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A Step-by-Step Guide to Selling Your Veterinary Practice to a Corporate Consolidator

The trend of veterinary practices being acquired by corporate consolidators has gained significant momentum in recent years, reshaping the landscape of the veterinary industry. The following guide is designed to provide practice owners with key insights and considerations to help them navigate the complex process of selling their veterinary practice to a corporate buyer.

1. Going to Market

For those practice owners who are interested in seeking out offers from corporate consolidators, engaging an experienced veterinary broker can be very helpful in taking your practice to market. A veterinary broker will calculate your practice's Earnings Before Interest, Taxation, Depreciation and Amortization (EBITDA), which is what corporate consolidators will use to determine the purchase price for your practice. A broker will present your practice's EBITDA level and communicate its growth potential to various corporate buyers in the industry, which can create a bidding process among buyers to maximize value. Corporate consolidators will typically make their offers based on a multiple of this EBITDA level.

Once you have received your offer (or ideally, multiple offers), your broker, accountant, and legal team will all be important resources in negotiating the terms of the offer and deciding which is best suited to your personal and professional goals. Offers typically come in the form of an offer letter or non-binding letter of intent, both of which will outline the general terms of the offer. Once you sign this document to accept the offer, you will likely be prohibited from exploring potential deals with other buyers.

2. Understanding the Offer

In initially assessing an offer, it is important to remember that, while many corporate consolidators were previously offering all cash deals with the full purchase price was paid at closing, buyers now often make more complex offers. Offers given now typically provide for some of the purchase price to be paid in cash at closing, with the remaining portion of the purchase price to be paid in the form of equity (stock or membership units), a promissory note, and/or earnout payments.

- **Equity** – If your offer provides for a portion of the purchase price to be paid in the form of equity, that equity will likely come in the form of either (A) a small, passive interest in the buyer's parent company (often called "TopCo equity"), or (B) a more significant, active investment in a new entity owned partially by your practice entity and partially by the consolidator (a "joint venture"). As an owner of TopCo equity, you will likely not receive any payments in connection with that equity until the consolidator undergoes a recapitalization event (i.e., a merger, IPO, debt restructuring, etc.). On the recapitalization event, you will receive a payment based upon what the consolidator receives for its entire business (meaning all of the practices it owns). Equity in a joint venture, however, will often entitle you to intermittent distributions of the profits generated by the joint venture over time, but you will not participate in the profits of other practices owned by the consolidator. Upon a recapitalization event, you will only participate in the proceeds received by the consolidator that are associated with your joint venture. Regardless of the form of equity you are offered, most consolidators will significantly limit your ability to sell or

otherwise transfer your equity outside of a recapitalization event.

- **Promissory Notes** – Another popular approach is for consolidators to pay some portion of the purchase price in the form of a promissory note, which allows the buyer to pay you in a series of installments or deferred payments as opposed to a lump-sum. The frequency and duration of payments and interest rates under these promissory notes varies depending on the consolidator and terms of the particular deal.

- **Earnouts** – Additionally, some corporate buyers will offer you a portion of the purchase price in the form of an earnout, which is a contingent payment structure that ties the payment of a specified portion of the purchase price to the practice achieving certain predetermined performance milestones after the sale. If your offer contains an earnout, it is important to note that these earnout targets can be difficult to achieve, and, even if your practice exceeds the prescribed milestones, you will not receive any earnout payments until the agreed-upon earnout period has expired.

In addition to the purchase price, it is also important to consider other factors when you are assessing your offer, such as the terms of your post-closing employment agreement, the mile radius and length of time of your non-compete, the amount of any retention bonuses offered to your associates and, if you own the property your practice is located on, the proposed terms of a lease or real estate acquisition.

3. Preparing for Due Diligence

Once you have chosen an offer and committed to a corporate buyer, the buyer will begin to perform comprehensive financial and legal due diligence on your practice. It is worth noting that the due diligence process is significantly more exhaustive when selling to a corporate consolidator as opposed to an associate or another practice owner.

- **Financial Due Diligence** – On the financial side, the buyer's accountants will perform a "quality of earnings" (QoE) analysis, which is a thorough examination of a practice's financial statements to assess its financial health and the accuracy and sustainability of its reported earnings. Your practice's accountant will be instrumental in helping you through this process. Buyers typically request historical financial statements, including income statements, balance sheets, and cash flow statements for at least the past three years, as well as detailed breakdowns of revenue, sales data, and operating expenses. The buyer's accountants will look at the practice's accounts receivable, accounts payable, and inventory to assess the efficiency of the practice's working capital management. Corporate tax returns, tax provisions, and related documentation are also requested to assess the practice's tax positions and potential liabilities.

- **Legal Due Diligence** – On the legal side, your attorney will be instrumental in helping you gather the requested documents. Buyers will want to see all corporate documents of the practice, including articles of

incorporation or organization and bylaws, shareholders' agreements or operating agreements. Buyers will request copies of the licenses held by all veterinarians and licensed veterinary technicians at the practice, facility permits, as well as DEA and state registrations for controlled substances. You will be asked to provide copies of all written contracts, including agreements with clients, employees, independent contractors, vendors, and service providers, and you should be prepared to contact any companies you have loans or equipment leases from, as any debt will likely need to be paid off in full at closing. You should also be prepared to provide copies of your insurance policies and employee benefit plans, and you will be asked about any ongoing or past litigation.

4. Understanding the Contracts

When selling to a corporate buyer, there will be various agreements for your attorney to negotiate that will define the terms, conditions, and relationships among the involved parties. The specific agreements may vary depending on the structure of the transaction and the preferences of the specific buyer you have chosen, but you can be sure that your transaction will include some combination or variation of the following documents:

- **Asset Purchase Agreement (APA), Stock Purchase Agreement (SPA), or Membership Interest Purchase Agreement (MIPA)** – Regardless of the structure of your transaction, there will be a purchase agreement that will specify the terms and conditions of the purchase of your practice's assets (in the case of an APA, which is the most common approach) or your practice's stock or ownership interests (in the case of an SPA or MIPA). In an APA, the buyer will purchase specific assets and liabilities of the business, which can include tangible assets (e.g., equipment and inventory) and intangible assets (e.g., contracts, goodwill, and intellectual property). On the other hand, in an SPA or MIPA, the buyer will acquire your stock or membership interests in the practice, making them the new owner of all the assets and liabilities of the business. While an asset purchase can specifically exclude any unknown liabilities from the purchase, a stock or membership purchase includes both the assets and liabilities expressly stated in the agreement and any hidden or unknown liabilities. The APA, SPA or MIPA is where the structure of your purchase price will be laid out, and there will be several ancillary documents attached to the purchase agreement which will function to transfer the assets or stock/ownership interests (i.e., a Bill of Sale, Assignment and Assumption Agreement, Intellectual Property Assignment Agreement, etc.).

- **Disclosure Schedules** – Regardless of the structure of the transaction, you will be required to make significant representations and warranties on behalf of the practice in the purchase agreement, which are statements that provide assurances to the buyer regarding

the current state of affairs or the condition of certain aspects of the practice. Any representations and warranties you make are expected to be truthful and accurate at the time they are made, and if a representation or warranty turns out to be untrue and it results in financial loss or damages to the buyer, you may be required to indemnify (compensate) the buyer for any losses suffered. Many of these representations and warranties will be qualified in the "disclosure schedules," which are attachments to the purchase agreement where you will provide additional information about the practice to supplement the representations and warranties you will make in the purchase agreement. Your attorney will be able to negotiate the language in the purchase agreement to make sure that you are protected and will review these representations and warranties with you so that you can be sure you are disclosing everything that needs to be disclosed in the disclosure schedules.

- **Employment Agreements** – Unless your offer contemplated immediate retirement, corporate buyers typically require practice owners to continue working at the practice for several years post-closing, devoting a similar number of clinical hours to the practice post-closing that you were working pre-closing. Your associates will also need to execute employment agreements with the buyer and may elect to hire their own attorney to help them negotiate their employment agreement. Most employment agreements from corporate buyers still incorporate a non-compete clause, which restricts the employee from competing with the buyer within a defined geographic area and for a specified duration. Any written employment agreements you have with your non-DVM employees will either be assigned to the buyer at closing or will be terminated so that the buyer can immediately hire any transferred employees effective as of the closing date.

- **Lease Agreement or Assignment** – Regardless of whether you own the practice real estate or lease the location from a third-party landlord, there is typically a leasing component in sales to corporate buyers. If you own the real estate, there will be a lease between you or your entity that owns the real estate (as landlord) and the corporate buyer (as tenant). If you lease the real estate from a third-party landlord, the buyer will typically request an assignment of that lease, which will often be accompanied by an amendment to adjust the lease's terms to better suit the buyer's needs. If you lease your location, it is important to have an open line of communication with your landlord early on in the sale process to help facilitate the lease assignment.

- **Joinder, Subscription and LLC Agreements** – In the event that you are receiving any equity as part of your deal (which often is issued to and held by the selling practice entity for tax purposes), the practice will be asked to execute a joinder or subscription agreement (or sometimes both) to memorialize the terms and conditions of the equity it is being issued. If you are receiving TopCo equity, these agreements will also require you to agree to be bound by the terms and conditions of the shareholders' agreement or operating agreement of the parent company you are receiving equity

in, and the terms and conditions of the parent company agreement are often non-negotiable. These parent company agreements are long and complex, so your attorney will be an important resource in explaining the restrictions you will be bound by during the period you hold your equity. In the event your transaction is structured as a joint venture, you and the buyer will need to negotiate an operating agreement, which will govern the relationship between your practice entity and the buyer entity and specify how the practice will be managed after closing.

5. Crossing the Finish Line

As the transaction progresses, the buyer will complete its due diligence and the transaction documents will be negotiated until both parties agree they are in final form. The buyer will propose a closing date, which is the day all the assets or stock/membership interests in the practice will be transferred to the buyer in exchange for the purchase price to be paid at closing. A few days prior to the closing date, the buyer's transition team will visit your practice to meet with your staff and set up credit card machines and other accounts in preparation for the transition. On the closing date itself, you and the buyer will exchange signatures to the transaction documents and the portion of the purchase price that is payable at closing will be delivered to you via wire transfer. Any expenses you have paid in advance of closing that apply to the period post-closing (i.e., real estate taxes, rent payments, monthly service payments, etc.) will be added to the purchase price as an adjustment. Because the name of your practice is sold to the buyer as part of the practice's intellectual property, buyers will typically require that you change the name of your entity immediately post-closing so that they can begin using the name themselves.

After the closing date, you will be paid as an employee pursuant to the terms of any employment agreement you signed, and any deferred payments or earnout amounts will be paid as set forth in the purchase agreement. If you received equity, usually your practice entity will continue to hold that equity until there is a recapitalization event or the consolidator exercises a repurchase option. You may receive intermittent distributions of the practice's profits in accordance with the operating agreement you negotiated, if your transaction was structured as a joint venture. If you are serving as the buyer's landlord pursuant to a lease agreement, you will be paid rent and will be responsible for certain maintenance and repairs under the terms of that lease. In the event that you retire or your employment with the buyer is otherwise terminated, you should alert your attorneys so that you can be sure you will be in compliance with any non-compete, non-solicit, and confidentiality covenants in the transaction documents you signed.

Selling to a corporate buyer can be an intimidating process for even the most business-savvy practice owner. This type of transaction is a marathon, not a sprint, and it is easy to get overwhelmed running a veterinary practice by day while responding to due diligence requests and reviewing transaction documents by night. Understanding the structure of the transaction and your role in the process is the first step in the right direction, and it is critical to surround yourself with the right team of advisors who will educate you and guide you through the process in a painless and efficient manner.

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