

**Practice Purchase 101:
Everything You Need
To Know To Purchase
Your First (Next)
Practice**


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thank you for being with us this year.**

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Meet Our Speakers



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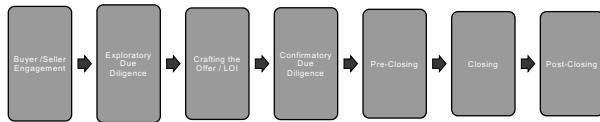
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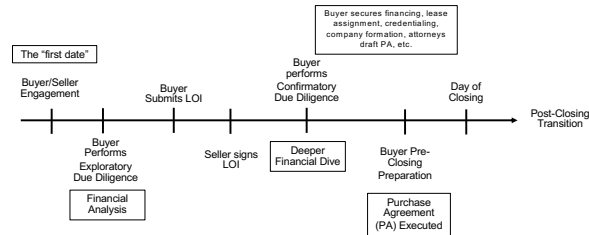
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7 Steps to a Practice Transition

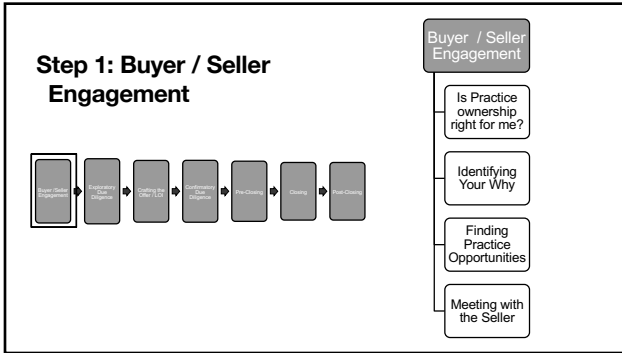


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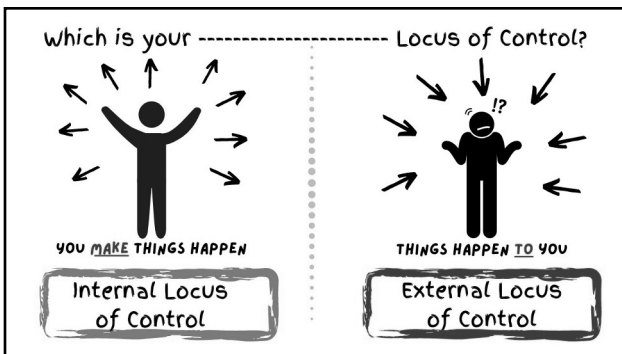
Timeline of a Practice Transition



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Is Practice Ownership Right For Me?

The biggest barrier to ownership is often a lack of knowledge and confidence.

"I don't know what to do!"

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Rural vs. Urban Practice

	Rural Practice	Urban Practice
Practice Revenue	\$1,000,000	\$1,000,000
Cost of Goods	\$280,000	\$280,000
People Costs*	\$220,000	\$280,000
Occupancy Costs*	\$60,000	\$100,000
Other Operating Expenses	\$120,000	\$120,000
OD Compensation* (Fair Market Rate)	\$170,000	\$150,000
Practice Profit	\$150,000	\$70,000

*Assumptions: COGS same for both location types; lower staff wages and occupancy costs for a rural practice; higher OD compensation for a rural practice.

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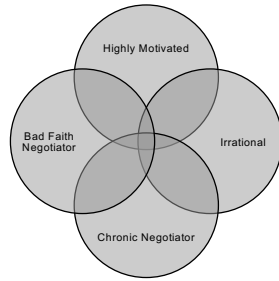
Some Sellers Aren't Serious About Selling

- First time selling and don't realize how difficult it is
- They don't learn how much the business is worth until they've seen an offer
- They don't like the time commitment
- Uncertainty about life after the sale
- Concerned about their employees
- Loss of identity



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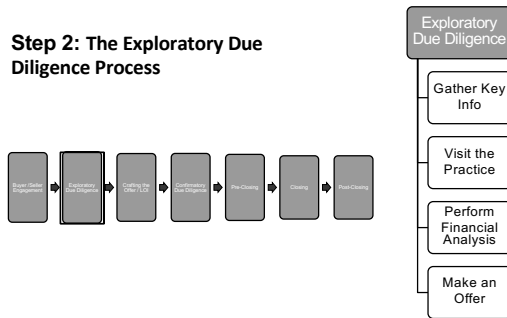
4 Common Seller Types



- **Highly Motivated Seller** - will do (just about) anything to get a deal done
- **Irrational Owner** - thinks he knows what his practice is worth, is anchored that number, and is sticking to his price without compromise
- **Chronic Negotiator** - finds any reason to drag out the deal. They often don't really want to sell.
- **Constant (Bad Faith) Negotiator** - wants to change the terms of the deal based on new information or circumstances.

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Step 2: The Exploratory Due Diligence Process



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Exploratory Due Diligence Information

- General Practice Information
- Operational Information
- Insurance Information
- Employee Information
- Equipment and Practice Debt
- Facility Information (Lease vs Building Ownership)
- Retail Data
- Financial Data



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Visiting The Practice

External Appearance:

- Location - parking, visibility, ease of entry, security
- Exterior Appearance
- Parking Lot location and size
- **Ease of Parking**
- Traffic into and out of the parking lot
- Busy intersections nearby?
- Office Signage
- **What kinds of businesses surround the office?**



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Visiting The Practice

Internal Appearance

- First Impression
- Office odors
- Entryway
- Size of optical
- Location of reception desk
- **Frame inventory and displays**
- Exam room layout
- **Type of equipment**
- **Functionality of equipment**
- Patient flow and efficiency
- Ancillary testing space
- Room for growth/expansion



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The Financial Analysis

- P&L for the last 3 years
- Current Balance Sheet
- Tax returns for the last 3 years
- Bank statement last 3-6 months
- Aging report for any outstanding A/R's (120 days or <)
- Create a practice Pro Forma

ABC Optometry Profit and Loss (Annual - Excludes)	
INCOME	
Net Fee Revenue	412,078
Net Referral Revenue	21,214
Net Grant	18,264
Net License	17,018
Net Services & Other Advances	7,500
Total Income	476,074
Cost of Goods Sold	
Net Cost of Goods	(1,250)
Net Cost of Services	(4,000)
Net Cost of Labor	(12,000)
Net Cost of Supplies	(12,000)
Net Cost of Rent	(12,000)
Gross Profit	454,824
Expenses	
Net Compensation	(174,500)
Net Franchise Fees	(1,000)
Net Marketing Expenses	(1,000)
Net Rent	(12,000)
Net Utilities	(1,000)
Net Insurance	(1,000)
Net Depreciation	(1,000)
Net Interest	(1,000)
Net Other Expenses	(1,000)
Net Total Expenses	(193,500)
Net Operating Income	261,324

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Creating A Practice Pro Forma

10-Year Pro Forma: Only enter data into cells with BLUE text

INCOME	Year 1 Assumptions	Year									
		Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9	Year 10
Net Fee Revenue	\$ 5	\$ 998,400	\$ 1,048,320	\$ 1,100,736	\$ 1,155,773	\$ 1,213,561	\$ 1,274,240	\$ 1,337,951	\$ 1,404,649	\$ 1,475,092	\$ 1,548,846
Net Referral Revenue	\$ 5										
Net Grant	\$ 58										
Net License	\$ 208										
Net Services & Other Advances	\$ 2,436										
Projected Revenue Growth	6%										
Projected VGR Growth	6%										
EXPENSES											
Cost of Goods Sold (COGS)	28%	\$ 279,552	\$ 293,310	\$ 308,266	\$ 323,616	\$ 339,377	\$ 356,707	\$ 374,626	\$ 393,256	\$ 412,626	\$ 432,877
Gross Margin	72%	\$ 718,848	\$ 754,990	\$ 792,530	\$ 832,156	\$ 874,184	\$ 917,543	\$ 963,325	\$ 1,011,493	\$ 1,062,466	\$ 1,115,969
Non-OD Staff Payroll	25%	\$ 249,600	\$ 262,080	\$ 275,184	\$ 288,943	\$ 303,390	\$ 318,500	\$ 334,388	\$ 351,212	\$ 368,773	\$ 387,212
Occupancy	Annual Increase	7.0%	7.2%	7.0%	6.8%	6.7%	6.5%	6.4%	6.3%	6.1%	6.0%
Rent	7%	\$ 65,000	\$ 69,900	\$ 75,200	\$ 80,900	\$ 87,000	\$ 93,500	\$ 100,400	\$ 107,700	\$ 115,400	\$ 123,500
Utilities	\$ 2,500	\$ 2,500	\$ 2,500	\$ 2,500	\$ 2,500	\$ 2,500	\$ 2,500	\$ 2,500	\$ 2,500	\$ 2,500	\$ 2,500
Security	\$ 400	\$ 400	\$ 400	\$ 400	\$ 400	\$ 400	\$ 400	\$ 400	\$ 400	\$ 400	\$ 400
Liability	\$ 3,000	\$ 3,000	\$ 3,000	\$ 3,000	\$ 3,000	\$ 3,000	\$ 3,000	\$ 3,000	\$ 3,000	\$ 3,000	\$ 3,000
Marketing	1%	\$ 9,984	\$ 10,483	\$ 11,007	\$ 11,556	\$ 12,130	\$ 12,730	\$ 13,356	\$ 14,008	\$ 14,687	\$ 15,393

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Creating A Practice Pro Forma

NET OPERATING INCOME (\$)		\$ 255,372	\$ 269,695	\$ 284,964	\$ 301,678	\$ 318,817	\$ 336,846	\$ 354,610	\$ 374,358	\$ 395,340	\$ 417,009
		25.6%	25.7%	25.9%	26.0%	26.2%	26.4%	26.5%	26.6%	26.8%	26.9%
OD PM Comp	66.0%	\$ 159,744	\$ 167,731	\$ 176,118	\$ 184,924	\$ 194,170	\$ 203,878	\$ 214,072	\$ 224,776	\$ 236,015	\$ 247,827
NET yr. CASH FLOW (EBITDA)		\$ 95,428	\$ 101,964	\$ 108,846	\$ 116,754	\$ 124,847	\$ 133,968	\$ 144,138	\$ 155,582	\$ 168,325	\$ 182,183
Debt Service (P+I)**		\$ 63,639	\$ 63,639	\$ 63,639	\$ 63,639	\$ 63,639	\$ 63,639	\$ 63,639	\$ 63,639	\$ 63,639	\$ 63,639
Tax Liability	20%	\$ 19,086	\$ 20,393	\$ 21,773	\$ 23,231	\$ 24,769	\$ 26,394	\$ 28,108	\$ 29,916	\$ 31,825	\$ 33,839
NET CASH FLOW \$ (After Tax + Debt)		\$ 12,703	\$ 17,932	\$ 23,454	\$ 29,284	\$ 35,438	\$ 41,935	\$ 48,791	\$ 56,027	\$ 63,661	\$ 71,715
NET % (After Tax + Debt)		1.3%	1.7%	2.1%	2.5%	2.9%	3.3%	3.6%	4.0%	4.3%	4.6%
Total Cash Required		\$ 82,725	\$ 84,032	\$ 85,413	\$ 86,870	\$ 88,405	\$ 90,013	\$ 91,747	\$ 93,556	\$ 95,464	\$ 97,473
DISCR (Target > 1.25)		1.15	1.21	1.27	1.34	1.40	1.47	1.53	1.60	1.67	1.74
Pre-Tax Cash Flow (After Debt)		\$ 31,789	\$ 38,325	\$ 45,227	\$ 52,515	\$ 60,208	\$ 68,328	\$ 76,899	\$ 85,943	\$ 95,486	\$ 105,554
Pre-Tax Return		3.2%	3.7%	4.1%	4.5%	5.0%	5.4%	5.7%	6.1%	6.5%	6.8%
ASSUMPTIONS:											
Loan Amount		\$500,000									
Interest Rate		5.00%									
Term		30									
Monthly Payment		\$61,639.31									
Loan Revenue		95.3%									

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Analyzing Key Performance Indicators (KPIs)

Key Metric	Formula
Revenue Per Exam (\$)	Total Revenue / Total Comprehensive Exams
Exam Capture Rate (%)	Exams Performed / Exam Slots Available
Frame Capture Rate (%)	Frames Sold / Total Comprehensive Exams
Lens Pairs Capture Rate (%)	Lens Pairs Sold / Total Comprehensive Exams
Average Eyewear Sale (\$)	Optical Sales / Lens Pairs Sold
CL Material Sales (\$)	CL Sales / CL Exams Performed
Exams Per Doctor Hour	Exams Performed / Total Doctor Hours
Revenue Per Doctor Hour	Total Revenue / Total Doctor Hours

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Dealing with Debt

- ▣ Loans must be **retired** at closing.
- ▣ Some **leases** may not be transferable.
- ▣ Assumed debt will **reduce** the purchase price.
- ▣ **Pre-pay penalties** may apply.



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Office Lease / Real Estate Considerations



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Additional Exploratory Due Diligence Considerations

- Professional and Retail Fee Schedule
- Assessing the competition
- Assessing the Practice Culture
- Insurance considerations
- Accounts Receivable Considerations
- Assessing the Reputation of the practice
- Doctor/Owner transition plans

Practice Buyer's Checklist

Checklist for a prospective buyer interested in purchasing a practice. The list will assist the buyer in identifying key areas of concern and help the buyer understand the practice's financial and operational performance. This checklist is intended to be used as a guide and is not intended to be a substitute for professional advice.

Checklist for the Buyer

- 1. Does the practice have a clear and concise business plan?
- 2. Is the practice's revenue growing?
- 3. Is the practice's profit margin healthy?
- 4. Is the practice's customer base diverse?
- 5. Is the practice's location in a desirable area?
- 6. Is the practice's equipment up-to-date?
- 7. Is the practice's staff well-trained and experienced?
- 8. Is the practice's reputation good?
- 9. Is the practice's financial records accurate and up-to-date?
- 10. Is the practice's insurance coverage adequate?
- 11. Is the practice's legal and regulatory compliance up-to-date?
- 12. Is the practice's marketing strategy effective?
- 13. Is the practice's operational efficiency high?
- 14. Is the practice's technology up-to-date?
- 15. Is the practice's human resources management effective?
- 16. Is the practice's risk management strategy sound?
- 17. Is the practice's overall financial health strong?
- 18. Is the practice's growth potential high?
- 19. Is the practice's competitive advantage clear?
- 20. Is the practice's exit strategy well-defined?

Make An Offer

- 1. Does the offer reflect the value of the practice?
- 2. Is the offer fair to the seller?
- 3. Is the offer supported by the buyer's financial strength?
- 4. Is the offer supported by the practice's financial performance?
- 5. Is the offer supported by the practice's growth potential?
- 6. Is the offer supported by the practice's competitive advantage?
- 7. Is the offer supported by the practice's exit strategy?
- 8. Is the offer supported by the practice's overall financial health?
- 9. Is the offer supported by the practice's reputation?
- 10. Is the offer supported by the practice's operational efficiency?
- 11. Is the offer supported by the practice's technology?
- 12. Is the offer supported by the practice's human resources management?
- 13. Is the offer supported by the practice's risk management strategy?
- 14. Is the offer supported by the practice's marketing strategy?
- 15. Is the offer supported by the practice's legal and regulatory compliance?
- 16. Is the offer supported by the practice's insurance coverage?
- 17. Is the offer supported by the practice's equipment?
- 18. Is the offer supported by the practice's location?
- 19. Is the offer supported by the practice's customer base?
- 20. Is the offer supported by the practice's profit margin?

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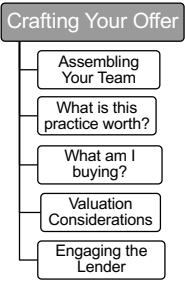
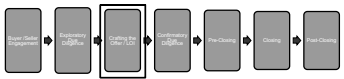
Post-Exploratory Due Diligence Considerations

- Is this a good cultural and lifestyle fit for me?
- Is the owner serious about selling?
- Does this make financial sense? (Does the math work?)
- Is the landlord likely to cooperate?
- Am I comfortable with the risk?
- Am I ready to make an offer?



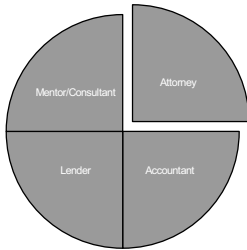
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Step 3 (Part 1): Crafting Your Offer / Submitting the Letter of Intent (LOI)



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Assembling Your Team



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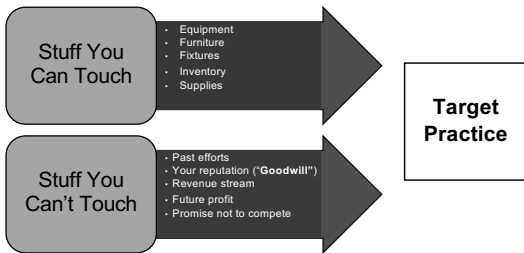
What is this practice worth?

Fair market value (FMV) is the **price** an asset would sell for (the practice) on the **open market**.

It is the price that would be agreed on between a **willing buyer** and a **willing seller**, with neither being required to act, and both having reasonable knowledge of the relevant facts.

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What Are You Buying?



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Understanding Practice Value

Tangible Assets	Intangible Assets	
<ul style="list-style-type: none"> • Fixed Assets (Equipment, Furniture, etc.) • Tenant Improvements • Inventory (Fair Market) • Supplies 	+	<ul style="list-style-type: none"> • Goodwill (1-3X Free Cash Flow) • Patient Records (\$5-10) • Covenant Not To Compete*
		= PRACTICE VALUE

*The value of a non-competition agreement is represented by the present value of the cash flows that would be lost if the covenanter were to compete, adjusted for the effective probability that the covenanter would compete, and compete successfully." Source: GBQ Consulting.com

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Intangible Assets

Goodwill. The "glue" to value.

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Transaction Types

- **Asset purchase** buys both tangible and intangible assets.
- **Stock sale** acquires the company's stock.
- Stock sale transfers **liability** to new owner.
- Most **healthcare** practices are sold as an asset sale.
- There are **tax advantages** to the **Seller** with a stock sale, and advantages to the **Buyer** in an asset purchase.

Asset Purchase vs. Stock Sale

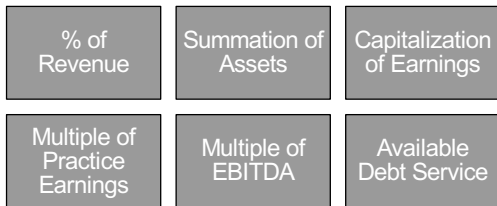
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Stock Sale vs. Asset Purchase

Stock Sale	Advantage	Disadvantage
Seller	Decreased liability; Tax advantages	May be some liability transferred
Buyer	Assumes third party contracts; TIN established; Simplified process; Avoids recredentialing	Increased liability; Lost tax benefits
Asset Purchase	Advantage	Disadvantage
Seller	Negotiating leverage?	Reduced tax advantages
Buyer	Decreased liability; Choose which assets to purchase; Tax advantages	Must reapply for third party payors and TIN

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Valuation Methods



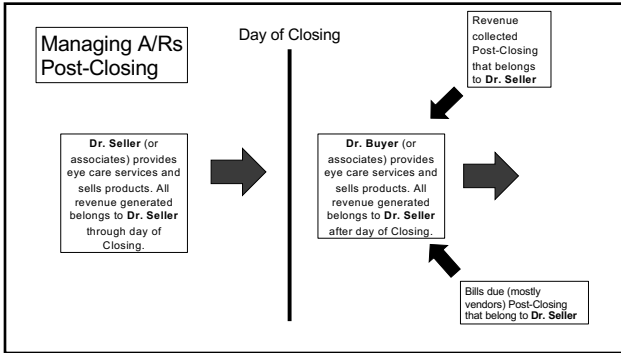
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Valuation Method: Available Debt Service

- Value based on what's left to **service the debt**.
- This is what the **banks** care about.
- Practice size and **control of expenses** greatly affect what's left to service debt.
- Every expense bucket has a **HUGE** impact on practice value.
- It's all about **cash flow**.

<i>Example:</i>	
Practice Revenue	\$800K
Practice Net	\$224K (28%)
OD FM Comp	\$140K (17.5%)
Free Cash Flow	\$84K
Available for Debt Service	\$67K (P+I)
Amortization	10 years
Practice Loan	\$560K

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Managing A/Rs Post-Closing

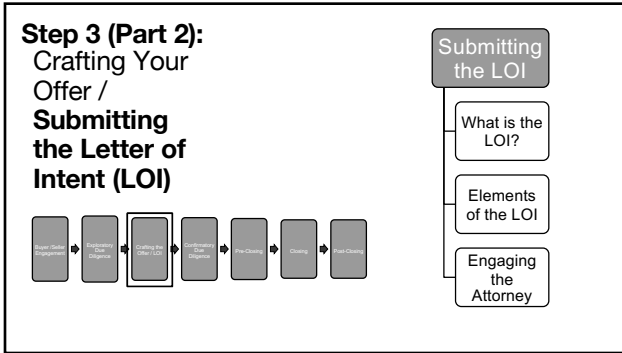
Possible Solutions	Advantages	Disadvantages
Include A/Rs in Purchase Price	Simple and easy for Seller. Transfers risk of collecting to Buyer.	Collectable A/Rs difficult to determine. May create a negotiation stumbling block with Buyer.
Buyer and Seller Track A/Rs and reconcile monthly	Clean and fair. Each party receives it's share of revenue and expenses it deserves.	Requires detailed recordkeeping, tracking and trust between the parties.
Buyer assumes both Receivables and Payables Post-Closing	Simple and easy to manage. Transfers risk of collecting to Buyer and avoids bookkeeping tasks.	If Receivables exceed Payables, Seller may be leaving cash on the table.

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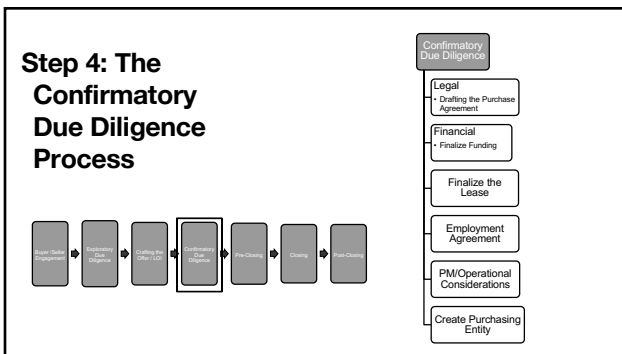
The practice value must be based on past performance, not future potential.

A buyer should only pay what the **cash flow** will support. Anything more rewards the Seller for the Buyer's **future efforts**, and potentially sets the Buyer up for **failure**.

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Due Diligence

3 types:

- Financial Due Diligence
- Legal Due Diligence
- Practice Management Due Diligence

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RESTRICTIVE COVENANTS

- Enforcement
- Associate Employment
- Sale & Acquisition
- Associate Buy-In



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ALLOCATION OF PURCHASE PRICE

Tangible v. Intangible

CPA Role

Typical Percentages



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ACCOUNTS RECEIVABLE

Who collects it?

How long should it be collected for?

How do you pay for it?




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Don't Ignore HR

18 documents

Beware of spouse



DENTAL & MEDICAL
DENTISTS • DENTISTS • DENTISTS

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The Lease

CAM

Full Service/NNN

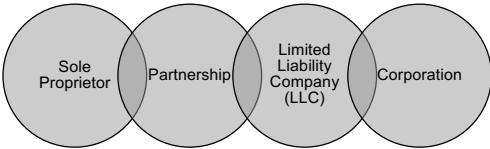
New lease or extension



DENTAL & MEDICAL
DENTISTS • DENTISTS • DENTISTS

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Creating the Purchasing Entity



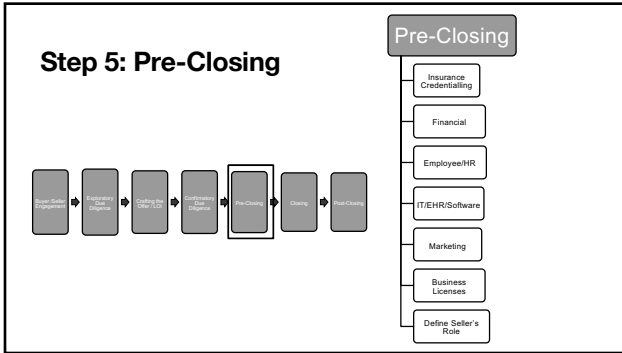
Sole Proprietor

Partnership

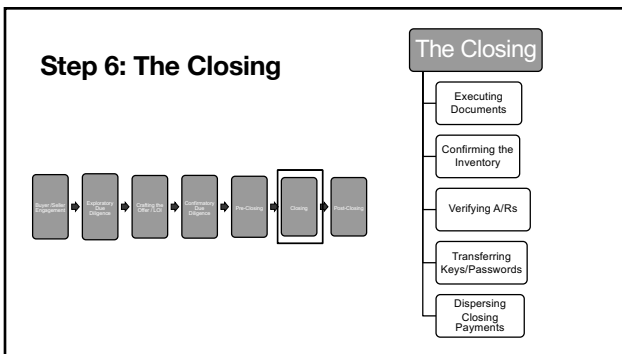
Limited Liability Company (LLC)

Corporation

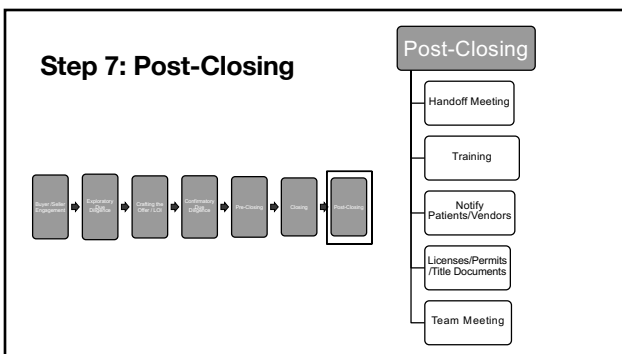
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Thank You!



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