VitalSkin DERMATOLOGY

A comprehensive guide to selling your practice.

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The decision to sell a physician practice is not easy but neither is running it.

You've put a lot of hard work into your practice, with some vision for what that effort would yield; what if you want to accelerate actually seeing those results? You don't want to take on additional debt, but you want to help the practice grow? Or maybe you want to free yourself from the administrative burden so you can focus on what you really value: patient care, fostering a strong culture, spending time with loved ones, and more?

For many physicians, their practice is their most valuable asset, and so even the prospect of selling it is naturally difficult and emotional to consider. A physician's practice often stands for their life's work, with much of their identity and personal self-worth tied up in the practice.

Some physicians are drawn to sell their practice because it's not working effectively for them and their goals, and they cannot conceive of how to improve their practice without taking on additional debt or putting more time and energy into the practice. Other physicians consider selling their business because they want to change their role in managing finances, in handling insurance, in managing administrative duties, and just juggling the personal, emotional, and mental burden of managing their business. They may feel totally buried under admin work instead of the types of interactions that drew them to a career in medicine in the first place, and want to focus their time on serving their patients and their families.

To make the best decision for the practice and for themselves, physicians need to be familiar with all of the options available to handle and even sell their practice. Physicians need to be supported during this process so that they can make the best decisions for their goals and for their future, with everything from accurate information through trustworthy guidance.

A knowledgeable, experienced partner through this process can make the difference in navigating business decisions and getting physicians the results they've earned.

The process to sell a physician practice can be simpler.

While the decision to sell a practice will always be somewhat challenging, physicians need not be in the dark about what will come next. The actual process of selling a practice can be simplified with clarity on what to expect, and the chance to consider any questions or concerns about this sale.

Once that decision to sell has been made, the following steps should be taken to optimize the end result.

Phase One: Preparation

STEP 1 | Continue to run, invest in and grow your business.

The business belongs to the original owner or group of owners until it is sold, and so it must be nurtured until the point of sale. Sellers often make the mistake of "cashing in" months or years before the actual sale of their business, destroying significant value in the process. In the end, many physicians are surprised when no buyers emerge for their practice or the practice value is considerably below what they thought it would be.

STEP 2 | Prepare early.

At a minimum, owners should start to prepare for the sale one or two years out; preparing three to five years before the sale is ideal. This allows sellers to be strategic sellers rather than forced sellers, and to maximize the final sale price. As with real estate, a few strategic investments or improvements along the way to the sale could deliver outsized returns. Given ample time to do so, these improvements can be easily accomplished.

As part of this preparation, physicians should educate themselves on the sales process—which can vary somewhat across different geographic markets—as well as become familiar with key concepts and terms. Sellers should be comfortable with business concepts including book value, fair value, fair market value, working capital value, earnings before interest, taxes, depreciation and amortization (EBITDA), goodwill, tangible assets, intangible assets, capital gains/losses, and ordinary income/losses.

STEP 3 | Assemble a team of professionals.

Selling a practice is complicated; if it is not structured correctly, it can have implications long after the sale. To get the best results and to protect their interests, sellers should have an experienced medical practice appraiser, a seasoned tax accountant, and an experienced health care transaction lawyer on their team of advisers. The physician's team should be able to answer any questions and educate them further on the sale process and key concepts.

STEP 4 | Understand the implications of an asset sale or a capital (stock) sale.

Tax considerations are a critical component of any sale. The implications for the seller and buyer can differ enough to where each party has their own preferences for the type of sale.

Most sellers prefer a capital sale because it allows them to pass corporate liability onto the buyer, and the sale of a professional corporation often generates capital gains tax for the seller.

Conversely, an asset sale is often preferred by the buyer. Buyers are able to shield themselves from any corporate liability resulting from past actions, and they are able to structure the deal that benefits them the most from a tax perspective.

Most transactions involving medical practices are in the form of an asset sale. In an asset sale, the sale is comprised of a collection of mini sales. The purchase price is separately allocated to each of the practice assets, the gain/loss on each asset is calculated, and the related tax is calculated.

Practice assets are classified as:

- accounts receivable;
- property held for sale to customers (i.e. inventory);
- depreciable property (i.e. waiting room furniture, exam room furniture, exam tables, lasers, computer equipment, automobiles, etc.);
- real property (i.e. land and buildings); or

- intangible property (i.e. patient records, buy/sell agreements, restrictive covenants, key employee contracts, brand name, exclusive marketing contracts, managed care contracts, goodwill, etc.).

Depreciable property and real property are often held for a year or longer, and any gains or losses from the sale of the asset are classified as capital gains/losses. Gains or losses generated from the sale of accounts receivable, inventory held for sale, or intangible property are usually taxed as ordinary income. Generally, capital gains are taxed at a lower rate than ordinary income. If the seller enters into an asset sale, they may want to defer a portion of the sale price to the extent allowed by law to reduce and/or defer their ordinary taxes.

STEP 5 | Analyze and benchmark your practice.

A frank understanding of the positive and negative aspects of a practice helps the seller position it optimally—and realistically—for a sale. Completing a strengths, weaknesses, opportunities, and threats (SWOT) analysis of the practice could potentially offer some objective clarity regarding its status, and how it could be positioned for sale.

Early on in the sales journey, items to consider include the following:

- patient satisfaction, reviews, and loyalty;
- insurance company contracts;
- referral sources;
- scope of services provided by the practice;
- quality of the staff and tenure with the practice;
- technology in the practice;
- quality of the office and office location;
- use of extenders;
- any ancillary income;
- any unique role in the community;
- competition in the service area; and
- market demographics.

To inform the SWOT analysis, several documents and statistics should be gathered beforehand, including the last three years of financial statements, tax returns, and operational statistics. These specific statistics included should include the following year-over-year (YOY) figures:

- the number of patients treated, new patients treated, and encounters;
- the mix of services rendered, broken down by service;
- cash collected per patient;
- provider productivity as measured by relative value units (RVU);
- aged A/R balances and bad debt; and
- the number of staff per provider.

All YOY results should be compared to industry benchmarks for a realistic practice assessment. The resulting figures can be used to inform the SWOT analysis.

Undoubtedly, this exercise will uncover weaknesses in the practice. One reason why it is ideal to start preparing for the sale several years out is to leave adequate time to address these weaknesses and significantly improve the practice metrics before they get in front of a potential buyer.

In the event that there is not enough time to address all vulnerabilities before the sale, honesty is the best policy. The seller will likely want to identify these vulnerabilities as so-called improvement areas. Most buyers, in turn, want to identify so-called synergy opportunities to justify the price they will pay.

STEP 6 | Develop a financial pro forma.

A practice appraiser or accountant should be used to prepare a financial pro forma using the last three-year financial analysis as a basis. Close scrutiny of this analysis should be used to catch any unusual expenses incurred during this time that should be added back. For example, if the expenses associated with selling the practice are not characteristic of business-as-usual, they would qualify to be added back.

Expenses should be normalized to reflect the normal course of business. Often, independent owners run "personal" expenses—such as cell phone bills, travel costs, automobile costs, spouse salary, and similar expenses—through their business. The result is an expense figure that might not reflect the normal costs of the practice's business. Ideally, these figures should be settled ahead of being shown to a potential buyer. If there is not adequate time to do this, expenses should be adjusted and normalized, and the seller should be prepared to explain and justify them.

STEP 7 | Get a practice appraisal.

Imagine selling a house without understanding the real estate market in the surrounding area. If a seller does not have a sense of the market for their practice, they will likely underestimate or overestimate its value. This could result in the seller not getting the full value for the practice, or scaring away would-be buyers.

Overpricing a practice is the number one reason a practice does not sell. Handling this issue is one area where early preparation is particularly helpful. If the seller has enough time, they should work with an advisory group to figure out how to increase the practice value.

Phase Two: Engagement

STEP 8 | Know what you want out of the sale of your practice.

Increasingly, physicians are selling their practice well before retirement. While these physicians want to continue to work, they no longer want the burdens of administration, the long hours, the ongoing costs associated with the practice, or any number of other hassles and obligations.

Under these circumstances, making sure there is a good cultural and clinical fit is critical, perhaps moreso than getting the highest price for the practice; a smooth transition makes the difference for the future of the practice. If the seller wants to exit the practice completely, they should be prepared to provide transitional services to maximize the sale price.

The longer the seller intends to stay with a practice—with three or more years being ideal—the higher the sale price should be. If the seller sells to a hospital, group practice, or corporate practice, the longer they remain engaged with the practice, the more likely the practice's economics will continue to thrive.

STEP 9 | Develop a list of potential buyers, research them, and conduct preliminary due diligence.

Potential buyers are likely to come from the following four groups:

1. associate partners;
2. local independent physicians or groups;
3. local hospitals; or
4. corporate physician groups.

Each buyer group has its own unique strengths and weaknesses, and due diligence should be used to research each of them. The specific buyer groups to be approached will depend on what is desired from the practice sale. For example, due to regulatory hurdles, a hospital buyer will probably not provide the best purchase price, but they might offer a compelling employment contract.

When identifying potential buyers, there are two choices: members of the seller's advisory team can approach potential buyers on the seller's behalf or to gauge interest, or the seller can approach them directly. Again, this will depend on the known preferences of the buyer as well as of the seller, and what is the desired outcome from the sale.

STEP 10 | Prepare to go to market.

Prior to going to market, a simple Confidential Information Memorandum (CIM) should be prepared. The purpose of the CIM is to provide potential buyers with the information needed to determine interest in the practice as well as to develop an initial bid.

A CIM will provide the following:

- a practice overview that highlights its strengths;
- identify areas for improvement that may drive enhanced financial performance for potential buyers;
- walk prospective buyers through potential market opportunities;
- provide a financial overview, pro forma, and details behind the addbacks and adjustments; and
- provide an expected sale structure and ongoing employment terms.

Most of the essential ingredients for the CIM were developed when the practice was analyzed and benchmarked, the financial pro forma was prepared, the practice appraisal was obtained, and the specific desired sale outcomes were identified.

STEP 11 | Go to market, sign non-disclosure agreement, and share CIM.

The early stages of going to market can be unpredictable and therefore somewhat daunting, particularly for physicians who are more accustomed to treating patients than courting buyers.

But the interactions inherent to these early stages are somewhat akin to high school courting. Some teenagers never get very serious, preferring to meet many people on their journey to figuring out what they wanted out of a serious relationship. Others dated more seriously, getting to know a select handful of people more intimately as they figured out what they want. There is no right or wrong answer to how sellers should go to market or how buyers should explore the market; there is only what makes the process comfortable for each party involved.

This initial courting process will be mostly superficial in nature. Before moving to a level where the communication and information sharing become more substantial, potential buyers should sign a non-disclosure agreement (NDA) to protect the details of the practice. Only after the NDA is signed should the CIM be shared.

Undoubtedly, the CIM will generate further questions and conversations. It's often during these conversations that the seller will gain a better sense of the buyer, who will be under pressure. The key to success in this sale is not necessarily ending with a great price, it's to end with the best sale. Often the best sale is about the best fit—not the best price.

Again, it goes back to what particular outcomes are desired from the sale of the practice.

Phase Three: Transaction

STEP 12 | Negotiate terms of the sale and sign letter of intent.

Formal negotiations usually happen in the form of a letter of intent. The letter of intent, which is a non-binding document, memorializes the terms of an agreement to which the buyer and seller have agreed. Putting the terms in writing helps to ensure the buyer and the seller are on the same page before incurring the expense of lawyers and accountants to close the deal.

The letter of intent spells out, at a high level, all of the material terms of the sale, subject to certain contingencies such as financing, findings from due diligence, and so forth. Provisions of a letter of intent might include the following:

- description of assets being purchased (is it an asset purchase or a capital purchase?);
- sale price;
- treatment of working capital;
- earnout provisions to the extent allowed under the law;
- holdbacks provisions;
- non-compete and non-solicitation provisions;
- buyer financing provisions;
- ongoing employment terms; and
- ongoing ownership provisions.

When evaluating the letter of intent, the seller should consider the entire economic package—not just the sales price—and the riskiness of the proposed transaction. After all, a record purchase price where the buyer is at significant risk of defaulting on the deal is likely not an attractive offer.

STEP 13 | Due diligence and final negotiations.

Due diligence in a practice sale is like completing a home inspection before finalizing an offer on a new home. Before a buyer makes a final commitment, they usually want to conduct due diligence. In other words, the buyer is seeking some further investigation to ensure the accuracy of the information presented during the sales process.

Due diligence usually involves an on-site inspection where the practice's daily operations are monitored, a billing audit to ensure no inappropriate or improper billing practices, and a close examination of financial records.

As long as all material concerns were addressed in the CIM and the upfront discussions, due diligence should go smoothly. Major discoveries in the due diligence not previously disclosed often derail the process and leave buyers skeptical of everything they were presented regarding the practice.

An important fact to remember in this sale process is that most buyers are experienced business operators. They know there is no such thing as a perfect business, and they expect issues within the business. Honesty is the best policy, particularly in the face of potential vulnerabilities.

After due diligence is complete, final negotiations are conducted. If there were no unexpected issues discovered during due diligence, the final negotiation process is relatively simple and straightforward.

And, just as with a home inspection, if any issues were discovered during due diligence, the buyer can be expected to respond with a counter-offer.

STEP 14 Legal documentation and deal closing.

Documentation supporting the sale of a medical practice is complicated. An experienced health care transaction lawyer should be on-hand to draft and assist with the sale process and documentation. The final documents(s) will likely include:

- the buy/sell agreement;
- confidentiality, non-compete, and non-solicitation agreement(s);
- consulting and/or employment agreement;
- transition plan;
- patient notification letter;
- real estate transaction/lease; and
- representations and warranties by the seller and indemnification provisions to protect the buyer.

To protect both the seller and the buyer, it is critical that all documents comply with Medicare fraud and abuse and anti-kickback statutes, as well as Stark and HIPAA laws.

STEP 15 Make a successful ownership transition.

Finally, after all of the effort expended to sell the practice, the seller and buyer must work together to ensure a successful ownership transition.

A successful transition is in the best interest of the buyer and the seller, the patients, and the practice employees. It ensures the buyer and the seller get maximum consideration, and that the patients and employees do not get stuck in the middle of a bad transition. A successful transition is usually the result of good planning by both the buyer and the seller, with the major components spelled out in the buy/sell agreement.

Of course, the transition activities will be dependent on the nature of the future agreement for the practice.

- If the seller is leaving immediately, the transition activities will be focused on communicating to patients and employees and working collaboratively to retain the team and patients.
- If the seller is continuing with the practice, the transition activities will take a different form. This transition might include transitioning the practice to a new electronic health record system, changing the name of the practice, merging and/or adding a new partner, or other similar activities.

Taking the time to carefully and diligently proceed through each of these steps will radically increase the likelihood of a favorable sale for both parties involved—seller and buyer alike. A reliable partner through this process can make all the difference in providing clarity on the business decisions at stake, as well as the expertise needed to navigate any challenges that may arise.

Visit vitalskinderm.com to schedule a one-on-one conversation about selling your practice.