

WIN-WIN PRACTICE TRANSITIONS

MAXIMIZE VALUE, MINIMIZE RISK



University at Buffalo Dental Alumni Association
Greater Buffalo Niagara Dental Meeting
November 6, 2008

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Strategic Transition Plan

1. Define Success for you
 - a. Personal and professional mission statements
2. Design path for success
 - a. Know transition options
3. Prepare Financial Analyses
 - a. Non-Owner/Buyer personal financial statement
 - i. Financing
 - b. Owner/Seller
 - i. Practice valuation
 - ii. Retirement/estate planning
4. Find Transition Opportunity
5. Due Diligence Investigation
6. Financing
7. Final Negotiation and Closing

Strategic Transition Plan Step #1. Define Success for You.

- a. Draft a Personal Philosophy/Mission Statement
 - o Who are you?
 - o What do you want?
- b. Set Personal Objectives
- c. Draft Practice Mission Statement
- d. Determine Practice Objectives/Goals

Priority Pyramid

1. Personal Goals
2. Professional/Practice Goals
3. Risk Reduction
4. Patients
5. Staff
6. \$

Strategic Transition Plan Step #2. Design a Path for Success

- a. Know transition options

Transition Options

- I. Phased Transition Plan to Inside Buyer
- II. Immediate Sale to Outside Buyer
- III. Goodwill/Record Only Sale to Outside Buyer
- IV. Strategic Wind-Down
- V. Practice Mergers

TRANSITION OPTION I. PHASED TRANSITION PLAN TO INSIDE BUYER

- Trial Employment
- Vested Employment
- Co-Ownership
- Reverse Employment

Owner Strategic Transition Plan Checklist

1. Assess health of self and family
2. Prepare personal financial plan
3. Review and update estate plan
4. Determine ability, need or desire to continue practice as partner or associate
5. Analyze financial aspects of practice
 - a. Obtain a Practice Valuation
6. Draft a Business Plan
7. www.business.gov/phases/launching

Owner Strategic Transition Plan: Offer to Associate

- Legal relationship of Parties:
 - Employee vs. Independent Contractor
- Compensation/benefits
- Term of trial and vested periods
- Restrictive Covenant
- 5. Buy-In (Co-Ownership) or Buy-Out Plans
 - Letter of Intent (in event of sale)
 - Practice valuation (purchase price or formula)
 - Terms of payment
 - Financing
 - Terms of Partnership Compensation
- 6. Termination

Trial Employment Period

- 1-6 months
- Termination without cause: “AT WILL”
- No rights of first refusal or options to purchase
- Trial Employment Period
- No Restrictive Covenant
 - Or delayed onset
 - Or gradual covenant buy-out
 - Watch specialty and small town

Vested Employment

- From end of trial period to end of employment contract
- Termination with cause only
- Restrictive Covenant

- Employee rights to buy-in or buy-out and right of first refusal
- Mandatory buy-out of O on death, disability

Vested Rights/Letter of Intent/Option

- Selling Price/Formula
- Date
- Payment Terms/financing
- Compensation after Buy-In/Out
- Avoid gradual buy-in
 - Equity in escrow

Buy-Sell Agreements

- Stock Buy-In Pre-Tax Method A
 - **IRS Red Flag**
 - When “management” payments actually go to retired, disabled or dead (estate) sellers, IRS will interpret and re-classify as stock buy-in and re-tax as dividends.
- Asset/Stock Blend Method B
(not in C-Corp)
 - Seller sells 25% of the **assets** of the LLC (allocate maximum to goodwill)
 - P forms a PC (S Corp) with the assets
 - The new PC becomes a member of the LLC

TRANSITION OPTION II: IMMEDIATE SALE TO OUTSIDE BUYER

Variations:

- Owner sells at peak or reduced value with option to remain employed or retire
- Owner/Estate forced to sell upon death or disability

General Dental Practice Valuation

- Determine fair market value:
 - Highest money value the practice will bring in a competitive market for a reasonable time to attract a knowledgeable purchaser, sold by a knowledgeable seller, neither under duress.
- Tangible Asset Values
(15-35% of Total Value)
 - Fair market value (fmv) – used in valuations
 - “In place” as part of “going concern” generating revenue stream
 - Tangible Assets depreciated over 12 years or 8%/yr with residual value at 10-20% minimum
 - Most accurate estimate of “worth”
- Intangible Asset Values
(65-85% of Total Value)
 - **Goodwill**

- Likelihood patients will transition to Purchaser
- Restrictive Covenant
- Patient Records (Information)
- Use of Seller's name, telephone number, identity/logo

Practice Valuation Report (PVR) Analysis Checklists

- Information Needed from PVR
 1. Effective Date
 - Within one year and year-to-date updates
 2. Fair Market Value (fmv) determined
 - Not fair value, book value, salvage value but fmv of a going concern, in place
 3. Three (3) years tax returns (Schedule Cs) utilized
 - Minimum 3 years
 4. Appraiser's Credentials
 - Qualified, experienced, unbiased (Broker bias)
 - Site visit completed
 5. Projected Cash Flow/Income Stream
 - "Normalized" Net – Fair Salary for B = Earnings
 - ADA mean/average expenses
 - "Earnings" used to pay debt
 - Net profitability: 35-45%
 - "Normalized" net profit for 3 years (trend)
 - Net income better than gross collections as indicator of practice value because it reflects cash flow generated
 6. Transferability of Patient Goodwill: Will future repeat past?
 - Seller willing to transition
 - Staff retention
 - Seller's age
 - Patients' age
 - Patients' location
 - Reason for sale
 - Death value inversely proportionate to time elapsed
 - After 6 months, intangible asset value = 0
 - Duress of Seller decreases value
 - Percentage of Managed Care
 7. Location
 - Demographics
 - Access
 - Parking
 8. Active Patient Count
 - Chart Audit
 - Ideal # patients per full-time DDS = 1,000 -1,400
 9. Tangible Asset Appraisal
 - List assets sold

- 15-20% of cost per item minimum, if serviceable
- List assets excluded
 - Accounts receivable
- 10. Practice Financial Policies
 - Fee schedule, managed care contracts
 - Collection policies (minimum collection rate = 97%)
- Information Not Available from PVR
 1. Premises Lease
 - Refer to attorney
 - Assumable or new lease available
 - Condition of leasehold
 2. Seller's Covenant Not to Compete
 - Refer to attorney
 3. Veracity and quality of financial records
 - Refer to accountant
 4. Practice legal compliance
 - Refer to attorney
 5. Practice liabilities, liens, loans
 - Refer to attorney
 6. Purchase Price Verification Analysis
 - Refer to accountant
 - Mandatory for buyer's accountant
 - With or without a PVR

Rules of Thumb: Practice value = 1 x Gross or 2 x Net
 National Average: 61% of last year's gross collections \pm 14%

Factors affecting Fair Market Value

1. Earned equity of associate
2. Transactional tax liability
3. Seller assisted financing
4. Increased cash down-payment
5. Buyer assumes debt or liabilities

Effect on value

1. Decrease
2. Increase or decrease
3. Increase
4. Decrease
5. Decrease

7. Chart Audit, review for activity, quality
 - Buyer
8. Quality of Owner's dentistry
 - Buyer
9. Asset and Facility condition
 - Buyer obtains inspection

10. Transition compatibility

- Buyer
- Additional Specialty Practice Information from PVR
 1. # DDS and professional referrers
 2. # patients referred by each referrer per month/year
 3. Age and location of referrer
 4. Time owner will remain with practice to transition
 5. Amount of Contracts Receivable (ortho only)
- Specialty Practices
 - Higher risk than general
 - Dependence upon referrals from dentists and other professionals
 - Risk increases
 - Increase in age of referrals
 - Decrease in number of referrals

Strategic Transition Plan Step #3. Prepare Financial Analyses: Non-Owner/Buyer

- Personal Financial Statement
- Financing

Strategic Transition Plan #4. Find a Transition Opportunity

- Owner/Seller must establish the following information
 - Selling price/valuation
 - Reason for and timing of sale
 - Type of owner financing, if available
 - Reverse employment
 - Lease
 - Restrictive Covenant
- Practice Brokers
 - An agent employed, under a Broker Contract, to bring Buyer and Seller together to enter a practice purchase contract for a brokerage commission.
 - Usually represent Seller
 - Dual representation may be conflict of interest
- Practice Broker Contracts
 - Commission often as high as 10% of Selling Price (avoid minimum commission, e.g., \$10,000)
 - Avoid Exclusive Right to Sell
 - Broker gets paid even if the Broker does not bring the parties together
 - Avoid Automatic Renewal
 - By Seller in writing

- Obtain Attorney Review
- Avoid dual representation
- Caution regarding Conflicts of Interest and unauthorized practice of law

Strategic Transition Plan Step #5. Due Diligence Investigation

Strategic Transition Plan Step #6. Financing Practice Purchase

- Seller Assisted Financing
- Lender financing
- Seller Assisted Financing
 - I. Investigation
 1. Seller approval of B's personal financial statement and curriculum vitae and **risk** exposure to Seller
 2. B's accountant's verification analysis
 - Determine maximum debt (monthly) affordable
 - II. Negotiation
 1. Variable (Floating or Performance Related) Selling Price
 - use if high risk of transferability of goodwill
 - Fixed Purchase Price
 - Negotiate Floating Purchase Price
 - Performance Related
 2. Payment Terms
 - Lower interest rate than institutional
 - Early (3 mo.) payment deferral
 - Interest only payments (3-6 months)
 - Graduated payments
 - Increased # yrs term
 - No prepayment penalty
 - Promissory note non-negotiable
 - (S cannot sell)
 3. Security required
 - Practice assets
 - Personal guarantee
 - Life insurance assignment
 - Disability insurance assignment
 - Spousal guarantee
 - 3rd party guarantees
 - 2nd mortgage on residence
 4. Default Terms

- Require written notice and allow cure time
- Seller's covenant not to compete and B's lease both often terminated
- Seller willing to assist Buyer

TRANSITION OPTION III: GOODWILL/RECORD ONLY SALE TO OUTSIDE BUYER

- Goodwill/Record Only Sale to Outside Buyer
 - Owner unable to market practice in existing location/neighborhood with existing facility and equipment
 - Higher risk of patient goodwill transferability due to location change
 - Floating purchase price
 - Escrow part of purchase price contingent upon Seller active transfer at new location (3-6 months)

TRANSITION OPTION IV: STRATEGIC WIND-DOWN

- Dentist personal and professional quality of life
- Gradual decrease in practice hours, new patients, procedures and income
- Gradual increase in practice referrals and personal time

Strategic Transition Plan Step #7. Final Negotiation and Closing

- Critical Terms
 - Buyer contingencies
 - Purchase of assets not stock
 - No assumption of liabilities
 - Purchase price and payment
- Covenant Not to Compete
- Office Lease Checklist
- Asset Transfer
- Allocation of Assets
- Stock Transfer