Dealing with Leases in Veterinary Practice Sales

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It is becoming more common for suppliers of veterinary products and services to enter into long-term contractual agreements with veterinary practice owners. These agreements can have far reaching implications for practice owners, especially if owners wish to sell their practice during the term of the agreement. Caution is advised before signing these long-term agreements.

As veterinary medicine has become more sophisticated, it has required some practices to invest in expensive equipment such as digital radiographs, MRIs, etc. The equipment may be purchased outright or through financing. Capital leases are frequently used to acquire the equipment and are considered financing leases. Liabilities play a role in practice value.

In an asset sale, the purchaser is buying the assets of the business and not the liabilities. With a share sale, the purchaser is buying the shares of the business. Unless other arrangements have been negotiated, it is expected the seller will pay off the long-term debt including the lease debt when selling their practice. If the buyer assumes the debt, it will likely be reflected in the price the buyer is willing to pay.

An equipment purchase using financing is a liability that can impact practice value calculations. Capital leases are also forms of financing that can impact practice value. Many operating leases recorded on income statements, when examined in detail, are actually capital leases and should be treated as a financing lease.

There is risk involved with investment in capital equipment. For example, will it generate enough cash flow to cover financing expenses? What happens if a practice owner enters into a lease agreement involving a major capital investment a year before a practice sale? A practice purchaser may be reluctant to take over a lease agreement without a proven track record of the asset generating the revenues to pay for itself. Even when the agreement provides that there will be rebates or credits to offset the liability payments, there are still consequences to the buyer that may not be acceptable.

If a practice sale is contemplated in the near future, consideration should be given to how a potential buyer will view the lease agreement. In some cases, an agreement may not be transferrable to a new owner.

Suppliers of veterinary practice services such as laboratory services are also making efforts to secure long-term service agreements with veterinary practices. These long-term arrangements can be beneficial to both the supplier and the practice but they can also be problematic for sellers and buyers when a practice sale and purchase is contemplated.

Some of these service agreements involve an attractive ‘discount’ on services; however, a closer read of the fine print will indicate these discounts must be refunded if the service agreement is discontinued. What if a practice purchaser does not wish to use the same laboratory services? What if she does not wish to enter into the same agreement? If the agreement is for a 5 year period and the practice has fulfilled 2 of the 5 years, the practice owners could be liable for 2 years of discounts if the agreement was terminated upon the sale of the practice.

The words “non-cancellable” and the words “non-transferable” may also appear in these long-term contracts for various services. The owner(s) who signed these agreements could find themselves fulfilling contract obligations well beyond their practice sale.

Upon the sale of a practice, sellers may find the long-term agreement they signed:

a) is not wanted by the buyers,
b) is non-transferable to the buyers,
c) cannot be cancelled,
d) requires sellers to payback any cumulative discounts they earned since signing the agreement, or
e) requires sellers to payout a lump sum to end the contract

These details can cost sellers dearly when they sell their practice. If though, the lease or relationship is assignable and/or transferable, it may be possible to transfer it to the buyer but this frequently includes a negotiated purchase price adjustment for the liability.

In conclusion, protect yourself. Use caution when entering into a long-term agreement or relationship. Read the details of the agreement. Consider the implications if an ownership change is in your future. Assess the agreement from the perspective of a buyer and the buyer’s attorney. Just because it is assignable or just because the relationship pays the cost, does not mean that the buyer will accept it.