SAALFELD GRIGGS DENTAL INDUSTRY TEAM
WHITE PAPER: PREPARING TO SELL - BEST PRACTICES

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Sound counsel. Smart business.

Just like with most other things in life, if you prepare properly for the sale of your practice, you will optimize your results. The following is a quick summary of what we consider to be "Best Practice" steps you should take to maximize your price and the odds of success in selling your practice.

1. **Don't Retire Before You Sell –**

   As we approach retirement, it is only natural to want to work less, take more time off, and enjoy life more. The trick is that you don't want to do that if it will result in a reduction in your production. Practices are sold based on a number of factors, and total production is one of the most significant. If you start to slow down and your production declines, then the price you will ultimately sell for will decline as well. So, how do you balance the desire to work less with maintaining a growing practice? Hiring an associate may be one answer. The associate can absorb the work you choose not to do and keep the practice growing. Another idea is to time your "slow down" with a fee increase and a shift to higher paying procedures so that less work does not translate into less revenue. Lastly, reduce your days only as you can increase your production by working more efficiently and seeing more patients on the days you do work.
   <u>The Bottom Line</u>: ***Work your practice in a way that results in steady or growing revenues right up until it is sold. This will help you maximize your return on the sale. It will also help support the bank loaning 100% of the purchase price rather than requiring you to carry back a percentage of the purchase price.***

2. **Pay Fair Market Rent and Have a Lease with an Appropriate Term –**

   If you own your dental office, it can be a great source of income after you sell the practice. However, the time to raise your rent to whatever is "fair market" in your locale is well before you sell, not at the time of the sale. You want your practice financials to reflect the impact of paying the fair rent during at least the 3 years immediately prior to the sale. Regardless of whether you own your building or not, you want to have a lease with plenty of options to renew AND the right to assign that lease to a buyer of your practice. Your buyer's lender will require that the buyer be able to stay at your current location for at least 10 years. Thus, your current lease term and all renewals should be at least 10 years and preferably more at the time of your sale.

<u>The Bottom Line</u>: *Pull your lease out and take a look. If it will be running out, ask the landlord for some options to renew. Typically a 5 year term with 2-4 renewal options of 5 years each will be best. If you own the building, make sure you keep your rent up to fair market and have support for the amount of rent you are charging in the form of meaningful comparables*.

3. **Properly Reward Your Staff –**

As you approach the end of your career, you may be tempted to escalate staff compensation as a well-deserved thank you to the people who helped you succeed. While altruistic, it will hurt you and it will hurt the buyer of your practice. You will be hurt because the higher overhead will be reflected as a lower price for your practice. Your buyer will be hurt because he or she will step into a practice that has no room for wage increases, thus making it harder to make staff feel good about the new boss.

<u>The Bottom Line</u>: *Keep your staff salaries and benefits in line with the going rate in the community. If you want to reward them at the time of sale, ask your buyer if you may give them a one-time bonus and make it clear to them that the bonus is meant as a thank you for their help building your practice, taking care of patients, and willingly helping the buyer continue your legacy.*

4. **Manage Your Accounts Receivable –**

Of course it is always best to properly manage your accounts receivable. Tight controls and reasonable aging of accounts receivable are signs of a healthy practice. Sometimes however old and stale accounts are left in place rather than being either effectively collected or written off. It is always best to clean this up well before a sale. Having a significant amount of very old accounts on the books that are either not paying or paying so little that it makes one wonder whether they will ever be paid off can be a red flag for a buyer. Most buyers prefer to buy the accounts receivable as they are a source of operating capital for the practice. However accounts that are over 120 days old are either sold at a very deep discount (>50%) or are simply transferred to the buyer for nothing.

<u>The Bottom Line</u>: *Avoid questions about patient collections by cleaning up your old accounts receivable well before listing your practice for sale.*

5. **Address Your Credit Balances –**

Credit balances on your books can come from multiple sources. Sometimes patients want to pay in advance for a full treatment plan. Patients or insurance companies also overpay occasionally resulting in a credit on your books. The former is fine, the latter can be problematic. Ultimately, overpayments need to be repaid to patients. However, if this is not promptly handled at the time of the payment, patients may move and then tracking them down can be a real chore as you try to return their money. Ultimately, if after 3 years and a diligent effort you are unable to find the patient, the payment must be paid to the state! This can be a time consuming headache if you have to handle this after a sale when you do not have full access to the records or the staff to help.

The Bottom Line: ***Make sure your staff is promptly refunding overpayments to patients to avoid creating a mess that will have to be cleaned up later. Minimal credit balances is another sign of a well-managed practice.***

6. **Don't Remodel Your Office, Well at Least Late in the Game –**

Really, I can't fix my office up, buy that new CEREC and cone beam and replace all the chairs with the latest and greatest? Certainly any buyer will want all that, right? The answer in my opinion is that the time to buy new equipment and make any improvements is only when you anticipate continuing to work until they are largely paid off. Your decision to buy them needs to be based on your own analysis that doing so will make you more profitable even while you are paying for them. They will likely not add much value to your practice except to the extent that they help you grow revenue and profits. We have seen doctors take on excessive debt late in their practices and then find that when they sell too much of the sales proceeds are used to pay off the debts rather than fund retirement.

The Bottom Line: ***Remodel and buy upgraded equipment early in your practice, pay it off, and then keep the practice sales proceeds for yourself rather than using them to pay off creditors.***

7. **Save for Retirement –**

You started preparing to sell your practice the day you begin operating it. Everything you do will either help you build the practice and maximize your sales price or detract from it. Your ability to sell and retire will also be directly related to how you have prepared yourself financially. Don't count on selling for so much that you will be able to retire and live on the sales proceeds alone. You should begin early and then consistently save for retirement. Ways to save include owning your own building, saving after tax income and investing it, and establishing a qualified retirement plan (i.e., 401k) which you can fund with pre-tax money and let grow tax deferred. We encourage our doctors to do all three. When you sell, you want the practice sale proceeds to be the icing on the cake in terms of your retirement income, not the whole meal.

The Bottom Line: ***Save early, save regularly, and save aggressively. Use every method at your disposal to effectively save. Set up your 401k early not late. As you approach retirement, consider establishing more advance retirement plan vehicles (i.e., such as a cash balance plan or defined benefit plan) to put away even more for later.***

8. You Don't Need an Employment Agreement –

Can that be right? No employment agreement? Yes, that is what we said. But to be clear, we mean that you, the doctor, do not need or want an employment agreement. This is particularly true if you are operating as a C corporation. When you have no employment agreement and are not bound by a non-compete under the terms of any other agreement, then the law supports the idea that all the goodwill of the practice belongs to you personally, and thus you can sell it rather than your PC. This is significant because it can result in a much lower tax rate on the sale, and you will avoid double taxation. If you have an employment agreement, it should probably be eliminated. Likewise, if you have any agreement that restricts your ability to compete with the practice, you need to have that looked at.

The Bottom Line: ***As the owner of the practice, you should not be restricted by a non-compete or employment agreement. Doing so may adversely impact your net after-tax sales proceeds.***

9. Don't Hire Associates without an Employment Agreement and Non-Competition Covenant –

Despite what many non-lawyers may say, non-competition covenants are in fact enforceable in Oregon. There are some specific rules you must comply with to make them stick, but the rules are not insurmountable and the best practice is to always require an associate to sign an employment agreement that contains (i) a non-solicitation covenant, and (ii) a covenant not to compete. These agreements must be in writing, and among other things must be signed BEFORE the person begins work. If you wait to have your associate sign until after he or she begins working, it is too late. Buyers of dental practices are rightfully concerned about a practice which has recently employed one or more associates and which is not protected by an enforceable non-compete. It presents a risk to the buyer that he or she may not want to accept, or which may result in a price adjustment to account for the added risk of someone else pirating your patients. Even if you are highly confident that your associate will ultimately buy your practice, insist on a well drafted contract that will be signed before he or she starts work. It is relatively cheap insurance. If the associate buys the practice, no harm done. If the associate leaves, then you are protected.

The Bottom Line: ***No associate should be permitted to work in your practice without a solid employment agreement that includes non-solicitation and non-competition covenants.***

10. Control Your Supply Inventory –

When you sell your practice, it will include what will be your normal level of inventory of supplies. Typically, this is valued at $5,000 to $10,000. As you approach the sale, don't buy extra inventory, and don't stop purchasing. Make sure that you are using up perishable supplies and replacing them with fresh ones. A common covenant included in the sale agreement will be that (i) the supplies are at normal levels in the range mentioned above, and (ii) that they are usable (i.e., will not be past their stated expiration date) for 6 months after the sale. Thus it is best to plan ahead so that this will not be a problem.

The Bottom Line: ***Management of your inventory is an important prerequisite to a successful sale. You want neither too much nor too little, but instead just the "right" amount.***

11. Put Your Best Foot Forward –

Remember that your practice will be thoroughly examined when it is time to sell. First, your broker will inspect the practice. He will want to see your financial records, patient charts, equipment, supplies, etc. That will be so he can prepare his appraisal and executive summary of the practice so it can be marketed. Once a prospective buyer is found, then that buyer will conduct his own due diligence review of the practice. Make sure that everything is in order so that these inspections leave the broker and the buyer impressed with everything they see. Even if your practice is very well run, there are always a few things that can be tightened up, better organized, and improved. Make the effort to do so before you sell. It is not unlike selling a classic car that you have taken great care of over the years. When it is time to sell, even though the car is clean and in apparent perfect shape, you will still give it a wash and polish to make it look its absolute best before showing it. Doing so will optimize your sale experience.

The Bottom Line: ***First impressions are important and if you make a great first impression, you will be paid for the effort by maximizing your sales price.***

12. Silence is Golden –

Remember, no deal is a done deal until the contract is signed and the money is in escrow. Things can happen that can derail a deal at the last minute despite the best efforts of you and your team to get the deal completed. For that reason you do not want to publicize the fact that you are retiring. Patients may be nervous about who will take your place, and those nerves can lead to them moving to a new doctor rather than waiting to meet your replacement. Thus, keep it quiet until the deal is truly done. Your team can advise you on how to best handle this.

The Bottom Line: ***When it comes to selling your practice, discretion truly is the better part of valor.***

13. Set Your Buyer up for Success –

You have spent your career building your practice. Someone else will eventually become its owner and caretaker, but it is your legacy. Your hope is that your staff will remain and be happy with the new buyer, and that the patients who have come to be your friends will be cared for with the same degree of skill and empathy as you demonstrated during your career. For that reason, you will select a buyer for your practice who you feel best enables you to meet that objective. Make sure that you set your buyer up to be successful. Leave him or her with a full schedule of good work to do. Book patients who you know will sing his or her praises after coming into the office. Introduce your buyer to the local dental community. Willingly tell others how qualified you think the buyer is and how excited you are for his or her success after you leave. This is not only the right thing to do, but if you own your building, this will better enable the buyer to purchase your building when the time is right.

<u>The Bottom Line</u>: ***You want your succession plan to be the crowning achievement of your practice. Ensuring that the buyer will be as successful as you is your opportunity to finish strong and pay it forward to benefit a young starting doctor and your patients.***

For more information related to dental practice sales, please contact Doug Alexander at 503.399.1070, or DAlexander@SGLaw.com.

About the Author:

Doug is licensed in both Oregon and Washington and has been representing dentists in sales, transitions, and operational legal matters for over 30 years. His practice predominantly focuses on the representation of dentists throughout the Northwest. He leads the firm's dental industry team which includes lawyers specialized in representing dentists in all types of business legal matters, including real estate and land use, corporate and tax, employment, litigation, employee benefits and estate planning. He regularly speaks and writes on dental related topics. References and a list of representative transactions are available upon request. Visit http://www.sglaw.com/industry-teams/dental-practices/ for more information.