	16,179
	<u>1,319,713</u>		<u>1,370,050</u>




Expenses

- 1. Revenue-Dependent (Variable)
- 2. Revenue-Independent (Fixed)




Calculate Change in Profit

Required Data	
Increase in Revenue	50,337 no lost clients
Annual Revenue per Client	550
Cost of Sales	27%
Number of Clients	2,491



Revenue-Dependent (Variable)

- Drugs and Supplies
- Preventative Medication
- Laboratory
- Diets
- Cremation



	2010 Revenue	2010 Expenses
Occupation Services & Immunizations		
Consultation	\$151,381.07	
Vaccines	\$210,247.82	\$15,619.83
Euthanasia		
Companion	\$15,408.54	\$5,524.75
Laboratory Services		
Laboratory In		\$0.00
Laboratory Out	\$103,750.57	\$30,518.59
Surgical Services		
General Surgery	\$142,003.61	\$6,797.99
Anesthetics		
General Anesthetics/Pain Meds.	\$73,368.75	\$4,519.22
Immunization Services		
General Supplies		\$4,473.22
IV Fluids / Hospitalization	\$47,764.53	\$1,732.82
Diagnostics		
Dental Supplies	\$19,560.69	\$2,108.08
X-Ray		
File/ Developing	\$14,308.12	\$1,993.13
Auxiliary Services		
Boarding	\$639.30	\$0.00
Grooming		
Diet Sales		
Milk-Cat	\$44,938.05	\$33,542.17
Whiskies		
Other		
Pharmacy		
General Medications	\$214,108.37	\$79,736.33
Preventative Medications	\$127,662.79	\$62,450.41

Tracking Variable Expenses

	Invoice #	Invoice #	Invoice #
General SUPPLIES	13	36.95	2
BOARDING			
LAB IN			
LAB OUT			
SURGERY			
ANESTHESIA			
DENTISTRY			
X-RAY			
VACCINES			
GROOMING	\$128.44		
I.V. FLUIDS			\$10.50
DIETS	\$151.45	\$306.40	\$161.02
PHARMACY	\$184.98	\$287.54	\$130.51
PREVENTATIVE MEDS.	\$178.24		\$107.20
RETAIL			
TOTAL	\$656.19	\$630.89	\$410.79

	2010 Revenue	2010 Expenses	Profit Contribution
Occupation Services & Immunizations			
Consultation	\$151,381.07		
Vaccines	\$210,247.82	\$15,619.83	
Euthanasia			
Companion	\$15,408.54	\$5,524.75	\$305,092.05
Laboratory Services			
Laboratory In		\$0.00	
Laboratory Out	\$103,750.57	\$30,518.59	\$73,231.98
Surgical Services			
General Surgery	\$142,003.61	\$6,797.99	\$135,205.62
Anesthetics			
General Anesthetics/Pain Meds.	\$73,368.75	\$4,519.22	\$68,849.53
Immunization Services			
General Supplies		\$4,473.22	
IV Fluids / Hospitalization	\$47,764.53	\$1,732.82	\$46,031.71
Diagnostics			
Dental supplies	\$19,560.69	\$2,108.08	\$17,452.61
X-Ray			
File/ Developing	\$14,308.12	\$1,993.13	\$12,314.99
Auxiliary Services			
Boarding	\$639.30	\$0.00	\$639.30
Grooming			
Diet Sales			
Milk-Cat	\$44,938.05	\$33,542.17	\$11,395.88
Whiskies			
Other			
Pharmacy			
General Medications	\$214,108.37	\$79,736.33	\$134,372.04
Preventative Medications	\$127,662.79	\$62,450.41	\$65,212.38

Gross Profit

- Revenue - Variable Costs (cost of goods) = Gross Profit
- Ontario Average Cost of Sales = 27.9%

Tracking Variable Expenses

Veterinary Purchasing Statement

	Invoice #	Invoice #	Invoice #	Invoice #	Total
Service Total					0.00
BST					0.00
Diets Total	0.00	0.00	0.00	0.00	0.00
Preventative Total	0.00	0.00	0.00	0.00	0.00
Drugs & Supplies	0.00	0.00	0.00	0.00	0.00
Diets					
[Large Blue Box]					
Preventative Medications					
[Large Green Box]					

Revenue-Independent (Fixed)

- Occupancy Costs
- Non-Professional Staff Costs
- Professional Staff Costs
- Operating Costs

Ontario Averages

Expenses as a % of Gross Revenue	Ontario Average
Office	1.9%
Accounting & Legal	0.9%
Bank Charges	1.7%
Advertising	1.1%
Utilities	1.8%
Professional Dues	0.4%
Equipment Rental	0.5%
Other	0.1%
Bad Debt	0.1%
Grooming	0.2%
Continuing Education	0.5%
Return to Professionals	35.7%

Quarterly Analysis

	First Quarter				
	2009	2010 Budget	2010 Actual	2010 - Budget	2010 - 2009
Revenue					
Professional Fees and Sales	150,816	155,341	153,804	-1,537	2,988
Cost of Sales					
Drugs and Supplies	32,375	33,346	36,562	3,216	4,187
Total					
Occupancy Costs					
Rent	4,471	6,388	6,388	0	1,916
Municipal Taxes	4,029	4,149	3,885	-265	-144
Insurance	467	481	1,607	1,126	1,140
Repairs & Maintenance	1,752	1,804	1,516	-288	-236
Utilities	1,123	1,157	831	-326	-292
Total	11,842	13,979	14,226	247	2,384
Staff Costs					
Non-Professional Wages	24,594	25,435	25,144	-291	1,450
Bookkeeping	0	0	0	0	0
Employee Benefits	0	0	0	0	0
Veterinary Wages	19,165	24,000	16,573	-7,427	-2,683
Total	43,859	49,435	42,717	-6,717	-1,133

- ### Operating Budget
- Maintaining a chart of accounts constitutes approximately 80% of the effort needed to develop and maintain an operating budget
 - An operating budget is forward looking and enables those proactive managerial decisions that will increase profitability

Annual Analysis

	2009	2010 Budget	2010 Actual	2010 - Budget	2010 - 2009
Revenue					
Professional Fees and Sales	641,094	660,326	481,439	-178,887	-159,654
Cost of Sales					
Drugs and Supplies	157,824	162,559	128,484	-34,075	-29,340
Total					
Occupancy Costs					
Rent	24,592	25,550	19,163	-6,387	-5,429
Municipal Taxes	11,478	11,822	7,471	-4,352	-4,007
Insurance	3,682	3,793	6,052	2,259	2,370
Repairs & Maintenance	7,624	7,853	5,821	-2,031	-1,802
Utilities	3,638	3,747	2,746	-1,001	-892
Total	51,014	62,765	41,253	-11,512	-9,761


Monthly Analysis

	January				
	2009	2010 Budget	2010 Actual	2010 - Budget	2010 - 2009
Revenue					
Professional Fees and Sales	50,015	51,515	44,358	-7,157	-5,657
Cost of Sales					
Drugs and Supplies	9,616	9,904	11,929	2,025	2,313
Total					
Occupancy Costs					
Rent	2,236	2,129	2,129	0	-106
Municipal Taxes	0	0	0	0	0
Insurance	156	160	536	375	380
Repairs & Maintenance	-61	-63	552	614	612
Utilities	406	418	409	-9	3
Total	2,737	2,645	3,625	980	889

- ### Manageable Costs
- Cost of Sales
 - Occupancy Costs
 - Professional Staff Costs
 - Non-Professional Staff Costs
 - Operating Costs


Revenue-Dependent (Variable)

- Drugs and Supplies
- Preventative Medication
- Laboratory
- Diets
- Cremation



Steps

- Review available Chart of Accounts Templates
 - OVMA
 - AAHA
- Give careful thought to those categories appropriate to your individual practice
 - You may wish to use similar categories as other practices to make comparisons easy
 - You need to be sure that your data is convertible to industry statistics
- In accounting software, ensure that the expense accounts are congruent with chart of accounts




Occupancy Costs

Occupancy Costs	Recorded Expense	
Rent	_____	Ontario
Business Taxes	_____	Rent 4.80%
Property Taxes	_____	Insurance 0.60%
Gas/Water	_____	Repairs and Maintenance 1.50%
Hydro	_____	Total 6.90%
Property Insurance	_____	
Waste Disposal	_____	
Repairs	_____	
Janitorial Services	_____	



Steps


- Determine what the management goals are and predict the revenue and expense changes that will happen on a month to month basis
- Monthly review of the actual numbers and differences experienced form previous year and budgeted numbers
- If appropriate, alter forward months to reflect the reality of the practice experience
- Alter practice operations to better meet the practice goals.



CEI


Operating Expenses

Office Overhead	Collection & Accounts
Office Supplies _____	Bad Debt _____
Computer Supplies _____	Collection Costs _____
Printing _____	Refunds _____
Phone _____	Returned Cheques _____
Postage _____	
Promotion	Professional Service
Advertising _____	Legal _____
Gifts _____	Accounting _____
Charitable Gifts _____	
Education	General Expenses
Seminar Costs _____	Automotive _____
Subscriptions & Books _____	Travel & Entertainment _____
Staff Meetings _____	Life Insurance _____
Financing	Miscellaneous
Bank Charges _____	General Supplies _____
Interest Operating Loan _____	
Interest Long-Term Debt _____	Equipment
	Repair & Maintenance _____
	Lease _____



Honest Assessment

- Given adequate time and adequate management tweaks
 - Is this goal attainable
 - Are the management changes advantageous and sustainable



Slide 39


CE1 In the image:

cheques should be checks

Copy Editor, 2/26/2011

Profit – Profit – Profit - Really


- As veterinarians, should we be so obsessed with profit?
- Profit, good medicine, good service and good client value are not mutually exclusive
- Small differences in profit make huge difference to career earnings and personal wealth



Investment Analysis


How about 20,000 more annual income

- Better management of the practice
- Better occupancy decisions
 - 1,200 square feet rather than 2,000




Methods to Analyze an Investment

- Payback Period
- Breakeven Point
- Simple Return on Investment
- Net Present Value




Real Value Derivation

- Additional \$20,000 Annual Profit
 - May equate to \$80,000 in practice value
 - The after tax (45% marginal rate) incremental worth of an annual \$20,000 of profit invested at 6% is \$750,000 at the end of 25 years




Payback Period

- Simply Defined as the length of time for the investment to payback the initial cost outlay
- Mathematically:

$$\text{Payback Period (in months)} = \frac{\text{Initial Cost Outlay}}{\text{Additional Monthly Revenue (or cost savings)} - \text{Additional Monthly Expense}}$$


Example to work through

- Buy a piece of lab equipment for \$25,000
- Cost savings \$1,800/month
- Increased labour cost/month is \$500




Breakeven Sales

- Analysis of what sales needed to get out of the RED
- Mathematically

$$\text{Break Even Sales in Units} = \frac{\text{Initial Cost Outlay}}{\text{Revenue per unit} - \text{Unit Expense}}$$

- But more often in relation to vet practices:

$$\text{Break Even Sales in \$} = \frac{\text{Initial Cost Outlay}}{(1 - \text{Variable Costs})}$$


Solution


$$\text{Payback Period (in months)} = \frac{\text{Initial Cost Outlay}}{\text{Additional Monthly Revenue (or cost savings)} - \text{Additional Monthly Expense}}$$

$$\text{Payback Period (in months)} = \frac{25,000}{1,800 - 500}$$

$$= 19.23 \text{ Months}$$

OR = 1.6 Years


- More complex scenarios possible as well



Break Even Continued


$$\text{Break Even Sales in \$} = \frac{\text{Initial Cost Outlay}}{(1 - \text{Variable Costs})}$$

- Fixed Costs:
 - Costs that do not fluctuate with revenue
- Variable Costs:
 - Costs directly correlated to revenue. Examples:
 - Cost of sales
 - Some staff costs
 - Small amounts of other costs




Pay Back Period Limitations

- What happens after the investment is paid off?
 - Would we not expect the investment to more than recoup its costs?
- Limitation is its inability to calculate ROI itself



Breakeven Example to Work Through

- Option to maintain the practice at its current state or update
- Facts you estimate out:
 - To upgrade will cost you \$100,000
- Variable Costs
 - Cost of Sales = 26%
 - No extra capacity in your staff, so 15% variable costs for staff



Solution

Break Even Sales in \$ = $\frac{\text{Initial Cost Outlay (1 - Variable Costs)}}{\text{Variable Costs} - 1}$

Initial Cost Outlay = \$100,000
 Variable Costs = 41% (26% for Cost of Goods Sold, 15% for Staff)

Break Even Sales in \$ = $\frac{100,000}{(1 - 41\%)}$

Break Even Sales in \$ = \$169,491.53

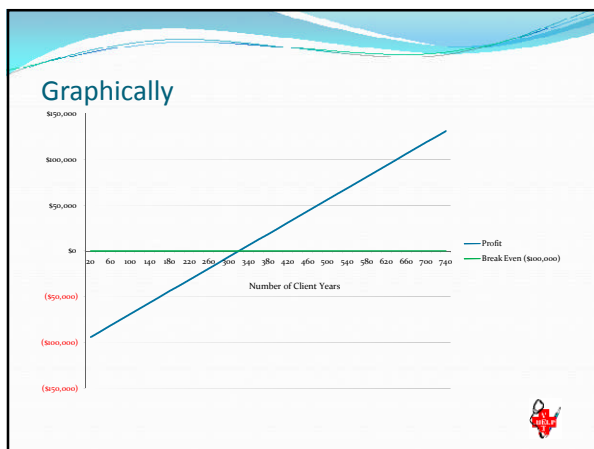
- Some Perspective:
 - Average client revenue / year: \$530
 - Number of additional client years needed = 320

Return on Investment

- The expected amount of yearly return as a percentage of the initial investment

$$\text{Return on Investment} = \frac{\text{Yearly Incremental Revenue (cost savings)} - \text{Yearly Incremental Costs}}{\text{Initial Cost Outlay}}$$

- Let's go Straight to some examples



ROI to work out

- Thinking of replacing equipment with a newer piece
 - It will cost \$70,000 and you will need to improve your facility with \$20,000
 - You can sell your old one for \$5,000
 - You expect it will yield additional yearly revenue of \$15,000
- Additional Yearly Costs
 - Staff \$0
 - Supplies \$2,000
 - Maintenance Agreement \$1,000 per year

Break Even Summary

- Downsides
 - Does not factor in an expected return
 - Does not factor in time
- Advantages
 - Reality check. It gives some perspective
 - Multimillion dollar facility upgrades/relocations
 - What kind of sales increase is necessary just to break even?

Solution

$$\text{Return on Investment} = \frac{\text{Yearly Incremental Revenue (cost savings)} - \text{Yearly Incremental Costs}}{\text{Initial Cost Outlay}}$$

Yearly Incremental Revenue	\$15,000
Yearly Incremental Costs	\$3,000 (\$2,000 supplies + \$1,000 Maintenance Agreement)
Initial Cost	\$85,000 (\$70,000 for equipment + \$20,000 for facility - \$5,000 sell old)

Therefore:


$$\text{Return on Investment} = \frac{\$15,000 - \$3,000}{\$85,000}$$

Return on Investment = 14.12%

- Return on Investment is not always positive

Return on Investment Summary

- Benefits:
 - Does allow for time to be included into the return calculation
 - Generally separates return on a yearly basis
- Disadvantages
 - Does not work well if the projected profit changes year over year
 - Does not inherently include differing risk levels




So How Does Net Present Value Work?

- If we required a 30% return, and machine generates cash only at the end of the second year in the amount of \$1.69


Year 0	←	Year 1	←	Year 2
\$ 1.00		\$ 1.30		\$ 1.69

- A machine that costs >\$1.00 is not a good investment
 - Machine with cost of \$1.20 has \$-0.20 NPV
- A machine that costs <\$1.00 is a good investment
 - Machine with cost of \$0.80 has \$0.20 NPV




Net Present Value

- Takes into account the fact that money values change with time (compounded interest)
- You will prefer I give you 1\$ now than 1\$ two years from now
- Compares your investment to similar investments by allocating a risk component to the investment



Net Present Value Summary

- Benefits
 - Takes into account the time value of money
 - Takes into account the differing risk levels
 - Metric to compare in case of having to choose between two projects (go with the one with the higher NPV)
- Disadvantages
 - Is not the most intuitive to perform
 - Is often not performed in the veterinary industry even for large decisions




Net Present Value Example

- Investment at 10%

Year 0	→	Year 1	→	Year 2
\$ 1.00		\$ 1.10		\$ 1.21
- Investment at 20%


Year 0	→	Year 1	→	Year 2
\$ 1.00		\$ 1.20		\$ 1.44
- Investment at 30%

Year 0	→	Year 1	→	Year 2
\$ 1.00		\$ 1.30		\$ 1.69



Investment Analysis Summary

- We have reviewed
 - Payback Period
 - Breakeven Sales
 - Return on Investment
 - Net Present Value
- Which one do you use?
 - Easy to answer
 - For small investments → the ones that make sense
 - For large investments → why not all of them?
 - Each can add something to the decision making process



Our Example Animal Hospital




Value Discussion




Example Animal Hospital Description

- One Vet Practice on verge of requiring another vet
- Used Ontario averages for all expenses
- Many of our discussions start from this point




What Are Buyer's Attributing Value to When Purchasing a Practice?

Future Cash Flow




	2010	% Rev
Revenue		
Professional Revenue	700,000	100.0%
	700,000	100.0%
Cost of Sales		
Drugs and Supplies	193,000	27.7%
	193,000	27.7%
Gross Profit	506,999	72.3%
Occupancy Costs		
Rent	34,200	4.9%
Insurance	5,000	0.8%
Utilities	11,800	1.7%
Repairs/Maintenance	5,000	0.7%
Total	56,000	8.0%
Staff Costs		
Non-Professional Wages & Benefits	140,700	20.1%
Management Compensation	14,000	2.0%
Professional Services	140,000	20.0%
	294,700	42.1%
Operating Expenses		
Professors	8,400	1.2%
Dees, Memberships	2,000	0.4%
Interest and Bank Charges	11,900	1.7%
Office	13,200	1.9%
Professional Fees	4,000	0.7%
Continued Education	3,500	0.5%
Bad Debt	700	0.1%
Other	9,300	1.3%
Total	54,000	7.8%
Operating Profit	95,300	13.6%



Practice Value

- Determined by Future Cash Flow Expectations
 - Size of the earnings to be purchased
- Associated risk
- Is classical risk/return tradeoff similar to other investments



Calculation

- Mathematically Consists of 3 Components:
 1. Net Free Cash Flow (Cash inflows – outflows)
 2. Capitalization Rate
 3. Growth Rate

$$\frac{\text{Net Free Cash Flow}}{\text{Capitalization Rate for Net Free Cash Flow}} \times (1 + \text{Sustainable Growth Rate})$$

Simplified:

Expected Yearly Return
Required Return Based on Risk



Income Statement			
Revenue			
Sales	\$805,000		\$805,000
Cost of Sales	\$209,300	-\$4,644	\$204,656
Gross Profit	\$595,700		\$600,344
Operating Expenses			
Salary / Benefits	\$196,000	-\$43,000	\$153,000
Associate Salaries / Locums	\$70,000		\$70,000
Rent	\$36,000		\$36,000
Common Fees	\$15,000		\$15,000
Insurance	\$3,600	-\$1,296	\$2,304
Utilities (heating/lighting)	\$7,000		\$7,000
Telephone	\$3,600		\$3,600
Office / Computer Supplies	\$19,000	-\$2,598	\$16,402
Bank Charges / Commissions	\$14,875		\$14,875
Professional Dues	\$2,400		\$2,400
Continuing Education	\$8,000	-\$4,365	\$3,635
Marketing	\$4,250		\$4,250
Repairs & Supplies	\$12,000	-\$8,649	\$3,351
Accounting	\$4,620		\$4,620
Bad Accounts	\$2,550		\$2,550
Total Operating Expenses	\$398,895		\$338,987
Operating Profit	\$196,805		\$261,357

1. Net Free Cashflow

- Forward Looking
- Consists of Cash Inflow – Cash Outflow:
 - Cash Inflow is Revenue
 - Cash Outflow is:
 - Operating Expenses
 - Taxes
 - Sustaining Capital Reinvestment
- Why After tax Cash?



Common Expense Adjustments

- Expenses that are non-operational in nature are eliminated
- Expenses that are non-recurring are eliminated

Income Splitting	Supplies for Personal Use
Automotive	Continuing Education
Repairs and Maintenance	Interest



Adjusted Profitability

- Financial Records (Statements) are prepared for purpose of calculating income tax
- Adjustments are made to determine the “real” practice profit
- Purpose is to estimate the profit that will be realized going into the future




Expenses Commonly Added

- Some expenses that will be realized going forward are not included in the historical income statement
 - Owner's Professional Compensation
 - Management Compensation
 - Rent




Adjustments not Made

- Cash Deals
- “Potential”
 - Any “potential” that is credited in the consideration of value must be from extrinsic forces
 - Unrealized potential will not change the value conclusion but may alter the marketability




Net Free Cash Flow After Tax Income

Adjusted Operating Income	95,200
Depreciation (estimated)	12,000
Adjusted Operating Income Before Taxes	83,200
Income Taxes	13,312
Adjusted Operating Income After Taxes	69,888




Adjusted Profitability

- Use historical data to try to forecast future earnings
- Future Profits that are Purchased
- Extremely variable from practice to practice
 - 0% to 25% of revenue




Net Free Cash Flow

Adjusted Operating Income (after taxes)	69,888
+ Noncash Charges	12,000
- Capital Expenditures	14,000
- Changes in Net Working Capital	0
+ Net Changes in Long-term Debt	0
= Net Cash Flow	67,888



Example Animal Hospital


- We’re going to use our example animal hospital
- Revenue of \$700K
- Adjusted Profit of \$95,200K
- Reinvestment needed for equipment \$14K
- Expected Growth Rate of 4%
- Expected Yearly CCA allowed: \$12K
- We’ll assume for now that no adjustments are needed



Into Our Original Calculation

Net Free Cash Flow	X	(1+ Sustainable Growth Rate)	
Capitalization Rate for Net Free Cash Flow			
67,888	X	1.04	= 353,018
		20%	


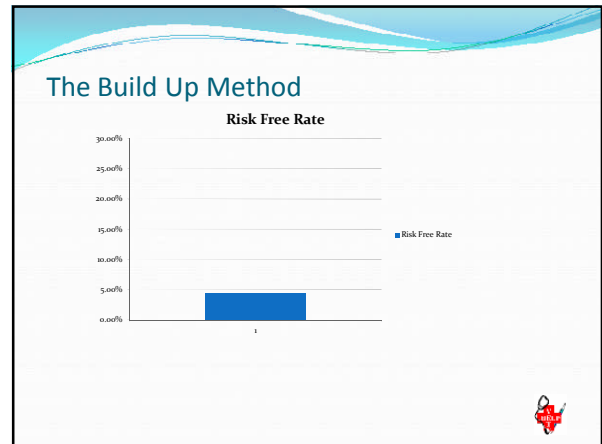
Rounded TO: \$353,000
We'll Discuss Capitalization Rate soon



2. Risk / Capitalization Rate

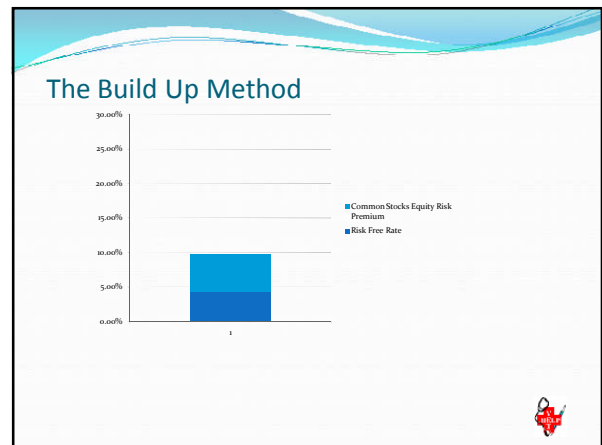
- Back to Our Calculation

$$\frac{\text{Net Free Cash Flow} \times (1 + \text{Sustainable Growth Rate})}{\text{Capitalization Rate for Net Free Cash Flow}}$$


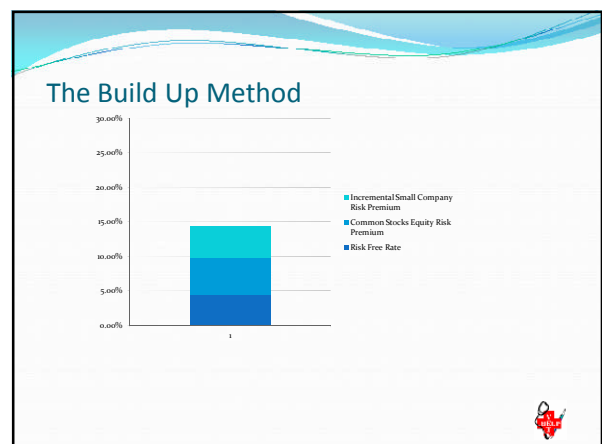
2. Risk / Capitalization Rate

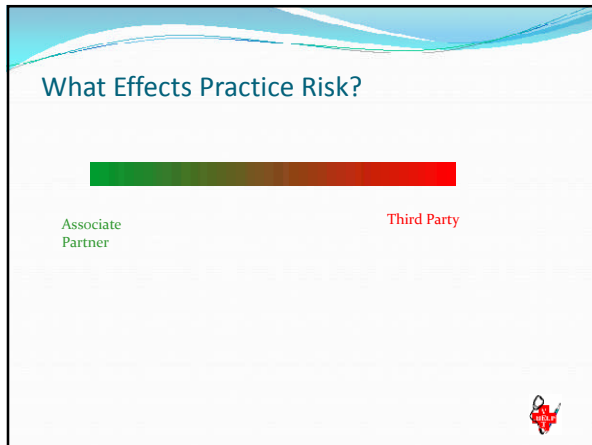
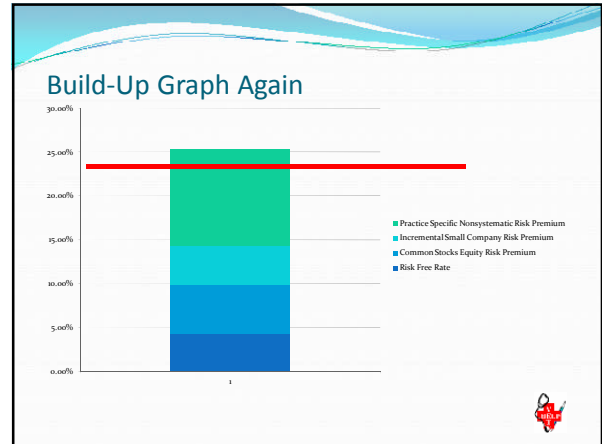
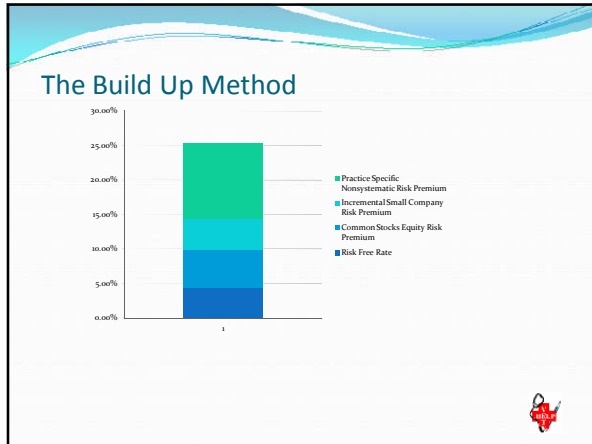
- Risk of the Investment
- Risk Return Trade-off
- Rate of Return
- Cap Rate = Required Return minus Growth

Mathematically

- How do we determine the required rate of return?
- Statistically with Publicly Traded Companies
- Private Company Data (if available)
- Build Up Method

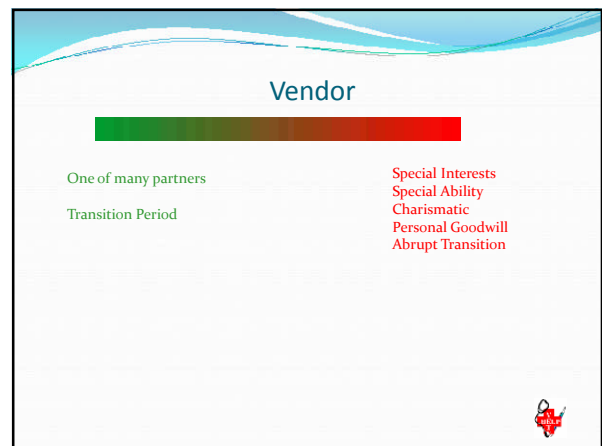


Calculation


$$\frac{67,888}{18\%} \times 1.04 = 392,242$$

- Increase in Value of Approximately \$39K
 - 11% Increase in Purchase Value
- Of Course we don't mean an associate you hired yesterday right out of school


• What does this mean to the practice owner?



Style of Practice



Congruent with Buyer Expectations	Unique Practice Style Appointment Length Staffing
-----------------------------------	---



Quality of Staff



Stable Mature Staff Well Paid	Unstable Minimum Wage Young
-------------------------------------	-----------------------------------




Pricing




Suggested Fees Low fees with chance to increase	Low Fees Sensitive Clientele Price Competition
--	--




Facility




In good repair No adverse traffic changes No adverse development changes	In poor repair Possible adverse traffic changes Possible adverse development changes
--	--



Demographics



Stable or Growing Affluence	Changing Or Likely to Change Negatively
-----------------------------	---




Competition



Sparse Large Market Congenial No Price Competition	Dense Small Market Bitter Price Competition
---	--




Profit Centers



High revenue from diagnostics and professional services

High revenue from vaccines, product sales, food sales and non-professional services




3. Growth Rate


- The anticipated sustainable growth rate appears twice in our calculation of value

$$\frac{\text{Net Free Cash Flow} \times (1 + \text{Sustainable Growth Rate})}{\text{Capitalization Rate for Net Free Cash Flow}}$$

- Remember that the Capitalization Rate = The Discount Rate less the Growth Rate




Facility Lease



Facility owned and offered for purchase


Long-term lease with adequate options to renew

Long-term lease is not in place and/or is not obtainable




Why do we take the adjusted earnings and add the growth rate?

- Because the adjusted income is the last year's results.
- A purchaser is interested in future earnings




Non-Compete Agreements




Agreements in place with associates and other key employees

No agreements in place with associates and other key employees



Why do we subtract the growth rate from the discount rate?

- We expect Earnings to Grow over time



This Hour's Explored Trends

- Use of Practice Manager
- Vet Tech / Vet Utilization
- Longer Appointments
- High Density Appointments
- High Tech Toys



Motivation?

- Practice owner can shed management responsibilities
- Better client service
- Increase revenue - Decrease costs
- Lifestyle / Increase net income



The Trend

Every Practice Needs a Practice Manager



Key Success Factors

- Pick the right manger
- Delegate to the manager
- Empower the manger



Theory Behind the Trend

- Spare owner's time to be spent on professional efforts
- A manager will improve practice operations
 - Improve human resources (improve staff)
 - Better selection
 - Better training
 - Better motivation
 - Better reviews and feedback
 - Employ more advanced marketing
 - Better cost control



Who Will be the Manager

- Promote from within
 - Will this person have the necessary skills
 - Will the owner delegate to this person
 - Will the owner empower this person
 - Will the staff give the necessary cooperation
- Outsource
 - Will cost more
 - Should have a better skill set
 - Owner delegation and empowerment
 - Will the staff give the necessary cooperation



How Much will the Manager Cost

- Promote from within
 - \$40,000?
- Outsource
 - \$60,000 to \$80,000



	December 31,		2010
	Before	Adjustment	
Revenue			
Professional Revenue	700,000	60,000	760,000
	700,000		760,000
Cost of Sales			
Drugs and Supplies	193,300		210,520
	193,300		210,520
Gross Profit	506,700		549,480
Occupancy Costs			
Rent	34,300		34,300
Insurance	6,600		6,600
Utilities	11,900		11,900
Repairs/Maintenance	9,800		9,800
Total	61,600		61,600
Staff Costs			
Non Professional Wages & Benefits	140,700	40,000	180,700
Management Compensation	14,000		14,000
Professional Services	140,000		140,000
Total	294,700		334,700
Operating Expenses			
Promotions	8,400		8,400
Dues, Memberships	2,800		2,800
Interest and Bank Charges	11,900		11,900
Office	13,300		13,300
Professional Fees	4,900		4,900
Continued Education	3,500		3,500
Bad Debt	700		700
Other	8,100		8,100
Total	54,600		54,600
Operating Profit	95,200		98,580



	December 31,		2010
	Before	Adjustment	
Revenue			
Professional Revenue	700,000		700,000
	700,000		700,000
Cost of Sales			
Drugs and Supplies	193,300		193,300
	193,300		193,300
Gross Profit	506,700		506,700
Occupancy Costs			
Rent	34,300		34,300
Insurance	6,600		6,600
Utilities	11,900		11,900
Repairs/Maintenance	9,800		9,800
Total	61,600		61,600
Staff Costs			
Non Professional Wages & Benefits	140,700	40,000	180,700
Management Compensation	14,000		14,000
Professional Services	140,000		140,000
Total	294,700		334,700
Operating Expenses			
Promotions	8,400		8,400
Dues, Memberships	2,800		2,800
Interest and Bank Charges	11,900		11,900
Office	13,300		13,300
Professional Fees	4,900		4,900
Continued Education	3,500		3,500
Bad Debt	700		700
Other	8,100		8,100
Total	54,600		54,600
Operating Profit	95,200		95,200



Increasing Revenue

- Advertising
 - Must add the cost of the advertising
- Is cost prohibitive
- Customer Service
 - Service Profit Chain



Where Is the Gain?

- Cost of Sales
- Occupancy Costs
- Non-Professional Staff Costs
- Professional Staff Costs
- Operating Costs



The Service Profit Chain




James L. Heskett, W. Earl Sasser, and Leonard A. Schlesinger,
The Service Profit Chain



Alternative

- Delegate to Existing Staff
- Empower Existing Staff
- Spread Compensation to Existing Staff




The Trend

Don't Have a Veterinarian do Anything That a Technician can do



Example Animal Hospital Income Statement Year Ending	December 31,	
	Before	2010 After
Revenue		
Professional Revenue	700,000	700,000
	700,000	700,000
Cost of Sales		
Drugs and Supplies	193,500	210,520
	193,500	210,520
Gross Profit	506,500	489,480
Occupancy Costs		
Rent	34,300	34,300
Insurance	5,600	5,600
Utilities	11,900	11,900
Repairs/Maintenance	9,800	9,800
Total	61,600	61,600
Staff Costs		
Non-Professional Wages & Benefits	140,700	170,700
Management Compensation	14,000	14,000
Professional Services	140,000	140,000
	294,700	324,700
Operating Expenses		
Pharmacies	8,400	8,400
Dues, Memberships	2,800	2,800
Interest and Bank Charges	11,900	11,900
Office	13,300	13,300
Professional Fees	4,900	4,900
Continued Education	3,500	3,500
Bad Debt	700	700
Other	9,100	9,100
Total	54,600	54,600
Operating Profit	95,200	108,200




Theory Behind the Trend

- Veterinarians have come to appreciate the abilities of veterinary technicians
 - No longer used for reception and kennel work
 - Utilize skills to draw blood, take x-rays, clean teeth etc., etc.
- Duties done by a technician free up the time of the veterinarian
 - Veterinarian can see additional clients or perform additional procedures with this freed up time




When does a Practice need a Manager

- Practices > \$2,000,000 annual revenue can afford a practice manager
- Larger practices can afford a person with the necessary skills
- Smaller practices with managers tend to be over managed
 - Newsletters
 - Handouts
 - Inventory Control
 - Software add-ons



Motivation?

- Provide technicians with a more rewarding role
- Reduce some of the work load of the veterinarian(s)
- Increase clientele and procedures completed
- Leverage the time of the technician, a lower cost employee
- Increase net income



Key Success Factors

- Technicians are available
 - This may not always be the case in more rural areas
- The case load of the practice will support both the technician and veterinarian
- Veterinarian is busy all the time the technician is busy



Offsetting the Increased Cost

- Increase the revenue
 - New practice that is growing quickly
 - Practice in an area of fast residential growth
- Reduce other costs
 - What costs
 - Other staff was already busy
 - Reduce veterinary cost



Staffing for the Strategy

- Existing staff is already busy
 - There is not a technician floating around to take on the responsibility
- Want to use the strategy consistently
 - Need to have a technician available all the hours the doctor(s) is working
 - This may be more that 40 hours per week
- The technicians added will be 1 to 1½
 - Increase staff cost will be in the area of \$60,000 annually



Example Animal Hospital Income Statement Year Ending	December 31,		
	Before	Adjustment	2010 After
Revenue			
Professional Revenue	700,000	65,000	765,000
	700,000		765,000
Cost of Sales			
Drugs and Supplies	193,900		217,445
	193,900		217,445
Gross Profit	506,100		547,555
Occupancy Costs			
Rent	34,300		34,300
Insurance	5,600		5,600
Utilities	11,900		11,900
Repairs/Maintenance	9,800		9,800
Total	61,600		61,600
Staff Costs			
Non Professional Wages & Benefits	140,700	60,000	200,700
Management Compensation	14,000		14,000
Professional Services	140,000		140,000
Total	294,700		294,700
Operating Expenses			
Promotions	8,400		8,400
Dues, Memberships	2,800		2,800
Interest and Bank Charges	11,900		11,900
Office	13,300		13,300
Professional Fees	4,900		4,900
Continued Education	3,500		3,500
Bad Debt	700		700
Other	9,100		9,100
Total	54,600		54,600
Operating Profit	95,200		96,655



Example Animal Hospital Income Statement Year Ending	December 31,		
	Before	Adjustment	2010 After
Revenue			
Professional Revenue	700,000		700,000
	700,000		700,000
Cost of Sales			
Drugs and Supplies	193,900		193,900
	193,900		193,900
Gross Profit	506,100		506,100
Occupancy Costs			
Rent	34,300		34,300
Insurance	5,600		5,600
Utilities	11,900		11,900
Repairs/Maintenance	9,800		9,800
Total	61,600		61,600
Staff Costs			
Non Professional Wages & Benefits	140,700	60,000	200,700
Management Compensation	14,000		14,000
Professional Services	140,000		140,000
Total	294,700		294,700
Operating Expenses			
Promotions	8,400		8,400
Dues, Memberships	2,800		2,800
Interest and Bank Charges	11,900		11,900
Office	13,300		13,300
Professional Fees	4,900		4,900
Continued Education	3,500		3,500
Bad Debt	700		700
Other	9,100		9,100
Total	54,600		54,600
Operating Profit	95,200		35,200



Example Animal Hospital Income Statement Year Ending	December 31,		
	Before	Adjustment	2010 After
Revenue			
Professional Revenue	700,000		700,000
	700,000		700,000
Cost of Sales			
Drugs and Supplies	193,900		193,900
	193,900		193,900
Gross Profit	506,100		506,100
Occupancy Costs			
Rent	34,300		34,300
Insurance	5,600		5,600
Utilities	11,900		11,900
Repairs/Maintenance	9,800		9,800
Total	61,600		61,600
Staff Costs			
Non Professional Wages & Benefits	140,700	60,000	200,700
Management Compensation	14,000		14,000
Professional Services	140,000	70,000	210,000
Total	294,700		294,700
Operating Expenses			
Promotions	8,400		8,400
Dues, Memberships	2,800		2,800
Interest and Bank Charges	11,900		11,900
Office	13,300		13,300
Professional Fees	4,900		4,900
Continued Education	3,500		3,500
Bad Debt	700		700
Other	9,100		9,100
Total	54,600		54,600
Operating Profit	95,200		105,200



What is the Gain

- Whopping \$10,000
- Got rid of a personality
- Remaining veterinary staff handle the caseload
 - Increased number of cases
 - Increased number of clients to see
 - Increased number of phone calls to return
- Fewer veterinarians to share undesirable hours and to cover for time off



The Trend

Utilization of Longer Appointments



Staffing Strategies

- Minimize doctors to leverage time of technicians who are paid a lower salary
- Staff heavier on veterinarians and minimize technician component
- Combined cost should not exceed 40% of revenue



Theory Behind the Trend

- Spend more time with each appointment
 - More thorough exam
 - More explicit explanation of exam findings
 - Better client education



Big Practice

- Works better in big practices where a technician is shared by multiple doctors
- Will never be economically sound strategy if the veterinarian never does anything a technician can do
- The goal should be to keep all staff busy all the time
 - Particularly the veterinarian who is the highest paid



Motivation?

- Better medicine
- Better education
- More sales
 - Services
 - Products
- Better compliance
- More profitable?




Key Success Factors

- To be successful at greater sales
 - Services and products during appointment
 - Services and products after appointment
 - Better compliance




Different Fees

Average Hourly Revenue		\$282
Consultation Fee		\$62
Appointment Length Min.	Consultaion Fee	Hourly Revenue
15	\$71	\$282
20	\$94	\$282
30	\$141	\$282
40	\$188	\$282
45	\$212	\$282




2010 OVMA Economic Study

- Average Hourly Veterinary Revenue – \$282
 - This is not specific to front office work



Conclusion

- 20 minute appointments will meet the average annual hourly revenue
 - If there are more sales – this could be a bonus
 - Who wants to be average
 - Can you sell more in 30 minutes than you can in 20
- 15 minute appointments, at capacity, will ensure that the average hourly revenue is exceeded
 - Veterinarians with client loyalty can sell as much in 15 minutes as those without loyalty in an hour




Revenue Potential

Average Hourly Revenue		\$282
Consultation Fee		\$62
Appointment Length Min.	Hourly Revenue	Hourly Shortfall
15	\$248	\$34
20	\$186	\$96
30	\$124	\$158
40	\$93	\$189
45	\$83	\$199



The Trend

High Density Appointments



Theory Behind the Trend

- Original Appointment Model
 - Vet goes from one (20 minute) appointment to the next
- High Density Model
 - Technician does first 10 minutes
 - Vet comes in and does last 10 minutes while the technician is off to do the first 10 minutes of the next one
 - In theory can have one less vet and replace it with a technician



Side Bar – Capacity/Need for More Staff

- Need to do the analysis
- Full appointment book does not mean more staff needed
- Need to weigh growth estimation vs. staff costs
- Is the capacity needed year round?



Two Applications to Review

1. The owner is looking to expand
2. There is currently already two or more vets at the practice



The Analysis

- Option 1
 - Grow through increased professional staff
 - Hire another veterinarian: \$75,000
- Option 2
 - Go high density
 - Will likely need to hire two techs
 - One to take on the appointments
 - One for the increased workload throughput
 - Cost of two techs: \$80,000 (2 x \$40,000)



1. Choices for Owner looking to Expand

- Hire another veterinarian
- OR
- Supplement with high density appointments



Qualitatively

- Do you want to be the only vet?
- Is there not some benefit of having an associate for covering the times when you can't (don't want to) be there?



2. Two+ Vet Practice Going High Density

- Hire an additional tech: \$40,000
- Fire a veterinarian: \$75,000
- Savings of \$35,000



When it doesn't

- As a plan for expansion
- When the owner is not willing to lose some of the freedom of letting a vet go
- When systems are not perfectly in place to ensure smooth transition from tech to vet
- When clients see it as a cut in service



Qualitatively

- Are you really going to fire a veterinarian to make it work?
- If it's only a two vet practice are you going to be motivated to be the only vet again.
- Does high density really work?
 - Can you get a good picture of the history from someone's notes?
 - Will the client not want to tell you all about it all over again?
 - Will the client see this as a cut in service?



The Trend

High Tech Equipment/Toys



When it works

- When there is already more than one vet
- You are comfortable letting a veterinarian go
- Don't mind, or want to, go back to having fewer associates
 - This last one does happen. Some vets just don't play nice in the sandbox.



Theory Behind the Trend

- Hospitals should have the equipment to give the best medical care possible
- New equipment leads to a source of income growth
- Clients perceive value from such offerings



Analysis

- Hospitals should have the equipment to give the best medical care possible
 - Yes, there should always be advancements in veterinary medicine
 - Need to compare to referring
 - Better quality care
 - Potentially better profit

Qualitatively

- Is 9.5% a high enough return?
- The referred ultrasound is likely of higher quality
- Is two a month a realistic number
 - Meaning billable to client at a minimum of \$450/use
 - For some it is, for others it is not
- Cost and time to become proficient

The Ultrasound Machine (or Other)

- Cost of Machine: \$40,000
- Useful Life: 5 Years
- Value after 5 years: \$7,500
- Ultrasounds per month: 2
- Cost to refer: \$450/use
- Staff costs to do it in house: \$50/use

Digital X-Ray

- Most common "I need" right now
- Should be subject to same analysis
- Qualitatively
 - Better imagery
 - Quicker response time
- Quantitatively
 - Less cost of processing
 - Charge more?

The Calculation

Year	0	1	2	3	4	5
Initial Cost	- 40,000					
Additional revenue		10,800	10,800	10,800	10,800	10,800
Costs		- 1,200	- 1,200	- 1,200	- 1,200	- 1,200
Before tax and CCA	- 40,000	9,600	9,600	9,600	9,600	9,600
tax @ 18%		- 1,536	- 1,536	- 1,536	- 1,536	- 1,536
after tax but before tax shield	- 40,000	8,064	8,064	8,064	8,064	8,064
tax shield		640	1,152	922	737	2,339
after tax from operations	- 40,000	8,704	9,216	8,986	8,801	10,403
Terminal Value						7,500
Final Cashflow	- 40,000	8,704	9,216	8,986	8,801	17,903
Discounted by 0.094767567545077	- 40,000	7,951	7,690	6,848	6,127	11,385
Internal Rate of Return		9.5%				

Note the return on investment is 9.5%

Perceived Value

-Economic Theory
 -A person will pay a price up to their perceived value
 -If client perceives greater value, will be willing to pay more
 -But do they perceive greater value?
 -Think of your dentist

What the client understands

- Digital X-Ray
 - Fantastic, now we can carry Rover's X-rays on our smartphone
- In house lab
 - I had no idea how it was done before
- Laser surgery or laser therapy
 - Laser hair removal
 - Better eyesight for Rover
- Is only of value to client if you can charge more
 - If you can't, the client doesn't perceive the increased value



When it doesn't work

- When it doesn't make good economic sense
- Effect on value of practice
 - Does not lead to a \$ for \$ increase in value necessarily

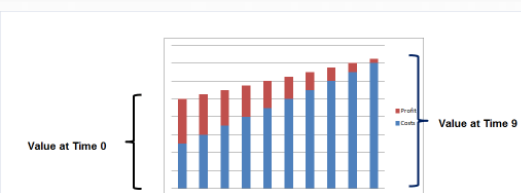


Intrinsic Value to Owner

- There is some intrinsic value to owner of better veterinary medicine
- Need to quantify that value
 - Is it personally worth \$5,000 a year to you to use digital X-Ray?
 - What is that per X-Ray?
 - 1 per day, approximately \$25/ X-Ray (cost of good lunch)
 - What else could have been done with that money?
 - Vacation
 - Year's tuition for university
- Of course, intrinsic value should be included in any analysis



Different Race to the Basement



- Higher value to client over time
- Higher costs for that increase in value = Lower profits
- Luckily not really seen as market effect yet
- Is seen on a case by case basis



When it works

- When it makes good economic sense
 - Intrinsic value can be part of the calculation
- Different for every piece of equipment
 - Scaler vs. DR
- Different for every hospital
 - Value proposition
 - High value/price vs. low cost/high volume
 - Size of hospital/ Number of times service performed
 - Half vet practice in Sioux Lookout vs. multi vet practice in Toronto



This Hour's Explored Trends

- Sale of Pet Foods
- One Stop Shop
- Managing to Industry Statistics
- In House Lab
- Practice Marketplace




The Trend

Pet Food Sales in the Veterinary Practice




Quick Calculations

- Food sales per year: \$100,000.00
- Gross margin 40%
- Need to hire an additional P/T staff at \$30,000 per year
 - Process the food sales
 - Tend to clients
 - Take inventory, place order, unpack order, stock front shelves
- Space requirement: 150 square feet
- Cost per square foot/year: \$30.00




Theory Behind the Trend

- Approximately 40% gross margin on sales
- Ancillary service to bring clients back
 - Another point of contact
 - Compliance




The Calculation of Margin

Yearly Analysis of Pet Food Sales	
Pet Food Sales	100,000
Cost of Products	70,000
Gross Margin	30,000
Other Costs	
Staff Costs	15,000
Cost of Space: Inventory and Display	4,500
Cost of Stock Outages and Holding Inventory	3,000
Total Other Costs	22,500
Real Margin on Pet Food	7,500
As a %	7.5%




Financial Analysis

- Is it really a 40% margin? What about:
 - Time it takes to answer questions and process sales
 - Time to perform inventory and unpack orders
 - Space requirement of food
 - Cost of stock outages and inventory costs
 - Perception by client of a “vet” cost and not a “food” cost



Example Animal Hospital Income Statement Year Ending	December 31,		2010
	2010	Adjustment	
Revenues			
Professional Revenue	700,000		700,000
Pet Food Sales	0	100,000	100,000
	700,000		800,000
Cost of Sales			
Drugs and Supplies	100,000	70,000	30,000
	100,000		30,000
Gross Profit	600,000		670,000
Operating Costs			
Rent	34,300		30,800
Insurance	6,800	4,000	6,800
Utilities	11,000		11,000
Repairs/Maintenance	8,900		8,900
Total	61,000		66,100
Staff Costs			
Non-Professional Wages & Benefits	140,700	15,000	155,700
Management Compensation	140,000		140,000
Professional Services	140,000		140,000
	280,700		285,700
Operating Expenses			
Provisiones	8,400		8,400
Dues, Memberships	2,800		2,800
Interest and Bank Charges	11,000		11,000
Office	10,300		10,300
Professional Fees	4,900		4,900
Continued Education	3,000		3,000
Bad Debt	700		700
Other	9,100	3,000	12,100
Total	64,000		68,400
Operating Profit	96,000		101,600
	AOI as %		12.0%

Highlights:
 -Revenue increase of \$100,000
 -Profit increase of \$7,500 (0.8%)
 Using our value calculations
 increase in value of:
\$33,000



When it works:

- Extra facility space beyond expectation of growth
- Staff at less than full utilization
 - But why would there be staff at less than full utilization?
 - What happens as practice grows?
- When your morals elude you and you want to offer "raw diet" or food with cold formed lifesaving bits® instead of prescription diets
 - Those people know how to market



Theory Behind the Trend

- Provide all service required for pets
 - Grooming
 - Boarding
 - Pet Accessories
 - Diets
- Be the go to source for all pet needs



When doesn't it work:

- Most of the time
 - Clients can obtain high quality foods elsewhere
 - Once food sales are introduced it is hard to eliminate
 - Do you really want to focus your growth initiative plans on pet food sales
 - Is that point of contact valuable?



Motivation?

- Provide better service(s) to clients
- Create client loyalty
- Increase clientele
- Spin Off professional services
- Increase net income
- Ego?



The Trend

One Stop Shopping




Key Success Factors

- Managerial Skills
 - Maintaining competent staff
 - Organizing the large more complex practice
- Utilizing business (practice) manager
- Providing the services well



Boarding

- Cost of Facility
 - \$ 8.00 per square foot - \$30 per square foot




Boarding

# Boarders	Nights	Rate	Revenue
10	365	25	91,250




Boarding

# Boarders	Nights	Rate	Revenue
5	365	25	45,625




Example Animal Hospital Income Statement Year Ending December 31,

	Before	Adjustment	2010 After
Revenue			
Professional Revenue	700,000		700,000
Boarding		91,250	791,250
Total	700,000		791,250
Cost of Sales			
Drugs and Supplies	193,300		193,300
Total	193,300		193,300
Gross Profit	506,700		597,950
Occupancy Costs			
Rent	34,300		34,300
Insurance	5,600		5,600
Utilities	11,900		11,900
Repairs/Maintenance	9,800		9,800
Total	61,600		61,600
Staff Costs			
Non Professional Wages & Benefits	140,700	45,000	185,700
Management Compensation	14,000		14,000
Professional Services	140,000		140,000
Total	294,700		339,700
Operating Expenses			
Phonations	8,400		8,400
Dues, Memberships	2,800		2,800
Interest and Bank Charges	11,900		11,900
Office	13,300		13,300
Professional Fees	4,900		4,900
Continued Education	3,500		3,500
Bad Debt	700		700
Other	9,300		9,300
Total	54,600		54,600
Operating Profit	95,200		141,450



Example Animal Hospital Income Statement Year Ending December 31,

	Before	Adjustment	2010 After
Revenue			
Professional Revenue	700,000		700,000
Boarding		45,625	745,625
Total	700,000		745,625
Cost of Sales			
Drugs and Supplies	193,300		193,300
Total	193,300		193,300
Gross Profit	506,700		551,725
Occupancy Costs			
Rent	34,300		34,300
Insurance	5,600		5,600
Utilities	11,900		11,900
Repairs/Maintenance	9,800		9,800
Total	61,600		61,600
Staff Costs			
Non Professional Wages & Benefits	140,700	45,000	185,700
Management Compensation	14,000		14,000
Professional Services	140,000		140,000
Total	294,700		339,700
Operating Expenses			
Phonations	8,400		8,400
Dues, Memberships	2,800		2,800
Interest and Bank Charges	11,900		11,900
Office	13,300		13,300
Professional Fees	4,900		4,900
Continued Education	3,500		3,500
Bad Debt	700		700
Other	9,300		9,300
Total	54,600		54,600
Operating Profit	95,200		95,625



Grooming


Grooms/Day	Days	Rate	Revenue
5	250	50	62,500



Example Animal Hospital Income Statement Year Ending			
	December 31,		2010
	Before	Adjustment	After
Revenue			
Professional Revenue	700,000		700,000
Grooming		62,500	762,500
Total	700,000		762,500
Cost of Sales			
Drugs and Supplies	193,300		193,300
Grooming		43,750	237,050
Total	193,300		237,050
Gross Profit	506,700		524,850
Occupancy Costs			
Rent	34,300		34,300
Insurance	5,600		5,600
Utilities	11,900		11,900
Repairs/Maintenance	3,800		3,800
Total	65,600		65,600
Staff Costs			
Non Professional Wages & Benefits	140,700		140,700
Management Compensation	14,000		14,000
Professional Services	140,000		140,000
Total	294,700		294,700
Operating Expenses			
Phonelines	2,400		2,400
Dues, Memberships	2,800		2,800
Interest and Bank Charges	11,900		11,900
Office	12,300		12,300
Professional Fees	4,900		4,900
Continued Education	3,500		3,500
Bad Debt	700		700
Other	9,100		9,100
Total	54,600		54,600
Operating Profit	95,200		113,950

Example Animal Hospital Income Statement Year Ending			
	December 31,		2010
	Before	Adjustment	After
Revenue			
Professional Revenue	700,000		700,000
Pet Supplies		10,000	710,000
Total	700,000		710,000
Cost of Sales			
Drugs and Supplies	193,300		193,300
Pet Supplies		5,000	198,300
Total	193,300		198,300
Gross Profit	506,700		511,500
Occupancy Costs			
Rent	34,300		34,300
Insurance	5,600		5,600
Utilities	11,900		11,900
Repairs/Maintenance	3,800		3,800
Total	65,600		65,600
Staff Costs			
Non Professional Wages & Benefits	140,700		140,700
Management Compensation	14,000		14,000
Professional Services	140,000		140,000
Total	294,700		294,700
Operating Expenses			
Phonelines	2,400		2,400
Dues, Memberships	2,800		2,800
Interest and Bank Charges	11,900		11,900
Office	12,300		12,300
Professional Fees	4,900		4,900
Continued Education	3,500		3,500
Bad Debt	700		700
Other	9,100		9,100
Total	54,600		54,600
Operating Profit	95,200		100,200

Pet Supplies



Beyond Direct Costs

- Additional reception staff
- Additional management

Pet Supplies

Sales	Margin	Cost
10,000	50%	5,000

	2010 Revenue	2010 Expenses	Profit Contribution
Operational Services & Incentives			
Consultation	\$191,381.07		
Vaccines	\$270,247.82	\$16,619.83	
Diagnosis			
Chestnut	\$16,408.54	\$6,524.75	\$306,892.85
Laboratory Services			
Laboratory In		\$0.00	
Laboratory Out	\$103,730.57	\$30,918.99	\$73,211.58
Surgical Services			
General Surgery	\$142,003.61	\$6,797.99	\$106,205.62
Anesthetics			
Class Injectable Pain Meds	\$73,358.79	\$4,519.22	\$68,839.57
Immunization Services			
General Supplies	\$4,473.22		
IT Phlebotomy - Hematology	\$47,764.63	\$1,732.82	\$41,568.49
Destiny			
Dental Supplies	\$19,560.69	\$2,188.08	\$17,452.61
X-Ray			
Film Developing	\$14,308.12	\$1,083.13	\$12,714.99
Auxiliary Services			
Reception			
Grooming	\$639.30	\$0.00	\$639.30
Diet Sales			
Medi-Cal	\$44,938.05	\$33,542.17	
Wholesome			
Other			\$11,395.88
Pharmacy			
General Medications	\$214,108.37	\$79,736.33	
Preventative Medications	\$107,662.79	\$60,410.41	\$201,584.42


The Trend

Managing to Industry Statistics




Key Success Factors

- Optimize Revenue
- Optimize Expenses




Evolution of this Trend

- Veterinarians are looking for guidance in setting the cost structure of their practices
- Look to industry benchmarks to use as a guide




What Benchmarks

- Tend to look at average benchmarks
- Should be looking at high performers




Motivation?

- Make more money
- Justification for management decisions



Ontario Averages

Ontario	Expense as a Percentage of Revenue					
	2005	2006	2007	2008	2009	2010
Drugs & Supplies	25.0%	24.9%	24.7%	24.5%	25.0%	25.2%
Wages	20.2%	20.0%	19.9%	19.2%	19.9%	20.0%
Specialists	0.5%	1.2%	0.2%	0.3%	0.4%	0.5%
Rent	0.2%	4.4%	4.2%	4.9%	4.8%	4.9%
Office	1.9%	1.8%	2.0%	1.9%	1.9%	1.9%
Accounting & Legal	0.8%	1.2%	0.9%	0.8%	0.9%	0.7%
Bank Charges	1.5%	2.3%	2.1%	2.4%	1.7%	1.7%
Depreciation	1.8%	1.9%	1.9%	1.4%	1.2%	1.5%
Utilities	1.7%	1.8%	1.8%	1.7%	1.8%	1.7%
Repair & Maintenance	1.5%	1.7%	1.6%	1.4%	1.5%	1.4%
Laboratory	2.3%	2.2%	2.3%	2.3%	2.4%	2.5%
Professional Dues	0.6%	0.4%	0.6%	0.4%	0.4%	0.4%
Other	0.1%	0.2%	0.0%	0.3%	0.1%	0.1%
Advertising	0.9%	1.1%	1.0%	0.9%	1.1%	1.2%
Equipment Rental	0.4%	0.3%	0.5%	0.2%	0.5%	0.5%
Bad Debt	0.1%	0.1%	0.1%	0.1%	0.1%	0.1%
Vehicle	0.2%	0.1%	0.0%	0.0%	0.0%	0.0%
Grooming	0.3%	0.4%	0.3%	0.3%	0.2%	0.1%
Continuing Education	0.4%	0.4%	0.6%	0.5%	0.5%	0.5%
Insurance	0.8%	0.8%	0.8%	0.6%	0.7%	0.8%
Total Expenses	66.7%	66.2%	65.1%	63.3%	65.7%	65.8%
Return to Professionals	33.8%	32.3%	34.9%	36.7%	34.3%	34.2%




Ontario Fees Over the Past 6 Years

Ontario	2005	2006	2007	2008	2009	2010
Fee Increase	6.0%	13.0%	12.0%	10.0%	8.0%	7.0%




Ontario Averages

Ontario	Expense as a Percentage of Revenue					
	2005	2006	2007	2008	2009	2010
Drugs & Supplies	25.0%	24.9%	24.7%	24.5%	25.0%	25.2%
Wages	20.2%	20.0%	19.9%	19.2%	19.9%	20.9%
Speculists	0.0%	1.2%	0.2%	0.2%	0.4%	0.0%
Rent	5.2%	4.4%	4.2%	4.9%	4.8%	4.9%
Office	1.9%	1.8%	2.0%	1.9%	1.9%	1.9%
Accounting & Legal	0.8%	1.2%	0.9%	0.9%	0.9%	0.7%
Bank Charges	1.0%	2.3%	2.1%	2.4%	1.7%	1.7%
Depreciation	1.8%	1.9%	1.9%	1.4%	1.2%	1.0%
Utilities	1.7%	1.8%	1.8%	1.7%	1.8%	1.7%
Repair & Maintenance	1.0%	1.7%	1.6%	1.4%	1.0%	1.4%
Laboratory	2.2%	2.2%	2.3%	2.3%	2.4%	2.0%
Professional Dues	0.6%	0.4%	0.5%	0.4%	0.4%	0.4%
Other	0.1%	0.2%	0.0%	0.3%	0.1%	0.1%
Advertising	0.9%	1.1%	1.0%	0.9%	1.1%	1.2%
Equipment Rental	0.4%	0.2%	0.5%	0.2%	0.3%	0.5%
Bad Debt	0.1%	0.1%	0.1%	0.1%	0.1%	0.1%
Vehicle	0.2%	0.1%	0.0%	0.0%		
Grooming	0.2%	0.4%	0.3%	0.3%	0.2%	0.1%
Continuing Education	0.1%	0.6%	0.6%	0.5%	0.5%	0.6%
Insurance	0.8%	0.8%	0.6%	0.7%	0.6%	0.8%
Total Expenses	66.7%	66.2%	65.1%	63.3%	65.7%	65.8%
Return to Professionals	33.8%	32.3%	34.9%	36.7%	34.3%	34.2%



Inflation Over the Past 6 Years


Ontario	2005	2006	2007	2008	2009	2010
Fee Increase	5.0%	13.0%	12.0%	10.0%	8.0%	7.0%
Inflation	2.2%	2.0%	2.1%	2.4%	0.3%	1.8%



Expenses Less Drugs and Supplies


	2005	2006	2007	2008	2009	2010
All But Cost of Sales	41.7%	41.3%	40.4%	38.8%	40.2%	40.6%



- ### Revenue Growth vs. Expense Growth
- Rate of growth of revenue greater than inflation
 - Most expenses should have increased at the rate of inflation
 - Drugs and supplies may be an exception
 - This expense ratio reduction does not seem to have happened
- 

Potential vs. Actual

		2005	2006	2007	2008	2009	2010
Actual	All But Cost of Sales	41.7%	41.3%	40.4%	38.8%	40.2%	40.6%
Potential	All But Cost of Sales	40.5%	36.6%	33.3%	30.9%	29.2%	27.8%
	Difference	1.2%	4.7%	7.1%	7.9%	11.0%	12.8%



Expanding on Potential Vs. Actual


Our Example Practice

Potential	2005	2006	2007	2008	2009	2010
Revenue	443,400	465,570	526,094	589,226	648,148	700,000
Expenses - All but Cost of Sales	40.6%	36.6%	33.4%	31.1%	28.9%	27.5%
Cost of Sales (actual)	25.0%	24.9%	24.7%	24.5%	25.5%	25.2%
Return to Professionals	152,965	179,056	220,355	261,633	295,665	331,303
as %	34%	38%	42%	44%	46%	47%

Our Example Practice


Actual	2005	2006	2007	2008	2009	2010
Revenue	443,400	465,570	526,094	589,226	648,148	700,000
Expenses - All but Cost of Sales	41.7%	41.3%	40.4%	38.8%	40.2%	40.6%
Cost of Sales (actual)	25.0%	24.9%	24.7%	24.5%	25.5%	25.2%
Return to Professionals	147,652	157,353	183,807	216,246	222,315	239,400
as %	33%	34%	35%	37%	34%	34%


Lost Return to Professionals	4,913	21,693	36,748	45,388	73,170	91,903
Total Lost Profit	274,815					
Lost Value	\$401,000					





The Trend


Utilization of In House Lab



- ### Lost Net Income
- The OVMA data represents the average
 - Some practices have controlled expenses and have become very profitable
 - Ontario average return to professional is 34%
 - High performance practices have return to professionals of 50% of revenue
- 

- ### Theory Behind the Trend
- Provide state of the art diagnostics
 - Immediate lab results for patients
 - Great health care
 - Great service
 - Do pre-op blood work
- 

- ### History Repeats Itself
- Continuing to manage by benchmarks results in Groundhogs Day
 - Is this fair to clients?
 - Are we driving clients away with high fees that we are wasting
- 

- ### Motivation?
- Provide better patient care
 - Increase practice profile
- 

Key Success Factors

- Price the service at a profitable level



Study published in VIN 2006

THE PROFIT DIFFERENCE CAN NO LONGER BE IGNORED				
Using	CBC Cost	Chemistry	Total Cost	Profit @ Fee of \$68.80*
Analyzer A	\$26.72	\$53.23	\$79.95	-\$11.15
Analyzer B	\$26.72	\$40.73	\$67.45	\$1.35
Commercial Lab	\$12.00	Avg. \$17.13	\$29.13	\$39.67
VetScreen + CBC	Major Savings Using Commercial Laboratory		\$22.50	\$46.30
CBC + 8 Chem + HW + U	Packaged Profiles		\$25.00	\$43.80

* \$68.80 is a fair fee for Profile: CBC as well as a potent Wellness Profile incentive for clients.



Background

- 1970's analyzers were laborious and had limited capabilities
- Government labs provided poor service
- 1980's analyzers became more automated and more capable
- Since - increasing automation and capability
- Simultaneously private labs providing comprehensive testing and increasingly good service



Location, Location, Location

- Many practices are in a location where in house lab is unnecessary
- Even in these highly serviced areas, many practices still have in house lab
 - Often used for pre-ops and emergency
 - All other lab work outsourced



The Conundrum

- Private labs provided more reliable results
 - Better equipment
 - Better quality control
- Private labs provided services at a price better than the cost of in house lab
- Private labs providing good service to a large portion of Ontario



Study published in VIN 2006

	In-Hospital Chemistry - Total Cost Analysis											
	# of Billable Profiles per Month:		# of Billable Profiles per Day:									
	60	120	10	20	30	40	50	60	70	80	90	100
1. Amended Equipment Cost (in % Investment) (Analyzer A: \$13,350; Analyzer B: \$11,000)	\$7.08	\$4.84	\$5.31	\$3.48	\$4.25	\$2.79	\$2.12	\$1.69				
2. Alternative Investment Loss (0% ROI)	\$1.38	\$0.70	\$0.87	\$0.57	\$0.69	\$0.45	\$0.35	\$0.23				
3. Reagent Costs (Direct)	\$16.50	\$14.50	\$16.50	\$14.50	\$16.50	\$14.50	\$16.50	\$14.50				
4. Quality Control Material Cost:	\$0.48	\$0.48	\$0.36	\$0.36	\$0.20	\$0.20	\$0.18	\$0.18				
5. Quality Control Reagent Cost:	\$12.00	\$10.95	\$9.00	\$7.80	\$7.20	\$6.83	\$6.00	\$5.16				
6. Reagent Testing in 0% OF Samples:	\$2.00	\$1.81	\$2.00	\$1.81	\$2.00	\$1.81	\$2.00	\$1.81				
7. Collection Material and Reagent Cost:	\$0.75	\$0.75	\$0.75	\$0.75	\$0.75	\$0.75	\$0.75	\$0.75				
8. Abnormal/Confirmatory In % OF Tests @ \$12 Each:	\$0.80	\$0.80	\$0.80	\$0.80	\$0.80	\$0.80	\$0.80	\$0.80				
9. Technician Labor Cost:	\$3.00	\$3.00	\$3.00	\$3.00	\$3.00	\$3.00	\$3.00	\$3.00				
10. Sample Collection Material Cost:	\$0.80	\$0.80	\$0.80	\$0.80	\$0.80	\$0.80	\$0.80	\$0.80				
11. Sample Collection Labor Cost:	\$1.80	\$1.80	\$1.80	\$1.80	\$1.80	\$1.80	\$1.80	\$1.80				
12. Pathogen and Repeat Cost:	\$2.00	\$1.80	\$2.00	\$1.80	\$2.00	\$1.80	\$2.00	\$1.80				
13. Instrument Maintenance, Service and Repair Cost:	\$1.40	\$0.80	\$1.00	\$0.70	\$0.80	\$0.60	\$0.80	\$0.60				
14. Don't Forget to Amalgam Staff Cost:	\$1.80	\$1.80	\$1.80	\$1.80	\$1.80	\$1.80	\$1.80	\$1.80				
15. Facility Cost:	\$0.79	\$0.28	\$0.79	\$0.27	\$0.60	\$0.37	\$0.22	\$0.18				
TOTAL Overhead Cost Per Billable Test:	\$55.95	\$45.14	\$47.23	\$46.73	\$43.80	\$38.08	\$34.93	\$33.79				



Cost Of CBC Processing In-House

# of CBC's per Month:	66	98	110	220
# of CBC's per Day:	3	4	5	10
Category	Cost(s) per Billable CBC			
1. Amortized Equipment:	\$8.13	\$6.10	\$4.88	\$2.44
2. Alternative Investment Lines:	\$1.98	\$1.49	\$1.19	\$0.62
3. Reagent Costs (Direct):	\$4.10	\$4.10	\$4.10	\$4.10
4. Quality Control Material Cost:	\$2.28	\$2.21	\$2.17	\$2.08
5. Quality Control Reagent Cost:	\$2.88	\$2.24	\$1.79	\$0.89
6. Repeat Testing Reagent:	\$0.41	\$0.41	\$0.41	\$0.41
7. Calibration Material & Reagents:	\$0.26	\$0.19	\$0.15	\$0.08
8. Confirmation Tests (Outside lab) (5% of CBCs)	\$0.00	\$0.00	\$0.00	\$0.00
9. Technician Labor Cost:	\$3.79	\$3.75	\$3.75	\$3.75
10. Sample Collection Materials:	\$0.39	\$0.39	\$0.39	\$0.39
11. Sample Collection Labor Cost:	\$2.90	\$2.90	\$2.90	\$2.90
12. Reagent and Patient Cost:	\$0.88	\$0.88	\$0.88	\$0.88
13. Maintenance/Service/Repair:	\$1.62	\$1.14	\$0.91	\$0.45
14. Result Entry and Archiving:	\$1.80	\$1.80	\$1.80	\$1.80
15. Amortized Facility Cost:	\$0.99	\$0.72	\$0.57	\$0.29
Cost for each billable CBC:	\$30.75	\$26.72	\$24.20	\$19.46
Interpretation/Consultation: (10 min) (1/100/100/year @ 200 Days, 4 times)	\$8.01	\$8.01	\$8.01	\$8.01
Total CBC w/ Professional Fees:	\$38.76	\$34.73	\$32.20	\$27.47
Hospital Profit @ \$30 per CBC:	-43.76	\$0.27	\$2.70	\$7.53

Study published in VIN 2006

Cost Of CBC (Only) From Reference Lab		\$12.00
Sample Collection Cost (Tech + Assistant 2 x 5 min each)	\$2.90	
Veterinarian Cost (10 minutes as above)	\$8.00	
Total CBC Cost With Professional Fees	\$10.90	
Average CBC Charge	\$35.00	
Hospital Bottom Line Profit	\$12.09 (4.8%)	

Cost Of CBC Added To Reference Lab Profile		\$5.00 (vs lab)
Sample Collection Cost (Tech + Assistant 2 x 5 min each)	\$2.90	
Veterinarian Cost (10 minutes as above)	\$8.00	
Total CBC Cost With Professional Fees	\$10.90	
Average CBC Charge	\$35.00	
Hospital Bottom Line Profit = CBC cost out	\$19.09 (54.8%)	

Valuation Methods 1950 - 1987

Companion Animal Practice Marketplace

Valuation Methods Lender Asset/Shares Consolidation

1950 - 1987 **Rules of Thumb**

Trends In the Veterinary Practice Marketplace

Rules of Thumb

Rules of Thumb

- value = a multiple of gross revenue

'One-Year' Rule

- 'a practice is worth one year's gross revenue'

A rule of thumb is a homemade recipe for making a guess. It is an easy-to-remember guide that falls somewhere between a mathematical formula and a shot in the dark^{KL}.

Tom Parker, *Rules of Thumb*, Houghton Mifflin: Boston, 1983, p. vii.

History of Companion Animal Veterinary Market Place

Companion Animal Practice Marketplace

Valuation Methods Lender Asset/Shares Consolidation


1950 to Present

Rule of Thumb Shortcomings

- Practices are not homogeneous
- Calculating at the level of Revenue and not profit
 - Extreme variability of profitability across practices
- Changing profitability with time
 - Return to professionals in the 1970's = 50%
 - Current return to professionals is 35%


Valuation Methods 1987 - 1995

Companion Animal Practice Marketplace			
Valuation Methods	Lender	Asset/Shares	Consolidation
1950 - 1987	Rules of Thumb		
1987 - 1995	Dual Capitalization		




The Last Ten Years

- Single Period Capitalization Method
 - Capitalization of a single income – preferably cash flow
- Based solely on profitability
- More Attention Paid to Risk
 - There are several factors that significantly alter the risk



How to Price Your Practice -McCafferty

- In 1987, Veterinary Economics published a series of three articles describing the application of an income-based business valuation method as a viable approach to value small animal veterinary practices
 - Dual Capitalization or Excess Earnings
 - Greatest determinant of value was size of the profit




Future Valuation Methods

Companion Animal Practice Marketplace			
Valuation Methods	Lender	Asset/Shares	Consolidation
1950 - 1987	Rules of Thumb		
1987 - 1995	Dual Capitalization		
1995 to Present	Dual Capitalization Single Period Capitalization		
Future	Cash Flow Analyses		




Valuation Methods 1995 to Present

Companion Animal Practice Marketplace			
Valuation Methods	Lender	Asset/Shares	Consolidation
1950 - 1987	Rules of Thumb		
1987 - 1995	Dual Capitalization		
1995 to Present	Dual Capitalization Single Period Capitalization		



Future Valuation Methodologies

- More emphasis on cash flow calculations rather than financial theory



Lenders 1950 to 1995

Companion Animal Practice Marketplace			
Valuation Methods	Lender	Asset/Shares	Consolidation
1950 - 1987	Rules of Thumb	Vendor	
1987 - 1995	Dual Capitalization	Vendor	
1995 to Present	Dual Capitalization Single Period Capitalization		
Future	Cash Flow Analyses		

- ### Banks Come onto Scene
- Hot economy in early and mid 1990's
 - Institutions looking for safe investments
 - Lending on the basis of Cash Flow
 - Collateral lenders looking for 75% collateral assets
 - Most practices are 75% goodwill
 - Maintenance of long amortization periods of 7 to 10 years compared to 3 to 5 years for most businesses

- ### Lenders 1950 to 1995
- Vendors (Take back)
 - Long Amortization Periods – often open ended
 - Sometimes period of low to no interest
 - Often interest rates were less than market rates

- ### Bank Influence on Marketplace
- Impact on veterinary practice marketplace**
- legitimacy and stability to marketplace
 - potentially creates a larger pool of buyers
 - provide assurances which back up buyer's decision
- Downside**
- increased the cost of financing
 - increased the complexity of obtaining financing
 - currently 7 year financing window

Lenders 1995 to Present


Companion Animal Practice Marketplace			
Valuation Methods	Lender	Asset/Shares	Consolidation
1950 - 1987	Rules of Thumb	Vendor	
1987 - 1995	Dual Capitalization	Vendor	
1995 to Present	Dual Capitalization Single Period Capitalization	Bank	
Future	Cash Flow Analyses		

Future Lenders

Companion Animal Practice Marketplace			
Valuation Methods	Lender	Asset/Shares	Consolidation
1950 - 1987	Rules of Thumb	Vendor	
1987 - 1995	Dual Capitalization	Vendor	
1995 to Present	Dual Capitalization Single Period Capitalization	Bank	
Future	Cash Flow Analyses	Bank?	

Future Lenders

- Banks
 - As long as amortization periods remain long
- Vendors
 - By default



Sale of Assets

Asset Sale		
Practice Value	600,000	Vendor's Tax Liability
Inventory	20,000	120,000
Prepaid Expenses	2,000	Purchaser Tax Write Off
Fixed Assets	35,000	Goodwill
Goodwill	543,000	3,400



Asset vs. Share Sale

	Companion Animal Practice Marketplace		Asset/Shares	Consolidation
	Valuation Methods	Lender		
1950 - 1987	Rules of Thumb	Vendor		
1987 - 1995	Dual Capitalization	Vendor		
1995 to Present	Dual Capitalization Single Period Capitalization	Bank	Professional Incorporation (2002)	
Future	Cash Flow Analyses	Bank?		




Sale of Shares

Share Sale		
Practice Value	560,000	Vendor's Tax Liability
Inventory	20,000	0
Prepaid Expenses	2,000	Purchaser Tax Write Off
Fixed Assets	35,000	Goodwill
Goodwill	503,000	0



Ability to Incorporate Practices

- As of 2002, Ontario legislature allowed the incorporation of professional practices
- The personal disposition of qualified small business corporation shares is entitled to the lifetime capital gain exemption
- Currently will be very few practice sell as assets



Asset vs. Share Sale

	Asset Sale	Share Sale
Vendor		
Practice Value	600,000	560,000
Vendor After Tax	480,000	560,000
Purchaser		
Practice Value	600,000	560,000
Purchaser	Indifferent	



Consolidation

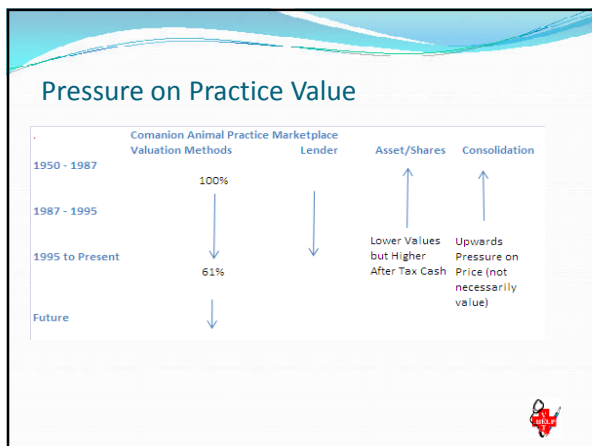
	Companion Animal Practice Marketplace Valuation Methods	Lender	Asset/Shares	Consolidation
1950 - 1987	Rules of Thumb	Vendor		
1987 - 1995	Dual Capitalization	Vendor		
1995 to Present	Dual Capitalization Single Period Capitalization	Bank	Professional Incorporation (2002)	Consolidators
Future	Cash Flow Analyses	Bank?		

- ### This Hour's Explored Trends
- Low Price Practices
 - Bigger is Better

- ### Consolidation
- Many consolidating groups
 - Big to Small
 - Motivated by relatively high levels of profit
 - 33% return to professionals
 - Cost of professionals typically 20% of revenue
 - Potential profit of 13% of revenue
 - Interested in large practice in large markets
 - Competitive bidding for practices in markets of interest

The Trend

Low Priced Practices/Price Competition



- ### Theory Behind the Trend
- The practice down the street is charging 10% less
 - I should match prices to ensure I don't lose clients and protect my profitability
 - OR
 - If I charged 10% less I would capture more clients and increase profitability

Example 1: Match the Competitor or NO

- Option 1
 - Lower prices 10% to match competitor
 - No lost clients
- OR
- Option 2
 - Retain prices
 - Lose 10% of your clients



Retain Prices

- Will undoubtedly lose some price sensitive clients
 - We'll be pessimistic and assume 10% for this example
- Price sensitive clients (generally speaking):
 - Spend less at the practice anyhow
 - Spend less on higher margin services
 - Disproportionate amount of conflicts



Analysis of Lowering Your Prices

- Your fixed costs are still fixed
- Your current clients have expectations of service
 - Makes it hard to cut any services in order to save costs



Example Annual Hospital Income Statement Year Ending	December 31,		2010
	2010	Adjustment	
Revenue			
Professional Revenue	700,000	-50,000	650,000
	0	0	0
	<u>700,000</u>		<u>650,000</u>
Cost of Sales			
Drugs and Supplies	100,000	-4,000	96,000
	<u>100,000</u>		<u>96,000</u>
Gross Profit	600,000		554,000
Occupancy Costs			
Rent	34,300		34,300
Insurance	5,000		5,000
Utilities	11,500		11,500
Repairs/Maintenance	5,000		5,000
Total	<u>61,800</u>		<u>61,800</u>
Staff Costs			
Non-Professional Wages & Benefits	140,700		140,700
Management Compensation	14,000		14,000
Professional Services	140,000		140,000
Total	<u>294,700</u>		<u>294,700</u>
Operating Expenses			
Protonics	8,400		8,400
Dues, Memberships	2,800		2,800
Interest and Bank Charges	11,900	-500	11,350
Office	13,300		13,300
Professional Fees	4,900		4,900
Continued Education	3,500		3,500
Bad Debt	700	-300	400
Other	5,100		5,100
Total	<u>64,600</u>		<u>63,650</u>
Operating Profit	55,400		70,350
	AOI as %	13.6%	10.7%

Highlights:
 -10% decrease in clients, 5% decrease in revenue
 -Loss of profit of \$24,360 (-2.9%)
 -Loss Value of \$106,000, but still retain some goodwill



Example Annual Hospital Income Statement Year Ending	December 31,		2010
	2010	Adjustment	
Revenue			
Professional Revenue	700,000	-70,000	630,000
	0	0	0
	<u>700,000</u>		<u>630,000</u>
Cost of Sales			
Drugs and Supplies	100,000		100,000
	<u>100,000</u>		<u>100,000</u>
Gross Profit	600,000		530,000
Occupancy Costs			
Rent	34,300		34,300
Insurance	5,000		5,000
Utilities	11,500		11,500
Repairs/Maintenance	5,000		5,000
Total	<u>61,800</u>		<u>61,800</u>
Staff Costs			
Non-Professional Wages & Benefits	140,700		140,700
Management Compensation	14,000		14,000
Professional Services	140,000		140,000
Total	<u>294,700</u>		<u>294,700</u>
Operating Expenses			
Protonics	8,400		8,400
Dues, Memberships	2,800		2,800
Interest and Bank Charges	11,900	-1,100	10,750
Office	13,300		13,300
Professional Fees	4,900		4,900
Continued Education	3,500		3,500
Bad Debt	700		700
Other	5,100		5,100
Total	<u>64,600</u>		<u>63,450</u>
Operating Profit	46,400		26,550
	AOI as %	13.6%	4.2%

Highlights:
 -Profit decrease of \$69,000 (-9.4%)
 -Effectively lose all your goodwill since capitalized cash flow below equipment value



Discussion

- Using our scenario you will lose less profit by retaining your prices
- You drop your prices and your competitor will drop their prices further
- Not easy to re-establish higher prices

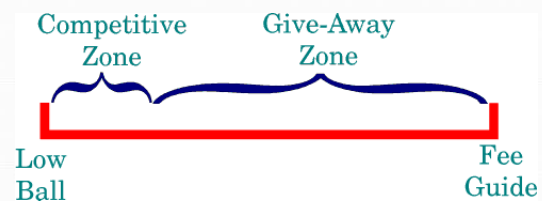


Example 2: Lower prices to gain clientele

- Through example
 - Lower your prices by 10%
 - Increase your clientele by 15%
- Result
 - Revenue increases marginally
 - 10% of current revenue decrease
 - Then 15% increase for new clients
 - Fixed costs remain fixed
 - Many variable costs increase
 - Are your competitors going to match and remove any potential increase
 - You are likely now going to work harder for less money



The Give-Away



Example Annual Receiptal Income Statement Year Ending		December 31,		2010	2011
		2010	Adjustment	Adjusted	
Revenue					
Professional Revenue		700,000	24,000	724,000	0
		0		0	724,000
Total		700,000		724,000	
Cost of Sales					
Drugs and Supplies		193,999	20,000	213,999	
Total		193,999		213,999	
Gross Profit		506,000		510,000	
Occupancy Costs					
Rent		24,200		24,200	
Insurance		5,000		5,000	
Utilities		11,900		11,900	
Repairs/Maintenance		5,900		5,900	
Total		47,000		47,000	
Staff Costs					
Non-Professional Wages & Benefits		140,700	21,165	161,865	
Management Compensation		14,000		14,000	
Professional Services		140,000	21,000	161,000	
Total		294,700		336,865	
Operating Expenses					
Provisions		8,400		8,400	
Dues, Memberships		2,800		2,800	
Interest and Bank Charges		11,900	417	12,317	
Office		13,200		13,200	
Professional Fees		4,900		4,900	
Continued Education		3,500		3,500	
Bad Debt		700	700	1,400	
Other		5,100		5,100	
Total		54,600		66,717	
Operating Profit		95,200		47,284	

Highlights:
 - Revenue increase of 3.5%
 - Loss of profit of \$48,000
 - Lose effectively all your goodwill

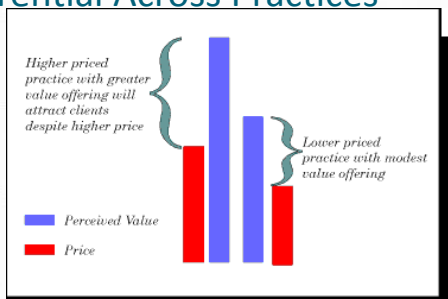


Should you Increase Prices?

- Again by Example
 - Increase prices 5%
 - Lose 10% of your clientele



Differential Across Practices




Example Annual Receiptal Income Statement Year Ending		December 31,		2010	2011
		2010	Adjustment	Adjusted	
Revenue					
Professional Revenue		700,000	-7,000	693,000	
		0		0	693,000
Total		700,000		693,000	
Cost of Sales					
Drugs and Supplies		193,999	-19,300	174,699	
Total		193,999		174,699	
Gross Profit		506,000		518,300	
Occupancy Costs					
Rent		24,200		24,200	
Insurance		5,000		5,000	
Utilities		11,900		11,900	
Repairs/Maintenance		5,900		5,900	
Total		47,000		47,000	
Staff Costs					
Non-Professional Wages & Benefits		140,700		140,700	
Management Compensation		14,000		14,000	
Professional Services		140,000		140,000	
Total		294,700		294,700	
Operating Expenses					
Provisions		8,400		8,400	
Dues, Memberships		2,800		2,800	
Interest and Bank Charges		11,900	-110	11,790	
Office		13,200		13,200	
Professional Fees		4,900		4,900	
Continued Education		3,500		3,500	
Bad Debt		700		700	
Other		5,100		5,100	
Total		54,600		54,690	
Operating Profit		95,200		107,209	
		AOI 9%		10.5%	

Highlights
 -Lower Revenue (dual effect)
 -Lower Cost of Sales
 -Higher Profit (\$12,500 (1.9%)
 -Increase Value: \$55,000
 -All with lower effort




Limit to Analysis

- Does not mean everyone should increase prices
- Some should decrease prices
- Economic Theory of “Elasticity of Demand”
 - % change in demand vs. % change in price
 - Different for every market
 - Rosedale vs. Scarborough
 - Different for every practice within a market as well




When it doesn't work

- When client expectations already fixed
- When fixed costs can't be adjusted accordingly
- When the owner is committed to offering anything above base service
-
- Most of the time



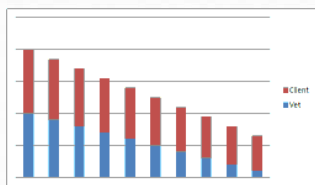

When it works

- No doubt that some practices are quite profitable charging lower prices
- Needs commitment to low costs and service offerings
- Should be done at time of practice inception
 - Manage client expectations
 - Manage all the fixed costs

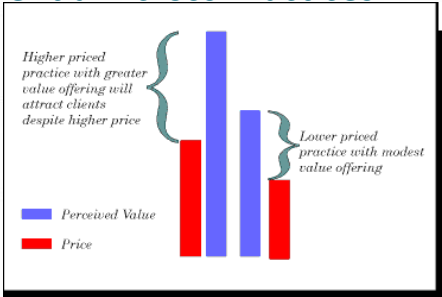


Race to the Basement

Value Allocation

Differential Across Practices




Higher priced practice with greater value offering will attract clients despite higher price

Lower priced practice with modest value offering

■ Perceived Value
■ Price

How to Avoid the “Race to the Basement” if you prefer not to offer less service

- Price within reason of the fee guide
 - Strict adherence not necessary, but it is a good guide
 - Collusion is illegal, but following suggested pricing is not
- Don't compete on price
 - Focus on customer satisfaction to convince customers of value




The Trend

Planning Excess Capacity




Key Success Factors

- Managerial Skills
 - Maintaining competent staff
 - Organizing the large more complex practice
- Adequate demand for added capacity

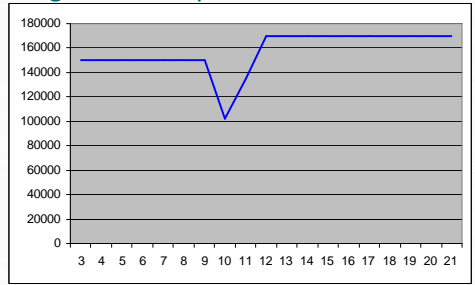


Theory Behind the Trend


- A mature practice has reached a point of capacity
 - Appointments are full
 - Physical space is limiting sales and operations
- Resolution is to
 - Increase staff
 - Expand facility



Adding Cost in Steps




Period	Revenue
3	150,000
4	150,000
5	150,000
6	150,000
7	150,000
8	150,000
9	150,000
10	100,000
11	150,000
12	170,000
13	170,000
14	170,000
15	170,000
16	170,000
17	170,000
18	170,000
19	170,000
20	170,000
21	170,000



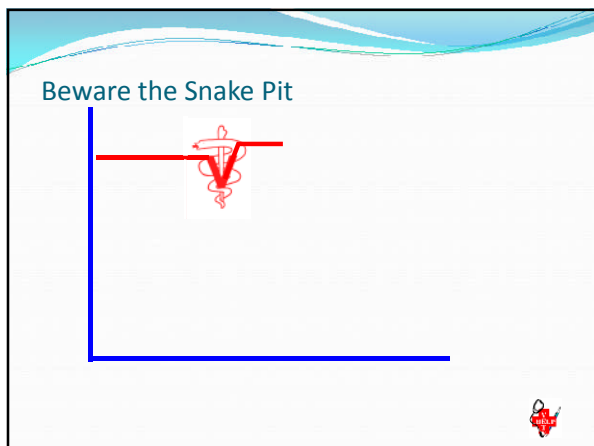
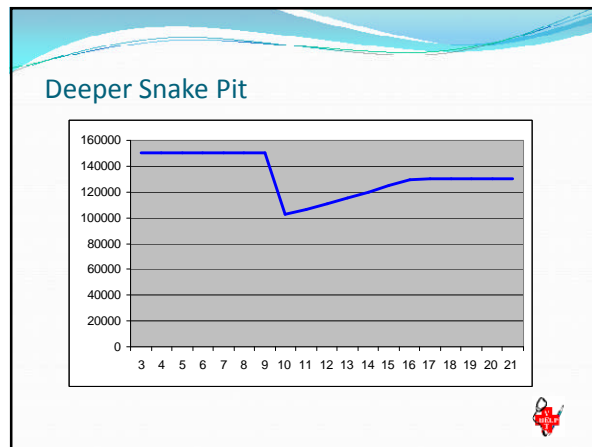
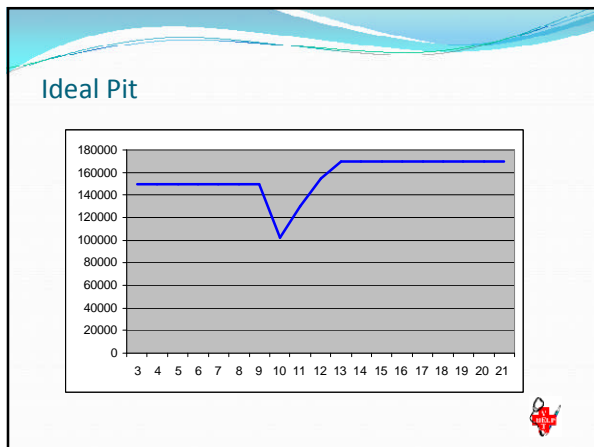
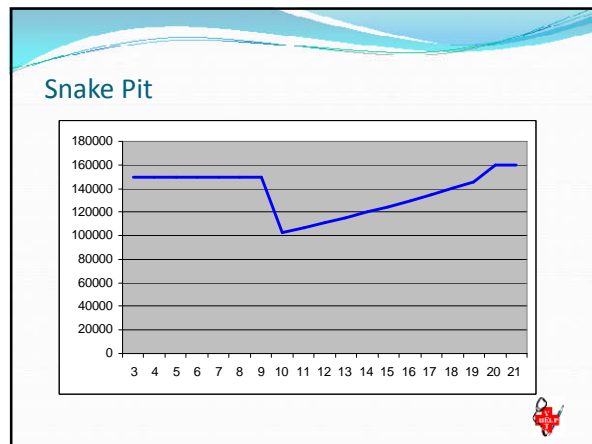
Motivation?

- Provide better service(s) to existing clients
- Flexibility of more staff
 - Sharing of case load, hours of operation
- Increase clientele
- Increase net income
- Ego?



	December 31,		
	2010	Adjustment	2010
Revenue			
Professional Revenue	700,000		700,000
	700,000		700,000
Cost of Sales			
Drugs and Supplies	193,900		193,900
	193,900		193,900
Gross Profit	506,100		506,100
Occupancy Costs			
Rent	34,300	34,000	68,300
Insurance	5,800	5,600	11,200
Utilities	11,900	11,500	23,600
Repairs/Maintenance	9,800	9,600	19,600
Total	61,800		122,900
Staff Costs			
Non-Professional Wages & Benefits	140,700	40,000	180,700
Management Compensation	14,000		14,000
Professional Services	140,000	70,000	210,000
	294,700		404,700
Operating Expenses			
Promotions	8,400		8,400
Clubs, Memberships	2,800		2,800
Interest and Bank Charges	11,900		11,900
Office	13,300		13,300
Professional Fees	4,900		4,900
Continued Education	3,500		3,500
Bad Debt	700		700
Other	3,100		3,100
Total	54,600		54,600
Operating Profit	95,200		76,100

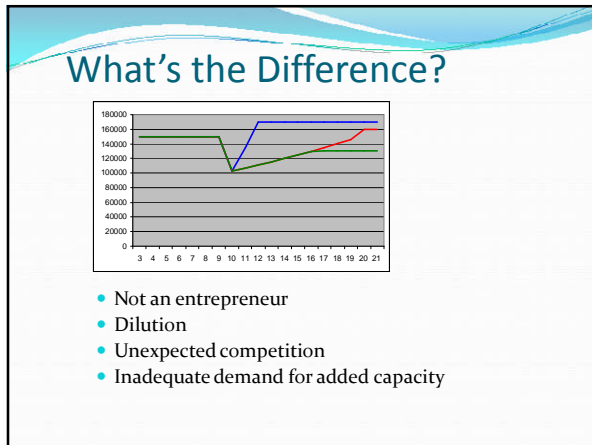
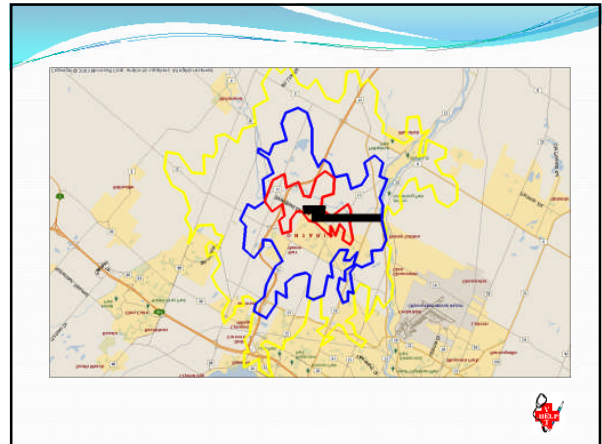
Example Animal Hospital Income Statement Year Ending			
	December 31, 2010		
	2010	Adjustment	2010 Adjusted
Revenue			
Professional Revenue	700,000		700,000
	<u>700,000</u>		<u>700,000</u>
Cost of Sales			
Drugs and Supplies	193,900		193,900
	<u>193,900</u>		<u>193,900</u>
Gross Profit	506,100		506,100
Occupancy Costs			
Rent	34,300	34,000	68,300
Insurance	5,600	5,600	11,200
Utilities	11,900	11,900	23,800
Repairs/Maintenance	9,800	9,800	19,600
Total	<u>61,600</u>		<u>122,900</u>
Staff Costs			
Non Professional Wages & Benefits	140,700	40,000	180,700
Management Compensation	14,000		14,000
Professional Services	140,000		140,000
Total	<u>294,700</u>		<u>334,700</u>
Operating Expenses			
Promotions	8,400		8,400
Dues, Memberships	2,800		2,800
Interest and Bank Charges	11,900		11,900
Office	13,300		13,300
Professional Fees	4,900		4,900
Continued Education	3,500		3,500
Bad Debt	700		700
Other	3,100		3,100
Total	<u>54,600</u>		<u>54,600</u>
Operating Profit	95,200		6,100



Example Animal Hospital Income Statement Year Ending			
	December 31, 2010		
	2010	Adjustment	2010 Adjusted
Revenue			
Professional Revenue	700,000		700,000
	<u>700,000</u>		<u>700,000</u>
Cost of Sales			
Drugs and Supplies	193,900	55,000	248,900
	<u>193,900</u>		<u>248,900</u>
Gross Profit	506,100		656,700
Occupancy Costs			
Rent	34,300	34,000	68,300
Insurance	5,600	5,600	11,200
Utilities	11,900	11,900	23,800
Repairs/Maintenance	9,800	9,800	19,600
Total	<u>61,600</u>		<u>122,900</u>
Staff Costs			
Non Professional Wages & Benefits	140,700	40,000	180,700
Management Compensation	14,000		14,000
Professional Services	140,000	70,000	210,000
Total	<u>294,700</u>		<u>404,700</u>
Operating Expenses			
Promotions	8,400		8,400
Dues, Memberships	2,800		2,800
Interest and Bank Charges	11,900		11,900
Office	13,300		13,300
Professional Fees	4,900		4,900
Continued Education	3,500		3,500
Bad Debt	700		700
Other	3,100		3,100
Total	<u>54,600</u>		<u>54,600</u>
Operating Profit	95,200		68,500

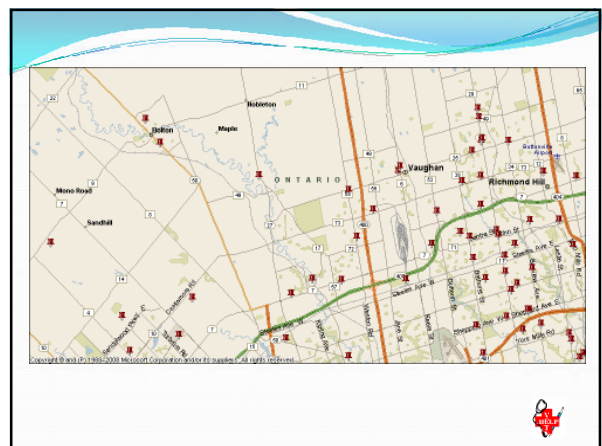
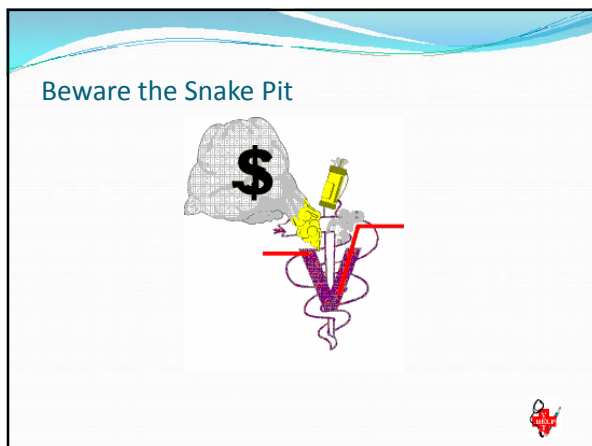
Example Animal Hospital Income Statement Year Ending	December 31,		
	2010	Adjustment	2010 Adjusted
Revenue			
Professional Revenue	700,000	275,000	975,000
	700,000		975,000
Cost of Sales			
Drugs and Supplies	193,300	76,175	270,075
	193,300		270,075
Gross Profit	506,700		704,925
Occupancy Costs			
Rent	34,300	34,000	68,300
Insurance	5,600	5,600	11,200
Utilities	11,900	11,900	23,800
Repairs/Maintenance	9,800	9,800	19,600
Total	61,600		122,900
Staff Costs			
Non-Professional Wages & Benefits	140,700	60,000	200,700
Management Compensation	14,000		14,000
Professional Services	140,000	70,000	210,000
Total	294,700		424,700
Operating Expenses			
Provisioning	8,400		8,400
Dues, Memberships	2,800		2,800
Interest and Bank Charges	11,900		11,900
Office	13,300		13,300
Professional Fees	4,900		4,900
Continued Education	3,000		3,000
Bad Debt	700		700
Other	9,100		9,100
Total	54,600		54,600
Operating Profit	95,200		102,725

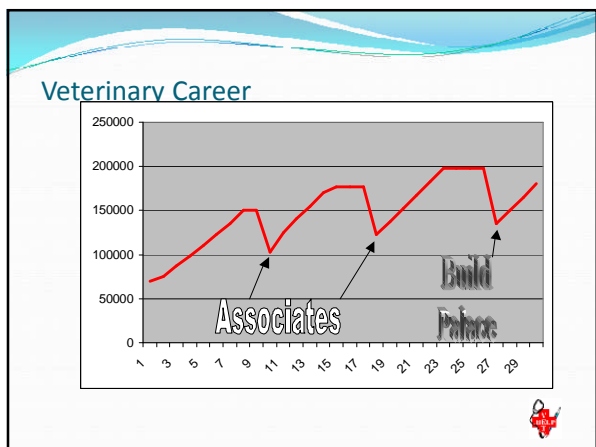
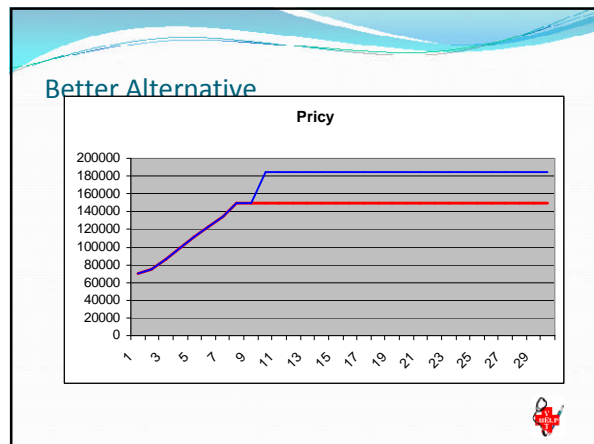
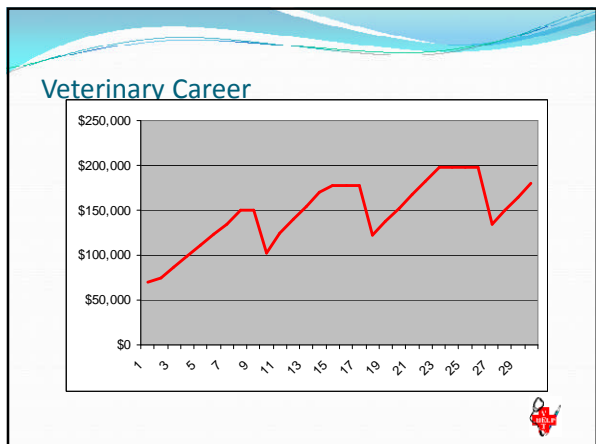
10% Growth 3.5 Years
5% Growth 8 Years



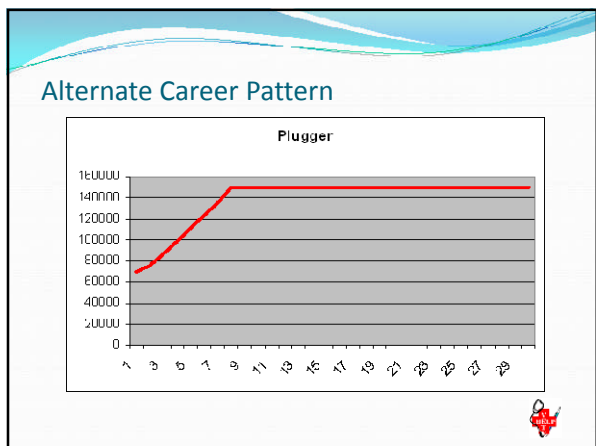
Census Snapshot

Census Snapshot	0 min - 5 min	5 min - 10 min	10 min - 15 min
Total Population	55,910	175,040	335,155
Males	27,660	87,185	162,915
Females	28,250	87,855	172,240
2001 Population by Age	55,910	175,040	335,155
0 to 4 years	3,315	9,810	17,020
5 to 19 years	8,995	24,530	47,625
20 to 24 years	3,300	11,345	22,480
25 to 34 years	10,640	37,295	66,195
35 to 44 years	11,565	35,270	60,505
45 to 54 years	8,130	24,850	45,325
55 to 64 years	4,125	14,220	29,595
65 to 74 years	3,290	9,850	24,360
75 to 84 years	1,970	5,895	16,160
85 years and over	580	2,020	5,815
Average age of population	36.3	36.8	38.5
Median age	36.4	36.2	37.2
Dominant age group	35 to 44 years	25 to 34 years	25 to 34 years






- ### Is this a Good Practice?
- 3 FTE Veterinarians
 - 6 RVT's
 - 4,000 square foot, ten year old facility
 - Featured in Vet Economics
 - Latest of technology
 - Laser surgery
 - Ultrasound
 - Digital X-ray



- ### Is this a Good Practice?
- 1 FTE Veterinarian
 - 3 total staff (non-RVT's)
 - 1,600 square foot, twenty year old facility
 - Never heard of the practice
 - Refers advanced work-ups

Can't Tell from the Outside

<ul style="list-style-type: none"> • 1 FTE Veterinarian • 2,000 Clients • Revenue = 800,000 • Revenue/Client \$400 • Annual Inv. 5,400 • Ave. Inv. \$148 	<ul style="list-style-type: none"> • 3 FTE Veterinarians • 3,500 Clients • Revenue = 1,800,000 • Revenue/Client \$514 • Annual Inv. 10,500 • Ave. Inv. \$171
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Success





Can't Tell from the Outside

<ul style="list-style-type: none"> • 1 FTE Veterinarian • 2,000 Clients • Revenue = 800,000 • Revenue/Client \$400 • Annual Inv. 5,400 • Ave. Inv. \$148 	<ul style="list-style-type: none"> • 3 FTE Veterinarians • 3,500 Clients • Revenue = 1,800,000 • Revenue/Client \$514 • Annual Inv. 10,500 • Ave. Inv. \$171
<ul style="list-style-type: none"> • Adjusted Operating Profit • \$200,000 • Practice Value • \$700,000 	<ul style="list-style-type: none"> • Adjusted Operating Profit • \$200,000 • Practice Value • \$700,000



What Propels the Trends

- Management experience of private practitioners
 - High density appointments
 - One stop shopping
 - Bigger is better
- Consultants
 - Every practice needs a practice manager
 - Managing to industry standards
 - Don't have veterinarians do what technicians can do
- Industry
 - Pet food sales
 - In House Lab
 - Toys (ultrasound, digital x-ray)



Success

