Selling Your Ophthalmology Practice

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* Financial Interest

Financial Interest Disclosure

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- Shareholders of and Consultants with The Health Care Group, Inc. and Health Care Consulting, Inc.
- Shareholders of and Attorneys with Health Care Law Associates, P.C.
Who We Are

- Business and legal advisors to physicians
- Publishers of the *Goodwill Registry*, used in valuation of ophthalmology and other medical practices
- Handle and advise re: practice buy-ins, buy-outs, sales, mergers and valuations

Introduction

- What’s Happening Now
- Pros and Cons of Selling
- Valuation of Your Practice
- Basic Sale Structure and Process
- Possible Continued Practice with Buyer After Sale

What’s Happening Now

- The pressure of demographics: Baby boom doctors reaching retirement
- Uncertainty in the air
  - ACOs
  - Budget pressure/reimbursements
  - EMR costs
  - Watching other doctors get out
So there are reasons to consider selling

- But not to panic...ophthalmology has been surprisingly resilient
- Per MGMA, median ophthalmologist compensation has increased 13.1% from 2010 to 2014, from $330,784 to $374,201
- SGR has been repealed
- Hospitals do not control referrals to ophthalmologists

What Are My Alternatives?

Outright Sale

- Cash and promissory note for the practice
  - Stock sale vs. asset sale
- 1-12 month transition period, usually
- Seller usually works short term as employee or contractor
- Seller retires
- But, what if you are not ready to retire?
Close Down

- Low effort, no legal fees, no brokerage costs
- But ….no value for your practice
- Will your patients be well cared for?
- Will your staff have jobs?
- What to do with charts?

Bring on Associate for Buy-In

- Can yield the highest value for your practice
- But takes a long time (6-10 years) to fully realize that value
- Significant hassle, fees, negotiation
- It may not work out

Stand Pat

- The “comfortable” decision
  - You know what your life will look like
  - Could ease workload and stress by dropping surgery
But Time Doesn’t Stand Still

- You are still exposed to reimbursement cuts, overhead increases
- Cutting back or dropping surgery will hurt the value of your practice
- Your health may preclude further delay
- You still have to deal with EMR and ICD-10
- You may have an interested buyer:
  - “Bird in the hand ….”

Compare Outright Sale

- Realize some value for your practice, now
- But you must be ready to pull the trigger
  - If a buyer offers you your desired purchase price today….
  - Are you ready to go?

Should I Sell My Building Too?

- Be flexible: sell or rent, as buyer wishes
- Simultaneous sale may be hard to achieve
- The value of your practice is perishable
  - Not true of office building or condo
What About My ASC?

- ASC enhances the value of your practice for buyer (ancillary profit)
- If you have partners in the ASC…
  - You will need their permission to sell to buyer

Give Yourself Time

- It always takes longer than you think
- Time pressures negatively affect price
- Time for related transactions: e.g., lease or sell office space
- Buyer has been found: 3-9 months
- Buyer not yet found: 12-24 months, or more

What’s for Sale?

- The Big Three
  - “Hard Assets”
    - Equipment, leasehold improvements, supplies, software
  - Accounts Receivable
  - Goodwill
    - Includes going concern value, charts, phone number, staff, seller’s endorsement of buyer, seller’s restrictive covenant
Hard Asset Valuation

- Book Value
  - Nearly always too low
  - Assets "expensed" under Section 179
    - These have an immediate book value of zero
    - The rest have a book value of zero in 5 - 7 years
- Specialized Appraisal
  - Not available for all items
  - Needs updating frequently

Modified Book Value Approach

- Eliminate assets no longer in use
- Eliminate personal assets
- Recalculate depreciation
  - 8 - 12 year life (overall)
  - Straight-line depreciation
  - Floor value: 20% of original cost
- Generally reasonable for most items

Supplies

- Optical frames, contact lenses, drugs
- Physical inventory, or
- Estimated value, based on prior year’s expense
  - E.g., prior year expense divided by 12 times 2 (for 2 months’ supply)
What’s Your Practice Worth?

- Accounts Receivable
  - Typically not sold in an asset sale
  - So seller generally collects and keeps the accounts receivable

What’s Your Practice Worth?

- Goodwill: What is it?
  - Any kind of intangible value
    - Likelihood of patient returning to the practice
    - Practice name, location, phone number
    - Reputation in marketplace
    - Value as a 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

2015 HCG Goodwill Registry

• Ten year average for ophthalmology is 26.72% of annual practice collections
• Five year average for ophthalmology is 27.2% of annual practice collections
• Guidelines for ophthalmology

THESE ARE (LONG RUN) AVERAGES!
YOURS MAY BE HIGHER OR LOWER!
Sealing the Deal: Nuts and Bolts

Stock or Assets

- Sellers want stock sales (all capital gain)
- Buyers want asset sales
  - Better tax treatment for buyer
  - Avoids liabilities
  - Buyer can “cherry pick” assets
    - E.g. no purchase of accounts receivable or outdated or unwanted equipment, frames, supplies, etc.

Price

- For what?
  - Stock or assets?
  - With or without accounts receivables?
  - With or without liabilities?
- Develop a term sheet or letter of intent
**Tax Allocation: ‘S’ Corp or No Corp**

<table>
<thead>
<tr>
<th>Item</th>
<th>Seller Wants:</th>
<th>Buyer Wants:</th>
</tr>
</thead>
<tbody>
<tr>
<td>Goodwill</td>
<td>$$$$$ (cap gain)</td>
<td>$ (slow write off)</td>
</tr>
<tr>
<td>Equipment</td>
<td>$ (ord. income)</td>
<td>$$$$$ (fast write off)</td>
</tr>
<tr>
<td>Inventory</td>
<td>$ (ord. income)</td>
<td>$$$$$$ (immed. deduct)</td>
</tr>
<tr>
<td>Consulting Pay</td>
<td>$ (ord. income + FICA)</td>
<td>$$$$$$ (immed. deduct)</td>
</tr>
<tr>
<td>Non Compete</td>
<td>$ (ord. income)</td>
<td>$ (slow write off)</td>
</tr>
</tbody>
</table>

**Tax Allocation: Seller Has ‘C’ Corp**

- Objective: Avoid corporate double tax
  - Funnel some of sales price outside the corporation directly to shareholder/doctor
  - Personal goodwill or personal non-compete
  - Talk with your tax advisor – some tax risk

**Sample Personal Goodwill Allocation**

- Buyer ➔ 100,000 ➔ Doctor
- Buyer ➔ 200,000 ➔ Corporation
  - 300,000 Total
Payment Terms
• 100% bank financing is best, or at least
• Significant $$$ upfront down payment (50%)
• Buyer has “skin in the game”

Payment Terms and Security
• Personal guarantee of promissory note
  • From buyer personally
  • From buyer’s spouse
• Collateral: all assets acquired PLUS buyer’s future accounts receivable
• Attorney’s fees, if Seller must sue buyer
• Life insurance on buyer

Target Sale Date
• Leave time for buyer to get licenses, hospital/ASC privileges, and payor credentials
• Assume that until title passes at closing, buyer may renege
  • Therefore, no letter to patients or other irrevocable acts prior to closing
Post Sale Employment of Seller

- Generally not guaranteed for more than 1 year
- Depends on the buyer
  - Larger group practices (3+ owners) may be able to accommodate seller
  - Solo buyer may not

Terms of Post Sale Employment

- Typical Pay: % of collections
- Duties (call? surgery?)
- Assignment of patients
- Termination rights of each party
- Days/hours/locations to be worked
- Non compete restriction
  - What about teaching, consulting, lecturing, etc.?

Lease of Space

- When seller is landlord
- Typical term 3-5 years
- Seller should avoid rights of first refusal or options to buy the real estate
  - This diminishes the saleability and value of the real estate
Due Diligence

- Call buyer’s references
  - Can buyer be trusted to take good care of your patients?
  - Does buyer have good business judgment?
- Run a lien and judgment search on buyer
  - Does buyer pay his/her/its debts?

Transition

- Letters to patients and referrers
  - Not sent prior to closing
  - Text of letter often agreed prior to sale
  - Who prepares the mailing, actually?
  - Who pays for the mailing?

- Collection of seller’s accounts receivable
  - Will buyer help?
  - Does buyer get a fee for helping with this?
  - How long will buyer help?
Transition (cont’d)

- Staff: What happens to staff’s accrued benefits, vacation, etc.?
- Use of seller’s name (door, brochures, etc.)
  - How long does this continue after sale?
  - Appropriate indemnifications to seller
- Custody and maintenance of medical records

QUESTIONS?

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