Veterinary Matters

DRIVING LIFELONG PROSPERITY

2017/18

SELLING YOUR VETERINARY PRACTICE

SIGN UP TO RECEIVE OUR BUSINESS UPDATES

Due to the new General Data Protection Regulation (GDPR) that comes into force on 25 May 2018, we need to confirm that you are happy to receive updates from us and that your details are correct.

SIGN UP/UPDATE ONLINE: **http://bit.ly/hazlewoods**

INSIDE

HAZLEWOODS

DRIVING LIFELONG PROSPERITY

Rapidly Changing Market

For veterinary practice owners that are considering selling, there are more options than ever before and valuations are buoyant. Is now the right time for you?

The market for buying and selling practices continues to change very rapidly. Understanding what changes are taking place and how you can make the most of these opportunities is crucial. Further corporate consolidation of the market is one trend, but there are many others. There is no substitute for taking up to date advice.

In this article, we focus on selling externally, although many of the principles apply to an internal change of ownership as well.

Taking the decision to sell one's practice is not one that will be taken lightly. If you are looking to sell your practice, you will understandably have lots of questions. Questions are good! There is no 'one size fits all' and whoever advises you should take time to listen to your desires for the sale, so that a plan can be tailored to suit you. Perhaps you would wish to ensure that not only do you achieve the best overall 'package' for yourself, but also that your staff are looked after and that your practice continues to thrive under new ownership. There are, of course, many other considerations.

VALUATION AND NEGOTIATION

Planning early for sale will always be beneficial and help to ensure that you are in a strong position when it comes to negotiating with potential purchasers. This can take many forms, but should include:

- → Taking advice on what attracts purchasers and how you can position your practice to achieve the best package for you;
- → Which purchasers buy which type of work. There are now more options for mixed practices, as well as those that focus solely on Small Animal, Farm or Equine work;
- → Understanding how practices are valued and how to enhance your practice value;
- → Tax planning;
- → and much more.

EBITDA is the main valuation approach for external sales and is a form of adjusted profit. Turnover is sometimes considered to 'sense check' the EBITDA valuation.

EBITDA stands for **E**arnings (i.e. profit) **B**efore (i.e. we are now going to make some adjustments to profit) **I**nterest, **T**ax, **D**epreciation and **A**mortisation.

A multiple is then applied to EBITDA to calculate a Gross Enterprise Valuation (GEV), which normally equates to the price a purchaser is happy to pay for goodwill and equipment (and sometimes leasehold improvements and practice vehicles).

Care needs to be taken when reviewing offer letters to check how potential purchasers have defined GEV. How leasehold improvements and vehicles are dealt with needs to be reviewed and this is all part of the negotiation. If a practice has high end equipment, such as a CT or MRI scanner, this also needs to be considered carefully and negotiated into the overall valuation as appropriate.

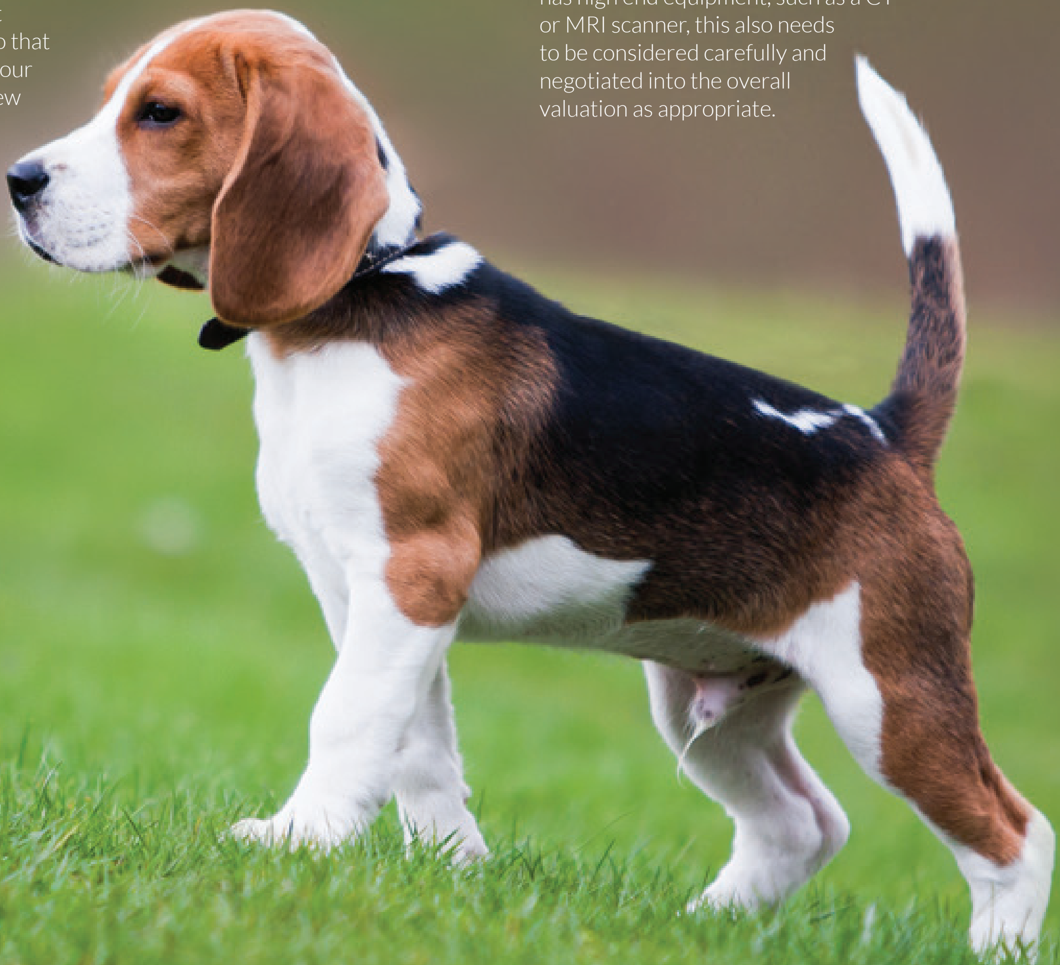


TABLE 1 - EXAMPLE EBITDA AND SHARE PRICE

	£	£	Notes
Profit before tax		409,120	
Plus:			
Interest payable		8,915	
Depreciation		17,284	
Amortisation		25,000	
Directors' remuneration		24,180	
Directors' pension contributions		32,000	
One off costs in P&L account:			
Redecoration of reception	9,127		
Legal fees re. new lease	2,866		
		11,993	
Private costs in P&L account:			
Motor	4,280		
Private medical for directors	2,634		
		6,914	
Less:			
Rent for main surgery		–	1
Rent for branch		(15,000)	2
Notional salaries and employer's NI for owners		(207,149)	3
EBITDA		313,257	
Multiple (varies, illustrative only)		10	
Gross Enterprise Valuation		3,132,570	
Other assets less liabilities (e.g. illustrative per phase 3 of sale process section below)		80,500	
Share price (before tax)		3,213,070	

Notes

1. No adjustment as full market rent currently paid
2. | | |
   |---|---|
   | Market rate | 40,000 |
   | Rent per P&L account | (25,000) |
   | EBITDA adjustment | 15,000 |
3. | | |
   |---|---|
   | Market rate salary, owner 1 £65,000 + employer's NI | 72,843 |
   | Market rate salary (part time), owner 2 £40,000 + employer's NI | 44,393 |
   | Market rate salary (undertakes some referral work), owner 3 £80,000 + employer's NI | 89,913 |
   | | 207,149 |

Table 1 shows an illustrative example of GEV based on an EBITDA multiple of 10.

Multiples vary and in addition, what was an appropriate multiple last month is not necessarily an appropriate multiple today. The market has and continues to change rapidly, particularly in this area. Multiples can differ for Small Animal, Equine and Farm work.

In addition, small changes made at the practice often have a significant impact. Imagine that the practice in Table 1 has 7 FTE vets (including the owners) and that upon investigation, the non-IV injection fee has been under-priced by £1.50 (excluding VAT) for some time. If we say that each vet charges 4 injections per day (it could be significantly more!), then with, say, 280 working days per vet per annum for this practice, the impact on the EBITDA of realigning this injection fee would be:

Price increase	£1.50
Number of injections per day per 1 FTE vet	4
Number of FTE vets	7
Number of working days per annum	280
Increase in EBITDA	11,760
Multiple (illustrative only)	10
Potential increase in GEV	£117,600

In this example, a simple price repositioning is shown to have a potential increase on the GEV of £70,560. Such simple adjustments can in reality make a significant difference if they are appropriately undertaken. Clearly the timing of such alterations is important so that the impact of the changes has time to flow through in to the figures presented to the potential purchasers.

More often than not, purchasers in external sales buy based on most recent trading, which is typically an EBITDA based on the most recent year end accounts. Therefore, strong performance in that year is important. That said, purchasers will wish to satisfy themselves that the results are sustainable and one way they will do this is to monitor how the practice has been performing since the most recent accounts. An upward trend is preferable and therefore, up to date management accounts information will be reviewed. Declining turnover post year end is likely to make potential buyers nervous. This review will form part of their due diligence process which is explained in more detail below.

Whatever EBITDA is presented it needs to be able to stand up to scrutiny so that it is credible. Simply providing sets of accounts without any further information is not sufficient information to give an accurate valuation.

All too often the approach to calculating EBITDA and the multiple is seen as being formulaic, but without delving into the detail of a practice, it is not possible to come up with an appropriate valuation.

Areas of particular interest, naming just a few, include:

- Mix of work (i.e. Small Animal, Farm, Equine (ambulatory/hospital), mixed, first opinion, referral versus first opinion);
- Competition;
- Financial performance since the year end end and how this may continue in the future (the 'run rate');
- Gross profit margin;
- Staffing levels and costs;
- Property market rental values – up to date property valuations may be required from a qualified property valuer;
- Dependence on owners (which might also impact on the length of transitional working as an employee post completion), owners' working time and preferences regarding transitional working;
- Private costs;
- Non-recurring expenditure etc.

IDENTIFYING BUYERS

It is worthwhile your adviser identifying competitor practices for you on a map, i.e. whether independent or corporate and who they are, as this helps identify how your practice may 'fit' strategically with different potential purchasers. This may affect how purchasers negotiate. Being supported in negotiations and understanding the particular nuances involved in the process and differences between purchasers is invaluable.

BEST 'PACKAGE' FOR YOU

We have referred to the 'package' achieved upon sale a number of times. What we mean is that when considering selling, it is not just price that is important, rather the whole package, including:

- Timing of receipt of the capital from the sale of the practice (and property if applicable), and will you receive all of the capital in one amount, or whether there will be any form of deferred payment or 'growth bonus';
- Any reinvestment and/or partnership opportunities that may be available;
- How the structure of the sale affects your tax position;
- The rent that you will receive if you own the properties from which the practice trades and on what terms, e.g. length of lease, type of break clauses, timing of rent reviews, who insures, repairs and maintains etc.;
- Your salary if you continue to work for the practice following the sale. This is a sensitive area as a higher salary means a lower EBITDA (and potentially lower GEV) and the pros and cons of both need to be weighed up. Alternatively, you may prefer to work a minimum transition period. A buyer will consider what are realistic, sustainable salary levels;
- Other terms of employment, e.g. holiday, CPD allowance etc.

Valuation is a complex and ever changing area and it pays to take advice. A sound understanding of all the different aspects of valuation greatly helps you and your adviser when negotiating.

STRUCTURE: THERE IS MORE TO IT THAN JUST GOODWILL AND EQUIPMENT!

It is also worth dispelling a myth: the value of your practice is not just the value of goodwill and equipment. It will also comprise the value of its assets, for example property (if owned), stock, cash, debtors, as well as its liabilities, such as amounts owed to suppliers, HMRC and loans etc. These need to be considered in addition to the GEV.

If you trade as a sole trader, partnership or LLP, then typically an external purchaser would buy goodwill, equipment, stock and sometimes debtors. This is known as a 'trade and asset' sale. You would retain ownership of the other assets, e.g. cash and use these to settle the liabilities up to the date of completion.

If you trade as a company, more often than not, a purchaser would buy the shares in your company plus the value of any directors' loan accounts would also be paid (or repaid if there are overdrawn directors' loan accounts). This is known as a 'share sale'. When selling shares, the new owner takes on everything, i.e. all assets and liabilities, not just goodwill, equipment and stock.

The vendor's tax position on sale will often drive the structure and whilst the above are typical ways of structuring sales, alternatives, such as a trade and asset sale out of a company, followed by a company liquidation are sometimes appropriate.

Structure and valuation go hand in hand and any advice taken should explain how these two areas interact and what it means for you in terms of after tax, cash in your hand.

Sales Process

As noted above, there should be no 'one size fits all' when it comes to selling. However, there is a typical sales process that is followed, which is illustrated below.

PHASE 1	PHASE 2	PHASE 3	PHASE 4	PHASE 5
Preparation for sale	Information memorandum	Offers	Due diligence	Drafting of sale and purchase contract and other legal documents
What to sell	Approaches	Shortlisting	Practicalities	Completion
Valuation	Meeting up with potential purchasers	Negotiation		Completion accounts/ apportionments
		Sale agreed		
		Heads of terms		

PHASE 1

This starts with preparing for sale and deciding what to sell (i.e. structure). Starting this process at least two years in advance is ideal.

Working with an adviser to calculate the practice EBITDA and assessing its valuation (as considered above) will set a benchmark to help you and your adviser to assess offers.

PHASE 2

An Information Memorandum (IM), also known as a Sales Memorandum is a document that is normally prepared by your adviser to give potential purchasers an insight into your practice to enable them to consider whether they would like to make an offer to purchase it.

An IM would typically include the following:

- A brief history and background of the practice;
- How you wish potential purchasers to make their offers and by when;
- Copies of accounts, summary of financial performance and a detailed EBITDA;
- Details about the facilities and equipment including practice property and whether the property is for sale or a lease is offered;
- Pricing;
- Key suppliers;
- Practice photos.

Before the IM is made available to potential purchasers, it is wise to put confidentiality agreements (also known as non-disclosure agreements) in place. Your adviser would normally help with this.

Having received the IM, it may be that interested parties will wish to visit your practice to see it first-hand. It can work well to do this out of hours to minimise disruption. Sometimes potential purchasers prefer to make an offer first.

Sometimes there may also be a separate meeting with your adviser and each potential purchaser to discuss your practice and explore the IM and financial aspects in more detail.

PHASE 3

Having received offers, you will need to shortlist them, if there are more than one, before deciding with whom to proceed to the next stage. The preferred buyer is then selected, thereby agreeing the sale in principle.

Your adviser should be interpreting the offers for you. There is no substitute for understanding what the offer means in terms of after tax cash in your hand, as well as discussing the other terms of the offer.

An example of an area that can often cause confusion is where an offer letter for a company share sale refers to an offer being on a 'debt free, cash free basis', say, with a £3,132,570 for GEV (in practice a buyer may round this figure a little). Ordinarily this means that £3,132,570 for goodwill and equipment would be paid plus the overall net value of the company's other assets and liabilities (e.g. debtor, stock, cash, amounts owed to suppliers, HMRC, loans etc.) also known as net assets.

Therefore, if the net value of the other assets and liabilities is £80,500 (i.e. the value of the assets exceeds the value of the liabilities), then the price paid for the shares would be £3,213,070 (being £3,132,570 plus £80,500) as shown in Table 1 earlier.

If instead, the value of the other assets and liabilities is negative £60,300 (i.e. the value of the other assets is less than the value of the liabilities), then the price paid for the shares would be £3,072,270 (being £3,132,570 less £60,300).

As noted above, Directors' loan accounts in companies would also be paid or repaid.

Whilst the GEV is typically fixed, the value of the other assets and liabilities will vary over time. This is where completion accounts (in the case of a company share sale) and apportionments (in the case of a trade and asset sale) are prepared to deal with this. This is covered off at phase 5 overleaf.

Deferred payments may form part of a purchaser's offer; this is where some of the GEV is deferred and paid at a later date. This may be contingent on, for example, the owners working a particular length of transition period as employees, or turnover being at least at its previous year's level. Sometimes there may be additional payments if growth targets are met post completion.

Once a sale has been agreed in principle, it is highly advisable for heads of terms to be prepared. This document sets out the main agreed terms between you and the buyer, helping to ensure clarity of understanding before time and money is spent on advancing the sales process further. The level of detail will depend on the size and structure of the deal. It can often be appropriate to put worked examples into the heads of terms to set out how the purchaser's offer level translates into figures as regards price.

The heads of terms are signed by both you and the buyer.

Depending on who the buyer is, sometimes a buyer's offer letter may be sufficiently detailed that it is taken to be the heads of terms, with you signing at the bottom of the offer letter to indicate that you agree with the terms of the offer.

The heads of terms will normally refer to a period of exclusivity, the length of which can vary. During this exclusivity period, the purchaser will wish to undertake due diligence (phase 4) in the knowledge that the practice should not be offered for sale to another party.

PHASE 4

Due diligence is a purchaser's investigation into the practice, frequently supported by their advisers. It can cover any aspect including financial, tax, employment, legal and commercial matters. If you are selling the shares in a company, the due diligence process is normally more involved than if you are selling an unincorporated practice (i.e. sole trader, partnership or LLP), as with a company sale, the buyer would be taking over 'ownership' of the company's history and all assets and liabilities.

Due diligence can be a time consuming process for you as seller. It therefore pays to be prepared and ensure your practice records are in good order early, to make responding to the due diligence requests as smooth as possible and to avoid any unwanted surprises.

Your advisers, both on the financial and legal side, should be able to help you with any queries you may have on the due diligence questions and guide you through what is required.

In the sales process chart, practicalities are detailed as being part of phase 4, although arguably thinking about practicalities is part of every phase.

Staff are so important to your practice and ensuring that they are looked after as part of a sale is understandably towards the top of many owners' selling wish list. Discussing staff with the purchaser, including how and when the sale will be communicated to them, is a sensitive matter that needs careful consideration. Employment legislation (e.g. TUPE) needs to be considered with your solicitor as part of this.

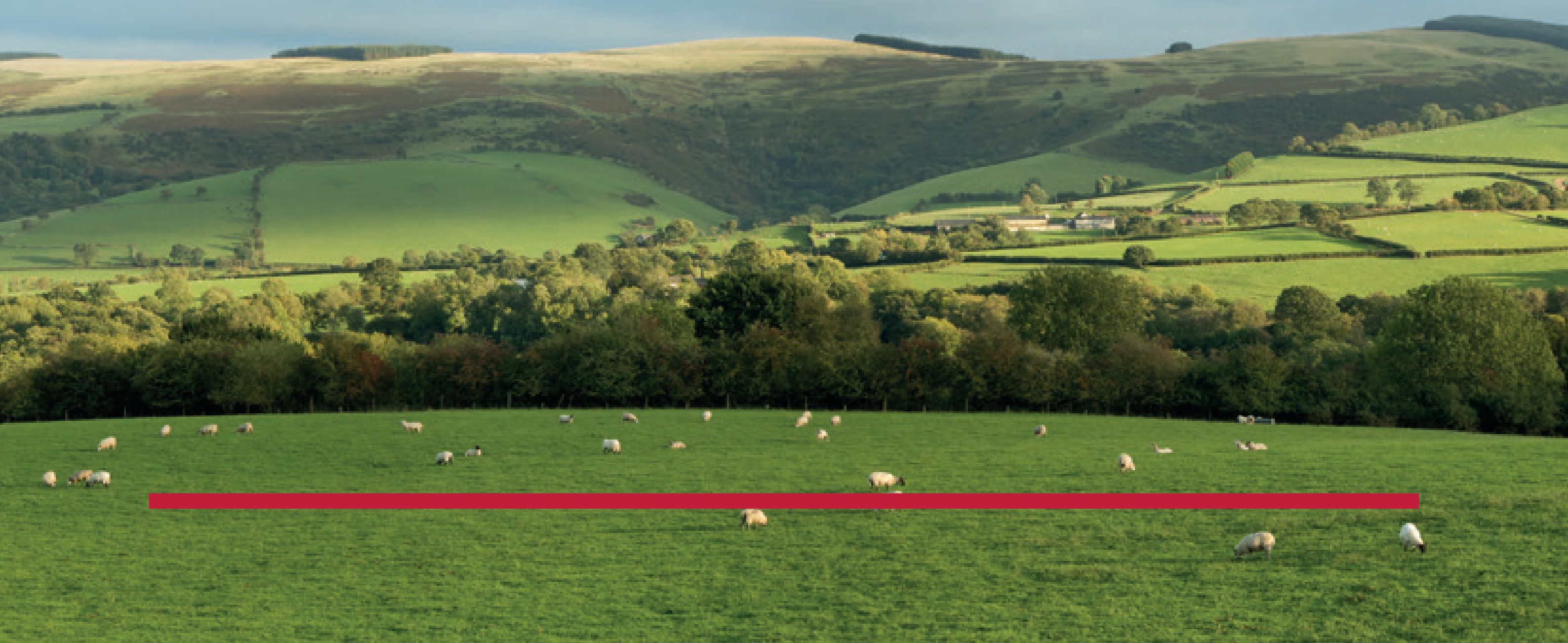
There are other practicalities to consider, such as:

- What to tell clients and when;
- When and how to best advise suppliers;
- Informing your bank;
- Whether and when bank loans are being paid off;
- Letting your insurers know;
- Planning for a stock take on the day of completion;
- Deregistering for VAT and PAYE (trade and asset sales);
- Reviewing your financial planning type policies, such as income protection, critical illness, private medical etc. as the terms of cover may be altered by your change in personal circumstances following the sale;
- Taking advice on what to do with the proceeds from sale.

PHASE 5

Following the successful completion of due diligence, legal documentation will be drafted by the solicitors in anticipation of the sale taking place on a proposed date. Normally the purchaser's solicitor will prepare the first draft of the legal documentation, for review by you and your advisers.

However the sale is being structured, there should be a sale and purchase agreement which sets out the terms on which the sale will take place. This agreement essentially puts meat on the bones of the heads of terms.



A sale and purchase agreement will typically include:

- Details of price, how this is constructed and when paid;
- The structure of the sale;
- Guidance on how completion accounts (share sales) or apportionments (trade and assets sales) will work in practice;
- Warranties, disclosures and indemnities. Warranties are factual statements regarding the state of the seller's business affairs at/before completion. Disclosures are a seller's clarification or exception regarding warranties. For example, a warranty may be that all equipment has been serviced up to date. Disclosure against this warranty may be that this is with the exception of the practice's X-ray machine which is overdue a service by two weeks, but that one is booked for four days post completion. Indemnities are promises to reimburse the purchase for a particular type of liability should it arise, for example, any unexpected tax liabilities coming to light after the sale, which relates to before the date of sale. This whole area is sensitive and requires close guidance on;
- Obligations of you and the buyer at the time of completion;
- Restrictive covenants, for example a clause stating that you must not practice or setup another veterinary practice within a particular distance from the practice being sold for a given number of years.

Once the sale agreement is in final form, completion can take place.

Practicalities for the day will need to have been considered in advance, such as ensuring the new owner has login details for online banking (if a share sale) and how the stocktake and valuation will be undertaken and by whom. There are of course considerations, many of which will be set out in the sale agreement.

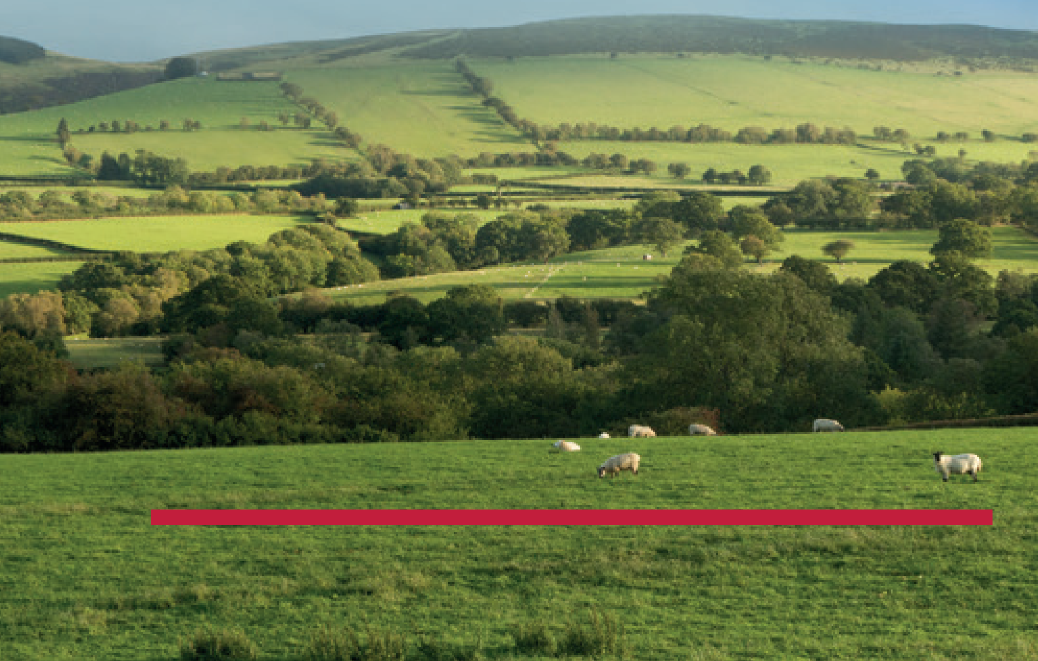
If you are staying on working at the practice post sale, typically you would have an employment contract which will need to have been drafted in advance and you would normally be paid through the payroll.

Completion accounts or apportionments will need to be considered.

Completion accounts are prepared with share sales to determine the actual value of the other assets and liabilities (separate to the GEV as touched upon above), so that the estimated value of these paid at completion can be settled upon based on their actual value.

Apportionments are prepared with trade and asset sales to settle up on the costs paid pre completion by the seller that relate to post completion, and costs paid post completion by the purchaser that relate to pre completion. They also allow other items to be settled up on, for example the actual stock and debtors (latter if being purchased) compared to their estimated values paid at completion.

Post sale, your accountant will also need to prepare your tax return and no doubt you would be wanting to continue to liaise with your Independent Financial Adviser as to how you may invest some or all of the proceeds from the sale.



SUMMARY

The market for selling veterinary practices is currently very buoyant with more options and opportunities than ever before. It is a rapidly changing market and there is no substitute for current advice.

At Hazlewoods, we can advise you on the whole process from your initial plan to sell, to post completion support. We know all the key buyers and understand how to support you with the nuances of valuation and negotiation, to help you secure the best possible package for you.

MEET THE TEAM WHO CAN HELP YOU

SUPPORTING PRACTICE OWNERS WITH SELLING

- Over 25 years' experience in the veterinary market
- Over £100m of veterinary practice sales in the past 3 years
- Experts in valuations
- We know all the key buyers
- Help with preparing for sale
- Tailored plan to suit you
- Best package
- Tax planning
- After sales support

SUPPORTING PRACTICES IN OTHER WAYS

Hazlewoods veterinary team has over 25 years' experience in advising veterinary clients in all aspects of accounting, tax and business advice. Our in-depth knowledge and experience allows us to fully understand clients' issues and advise them accordingly.

Our focus is on profit improvement, becoming an integral part of your practice, and providing a useful sounding board for commercial decisions, as well as providing all the traditional services you would expect from a firm of accountants.

We have experience in advising practices ranging from sole traders to partnerships and companies of various sizes. These include small animal, large animal, equine, referral and mixed practices.

We act for over 250 veterinary practices across England, Scotland and Wales.

MARK HARWOOD
01242 680000
mark.harwood@hazlewoods.co.uk

PHIL SWAN
01242 680000
phil.swan@hazlewoods.co.uk

SUZANNE HEADINGTON
01242 680000
suzanne.headington@hazlewoods.co.uk

RACHEL VINES
01242 680000
rachel.vines@hazlewoods.co.uk

SIGN UP TO RECEIVE OUR BUSINESS UPDATES

Due to the new General Data Protection Regulation (GDPR) that comes into force on 25 May 2018, we need to confirm that you are happy to receive updates from us and that your details are correct.

SIGN UP/UPDATE ONLINE: **http://bit.ly/hazlewoods**

Staverton Court, Staverton, Cheltenham, GL51 0UX
Tel. 01242 680000 Fax. 01242 680857

www.hazlewoods.co.uk / @Hazlewoods_Vets

HAZLEWOODS
DRIVING LIFELONG PROSPERITY