Acquiring an Ophthalmology Practice: Soup to Nuts
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The Health Care Group ®
Plymouth Meeting, PA

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* Financial Interest

Financial Disclosure

- 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?

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

Younger Solos
- Seek group environment
- Relief from management headaches
- Access to ancillary services
- Greater income stability
- Coverage
- Collegiality
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
  - Will patients accept you?
  - Can you replicate seller’s work effort?
  - 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
  - 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 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

- 2015 HCG Goodwill Registry
  - Ten year average for ophthalmology is 26.72% of annual practice collections

THIS IS A (LONG RUN) AVERAGE!
YOURS MAY BE HIGHER OR LOWER!
AVERAGE OPHTHALMOLOGY GOODWILL PERCENT

<table>
<thead>
<tr>
<th>Years</th>
<th>Goodwill %</th>
</tr>
</thead>
<tbody>
<tr>
<td>2005 - 2014</td>
<td>26.72%</td>
</tr>
<tr>
<td>2010 - 2014</td>
<td>27.26%</td>
</tr>
<tr>
<td>2011 - 2014</td>
<td>27.42%</td>
</tr>
<tr>
<td>2012 - 2014</td>
<td>27.61%</td>
</tr>
<tr>
<td>2013 - 2014</td>
<td>25.88%</td>
</tr>
<tr>
<td>2006</td>
<td>37.61%</td>
</tr>
<tr>
<td>2007</td>
<td>37.45%</td>
</tr>
<tr>
<td>2008</td>
<td>22.16%</td>
</tr>
<tr>
<td>2009</td>
<td>29.69%</td>
</tr>
<tr>
<td>2010</td>
<td>18.56%</td>
</tr>
<tr>
<td>2011</td>
<td>26.25%</td>
</tr>
<tr>
<td>2012</td>
<td>37.44%</td>
</tr>
<tr>
<td>2013</td>
<td>39.23%</td>
</tr>
<tr>
<td>2014</td>
<td>26.11%</td>
</tr>
</tbody>
</table>

Source: Goodwill Registry 2015
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

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

Tax Allocation: Seller Has ‘C’ Corp

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

Tax Allocation – Seller C Corp

<table>
<thead>
<tr>
<th>Asset</th>
<th>Seller</th>
<th>Buyer</th>
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<tr>
<td>Goodwill (personal)</td>
<td>$$$$$ (cap gn)</td>
<td>$ (slow writeoff)</td>
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<tr>
<td>Equipment</td>
<td>$ (ord income and FICA)</td>
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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
- Use a LOI or term sheet to flesh out key terms
- Stock versus assets
- Any excluded assets? AR?
- Tax allocation
- Seller’s post sale compensation
Asset Purchase Agreement

- Assets to be purchased
- Liabilities excluded
- Any contracts to be assumed?
- Price, payment terms
- Timing of closing
- Non-compete clause

Asset Purchase Agreement (cont’d)

- Transitional issues: e.g., letter to patients, referrers
  - 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
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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