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Which Deal Structure is Right for You?

Deal Structures in the Veterinary Market

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Joint Ventures

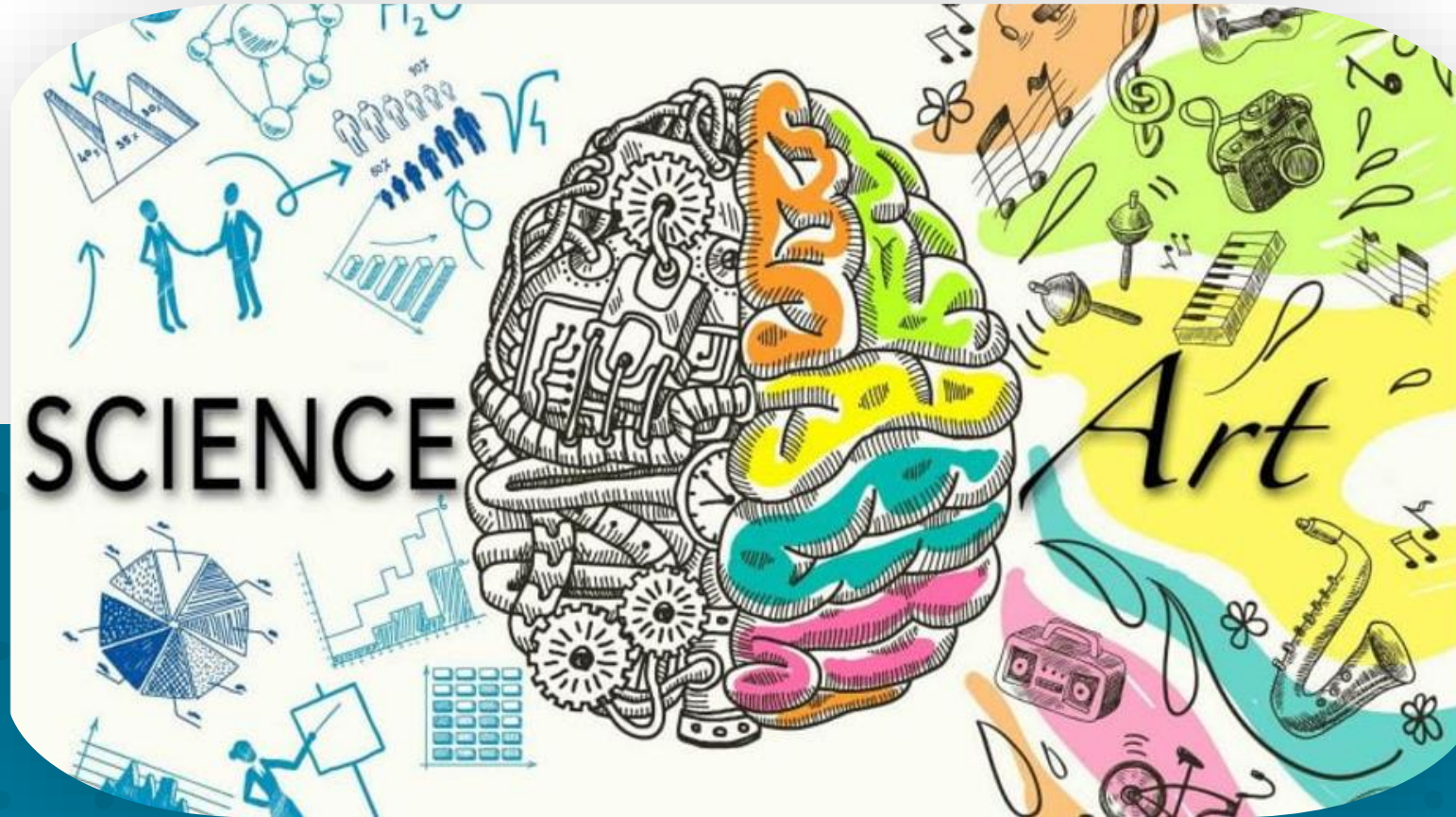
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Earnouts & Contingent / Seller Notes

1 The Art and Science of Valuation





The Science of Valuation

Hospital Valuation =

TTM Normalized EBITDA x
Multiple

What is Normalized EBITDA?

- › EBITDA adjusted to eliminate the costs that would **NOT** be there and leaves only costs that would be there with a corporate owner

Addbacks:

- › Personal: Auto, life insurance, family on the payroll, travel
- › Capital Expenses: New equipment, building improvements
- › Advisors: Accountant, lawyer, business consultants
- › and... MORE!

Additional expenses include benefit costs that may be lower with an individual owner than a corporate owner (401k match, health)

The #1 Biggest Mistake Sellers Make

Sending prospective buyers your P&L and letting them determine your TTM Normalized EBITDA

The "Art" of Determining the Multiple a Practice Receives?

PRACTICE CHARACTERISTIC	BELOW MARKET MULTIPLE	MARKET MULTIPLE	ABOVE MARKET MULTIPLE
Annual Revenue Growth	Under 5%	5-10%	10%+
Annual Revenues	Under \$2.0 Million	\$2-3 Million	\$3.0+ Million
Geography	Rural /Small Town or Slow Growing Cities	Average Growing City or Suburb	Fast Growing/ Gentrifying Areas
Demographics	Modest or Lower Income	Moderate Income	High Income
DVM Concentration Risk	1 DVM Produces 40% of Revenue (3 DVM Practice)	Biggest Producer is 30-40% (3 DVM Practice)	DVMs are Equal Producers
Staff Turnover	High Turnover	A Core of Stable Long-Term Staff	75% of Staff are Long-Term Employees
Building Capacity	At Capacity, Hard to Grow Revenues	Ability to Grow Revenues 14-40% without adding space	Grow Revenues 50%+ Without More Space
Building Design	Dated, Client-Facing Areas Need Remodel	Space looks reasonable for the demographics	Freshly Remodeled or Recently Built Out Space
EBITDA Margins	Below 14% or Above 30%	14-19%	19-25%

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Deal Structure Overview

Common Deal Structure Elements Today

What does it all mean?



Cash



**Joint
Ventures**



**TopCo or
Private Equity**



Earnouts



**Contingent or
Seller
Notes**



The Right Terms: Financial

Deal Structure	Betting on Yourself	Betting on the Buyer
TopCo Equity		✓
Joint Venture	✓	
Both TopCo Equity & Joint Venture	✓	✓
Earnout	✓	
Contingent Notes	✓	
Seller Notes		✓



Cash offers less frequent & lower amount of cash currently



Private Equity TopCo -- participation at the parent company level but illiquid and no cash flow



Joint Venture -- More leadership/investment at the practice level and continued cash flow



TopCo, JV and Earnouts -- Possible associate/staff involvement:

Joint Venture vs. TopCo Equity

TopCo Equity is owning a portion of the Parent Company – which is buying many hospitals



Parent Company -- Buyer

Joint Venture is owning a piece of your individual hospital(s)



**Seller's
Hospital(s)**

**Another Hospital
owned by Buyer**

**Another Hospital
owned by Buyer**

TopCo/JV Investment Uses



TopCo & JV –
Majority of current
buyers use one of
these structures



90%+ of current
transactions



Lowers risk for
companies as
higher multiples
increase risk

- Helps ensure continued engagement on part of seller
- Less cash paid upfront



Ability to
include key
associates/staff

- Lower risk longer

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Joint Ventures

Joint Ventures



Continuing investment in the existing practice - something which you already own!

- Lower risk than current risk level? Sell 60%-80% & retain 20%-40%



Governance -- Minority owner rights?

- Do you have veto rights on some big decisions?
- Do you have NO rights?



Put / Call Rights

- How do you exit your JV ownership?



Management fee/
Other fees - disclosure.

- Do they apply on earnout/exit?



Quarterly profit distributions



Tax-deferred investment structure



Likely subordinated to company debt



Management duties:
Company

Veterinary duties: Seller

Joint Ventures

Put/Call Options:
Future right to buy/sell
the remaining portion



Multiple?



Discount?



Floor?

Seller

- Time-based or recap tag along?
- Valuation? How Paid?
- Minimum or maximum time frames?

Buyer

- Time based?
- Repurchase rights at exit?
- Drag along?

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TopCo Equity

TopCo Equity Structure

- Pre-tax contribution to veterinary company LLC
- Ownership interest in parent veterinary company
 - Minority owner – along for the ride
 - PE owner sets values and exit timing
- Diversification into multiple practices
- Debt
- No cash flow
- Capital calls?
- Non-compete terms? Sellers and associates with equity

TopCo Equity Structure



Multiple Share Classes?

- **Common**
- **Preferred** (sometimes more than 1)
 - Interest rate or hurdle?
 - Participation?
- **Management – Time-based or performance-based? Hurdle?**
- **Waterfall – prioritized returns**
 - Capital stack has different risk levels and should have different returns.



Valuation

- **Company discretion**
 - What are you being paid and what are you paying? Closer is better.
- **Discount to company multiples**
- **Updated regularly**

TopCo Equity Structure



Put/Call Options: Future right to buy / sell the equity

- **Buyer Options**
- **Seller Options** – Tag Along
- **Valuation? FMV or discount. Timing?**
- **Multiple?**
 - Current market multiples
 - Hospital level multiples
 - Discounts for bad acts?



Rollover Rights

- **Required vs Optional**
- **Valuation**

TopCo Equity Returns

Time sensitive. Earlier stages may be better return

- Risk level higher
- Duration typically increases returns, longer investment = greater returns (but illiquid)






Size sensitive returns

- Smaller has greater percentage growth
- Faster percentage growth may = higher return
- Larger more stable = lower growth / risk

Historical 30%-400%. Likely lower now as values higher and growth lower.

Joint Venture vs TopCo Equity

Summary

	Joint Ventures / Co-Ownership	TopCo or Private Equity
 Investment / Ownership In	Your Clinic(s) as a minority partner	Buyer or parent company. May be multiple share classes
 Cash Flow Characteristics	Monthly/quarterly cash distributions based on net clinic performance. Shared expenses + WC/FF&E	No Distributions
 Value Creation	With growth in EBITDA of your clinic(s). Lower returns vs PE.	Parent company success = your success. Higher returns.
 Risk Profile	Lower risk as local DVM you have some control/influence over success. Minimal practice level debt.	Higher risk and virtually no control over returns. Significant leverage.
 Exit Options	Depends – sometimes have tag along rights or a Put/Call Option	When current investor sells - no control by practice seller

Joint Venture vs TopCo Equity

Summary

	Joint Ventures / Co-Ownership	TopCo or Private Equity
 Investment at time of Sale	Pre-Tax dollars, no taxes until sell the retained ownership in hospital	No taxes until the parent company is sold
 Prevalence of the Structure	Several focus on/require this strategy -More will do in certain circumstances	Widely utilized by almost all – 90%+ of companies
 Ability to Include Key Associates	Yes. May need to borrow \$\$ for buy-in (Buyers/Sellers can lend to them)	Yes. Taxable at grant if equity has current value (most do)
 Recapitalization – Retention/Rollover	Illiquid until Put/Call Option exercise	Illiquid until company sale

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Earnouts & Contingent / Seller Notes

Earnouts

- Less Common Today
- Specific Situations Include:
 - Consistent above market (10%+) revenue and EBITDA growth
 - Recently hired DVM (full impact is not in the financials)
- EBITDA or Revenue-Based
- Multiple Applied to EBITDA growth?
- Maximum Payout or No 'Cap'
- Timeframe – One Year Measurement Period
- 100% Sales or JVs?

Contingent and Seller Notes



Contingent Notes

- **REV or EBITDA hurdle to achieve**
- **Paid out over multiple years**
 - Annual payments, not guaranteed
 - If miss a year, usually have 'catch up' provisions
 - Includes interest
- **Retention tool to ensure employment contract compliance**
- **Payout period** – employment commitment
- **Guarantor?**



Seller Notes

- **No economic targets**
- **Require continued employment**
- **Monthly or annual payments**
 - Priority of payment if issues with buyer?
- **Guarantor?**
 - Priority of payment if issues with buyer?

Deal Structure Summary

Veterinarians typically have:



Limited knowledge of complex deal structures
(anything but cash 😊)



Limited ability to analyze Options



Limited information on private companies



Companies regularly pitching them



Speculated incredible/hyped past/future JV/PE returns



So, what to do?

Take your time, get educated, understand market & get professional advice relevant to the task

Focus on your priorities

Understand the risks and returns are variable

Understand what you are agreeing to/investing in.



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Thank You!

Do you have any questions?

