

The Art, Science and Emotion of a Practice Sale

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For most of your professional life you have looked to your practice as a steady stream of current cash flow. It has been where you make your living. It has been your job. Your career. Your financial engine. It has often defined who you are. In short, you have focused on *running* your practice. But at some point you have to give serious thought to looking at your baby as a valuable asset in itself. And have it poked and prodded and subject to due diligence by prospective buyers. As you approach that point, you may want to ask yourself a few questions:

- Does your practice value represent an important part of your financial assets?
- How devastating would the financial impact be on your family if you became disabled—or died prematurely?
- Would you be upset if you did not get the highest fair market value for your practice sale?
- Do you need to add an associate or build up your practice to maximize its value?
- How would you feel if you paid more taxes than you had to on the sale?
- Although you may *want* to retire, do you know if you can *afford* to....?!?
- Are you counting on slowing down but still working in your practice after a sale?
- Once you hang up your hand piece for good, then what are you going to do with yourself?

Most practitioners do not think about the value of their practice or about the questions above until it is time to “cash out” and move on. But “moving on” is no longer limited to just the traditional picture of “retirement”. Did you realize that over one half of sellers are under 60 years of age due to various changes in their circumstances or goals?!? On the other end of the spectrum, age 70 is becoming the new retirement age for many folks due to the economy and declining portfolio values—or just their failure to have planned an exit strategy.

Speaking of failing to plan, would it surprise you to know that 6 out of 10 practices simply close their doors?!? How sad. Not only for the practitioner, but also for their “stakeholders” who rely on them: their families, their loyal team and their patients.

We are beginning to see more distress sales too. (And we aren’t even considering most practitioners’ urge to sell on many Monday mornings—or after every blow-up and brush-fire in the office!)

**When it comes down to it, there are just two times when you sell your practice: when you “*want*” to and when you “*have*” to!
Are you—or will you—be ready?**

Also, a “sale” does not necessarily mean that you are selling out and leaving. Part of your long term financial strategy may be to sell your practice *more than once!* By that, we mean that it may be a wise move to bring in a partner to buy half the practice now. That not only gives you a cash infusion to pay off some debt, fund your retirement plan, etc.; but the real payoff comes 5-10+ years later—when you are ready to sell the second half. You may discover that it has grown to be as large or larger than the entire practice was when you sold the first half! (That is one

reason you may want an entrepreneurial, energetic rain maker as a partner—and not just another pair of hands.)

So with the myriad of options (immediate/deferred buy-ins/buy-outs, earned equity approaches, etc.) we would like to share some insights based on the Willeford Group’s combined experience of over 100 years of working with dentists. Regardless of the reason for a sale, be it either a “transition” or a “succession”, we would like to help you not only maximize your practice value but also to protect that value in the case of an emergency sale. To that end, we have broken our comments into the following eight sections:

- I. The goodwill challenge: Selling what you can’t see**
- II. The selling environment: Presale considerations**
- III. Your goals: Your needs, wants and wishes**
- IV. Your practice: The vehicle to attain your goals**
- V. Value vs. Sales price: Art or science?**
- VI. Parties to the sale: Not just your “buyer”!**
- VII. The selling process itself: 18 important steps**
- VIII. The decision: Four options**

I. The Challenge: Selling What You Can’t See!

No matter what your situation is, selling a practice is not an easy proposition, even if your practice is profitable, well documented and has a demand in the current market. It is much more complex than selling a *tangible* asset like a house, a car or a piece of land, where the prospective buyer can literally see and touch what they are buying.

But with a dental practice you are not just selling cotton rolls and some used equipment. At least 75% of your value is in the *intangible* asset loosely called goodwill. In addition to the benefit of having a skilled workforce and systems in place, the primary value of goodwill is the expectation that *patients will continue to frequent the practice*. How in the world do you measure that?!? Suffice it to say, a prospective buyer—be it one who has already worked with you as an associate—or even a family member, will approach this biggest purchase in his or her life with a lot of trepidation.

It is that trepidation and healthy skepticism that can easily put you at odds with a prospective buyer. By definition, you two are on opposite sides of the transaction. No matter how kindly your intentions may be, the prospective buyer *must* take everything you say with a grain of salt. That can easily hurt your feelings, because, as a professional, you are used to getting respect and trust from your customers—your patients—up to this point. But now you are facing one of your trickiest and biggest business transactions in your career: trying to convince someone to buy something they can’t really see or touch!

We respectfully suggest that this is *not* something you try at home and on your own. Nor is this the time to turn to your well-meaning lawyer friend, unless they have a *lot* of transition experience. Even then, your buyer will have his own team of skeptical advocates. The two

opposing sides often generate a lot of heat—and fees—but not much light. And all the while you and your prospect are trying to keep up a good face; and you are trying to continue to practice! Here is where a respected, experienced transition consultant or broker can serve as an intermediary to keep all the parties on track.

However, long before you pull the trigger on an actual sale—and before making any decisions or commitment to *any* course of action for that matter—we have found that most dentists achieve some peace of mind and confidence in their chosen game plan by taking a logical approach to understanding the *practice sale environment and the process*.

II. The Selling Environment and Process: An Overview

Exploring the uncharted waters of the selling process will plunge you into a whole new world of:

- *People*—including lookers, buyers, brokers, consultants, spouses, your best buddies with their good intentions, lawyers and accountants. Yours as well as the other party's! All of these can consume incredible amounts of time and money. And most of them communicate in languages totally alien to what most practice owners are accustomed to.
- *Concepts*—including reconstructed financial statements, return on investment, consulting agreements, discretionary income and taxable income vs. cash flow, to name a few.
- *Dichotomies*—such as the need to selectively distribute yet maintain the confidentiality of highly sensitive practice information. And to let the market place know of your practice availability while concealing your intentions from your patient base, your team, your fellow practitioners and your referring sources.

Some pre-sale considerations must include:

- Very specific definitions of your personal goals. (If the sale of your practice won't allow you to achieve the results you seek, you need to either reconsider the sale or restructure the practice until it can.)
- Organizing your practice's financial and management information from multiple sources into a form that can be utilized to determine its "Fair Market Value"—and to build a compelling narrative to support that value in the mind of the prospective buyer.
- Actual determination of the "Fair Market Value" using approved industry valuation standards. (Not just some "rule of thumb" which is only good for measuring thumbs!) Ask if your appraiser is confident enough in his analysis to back it up in court. You will be surprised that many will not be!
- Determination of the relationship of the "Fair Market Value" to the current marketplace.
- Understand the terms and conditions that might reasonably be obtained in the marketplace.
- Finally, relating "Fair Market Value," terms and conditions of sale and the realities of the current market to your predetermined goals and time frame.

False starts or wrong turns can be very destructive to both your wallet and psyche. You have perhaps known the angst of sitting around and trying to sell an inanimate object like your home.

Perhaps experiencing a few dashed hopes and busted deals. Well, can you imagine the stress of selling your practice—your life’s work? Prospects and their advisors poking and prodding and questioning—and challenging—everything about your pride and joy?!?

It is not fair to your buyer and to everyone around you to start down the path toward a sale lightly. Sadly, we know of too many cases where the *seller* got cold feet at the altar and left his suitor standing in the aisle. In the worst case, that can even lead to legal repercussions. So you need to take a personal inventory, financially as well as psychologically, to see if you are in good shape for the journey.

III. Your Goals: Your Needs, Wants and Wishes

We will refer to those, collectively, as your “goals”. Without specific goals in mind for your post sale energies—and the financial wherewithal to support them, you probably are not ready to sell, but rather ready to begin the planning process and your education about the selling experience.

**If you don’t know where you are going,
you might not get there!**

If you do not specifically define your personal goals in relation to the sale of the practice, the result can easily be a financial disaster. (We all know of a number of dentists who sold, but who are then suddenly working again within a few years....) Why sell your practice to attain some one else’s goals (those of the buyer, or an attorney, accountant or broker)? Although it makes little sense, relatively few practice owners approach and plan the sale of what is usually their most valuable possession from *their* perspective and *their* needs.

You dramatically increase the odds for success if *you* and your team:

- Control the conditions of the sale;
- Structure the transaction to attain your goals and objectives (assuming that your practice has the capacity to attract a buyer at the price required to attain your goals);
- Create a specific and thorough plan of action to accomplish those objectives; and
- Implement and monitor that plan from inception to completion.

If and when you decide to consummate a transaction, you will have then made your decision with the full knowledge that you really got the ***“highest price that the market would allow, in the shortest period of time, with the least interruption to your practice and personal life.”*** (When you boil it all down, isn’t this what you are trying to accomplish?)

IV. Your Practice: The Vehicle To Attain Your Goals

In the most simplistic view, all practices consist of systems, assets and people combined to generate cash flow which in combination create the “saleable value”. Accepting that definition, there are no two practices alike. Each has its unique benefits, problems and value.

How a buyer and his advisors *perceive the vehicle* in terms of its potential for *attaining the buyer's personal goals* of value received (a) for the investment he made, and (b) for the day to day burden of management will largely determine *the price* he is willing to pay!

The methods used to define and the depth to which a buyer and his advisers understand *the vehicle* and how those parameters are defined and communicated directly affect the price and time frame of the transaction.

With the preceding in mind, the next step in the selling process is to *define the vehicle* which for the most part is your patient base and its cash flow, in terms that create a *value* in the mind of the buyer and the buyer's advisers and provide them with a track to run on for future verification.

V. Value vs. Sales Price: Art or Science?

Value, like beauty, is in the eye of the beholder. What's it worth? To whom? Under what terms and conditions? Compared to what? When?

The definition of "*Fair Market Value*" generally accepted by the IRS (see revenue ruling 59-60), the Merger & Acquisition world and the various practice appraisal societies is: "That amount in cash or equivalent, that a buyer might reasonably pay and a seller might reasonably accept, for a practice opportunity that has been exposed to the market for a reasonable period of time, with both parties in possession of all the facts and neither being under any compulsion to act."

Conceptually, the valuation of a dental practice is similar to that of any other investment, and can be stated as follows:

$$\text{Value} = \frac{\text{Cash Flow}}{\text{Risk}} \quad +/- \text{Desirability}$$

Since Cash Flow is on the top of the equation, an increase in cash flow increases Value. Risk represents the chances that the cash flow will or will not continue into the future. Since Risk is in the denominator, greater risk decreases the Value. Also, since a Buyer is not simply buying a "black box" that generates cash flow, the value is impacted by the Desirability of the practice. This could be a function of intangible as well as tangible attributes, such as geographic location, economic environment, office design, age of equipment and style of practice, to name a few.

Practically speaking, a Buyer wants to buy a practice that has enough cash flow to pay themselves a reasonable wage and to service the debt of buying the practice.

Concepts aside, **the market will ultimately determine the value of your practice!** What you may want for the practice is really meaningless. A careful valuation of the benefits and assets, tangible and intangible, hidden and visible, and the accurate communication of those values in

terms comprehensible and *acceptable to the buyer* and his advisors are essential to a successful transaction.

Many values, both positive and negative, are hidden or buried within what is considered to be the normal operations of a practice. To get top dollar for your practice, you will have to find and define, to a buyer's satisfaction and understanding, the most minute details of your operation in terms of *his values and needs*—especially the hidden values—and eliminate as many as possible of the *hidden pitfalls* inherent in all practices.

The accounting perspective of a practice as defined by tax returns and financial statements are structured to present a tax oriented picture—using the tax laws to minimize net income in order to minimize taxes. The other side of this coin is that this tax shaded view which minimized profit (and Cash Flow in our equation) also diminishes the value of your practice at selling time. Reconstruction of your practice to reflect *an economic perspective, rather than a tax perspective, is absolutely essential* and critical to achieving the highest Fair Market Value. However, the valuation may be impacted by the need to balance out the income tax consequences, especially in cases of intra-family sales.

VI. Parties To the Sale: Not Just Your “Buyer”!

Who is the “buyer” anyway?

It is the incredibly rare individual buyer, and nonexistent corporate buyer, who make a buying decision alone and without counsel of others. At the very least, the individual buyer is a *minimum* of a “*team of five*”, consisting of the buyer (either knowledgeable or experienced or not), the buyer's spouse, practice confidant, lawyer and accountant. All of these people will have varying degrees of knowledge and perspective regarding: your practice and its value; their buyer's needs (real or perceived); investment criteria; goals; talents; weaknesses; abilities, etc., ad infinitum. However, we guarantee that they will all have very strong opinions to offer the buyer, usually in the form of *negative encouragement*.

Think about the last great idea that you had and how well it was understood, never mind received, by your confidants. To a large degree, the price that a buyer is willing to pay is directly and strongly influenced by the quality of information disseminated about the practice, how well that information is presented with specific regard to the buyer's goals, needs and fears (real or perceived) and whether it is presented in a format understandable from the perspectives, knowledge, needs and methodology of the “*team of five*.”

Frequently a buyer's practice confidant (usually a friend in business or local “rocket scientist”), accountant or lawyer says: “I think you are paying too much for this practice.” It is the rare exception for the buyers to ask what specific knowledge, information and criteria that opinion is based upon.

It has been our experience that a buyer will give more emotional credence to a knee jerk reaction from a member of his “*team of five*” than to the logical documented presentation of information to the contrary.

More important, however, is the reality that it is not in the best interest of the buyer to offer to pay the highest price that the market will allow. And for some buyers, negotiating a lower price is simply “the art-of-the-deal” and must be exercised to achieve a deal.

Allowing the buyer to determine the value of your practice is like hiring a fox to watch the chickens.

In today’s sophisticated market, the typical practice buyer usually has the advantage over a seller. This situation is brought about by several factors.

1. Since the buyer has the money, he—or his banker—usually determine the value of the practice opportunity predicated upon his specific requirements, goals and values. This is not always to the advantage of a seller.
2. Buyers and their advisors are usually more familiar with the buying/selling process. A first time buyer in the half million dollar to two million dollar range will typically spend between one and three years in his search, reviewing tens or even hundreds of opportunities before making his purchase. Or his advisors have. This experience alone puts the buyer and his advisors ahead of most sellers.
3. Depending on the practice, the supply and demand curves can have a huge impact on the results. A dental practice can take from 6 to 36 months to sell.

Trying to rush the process usually creates a serious reduction in the price or, even worse, a failed transaction requiring starting from scratch.

VII. The Process: 18 Steps

The process of selling a practice is complex, costly, and time consuming.

We have identified eighteen steps mandatory to the selling process in one degree or another. The relative importance of each step varies somewhat with each transaction, but to attain a top dollar sale, the degree of planning, attention to detail and follow through in every step has a direct bearing on the outcome of the transaction. Which steps you miss or chose to bypass and how much are you willing to lose because of it is up to you.

Following is an outline and brief description of the steps necessary to the process. Either *you* have to handle these steps or a broker/transition consultant will do most of these for you.

1. **Your Goal** Only *you* can determine why *you* want to sell and what *you* want to accomplish.

2. **Define** You know your practice best. It is your place to define: the assets and liabilities; the market, past present and future; the burden of management; the benefits of ownership; the potentials not tapped and the pitfalls you have avoided. *A buyer pays for the past, but he is really buying the future.* A good consultant knows how to create the best picture of the future for the buyer.

3. **Research** To sell for top dollar, it behooves you to provide the research and the information to “*build an act of willingness*” and a buyer’s “comfort level” with a direct and measurable effect on the price, terms and conditions of the sale. There must be a solid and documented understanding of: the practice and its place in the market, local industry and regional economy – past, present and future, which results in a stronger comfort level and a higher offer. If you provide a buyer with a path through the forest, he will usually follow it. With no path a buyer will usually stand outside the forest and err on the side of caution with any offer.

4. **Reconstruct** To minimize your tax liability, the net profit of a practice is minimized. Unfortunately, this tax structured financial picture presents an unfair presentation of the practice concerning determination of its “Fair Market Value.” A true economic picture must be created to both appraise the value of a practice and review a potential structure of price, terms, and conditions possible within the current marketplace.

5. **Value** To sell for top dollar you should pre-determine the value of your practice, understand and be prepared to *justify that value* to a buyer and his advisors. Since no two practices are alike, allowing buyers to use “comparables” or industry “rules of thumb” to determine value is almost always detrimental to a seller.

6. **Pre-Structure** The actual Sales Price can vary from the Valuation by as much as 50%, depending upon the terms and conditions of the transaction. Pre-structuring several scenarios of acceptable price, terms and conditions provides a focus for all marketing efforts and a basis for review of subsequent offers.

7. **Package** Communication of value and benefits is the key to a successful sale. Confidential quid pro quo dissemination of accurate practice and financial data to *qualified prospects* in a format comprehensible to his “*team of five*” is a must. To avoid miscommunication, a written representation of essential information is mandatory. Compilation of the pertinent data from your research and assembly of same into a document that clearly and accurately defines your practice and its place in the world can be utilized to define its value in the marketplace. Of course, this must be accomplished in such a manner that proprietary information is not released to potential buyers, advisors, competitors, patients, employees, or other parties without both a “need to know” and signed non-disclosure agreements.

8. **Plan** For maximum results, a specific and progressive marketing plan must be created to reach out to the largest possible audience, identify suspects, qualify suspects into prospects, build an act of willingness in a prospect and garner offers that attain the

goals of both parties. All while qualifying out the “tire kickers” and “nutcases” that are rampant in the market. Plan your work and work your plan—and your plan will work!

9. Market Implementation of the plan. A weeding out process which should culminate in an offer at the highest price that the market will allow in the shortest period of time.

10. Monitor To implement a marketing plan without the ability to closely monitor progress and market response eliminates the possibility of adjusting your plan to that market response.

11. Offer Hopefully, good marketing should provide several offers allowing you to choose the one best suited to your goals. All offers should be written to avoid miscommunication. All written offers should be reviewed and considered in relation to your minimum requirements and pre-structuring parameters.

12. Negotiation “Yes! No! How about.....?” are the only three possible responses to an offer. The negotiating process should fine tune reasonable offers to suit the needs of buyer and seller. At this stage, if all involved seek *solutions* for the inevitable problems rather than just the problems, a mutually beneficial transaction can usually be arranged. This is the point where many transactions fall apart. In our experience, it is mostly due to inadequate communication, mismanaged expectations and allowing attorneys to structure the transaction rather than just reducing an agreed upon transaction to the legal format of a contract.

13. Acceptance Acceptance is the goal of the negotiation processes. In successful transactions, both buyer and seller have adjusted to the needs of the other in theory, and the basic price, terms and conditions have been agreed upon and reduced to writing in the form of a Non Binding Letter of Intent. This is a document to focus the legal professionals on the desires of the parties from a practical or business perspective and allows them to translate those desires into the format of a legal contract of sale.

14. Structuring This critical step is the second most dangerous step with regard to lost transactions. The accountants and lawyers of both parties often unintentionally add confusion and disharmony to a transaction, each striving to gain an “edge” for his client. If the buyer and seller maintain focus on the goal line and demand solutions from their professionals along with the inevitable problems, those problems have a habit of disappearing. The basic conditions of the sale should be addressed and agreed upon by the parties with support from the seller’s CPA’s advice on tax related issues. A Non Binding Letter of Intent should be signed by the buyer and the seller to reduce the miscommunications between legal and accounting professionals.

15. Contract In this step, the negotiated transaction, including price, terms and conditions, structure and logistics for due diligence, are agreed to in writing and put into a legal document by the seller’s attorney. In this step the stage is set for verification of the representations upon which the non-binding letter of intent was constructed.

16. Due Diligence A period of time, best specifically defined contractually, in which the buyer and his advisers can verify the representations supporting the terms of the transaction. The more specific the definition of what is to be reviewed, how and where to review it, the better for all concerned.

17. Closing The formal and final adjustment made to execute the terms and conditions of the contract and officially transfer ownership of the practice.

18. Transition All transactions have a transition period. They can range from as little as one hour to over five years. They are best defined by contract as to length and context. Structuring a proper transition, both in time and function can have a major impact on the success or failure of a sale. A practice management consultant can often make the transition smoother and more successful—for doctors, staff and patients.

VIII. The Decision: Four Options

If you've done your homework, the decision and direction to take will be self explanatory and made predicated upon a thorough knowledge of, and a complete understanding of, the choices available to you.

Every shortcut you take will have a direct and measurable effect upon the price, terms and conditions of your transaction.

At this point in time you really only have four options: to keep your practice; adjust your practice for future salability; sell it yourself; or retain a professional to assist you in the sale.

A professional transition consultant/broker can help you with three out of four.