Acquiring Practices: Buying Strangers, Friends, and Enemies

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The Health Care Group®
Plymouth Meeting, PA

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* Financial Interest

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- We have the following financial interests or relationships to disclose:
  - Shareholders and Consultants: The Health Care Group, Inc. and Health Care Consulting, Inc.
  - Shareholders and Attorneys: Health Care Law Associates, P.C.

Who We Are

- Business and legal advisors to ophthalmologists and other physicians
- Publishers of the Goodwill Registry, used in medical practice valuation
- Handle and advise re: buy-ins, sales, valuations, compensation
Why Buy?
- Solo Buyer
  - Needs a job
  - Not getting desired opportunities with groups
  - Or entrepreneurial desire

Group Practice Buyer Wants:
- Geographic expansion
  - Avoid costs and time of developing a new office, new patient base
- Expand volume to cover existing costs
  - Keep an associate busy
  - Make all physicians busier
- Acquire surgery

Do We Really Need to Do This?
- Why not wait the solo out?
  - His patients will migrate to us anyway…. Maybe…. unless someone else buys
- A purchase makes for a better transition
  - Seller is cooperative
  - Timetable is controlled
  - Joint notice to patients
Who are the Potential Sellers... and What do They Want?

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Retiring doctors

- Want cash out
- Graceful exit
- Care for their patients
- Jobs for their staff
- A home for their charts
- Avoid the need to close shop

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Younger Solos

- Seek group environment
- Relief from management headaches
- Access to ancillary services
- Greater income stability
- Coverage
- Collegiality

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Late Career Solos

- 3 – 7 years of practice left
- Looking for an exit plan
- Maybe drop surgery
- Maybe cut back hours
- Relief from management headaches
- Secure a buy-out

Selecting a Target

- Newly trained or relocating physician buyer can be geographically flexible
- Seeks a well run practice in desirable area, priced reasonably

Selecting a Target

- For newly trained resident or relocating doctor, a key issue is continuity
  - Are you (buyer) a good substitute for seller?
  - Will patients accept you in place of seller?
  - Can you replicate seller’s work effort and volume?
  - Will the staff stay when seller retires?
Selecting a Target

• Established group is more opportunistic
  • It may not be looking to buy
  • But a practice becomes available

Selecting a Target

• For established groups, the question is a strategic one
  • Is target available at a reasonable price?
  • Can buyer handle the extra volume?
  • Is seller cooperative or difficult?
  • Will somebody else buy it?

Structure

• Typically an asset sale, rather than stock sale
  • Buyer avoids seller’s liabilities
  • Buyer can pick and choose equipment
  • Buyer gets enhanced tax basis
  • Cash or notes in exchange for assets
The First Hurdle: The Sales Price

- Components of Practice Value
  - “Hard Assets”
    - Equipment, improvements, supplies, software
  - Accounts Receivable
  - Goodwill/going concern value:
    - Includes charts, phone number, staff, endorsement

Hard Asset Valuation

- Book Value
  - Nearly always too low
  - Think about all the items that you “expensed”
    - These have an immediate book value of zero
    - The rest have a book value of zero in 5-7 yrs
- Specialized Appraisal
  - Not available for all items
  - Needs updating frequently

Modified Book Value Approach

- Recompute depreciation
  - 9-15 year life (overall)
  - Straight line depreciation
  - Floor value: 20% of original cost
  - Generally reasonable for most items
Supplies

- Optical frames, contact lenses, other medical supplies
- Physical inventory, or
- Estimated value, based on prior year expense
  - E.g., prior year expense divided by 12 times 2 (for 2 months supply)

Valuation: Accounts Receivable

- Face value times collection ratio
- Exclude deadwood (over 180 days)
- AR may be excluded entirely from transaction
  - Let seller collect and keep it, rather than sell it

Valuation: Goodwill

- Goodwill: What is it?
  - Any kind of intangible value
    - Likelihood of patient return
    - Practice name, location, phone number
    - Reputation in marketplace
    - Value as going concern
Goodwill Valuation Methods

- “Income” Approaches
  - Excess Earnings
  - Discounted Cash Flow
  - Capitalized Earnings
- Comparable Sales or “Market”

Comparable Sales Method

- Same idea as pricing a house
- Benchmark value, based on neighborhood comparables
- Adjust for individual features
  - Good: high profit, nice location, lifestyle, modern facilities, moderate competition, good payor mix
  - Bad: low earnings, undesirable location, closed panels

Comparable Sales Method

- 2014 HCG Goodwill Registry
- Ten year average for ophthalmology is 27.12% of annual practice collections

  THIS IS A (LONG RUN) AVERAGE!
  YOURS MAY BE HIGHER OR LOWER!
Stock vs. Assets

- Asset deal nearly always better for buyer
- Tax advantages
  - Assets are depreciable
  - Stock is not

Stock vs. Assets

- Asset deal also allows buyer to:
  - Exclude undesired assets
  - Avoid contingent liabilities
  - Avoid valuing AR

Tax Allocation: ‘S’ Corp or no Corp

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<thead>
<tr>
<th>Item</th>
<th>Seller Wants:</th>
<th>Buyer Wants:</th>
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<tbody>
<tr>
<td>Goodwill</td>
<td>$$$$$ (cap gn)</td>
<td>$ (slow writeoff)</td>
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**Tax Allocation: Seller Has ‘C’ Corp**

- Objective: Avoid corporate double tax
  - Funnel sales price outside corp directly to doctor
  - Personal goodwill

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**Tax Allocation – Seller C Corp**

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**Financing**

- Cash or notes
- Often a concern for newly trained doctors
- But bank financing is often available
- If you can, avoid paying all cash to seller
  - Delayed payment helps incent seller to cooperate with transition in first year
Post Sale Employment of Seller

- Recommend brief (1 year or less) transition period when solo buys solo
  - Whose practice is it anyway?
- Longer term employment arrangements are feasible when solo joins group
  - Group is clearly in control

The Negotiation Process

- Seller goes first on price, then buyer responds
- Use a LOI or term sheet to flesh out key terms
  - Stock versus assets
  - Whether AR are included in price
  - Tax allocation
  - Seller’s desired post sale compensation package

Asset Purchase Agreement

- Price, payment terms
- Non-compete clause – 3-5 years, with good broad radius
- Transitional issues: e.g., letter to patients
  - Text should be pre-agreed
  - Who physically prepares the mailing?
  - Post sale obligations: buyer to take over custody of records
Seller Employment Agreement

- Term and termination
- Hours and time away
- Compensation: typically a % of collections
- Patient transition obligations

Ancillary Transactions

- Buyer needs to lease the office space
  - Is selling physician the landlord?
  - Can buyer have right of first refusal on future sale of property?
- Can buyer acquire seller’s equity in local ASC?

Due Diligence

- Do lien search on seller and his corporation
  - Could be tax liens or other problems
- Take a look at the medical charts
  - Comfortable with Seller's clinical care?
- Look at CPT
  - Excessive testing?
Odds and Ends

• Buyer should set up a new corporation or LLC to acquire the assets
• Allow lead time to get credentialed and get provider numbers, before closing
• Collection of seller’s accounts receivable
  • Does buyer get a fee for helping with this?
  • How long will buyer help?

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