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ATTORNEYS & COUNSELORS AT LAW

PURCHASING/SELLING VETERINARY PRACTICES

Agenda

A. Motives for Purchase/Sale
B. Professionals to Involve
C. Timeline
D. Confidentiality Agreements
E. Letters of Intent
F. Due Diligence
G. Structuring the Transaction
H. Closing

A. Motives for <u>Sale</u> of Practice

1. Retirement
2. Health Issues
3. Financial Distress
4. Discord between Owners
5. Receive an Offer "To Good To Pass Up"

A. Motives for Purchase of Practice

1. Own Practice
2. Control Destiny
3. Financial Security
4. Add Value and Create Wealth
5. Acquire a Competitor

B. Professionals to Involve

The core participants in the Purchase/Sale process are:

1. Principal Owners of Buyer/Seller
2. Attorney
   - Business
   - Tax
   - Real Estate
   - Employment
3. Accountant/Tax Advisor
4. Appraiser
   - Practice
   - Real Estate
5. Banker

C. Timeline for Purchase/Sale

1. Due Diligence [30 Days]
   - Preliminary Discussions
   - Confidentiality Agreements
   - Buyer Conducts Due Diligence
2. Letter of Intent [14 Days]
3. Purchase Agreement [30 – 60 Days]
   - Due Diligence Continues
   - Seller prepares Disclosure Schedules
   - Sign Purchase Agreement
4. Finalize Transaction – Closing [30 Days]

D. Confidentiality Agreements

What is it?

- Agreement that restricts the use of the Seller's Confidential or Proprietary Information given to Buyer.
- Typically the first documents in the purchase/sale.

Why is it Necessary?

- Buyer needs to review the information to make an informed decision.
- Seller needs protection so Buyer does not improperly use Confidential Information.

D. Confidentiality Agreements (cont.)

Key Provisions

1. Identification of Parties
   - Business Entities
   - Owners
   - Key Managers
2. Identification of Third Parties who have access to Confidential Information
   - Attorneys
   - Accountants
3. Definition of Confidential Information
   - Client Lists
   - Financial Information

D. Confidentiality Agreements (cont.)

Key Provisions (cont.)

4. Nondisclosure regarding Transaction
5. Prohibition on Solicitation of Employee and Customers
6. Return of Confidential Information
7. Exclusive Dealing – "No Shop"
8. Provisions stating that the Confidentiality Agreement is binding and enforceable, including remedies for breach of Agreement.

E. Letters of Intent

What is it?

- A non-binding understanding that serves to frame the negotiations towards a definitive Purchase Agreement.
- An "Agreement to Agree."
- Contains the basic terms of the proposed deal.

Is it Necessary?

- No, parties often proceed directly to draft and negotiate Purchase Agreement.
- Alternative – one page Term Sheet

E. Letters of Intent (cont.)

- Advantages
  - Establishes basic deal terms
  - Sets a timeline for negotiation and due diligence
  - "No-Shop" Clause
  - May be necessary for financing
- Disadvantages
  - Can be costly to prepare/negotiate
  - Result in negotiation of too many details to early on
  - Could result in binding agreement if not careful

E. Letters of Intent (cont.)

What should the Letter of Intent Include?

- Pricing Mechanism (Purchase Price)
- Form of Transaction (Stock or Asset Purchase)
- Assets/Liabilities to be included in transaction
- Other
  - Confidentiality Obligation

F. Due Diligence

What is it?

- Investigation of the assets, liabilities, legal status, and various other aspects of the practice to be acquired.
- The overall goal is to confirm the value of the practice being acquired and analyze the pre-closing and post-closing risks associated with the purchase.
- Usually Buyer's attorney will prepare and deliver to Seller a detailed list of requested information and documents.

The due diligence review includes:

1. Buyer's Due Diligence
    - Financial and Tax Reporting
        - Financial Statements
        - Asset and Depreciation Schedules
        - Inventory Records
    - Organizational Documents
        - Articles of Incorporation
        - Bylaws
        - Shareholder Agreements
        - Minute Books

F. Due Diligence

1. Buyer's Due Diligence (cont.)
   - Employee Records and Agreements
   - Real Estate Records
     - Title Evidence
     - Leases
     - Phase I and Environmental Assessments
     - Property Tax Statements
     - Maintenance and Repair Records)
   - Litigation and Insurance Matters
2. Seller's Due Diligence
   - Whether Buyer has sufficient resources to close the transaction.

G. Structuring the Transaction

Three Basic Structures for Business Acquisition:

1. Asset Acquisition: Specific Assets of the Veterinary Practice are Purchased
   - Inventory
   - Medical and Office Equipment
   - Computer Hardware and Software
   - Client Lists
   - Goodwill
   - Accounts Receivable
2. Stock Acquisition: Owners of the Veterinary Practice Sell their Shares to the Buyer.
3. Merger

G. Structuring the Transaction (cont.)

Factors that drive the choice of structure:

- Tax Consequences
- Liability Risk

Buyers Prefer Asset Purchase

- Tax Reasons: Buyer can write-off, through depreciation, the various asset categories and obtain a more efficient cost of acquisition.
- Liability Risk: Buyer wants to purchase assets so they do not inadvertently assume undisclosed or unknown liabilities of Seller.

Sellers Prefer Stock Purchase

- Tax Reasons: Sale of stock is a capital transaction subject to lower capital gains rates.
- Liability Risk: If only assets are sold, Seller may remain responsible for satisfying existing liabilities and dealing with potential unknown liabilities.

G. Structuring the Transaction (cont.)

Tax Consequences and Price

- Buyer who obtains more favorable tax treatment is likely to pay more in total consideration.
- Seller who must pay taxes at ordinary income tax rates rather than capital gains will demand higher purchase price

G. Structuring the Transaction (cont.)

Asset Acquisition – Tax Treatment of Acquired Assets

1. Goodwill
   - Seller – Capital Gain
   - Buyer – Capitalize and amortize over 15 years
2. Covenant Not to Compete
   - Seller – Ordinary Income
   - Buyer – Capitalize and amortize over 15 years
3. Consulting/Employment Agreements
   - Seller – Ordinary Income subject to FICA
   - Buyer – Current Deduction

G. Structuring the Transaction (cont.)

Forms of Consideration

1. Cash is king
2. Promissory Note [Seller Financing]
   - Security Agreement
   - Personal Guaranty
3. Employment/Consulting Agreement
   - Actual services rendered and reasonable compensation
   - Covenant Not To Compete
4. Holdback or Escrow?

G. Structuring the Transaction (cont.)

Document the Transaction - The Purchase Agreement

1. Definition of Terms
2. Operative Terms
   - Price
   - Form of Consideration
3. Representations and Warranties
   - Representation and Warranties are historic looking statements about certain facts at a specific point in time
   - General Purpose:
     - Confirm buyer’s due diligence
     - Pre-closing right to walk if inaccurate
     - Post-closing indemnification.

G. Structuring the Transaction (cont.)

3. Representations and Warranties (cont.)
   - Knowledge and Materiality Qualifiers
   - Common Representations and Warranties of Seller
     - Incorporation/Ownership Structure
     - No Breach of Contracts, Permits or Licenses
     - No Undisclosed Liabilities
     - Good Title to Assets and Properties
     - Financial Statements
     - Environmental
     - Tax Matters
   - Common Representations and Warranties of Buyer
     - Incorporation/Ownership Structure
     - Authority
     - Financing
     - Financial Statements and Other Representations

G. Structuring the Transaction (cont.)

4. Disclosure Schedules (Exhibits)
   - Set forth exceptions to representations and warranties
   - Identify material agreements, permits, etc.

5. Covenants
   - Covenants are future looking; a promise or agreement to do something.
   - Pre-closing and Post-closing Covenants
   - Covenants of Seller
     - Conduct business in ordinary course
     - Provide buyers with access to business, books and records
     - Make necessary regulatory filings, obtain all necessary consents and approvals
     - Do what is necessary to carry-out the transaction

G. Structuring the Transaction (cont.)

5. Covenants (cont.)
   - Covenants of Buyer
     - Make necessary regulatory filings and obtain all necessary consents
     - Obtain necessary financing
     - Do what is necessary to carry-out the transaction
6. Conditions Precedent to Closing
   - Certain conditions must be satisfied by the parties prior to closing the transaction
   - Conditions Precedent to Buyer's Obligation to Close
     - Accuracy of Seller's representations ("Bring Down Certificate")
     - Performance of the covenants and obligations of Seller
     - Delivery of appropriate consents and appropriate documents
     - Absence of litigation and conflicting contractual obligations
     - Delivery of environmental report and resolution of environmental issues
     - Obtaining satisfactory financing

G. Structuring the Transaction (cont.)

6. Conditions Precedent to Closing (cont.)
   - Conditions Precedent to Seller's Obligation to Close
     - Accuracy of Buyer's representations and warranties
     - Buyer's performance of covenants and obligations
7. Termination
   - Provides either party with the right to terminate the agreement and walk from the transaction
   - Define how notice of termination is given and whether breaching party has opportunity to cure
   - Termination Rights
     - Mutual agreement
     - Breach of representation, warranty or covenant
     - Due-diligence out

G. Structuring the Transaction (cont.)

8. Indemnification Provisions
   - Allocates business risk and gives parties explicit remedies if a party suffers damage after the closing due to breach of representation, warranty or covenant.
   - Standard Indemnification Issues
     - Survival
     - Breaches that give rise to indemnification
     - Limitations on amount of potential indemnification, time limits for asserting claims, right of setoff, escrow of sales proceeds to cover potential claims
     - Rights with regard to third party claims
9. Confidentiality
10. General Provisions – notice, governing law, merger, ADR, assignments

G. Structuring the Transaction (cont.)

11. Ancillary Documents
    - Promissory Notes
    - Pledge and Security Agreements
    - Employment/Consulting Agreements
    - Escrow Agreements
    - Title Transfer Documents
        - Deeds
        - Assignment of Leases
        - Bill of Sale
        - Assumption of Liabilities
        - Assignment and Assumption Contracts
    - Assignment of Intellectual Property Rights
    - Title Transfer Documents
    - Certificate of parties' organizational documents and resolutions

H. Closing

1. Simultaneous sign-and-close transaction:
   - Signing of purchase agreement and closing occur at same time
2. Staggered sign-then-close transaction:
   - Purchase agreements signed and closing occurs later, after satisfaction of various conditions
3. Generally occur face-to-face but technology permits electronic closings
   - Contingencies have been met
   - Documents signed
   - Transfer of title to assets
   - Consideration is due

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