

Exit Strategies — The Rat Race Is Over And The Rats Didn't Win!

by **William P. Prescott, E.M.B.A., J.D.**

Wickens, Herzer, Panza, Cook & Batista Co.

35765 Chester Road • Avon, OH 44011-1262

Direct Dial 440/695-8067

Fax 440/695-8098

Cell 440/320-8984

Email: WPrescott@WickensLaw.com

Website: www.PrescottDentalLaw.com



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Succession Planning Issues

- Can You Afford to Retire?
- What Will You Do With Your Time?
- Prepare Your Personal Financial Plan.
- Adjust the Financial Plan to Reflect Life Changes.
- Determine Whether Your Retirement is Complete or Partial.
- **Assess Health Care Availability and Cost.**
- Authorize Preparation of the Practice Valuation.
- Maximize System Effectiveness and Practice Profitability.
- Maintain the Practice, But Do Not Overspend.
- Prepare Your Succession Plan.
- How Do You Locate Your Successor?
- Review and Update Estate Plans / Terminate Retirement Plan / Dissolve Practice Entity at Appropriate Times.

Practice Succession Options

- Complete Sale.
- Hire Associate with Later Sale.
- Co-Ownership.
- Solo Group Arrangement.
- Merger.
- Walk Away.

Assemble Advisory Team Early and Understand How Advisors Are Paid

How Do I Locate My Successor?

Figure 2-1 Complete Sale

- Prepare Practice For Sale — How?
- Sell It When You're Ready.
- What Will You Do With Your Time?
- Can You Afford to Do This?

Figure 2-2 Hire Associate With Later Sale

- Locate Associate — What Comes First?
- Seller Due Diligence.
- Authorize Preparation of Valuation Report.
 - Valuation Date — One Year Out?
 - Mutually Agreed Equipment and Technology Formula.
- Earnest Money Deposit In the Form of a Promissory Note.
- Letter of Understanding.
- Authorize Preparation of Purchase and Sale Agreements.
- Importance of Restrictive Covenant.
 - Buy-Out Provision?
- Payment Terms.
- Continued Employment of Seller.
 - If You Need to Continue to Work, Maybe You're Not Ready To Sell?
 - Advantageous for Large and "Leader" Oriented Practices.
- Some Specialty Practices.
- Lease.
- Real Estate — Option / Modified Right of First Refusal / Obligation to Purchase.

Figure 2-3 Co-Ownership

- The Buy-In.
 - Will or Should Dr. Junior Incur a Pay Reduction?
 - Financing?
- The Buy-Out.
 - Mandatory or Optional?
 - Financing?
- Operations.
 - Decision Making Control.
 - Allocation of Compensation.
 - ❖ Practice Pays Overhead.
 - ❖ Pro Rata Payment of Overhead.
 - ❖ Equal Compensation and/or Distributions Based Upon Ownership.
 - Employment of Family Members As Dentists and/or Staff.
- Three Business and Tax Structures, Two of Which Can Have Tax Problems.

Figure 2-4 Solo Group Arrangement

- Two Practices in One Facility.
- Great Alternative to Co-Ownership Because No Mandatory Retirement Buy-Out.
- Resolves Tax Issues, Except For Family Members, For Practices Formed Prior to August 10, 1993.
- Applicability to Specialists and Multi-Specialties.
- Dentists Who Provide Unique Treatment, e.g., Sleep Apnea or Sedation.

Figure 2-5 Merger

- Always Look.
 - How and Through Who?
- Merge a Practice Into Your Facility or Vice-Versa.
- Helps the Dentist With Low Annual Revenue and Low Value.
- May Allow the Seller to Continue to Work for a measured Period of Time.
- Contingent Sales.
 - Tangible Asset Purchase.
 - Goodwill.
 - Down Payment.
 - One Year Measurement Period.

Figure 2-6 Walk Away Analysis

1. Revenue	\$ 800,000
2. Owner Profit of 40%	320,000
3. Work Two Years	<u> x 2</u>
4. Estimated Two Years' Income	\$ 640,000
5. Work Less? Estimated	\$ 500,000
6. Sell Practice at 65% of Revenue	\$ 520,000

Which Alternative Looks Better?

The Importance of the Practice Valuation

- Increasing Versus Decreasing Practice Values.
- Destination Locations.
- Importance of Practice Profitability and Collections.
- Impact of Reduced Fee and Managed Care Plans.
- Relocation or Expansion.
- Post-Retirement Services by Seller.
- Accounts Receivable and Debt.
- Procedures You Don't Do!
- High and Low Revenue Practices.
- Satellite Offices.

Calculating Practice Value In a Real Strange Market

- Summation of Assets.
 - Dental Equipment, Office Equipment, Furniture and Technology.
 - ❖ Book Value, Plus $\frac{1}{3}$ Accumulated Depreciation.
 - ❖ 10 year Straight Line Depreciation, With 20% Salvage Value.
 - Dental Supplies.
 - ❖ 3 - 4 Months on Hand.
 - Dental Instruments.
 - ❖ $\frac{1}{2}$ of 1% of Most Recent Year Collections.
 - Goodwill – 30 Factors, But Most Recent Year Collections and Profit Most Significant.
 - ❖ ADA Publication.
 - ◆ .2 - .5 of Most Recent Year Collections.
 - ◆ 1.0 - 1.5 of Most Recent Yearly Owner Profit in All Forms.
 - ❖ Goodwill Registry, 2015 - 47% of Most Recent Year Collections – Slightly Higher for Specialists.
- Capitalization of Earnings.
- Multiple of Gross Revenue / Similar Practices.

Example — Asset Summation

Dental Equipment, Office Equipment,
Furniture and Technology

Dental Supplies

Dental Instruments

Collective Subtotal \$ 150,000

Goodwill Value \$ 500,000

Estimated FMV of the Practice \$ 650,000

Example — Considerations

- New Owner Compensation at 27.5%, Includes Hygiene in a General Practice — Higher in a Specialty Practice.
- Two Doctors May Be Required for this Level of Collections.
- Analysis Did Not Include Capital Expenditures or Operating Expenses if A/R Not Purchased — Right Hand, Left Hand Treatment Rooms Still a Problem, as Well as Very Old Equipment.
- How Transferrable is the Goodwill and What is the Effect of a Reduction in Collections Following the Purchase and Sale?
- What are the Unique Procedures Performed by the Existing Owner, e.g., Orthodontics?

Example — Capitalization of Earnings

Most Recent Year Collections	\$1,000,000	\$1,000,000	\$1,000,000
Owner Profit Percentage	<u>x 38%</u>	<u>x 40%</u>	<u>x 42%</u>
Available Profit	\$380,000	\$400,000	\$420,000
New Owner Compensation at 27.5%	< <u>\$270,500</u> >	< <u>\$270,500</u> >	< <u>\$270,500</u> >
Available Profit to Capitalize at 20% Rate	\$109,500	\$129,500	\$149,500
20% Capitalization Rate	<u>_____ ÷ .2</u>	<u>_____ ÷ .2</u>	<u>_____ ÷ .2</u>
Estimated FMV of the Practice	\$547,500	\$647,500	\$747,500

Small Increases in Profitability
Have Significant Effects Upon Practice Value

Negotiating The Win-Win Practice Sale & Acquisition

➤ Asset Sale.

- Reporting Requirements — What's This Form 8594?
- Contingent Liabilities.
- Like-Kind Exchanges — How Often Is This Done?
- Goodwill — Corporate?
- Personal Goodwill — Well, it Really Is Better, But Better Be Able to Prove it!
 - ❖ Kennedy Case.
- The Howard Case, its Appeal and Lessons Learned.
 - ❖ Plan for the Sale.
 - ❖ Consider Converting to an S-Corporation.
 - ❖ Authorize an Appraisal of Your Personal Goodwill, Versus Any Corporate Goodwill.
 - ❖ Expect Increased Audits of Personal Goodwill.
 - ❖ Personal Goodwill in Co-Ownership Buy-Outs is Another Matter.
- Applicability of Cases Since Howard.

Negotiating The Win-Win Practice Sale & Acquisition (cont'd)

- Sale to Family Members — Treat Like a Third Party.
- Representations and Warranties.
- Mutual Indemnification/Mutual Due Diligence.
- Retreatment and Unique Procedures — Orthodontics, Implants, Cosmetic Cases.
- The Letter of Intent.
- Obtaining Financing — How Long Does This Take?
- Seller Assisted Financing — It's Okay If You Get Paid! Are You Second In Line?
- Contingent Transactions.
- Practice Mergers.
- Covenants Not To Compete.
- Continued Employment/Engagement of Seller.
 - Within the Purchaser's Discretion.
 - Seller Must Work Agreed Time Period as Needed by Purchaser.
- Employment of Staff.
 - Existing Compensation.
 - Benefits.
 - Hours Worked.

THE IMPORTANCE OF DUE DILIGENCE — WHAT TO ASK / WHAT YOU WILL BE ASKED

- Compatibility of Purchaser and Seller.
- Financial Information.
- Practice Facility.
- Lease and Real Estate
- Operations.
- Employment Relations and Benefits.
- Litigation — Pending / Threatened.
- Organizational Matters.

Corporate Practices — Selling To Or Working For Them — They're Back!

- The Economics.
- Getting Paid.
- Unwinding the Transaction.
- How They Will Affect You.
- What You Can Do to Protect and Grow Your Practice!
- State Dental Board and Legislative Issues.

Hiring The Associate

- Locating an Associate — How?
- The Associate Interview Process.
- Spouse in the Practice.
- Length of Association, 1-3 Years, Then What?
- When Will You Relocate or Expand?
- Proposal for Employment.
- Worker Classification.
- Key Employment Agreement Provisions.
- Associate to Ownership.

Hiring The Associate (cont'd)

- Key Employment Agreement Provisions.
 - Compensation.
 - ❖ Collections.
 - ❖ Adjusted Production.
 - ❖ Base Salary vs. Draw
 - ❖ Benefits, Insurances and Direct Business Expenses.
 - ❖ Bonuses, Based on Production or Discretionary?
 - Restrictive Covenant.
 - ❖ When Does it Start?
 - ❖ A Buy-Out?
 - ❖ Associate's Patients.
 - Termination Provisions.
 - ❖ Notice.
 - ❖ Cause — Cure Period?
 - ❖ Death, Disability.
 - ❖ Loss of License.
- Associate to Ownership.

Example — Associate Needs Analysis

➤ Assumptions.

- Associate Will Work Full-Time — 32 Hours Per Week and Will Earn the Greater of \$120,000 (Includes Payroll Taxes and Benefits) Per Year or 30% of Adjusted Production, Including Hygiene Exam Fees, But Not X Rays or Hygiene Services.
- Assistant Will Cost \$35,000 Per Year, Inclusive of Compensation, Payroll Taxes and Benefits.
- Additional Equipment, Remodeling, Supply and Laboratory Costs, Payable Over 7 Years, Inclusive of Interest of \$10,000.

➤ Costs and Required Collections.

▪ Associate	\$ 120,000
▪ Assistant	\$ 35,000
▪ Capital Expenditures, Supplies and Lab	\$ 10,000
▪ Marketing and Advertising Costs	\$ 10,000
▪ Estimated Yearly Associate Cost	\$ 175,000
▪ Divided by 12 Months	÷ 12
▪ Minimum Monthly Collections Before Administrative Profit	\$ 14,583

Example — Associate Needs Analysis

➤ Analysis.

- Practice Should Earn a 10 - 15% Administrative Profit On the Associate.
- Consider Mentorship Time, New Patient Flow, Facility Use, Practice Systems, Reduction of Practice Owner's Collections.
- How Many Active Patients Are There in the Practice?
- Why is the Associate Being Hired?
- Note, \$120,000 is 30% of \$400,000.
- **Business Rule — If Variable Costs are Covered and Associate Contributes to Fixed Costs, the Decision to Hire is Economically Sound.**

Using Restrictive Covenants For The Associate and Departing Owner

- Enforcement.
- Associate Employment.
- Sale and Acquisition.
- Associate Buy-Ins and Owner Buy-Outs.
- Non-Competition.
 - Time.
 - Radius.
 - Non-Solicitation.
 - ❖ Patients.
 - ❖ Referral Sources.
 - ❖ Staff.

Using Restrictive Covenants For The Associate and Departing Owner (cont'd)

- Confidential Information.
- Liquidated Damage Provisions.
- Reverse Restrictive Covenant.
- Buy-Out of Restrictive Covenant — Maintain a Separate Patient Base.
- Ability to Transfer to Successors and Assigns.

Negotiating Your Facility Lease

- Choice of Locations Gives You Bargaining Position.
- Measure the Facility.
- Leasehold Improvement Costs — Pay Landlord Increased Rent or Tenant Pays / Cost Segregation Study.
- Lease Considerations.
 - Security Deposit.
 - Term.
 - Renewal Options.
 - Rental Increases.
 - Assignment and Subletting — Especially When You Want to Retire.
 - Option to Terminate Upon Death or Disability.
 - Ability to Expand.
 - Maintenance and HVAC Costs.
 - Improvements — Consent Required?
 - Adequate Parking.
 - Cure Period for Default.

Owning, Acquiring and Selling Your Practice Facility

- New, Existing or Multi-Tenant?
- Condominium Suite?
- Cost Segregation Analysis.
- Options/Modified Versus Rights of First Refusal.
- Appraisal, Appraiser Selection and Appraisal Methodology.
- Environmental Considerations.
- Negotiating the Sale or Purchase of Real Estate at This Time.
- Financing the Real Estate.
- Determining Rent.

Dissolving Your Practice Entity

- Your Practice Versus Real Estate.
- Corporate Maintenance.
- Entity Dissolution.

What About Termination of Your Retirement Plan?

Designing and Relocating Your Practice Facility

- Prepare Personal Budget and Financial Statement Which Will Delineate Income Requirements — Monthly/Yearly.
- Determine Practice Costs.
- Complete Demographic Analysis.
- Revenue Projection — Patients and Patient Charges.
- Determine Lending Requirements / Availability.
- Determine Entity Selection for Practice and Real Estate, If Applicable.
- Prepare Strategic Plan — Prepare 5-Year Budget — First 2 Years By Month; Then 10, 15, 20 Years. This Shows Necessity for Mission and Vision Statements.
- Determine Additional Income Requirements.
- Project Analysis and Completion Dates — Sign Lease / Form Entity / Obtain Financing. What Else Do I Need To Do? Hire Staff?
- Opening — Systems in Place!

Summary and Thoughts

Leave When You're Ready — Your Way!