

# Steps to Buying an Existing Practice

The primary reason to buy an existing practice is to gain immediate access to a patient base. This base means immediate cash flow. Coupled with the endorsement of the selling dentist, this is typically the fastest and most cost-efficient way to generate a patient base for the new dentist. The steps to acquiring this base are fairly simple and, can make buying an existing practice a reasonably straightforward process.

## Advantages to Buying

In addition to acquiring the existing patient base, there are other reasons that buying an existing practice makes sense. The ongoing replacement mechanism for that patient base, i.e., the “new patient flow,” which includes roughly eighty percent of your new patients as referred by existing patients. The existing patient base represents a “built-in” marketing vehicle for the acquisition of new patients.

Competent trained dental personnel (existing staff) are high on list of importance when buying a practice. They are familiar with day-to-day operations and also serve as the transition connection for the existing patients, helping to transfer patient loyalty to the new dentist. The importance and value to the patients of knowing that the familiar staff still awaits them cannot be over-emphasized.

Few dentists receive adequate business training. The emphasis in dental school is clinical—the skills necessary to pass state licensing requirements. Buying an existing practice allows immediate access to the business systems necessary to run the dental practice. An existing practice eliminates the worry of the inadequacy relative to the business side of dentistry.

The location of the practice will continue to support the existing patient base. Patients are familiar with the basics of the practice—location, staff, fees for service, etc. History shows that 90%–95% of acquired patients will give the new dentist a chance.

## The Starting Point

The most important part of buying an existing practice is determining where you and your family want to live. Other concerns may be educational or career-related for the spouse; local schools; the community’s recreational, cultural, and sports needs for the entire family.

After the location, the next step is to contact sources to help you find your dream practice. This includes dental practice brokers,

dental supply companies, and postings at the dental schools closest to the desired area. Local, state, and national trade journals may also provide listings.

A demographic survey of the desired region is also beneficial, including an analysis of local dentists, especially related to their age, allowing direct contact with the target group. Letters can be sent expressing your desire to re-locate to the community and asking if they are aware of any dentists considering retirement, or those interested in taking on an associate who desires a purchase or partnership.

A careful analysis of your financial needs should be made. Determine what your monthly obligations are—school loans, other loans, and credit card debt. Set up a monthly budget for day-to-day living expenses in combination with the monthly debt, which will set the parameters for the size of practice needed to cover operating expenses, profit to pay your debts, living expenses, taxes and retirement.

## Selecting Your Advisors

Buying a dental practice requires seeking assistance from specialized professionals:

*Transition Consultant*—Typically someone involved as a dental practice broker but with more services and knowledge than just matching a buyer and seller. The best situation is a “Buyers Agent” who works only for you and will assist you in locating a practice, analyzing the practice, determining the correct price to offer, securing financing, and providing the services necessary to close the sale.

*Dual Agent*—A new dentist should never pay for representation from someone who already has a practice listed for sale and from which they will already receive a commission. How can someone represent a Seller for a percentage of the sale price as a fee when the higher the price they can get, the higher the fee they will earn, while claiming to be representing the Buyer fairly at the same time?

*Accountant*—Typically, an accountant assists in the analysis of the practice and should be a specialist in healthcare practices.

*Attorney*—The attorney will review the sale documents.

### Practice Analysis

When a possible practice opportunity is located, expect to sign a “Non-Disclosure” Agreement prior to receiving any specific information about the practice. This Agreement is designed to protect the Seller through confidentiality related to the fact that the dentist is considering a change of ownership. It is best for both the Seller and Buyer not to disclose information until the deal is done. If a transition is prematurely disclosed, the staff may elect to leave— followed by patients, whose loyalty to the staff may come first.

If word gets out into the community that a doctor’s retirement is eminent, the potential for patient loss increases. If patients are not given advanced warning of a change, most will take the path of least resistance, giving the new dentist a try.

The other purpose of the Non-Disclosure Agreement is to protect the personal information of the Seller, including tax and financial information relative to why the practice is for sale, confidential information about the existing staff, methods of operation (“trade secrets”), and other information that gives the dentist a competitive advantage.

Preliminary analysis of the financial information is the next step. The asking price, gross receipts, and available adjusted net receipts after debt retirement are first considerations. Will you be able to produce the level of gross receipts previously produced by the Seller? If not, will the Seller stay for the needed time to help you with production? At that level of production, and after principle and interest payments at the current asking price, will the net receipts allow you to meet your personal financial needs, including debt retirement? If the answer to any of these questions is “No,” there is no need for any further analysis.

If the preliminary analysis is positive, then seeing the practice and spending time with the Seller is next. Look for obvious issues. Confirm positives and identify areas that need to be addressed if you buy the practice. First, confirm the active patient count: This is the most important thing you are buying. The number of patients who have seen the dentist in the past eighteen months will determine a host of other factors, i.e., whether the current dentist is under-producing or over-producing on the existing patient base as well as whether the facility is of adequate size and staff, especially relative to hygiene.

Patient flow will tell whether the practice is growing, shrinking, or if leaving patients are being replaced. Lack of adequate new patient flow is not necessarily a deal killer, but plans to stimulate new patients should be made.

Is there a major personality difference between you and the Seller? If upgrades are required—budget for equipment replacement. Age and condition of equipment indicates possible downgrading of the practice.

Interviewing the selling dentist provides additional information. Unlike the sale of real estate wherein the real estate agent does their best to keep the Buyer and Seller from meeting each other, we have found the reverse to be true in a dental practice sale. Meeting the Seller is an integral part of the process. And, because of confidentiality, this typically must be done outside of normal business hours.

Questions that can only be answered by meeting the Seller include an evaluation of their personality. While different personalities and communication skills are not deal killers, significant differences will need to be addressed when subsequently dealing with the patients. Types of dentistry preferred by the senior dentist, type of materials used, special areas of interest, overall assessment of the dental community and patient community etc., is additional information that best comes directly from the Seller.

These are just a few of the areas to be considered when visiting the practice. The reader is encouraged to seek additional information on this part of the process.

If visiting the practice, (usually two or three visits are required prior to making an offer), produces a positive impact—next is a careful total evaluation of the practice numbers, which is best done with the assistance of a transition consultant and/or accountant who restricts their practice to healthcare professionals.

The practice valuation is the most important area to be addressed. In addition to providing justification for the asking price, the valuation should provide an adjusted income statement generated as part of the valuation process. Only values determined using net income should be considered, not those using formulas involving gross income. This net income will involve consideration of only those expenses directly related the production of dentistry, not additional allowable tax deductible expenses that actually go to the seller’s benefit— expenses such as health insurance paid through the practice, retirement plans for the Seller, automobile expenses, etc.

As the practice valuation, financial statements, tax returns, and other related reports are considered, one of the questions that must be answered is whether the numbers indicated make sense. Clinical supplies listed as 22% of gross receipts do not match with the national average of 6.2-7% of gross receipts. Staff salaries at 36% do not match the national average of 22-27%.

These types of discrepancies must be carefully investigated.

The asking price should also be evaluated. Typically, the price offered, if the asking price is within national averages, will be within ninety percent of the valuation price. This provides a starting point.

### Making the Offer

Every transaction has logical and emotional components. The Buyer thinks (or feels) the practice is worth \$100,000 and the Seller thinks (or feels) it is worth \$500,000 when in reality the valuation says it is worth \$250,000. When it comes to making the offer, this is best done through a knowledgeable third-party professional who can effectively deal only with the logic.

Although the price of a practice is only one of about two hundred details—that must be agreed to and, if the parties agree on a price, 95% of the transactions occur. Therefore, getting a sale price agreement is the major first step. After the parties agree on the price other details seem to fall in place.

Price agreement is evidenced by the offering and acceptance of a formal “Offer to Purchase.” This includes provisions in addition to the price, and will be subject to securing financing, securing either a lease or the purchase of the facility (if you are buying the real estate in addition to the practice, this is an entirely separate transaction), and agreement to all of the other terms and conditions as set forth in the Practice Sale Agreement.

There are many different levels of purchase offers. Some only include what was listed in the above paragraph. Others contain a multitude of details relative to the transaction and take on more of the form of a “Binding Letter of Intent.” To understand the offer process, we need to look at it from both the Buyer’s and the Seller’s perspective.

The Seller would like to know the practice has been sold and is typically unwilling to take the practice off the market unless they know they have a buyer “locked-in.” They subsequently are looking for a binding agreement secured by some type of earnest money or good-faith deposit. Their fear is that after several months of negotiations, the Buyer might back out of the deal.

The Buyer is acutely aware that their decision to purchase an existing practice is for the most part an irreversible commitment that they will be attached and obligated to for a long time. This is the most important decision of their budding dental career. Subsequently, there may be levels of anxiety about a binding agreement until all of the details are known.

The “Offer to Purchase” should take the form of a preliminary, non-binding formality. The only binding aspect should be the

agreed price. This is required by most lenders prior to serious consideration relative to their decision to provide the funds for the purchase. However, it should be open-ended enough to allow the Buyer time to continue due diligence and provide all the details of the proposed practice sale agreement including the complete terms of sale.

### Securing Financing

After obtaining an accepted “Offer to Purchase”, the next step is to secure the necessary financing. Most lenders will require the Buyer’s resume, net-worth statement, the past two years income tax returns, a consent to conduct a credit check, copies of the Buyer’s dental, drivers and DEA license, and the lender’s credit application.

In addition to the Buyer’s information, the lender will also require certain information from the Seller, including a copy of the practice valuation, copies of the practice’s income tax returns and profit and loss statements, and an historical depreciation schedule listing the equipment, furnishings, and fixtures belonging to the dental practice. If a business plan is available, it should also be submitted. If it is not, most lenders require a projected two-year budget for the practice. Many will also request the practice’s active patient count.

Using a third-party lender has a couple of substantial hidden benefits. The most important is the fact that the borrower is automatically receiving a second opinion relative to the feasibility of the proposed purchase. The lender will carefully review the transaction to ascertain whether it falls within the parameters of other practice sales and the banks lending parameters. If the lender offers a financing commitment, the Buyer can be assured that the lender believes this is a good business decision that will provide enough income after expenses to not only re-pay the lender, but also meet the Buyer’s personal financial needs.

The second primary advantage is the fact that the lender knows where and how to search for hidden liens relative to the property being acquired. After all, it is primarily their money that will be at risk if another entity shows up demanding its collateral. Your lender will literally become your partner in this transaction.

The two benefits listed for a third-party lender are not available if the Seller agrees to provide the financing. In other words, there will be no “knowledgeable” third party with assets potentially at risk reviewing this transaction. In addition, Seller involved financing typically does not enjoy as smooth a transition as third-party financing. The Seller, feeling a major part of their retirement funding is at risk,

tends to be far more critical of the new dentist and frequently, the personal relationship and subsequent goodwill between the parties deteriorates.

### Practice Sale Agreement

This agreement will have all of the details of the sale, including Buyer and Seller warranties to each other, the allocation of the sale price for taxation purposes, and an identification of the assets actually sold—also, the details on custodianship of the patients' records. Patient records belong to the patient. What happens at a practice sale is a transfer of custodianship for those records.

Other provisions of the Practice Sale Agreement specify the details of the Covenant-not-to-Compete and a promise on the part of the Seller not to encourage the employees to seek employment elsewhere. If this occurs, the patients, representing the goodwill of the practice and having the highest dollar cost, will seek the services of the old dentist, leaving the new dentist with large monthly payments, old, used dental equipment, and no patients or cash flow. The purpose of allocating some of the purchase price to the Covenant-not-to-Compete is to provide a value for the covenant or promise. If this valuable, contractually valid, covenant is broken, the assignment of value encourages a court to enforce it.

A complete dental practice sale is not a complicated transaction. The Practice Sale Agreement should be fairly written and easily understood without the need for an interpretation by an expensive attorney. The initial proposed agreement is frequently provided by the practice broker, transition consultant, or Seller's attorney. The cost to the Buyer to have the agreement reviewed by an attorney should be less than \$1,000.

The key to keeping legal costs under control is for the parties to reach their own agreement relative to the terms of the practice sale. The attorney's review is to make certain the agreements protect each party and make certain that the "i's" are dotted and the "t's" are crossed. They should not to rewrite or renegotiate the deal.

### The Remaining Details

Concurrent with the Practice Sale Agreement, you will either be purchasing the real estate or negotiating a lease for the premises occupied by the practice. Your lender will require a lease containing a term, including extensions or options to renew, equal to the term of the loan.

While the Practice Sale Agreement and lease and/or building purchase documents are being drafted, negotiated, and reviewed, several other details need to be addressed. Most

lenders will require life insurance and disability insurance to cover the payment due on the loan. This frequently takes several weeks to accomplish, so arrangements for this insurance should begin while financing is pending. In addition to the life and disability insurance, content insurance, malpractice insurance, and liability insurance should be applied for as soon as the financing is approved.

After financing, you will need to apply for a tax identification number (if you are going to operate the practice as a sole proprietorship, you can use your social security number). You will need to open a business checking account, order checks, and get business cards and stationery. This will also be the time to transfer any insurance policies requiring contractual arrangements for preferred provider status. Lastly, you will need to agree with the Seller on the content for a patient notification letter. This letter will be printed, addressed, and prepared for mailing as soon as the closing is completed.

### Completing the Purchase

Most closings are actually more of a process. The reason for this is logistics. Frequently the Buyer is in one state, the practice and Seller are in another state, the transition consultant coordinating everything and handling the money is located in a third state, and the lender providing the financing is located in a fourth state.

In this event, documents are signed separately, delivered overnight to the next party, and a fully executed copy is forwarded to the lender. The lender wires the funds to the closing agent, frequently the broker, who in turn either wires the money to the parties or overnights a check. When the Seller receives his/her money, the deal is done. Then the announcement letters are sent.

Typically, for confidentiality, meeting the staff will not occur until after the closing. Depending on the details of the sale, the Seller may or may not remain to aid in the transition. It is not necessary for the Seller to remain, as long as a referral letter is received by the patients. In fact, if the Seller is going to be leaving the practice in less than a year, it is advisable for the Seller to leave immediately.

From the date the offer is accepted, transactions can be completed in as few as eight business days, with an average of three-to-four weeks. If you are buying the real estate, financing is more complicated, expect six-to-eight weeks.