MONEY MATTERS

An Examination You'll Never Forget

For both parties, due diligence is a time-consuming but fundamental step in the sale of a veterinary practice.

BY LESLIE A. MAMALIS, MBA, MSIT, CVA

istockphoto.com/z_wei

Due diligence is common when purchasing a house, getting a bank loan, and buying or selling a veterinary practice. It's simply the research needed to minimize the unknowns. In other words, due diligence mitigates the risks facing a buyer or lender and determines whether the purchase price is reasonable.

Most of this article addresses buyers' due diligence, particularly by corporate consolidators, but sellers sometimes conduct research, too. In a private transaction, for example, the buyer might be an associate veterinarian or relief doctor with whom the seller has worked. Assuming the seller plans to remain in the community and not move to a tropical island, the seller wants to know that the buyer is a decent human being licensed to practice veterinary medicine and can afford the asking price. The seller also wants assurance that the animals, clients and employees will be in good hands.

During private sales, the bank financing the loan will perform most of the due diligence. The lender wants evidence that the buyer has the means to repay the note. Part of the analysis involves calculating the money the buyer will have to run the practice, service the loan and earn a reasonable salary.

An Introductory Period

When the practice buyer is a consolidator, the selling doctor won't need to research the company's wherewithal to pay. If the buyer were having cash-flow problems, every news outlet in the industry would know. Instead, most practice owners learn more by contacting other veterinarians who sold to the company. Savvy sellers don't call the doctors on the company's reference list. Instead, they look for practices on the consolidator's website and cold-call the previous owner.

Given the time, money and stress involved before the letter of intent is signed, many sellers think the worst is now behind them. However, while the letter of intent might seem like the last step, it's actually one of the first. Just as a mortgage lender orders a home inspection and appraisal before approving a loan, corporate owners want a comprehensive understanding of the hospital's history and how the practice would fit into their portfolio or investment strategy.

When the buyer is a consolidator, due diligence equals risk mitigation. The company is much more sophisticated than a typical private buyer. And it has to be because the company might have offered a lot more money than a private buyer would pay. You better believe a consolidator will thoroughly review your practice.

Many purchase offers are made based on financial data. But the books tell only part of a practice's story. The due diligence phase is when the buyer digs into every aspect of your business to determine whether other factors could thwart the sale or impact the profits under new ownership. The more the buyer knows about you and your practice, the fewer the surprises after the sale. If problems exist, a buyer wants to know about them now and could reduce the offer.

Due diligence also is the process of verifying the accuracy of the information you provide. Most veterinarians are uncommonly honest and trusting, so being asked to prove the truthfulness of what you share can be off-putting. However, don't get defensive. Due diligence is part of the price you pay for a generous purchase offer.

A Lengthy Checklist

Expect a buyer's due diligence request to be pages and pages long. While nothing on the list is impossible to produce, expect to devote several days to pulling everything together. Here are some of the documents frequently requested:

- Original articles of incorporation and any addenda. You'll probably have to track down bylaws, operating agreements and all sales contracts — with signatures — from the date the business began.
- Professional and Drug Enforcement Administration licenses.
- Two or three years of monthly bank statements.
- Notes payable, even if the buyer won't assume them.
- Purchase histories with your primary suppliers.
- Equipment maintenance contracts and the history of service calls.
- Employee handbooks, job descriptions and paid-time-off balances.
- Occupational Safety and Health Administration reports or workers' compensation claims and the outcomes.
- Prior job postings and your recruitment pipeline.
- Insurance policies and summaries of the premiums, coverage limits and expiration dates.
- Internal privacy policies, including data security for client credit cards.

The list will go on and on.

Other People Can Help

While you can't avoid due diligence, you can make it more manageable. Start by delegating as much as possible to others — your accountant, attorney, practice manager and payroll representative. Better yet, hire a professional organizer, someone who makes a living by going through stacks of paper and labeling, color-coding and otherwise sorting unruly documents into an organized set of records. Unlike your practice manager, a professional organizer can work uninterrupted.

When you sell to a consolidator, the due diligence can be as nerve-wracking as an IRS audit. But it doesn't need to be. Collect and organize your records, clean up the financial statements, and correct any errors in your practice information management system, especially with the inventory.

The process is tedious, but keep this desired outcome in mind: a practice sale in which everyone comes out ahead. TVB

TIME-SAVING TIPS

Here are six ways to simplify a practice sale and reduce stress:

- Confirm the business is legally yours to sell. So, resolve all ownership issues before you contemplate a sale. For example, did you consult any minority or silent business partners? Is a former spouse still listed as an owner?
- Get a practice valuation three to five years before you plan to sell, and ask the expert to identify any areas of concern. Then, address the problems before you are elbow-deep in due diligence.
- Keep good records. Take a hard look at your financial statements. A buyer will want details if your tax accountant lumps expenses into vague categories. Also, save month-end and annual production reports. You could have trouble accessing old data if you convert to a new computer system within a few years of selling.
- Clean up the inventory in your practice information management system. If you turn over a report showing a bunch of negative quantities or thousands of dollars in obsolete drugs, your inventory process will appear sloppy and haphazard.
- Your buyer will request an equipment list, so ask your tax accountant to remove old, broken and long-gone items from the depreciation schedule.
- Request a sample document list from your practice broker or sales representative. This gives you time to pull together all the information before you're under a deadline.

LESLIE A. MAMALIS
The Money Matters columnist is the owner and senior consultant at Summit Veterinary Advisors. She is co-chair of the VetPartners Valuation Council. Learn more at summitveterinaryadvisors.com.