

Selling Your Ophthalmic Practice in an Uncertain World

Things you need to know.

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If you are a senior ophthalmologist considering retirement in the next few years, you need to know a few key things about selling your practice. In our 40 years of advising physicians, including large numbers of ophthalmologists, we at The Health Care Group, Inc., have had the privilege of overseeing all kinds of sales of all kinds of practices in all kinds of markets. This article is a guide for those of you looking to sell your practice in the current economic climate.

ARE YOU READY?

We frequently field phone calls from senior ophthalmologists considering the sale of their practices. The first question we ask them is, "Are you ready to pull the trigger?"

The ideal practice, from a dollar-maximizing standpoint, is one in which the senior physician is ready to turn over the keys of the practice to a buyer who wants immediate possession. Some potential sellers are looking to have their cake and eat it, too. They want to sell their practices for big dollars but then go on working, for the same pay, for another 3 to 5 years. That is a tough pitch to make to buyers, many of whom will feel threatened (financially and managerially) by the continuing presence of the senior ophthalmologist. It is not an ideal situation for the seller, either, who will likely feel uncomfortable as a mere employee of the practice that he or she owned for many years.

If you are not willing to completely and immediately step aside, it may be best to postpone sales efforts.

GIVE YOURSELF TIME AND KEEP WORKING

Although a sale can be accomplished relatively quickly once a buyer is found, the process of finding a buyer and negotiating the sale may take time. Do yourself a favor

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and start early. You will need to

- find advisors (an attorney, appraiser, and accountant)
- find a buyer (the most time-consuming task)
- determine a selling price for your practice and propose terms
- negotiate sales terms
- prepare and sign legal documentation
- complete the closing

This process can take anywhere from 6 months to more than 1 year. If you delay, you may later find yourself desperate to get out due to retirement plans or ill health. The sale can then become a "distress" transaction with a low sale price.

While you are plotting your alternatives, keep working hard! All buyers want to see good financials. It is discouraging to look at a practice and see a declining revenue stream. No one wants to pay top dollar for a practice that appears to be heading south (even if the seller assures the buyer that the volume will go right back up if the buyer adds sessions). Psychology is critical here. For the buyer, a little fear can outweigh a lot of hope.

WHAT SHOULD YOU SELL?

Let's assume that you are ready to pull the trigger. What are you selling? The obvious answer is the medical prac-

tice, but what if you also own the office in which your practice is located or a piece of a nearby ambulatory surgical center (ASC)? Should you try to sell these other assets at the same time?

The ASC's equity will likely be attractive to the buyer, if the facility is at all profitable. If you are the sole owner of the ASC, then yes, absolutely, you should sell it at the same time as your medical practice. It makes the package more attractive. If you are only a part owner of the ASC, however, you may face restrictions. Check the terms of your ASC's buy-sell agreement and ask your ASC partners to allow you to transfer your equity to a new surgeon. They may be open to this option if it will enable the ASC to retain your case volume (as continued by your buyer-successor).

The real estate (practice office) is a different matter. Unlike your medical practice, it will retain its value indefinitely, even if you do not sell it now. You can rent it to the buyer of your medical practice for a few years and then either sell it to him or her later or rent it out to someone else. If you try to sell real estate right away to the same doctor who is buying your medical practice, the financial load may be more than he or she can comfortably afford.

WHAT IS MY PRACTICE WORTH?

This is what everyone wants to know. There are three components of a medical practice's value: hard assets (equipment, buildouts, supplies), accounts receivable, and goodwill (going concern, which is the value of having all systems in place and being ready to operate a medical practice). Of these, generally only hard assets and goodwill are transferred. Receivables are normally not sold because it is difficult for a buyer to value them, especially if they are old. It is better for the seller simply to collect these receivables and put them in his or her pocket.

Hard Asset Values

Hard asset values can be considerable in the sale of an ophthalmic practice. Each lane requires substantial purchases, and over the years, many ophthalmic practices spend hundreds of thousands of dollars. The value of some items, such as high-end slit lamps and buildouts, depreciates very slowly.

The depreciation schedules show the book value of all equipment in the practice, but these figures are nearly always far too low. They understate the true economic value of equipment. The IRS allows depreciation over a relatively short useful life (5-7 years), and many practices have taken advantage of Section 179 depreciation, which allows the entire purchase price to be deducted immediately, in the first year.¹

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To understand how book value understates true fair market value, assume that your practice elected Section 179 treatment for some recent purchases. Immediately, because of the Section 179 deduction, the book value of the acquired item dropped to zero. A book value appraisal would thus treat this asset as having no value whatsoever, but that is obviously not true. Accordingly, we recommend the following modifications to book value.

Restate depreciation over an average useful life of 8 to 12 years, rather than take the immediate deduction of Section 179 or the 5- to 7-year period allowed for most equipment items for tax depreciation. Also, in the modified method, depreciation is restated on a straight-line basis, as opposed to the accelerated methods allowed by the IRS for tax purposes. Finally, assume that all items, even if fully depreciated, retain some value if still useable. We peg this value at 20% of the original cost.

Some appraisers further refine the value of an item by assigning different useful lives to different things. For instance, they might assign a 3-year useful life to computers, a 20- or 30-year life to buildouts, and perhaps a 10-year useful life for all other items. It certainly is possible to refine the calculation in this way, but oftentimes, a uniform 8- to 12-year life is sufficient, on average. It is not exactly right for every item, but we find it generally provides a reasonable evaluation.

Goodwill

Goodwill, as discussed in this article, means all intangible values of any kind. It is everything other than hard assets or accounts receivable. Goodwill includes patients' charts, lists of patients, business records, the practice's phone and fax numbers, e-mail addresses, the practice's Web site, name recognition, and leasehold location. All of these things help foster patients' continued loyalty and revenue. *Goodwill*, as the term is used here, also includes going concern value. This includes having an existing workforce, established procedures and routines, all equipment carefully selected and operational, all software functioning smoothly, etc.

The largest value of many practices is goodwill. It is not necessarily present in every practice sale, but it can often be substantial. A variety of methods can be employed to appraise goodwill, but in our experience, the most reliable is the market approach, which relies on comparable sales.

This is the same approach used to value residential real estate. Sales of similar assets provide benchmarks for valuation of the subject property.

Your specific practice may have a higher or lower value based on a variety of factors, such as its location and profitability as well as the demand for and supply of ophthalmic services in your marketplace. For example, in a very rural area, it may be difficult to command any goodwill value for your practice, because it would likely be relatively easy for a buyer to set up a competitive practice and thereby avoid the need to buy your practice and pay anything for your goodwill. In a nice suburban or urban area, however, there is surely more competition among ophthalmic providers, and therefore it is more difficult for a new entrant to build a practice from scratch. Assuming a relative balance between supply and demand for ophthalmic services, all patients are “spoken for.” Such a competitive situation is conducive to the payment of substantial goodwill values. Without the purchase of an existing practice’s goodwill, it may be very difficult to start a new practice and achieve profitability in a reasonable time period.

STRUCTURING THE SALE

Once you have found a buyer and negotiated a price, important decisions remain. For example, if your practice is incorporated, you could transfer the practice by selling all of the stock of the corporation to the buyer. This is considered a stock sale. Alternatively, the transfer can be accomplished by selling all of the core assets of the corporation (equipment and goodwill) to the buyer, who will set up a new corporation (or LLC) to operate the practice. This is considered an asset sale.

All sellers desire a stock sale structure, because it provides them with beneficial capital gains tax treatment. Buyers (or their attorneys) nearly always demand an asset sale, because it provides better tax results for them and allows them to avoid any contact with hidden liabilities of the practice. These include potential Medicare recoupment claims, tax audits, and malpractice exposure. If the sale is structured as an asset sale, the buyer and seller must negotiate the tax allocation. The tax consequences are significantly different for buyers and sellers based on how much of the purchase price is allocated to various items such as goodwill and equipment.

PAYMENT

Generally, we recommend requiring all or a substantial portion of the purchase price to be paid upfront. If the buyer puts no money down, or only a small amount, the risk is too great that he or she will later walk away from his or her obligations to you if he or she cannot operate

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the practice profitably.

If you provide seller financing, make sure to retain adequate collateral. At a minimum, the collateral will be the assets that have been sold to the buyer. It could also include other personal assets of the buyer, such as a second mortgage on a home. You may wish to consider requiring the buyer to obtain a life insurance policy on his or her life so that you will still get your deferred payments if he or she dies suddenly. You should require a personal guarantee from the individual doctor and not simply agree that his or her newly formed corporation is the only obligor on the promissory note.

COLLECTIONS OF ACCOUNTS RECEIVABLE

As noted, most buyers do not want to buy sellers’ accounts receivable. This means that you will need to collect them yourself. In this regard, it is best to retain the assistance of the buyer, since he or she will now be the employer of your staff. Generally, buyers will agree to perform this task for a percentage of collections, like a billing agency.

CONCLUSION

Selling your medical practice is a complex but potentially remunerative effort. Start early and get good advisors. Recognize that the sale of your practice, and the price you get, is not a comment on your career or the efforts and sacrifices you have made over the years. It is simply a function of market conditions, which may be favorable or unfavorable. Listen to your advisors and be realistic about your alternatives. □

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1. Cornell University Law School. Election to expense certain depreciable business assets. U.S.C. § 179. http://www.law.cornell.edu/uscode/26/uscode_sec_26_00000179----000-.html. Accessed September 23, 2010.