

Successful Strategies for Buying Selling A Dental Practice

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*Whether you're buying
your first dental practice
or getting ready to sell an
established practice, you
can help assure the most
favorable outcome by
following the seven steps
discussed in this article.*

WHETHER YOU'RE VENTURING OUT on your own to buy your first dental practice or getting ready to sell an established practice, you're about to undertake a business transaction with important implications for your future. Many dentists embark on this effort with the best of intentions, only to find that the process can be time-consuming, stressful and turn out less successfully than they had expected.

What is the best way to go about buying or selling a dental practice to ensure the most favorable outcome?

Start out with a plan. Approaching the transaction in a systematic way makes it less overwhelming. The process of buying or selling a dental practice can be broken down into a series of steps, with key decisions made at each juncture.

1. Set Objectives

The first thing you need to do is develop the personal and financial objectives you want to achieve. If you're buying your first practice, you should establish goals for the size and location of the practice, the type of patient base you're seeking, whether you want to be a partner or a solo practitioner, and how much debt you are comfortable assuming.

If you're transitioning out of a practice, you'll need to consider whether to establish a partnership buy-in or seek outside buyers.

Also important is timing the sale or buy-in of your practice to maximize its value, and deciding how long you'll want or be needed to stay on after your practice changes hands.

Once these objectives are clearly defined, you're in a position to "begin with the end in mind."

2. Determine Your Timing

Dentists just starting out in practice typically spend two to five years working as an associate in an established practice. During this period, they can hone their technical skills and build confidence without having to shoulder the financial and managerial responsibility of the whole practice. But sooner or later, most associates realize that they cannot reach their salary expectations as an employee and decide it's time to either become a partner or set out on their own. And it's common for the dental associate to start feeling like he or she is functioning as a partner but being remunerated as an employee.

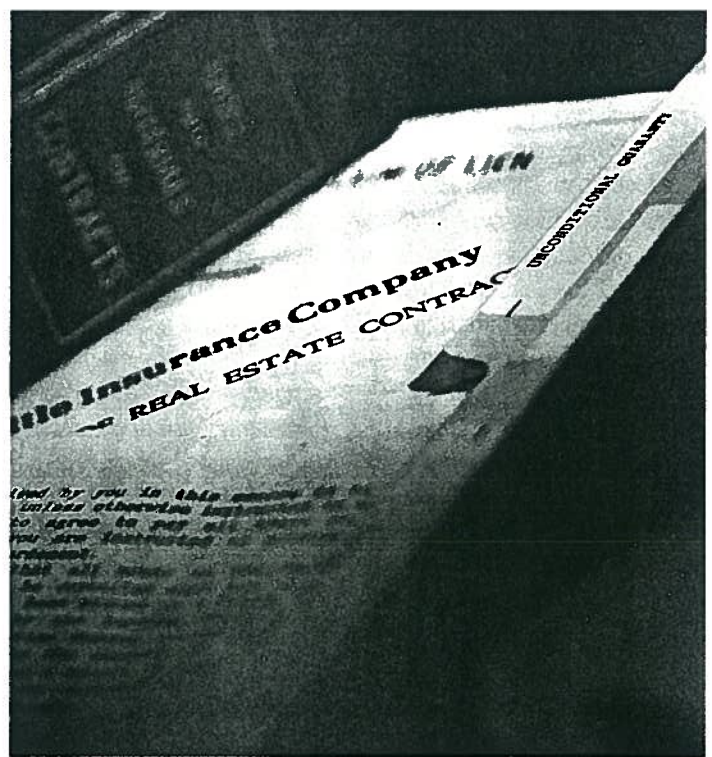
More often than not, dentists opt to buy a practice early in their career. While this is a major step, it's one they are ready for once they are confident of two things: their ability to perform at a satisfactory production level, and their readiness to take on the responsibilities of running what is essentially a "small business."

While exceptions can be found, our experience with dentists shows that the majority of dental associateships do not result in successful partnerships or buy-ins. Psychological and financial obstacles generally stand in the way. For a partnership or buy-in to have the best chance for success, the financial and operating terms should be established in advance. A written agreement clearly spelling out all terms, restrictive covenants and the timing of key transition events goes a long way towards avoiding problems from cropping up later on.

The optimal strategy is to time the sale of your practice to achieve the maximum financial gain possible.

What about the dentist who is trying to decide the best time to sell an established practice? This is a lifestyle and financial decision that will differ from one dentist to the next. Dentists sell their practices for reasons that can range from the desire to relocate or work part-time, to wanting to change careers or retire. The optimal strategy is to strive to time the sale of your practice to achieve the maximum financial gain possible. A practice that enjoys high production and profits, a solid patient base and dependable staff is at its most valuable point in the marketplace. Once the practice becomes part-time, production numbers and active patients generally start to drop. A decrease in gross income will cause a direct reduction in the value of the practice.

The most common strategy is to sell a dental practice at or near its peak production and then walk away shortly after it is sold. This provides a quick transition for the seller and eliminates the need for any extended relationship between the selling dentist and the buyer, who generally wants to take charge soon after closing on



the practice. Also, most practices are not large enough in terms of physical space and patient load to accommodate both dentists through a prolonged transition.

3. Have the Practice Appraised

Once you've determined that now is the time to sell your practice, getting a professional appraisal done is an essential step. A thorough appraisal is key to determining the fair market value of the practice being sold and should serve as the blueprint for developing the optimum selling price and preliminary financial terms. It's also an important marketing tool, as it provides potential buyers with disclosure about key features of the practice and establishes the rationale for its market value. Without it, you risk subjecting the sale price to arbitrary negotiations between the buyer and seller.

If you're buying a practice, you should have access to the appraisals of all practices you're considering. The appraisal should be conducted by a practice broker or transition consultant with experience in this area. It should include all of the items listed below.

History of Practice: Background on the selling doctor; how long the practice has been established; current and previous locations; any special attributes of practice, for example, specialized procedures.

Description of Facility: Size and layout of office, including number of operatories; type and age of equipment; lease or ownership of real estate with associated fees.

Information about Community: Basic demographics about community and where practice is located in community, that is, downtown or residential.

Office Hours: Hours for the doctor and the hygienist, as well as other key personnel.

Fee Structure: Breakdown of fees by procedures and also by fee-for-service versus reduced fee plans. Include percentage of doctor's income produced by each procedure, if available.

- **Gross/Net Income:** Reported income for last three years and year-to-date as stated on practice tax returns. The net income is derived by restructuring practice expenses to reflect the true profit and cash flow of the practice. To determine the true profit, non-cash deductions (i.e., depreciation and amortization) and personal expenses not necessary to run the practice (for example, owner's medical insurance or car lease payments) are added to profits. This step is key for assessing practice value and will be used by the purchaser's accountant and financing source to determine how the purchase is to be funded and how much cash flow remains for the practitioner.
- **Patient Profile:** Demographics of patient base, including age range and socioeconomic factors. The number of active and new patients are important barometers of practice vitality and growth.
- **Employees:** The number and type of staff, both professional and administrative. An important variable here is whether the employees plan to remain with the practice to ensure continuity.

Once this information is documented, it is entered into a valuation method to derive the practice value. The model our firm uses is heavily weighted towards practice income and patient base, the two most critical determinants of practice value. An industry accepted approach, the composite valuation method compares the common elements found in dental practices to an ideal practice (the "model") in order to develop a percentile rating, which is then multiplied by 1.0 to 1.5, a standard market factor for net receipts. This market factor hinges on variables like the location of the practice,

another significant determinant of practice value. The resulting percentage is then applied to the practice net income, and the value derived is added to the value of the tangible assets, that is, equipment, leasehold improvements, to obtain the fair market value of the practice (Appendix 1).

It's important to remember that while an appraisal is an important tool, all appraisals employ subjective valuation criteria to arrive at their conclusions. Also, any appraisal is only as good as the professional who's conducting it. The appraiser must be knowledgeable about the dental marketplace and have firsthand information about actual sales in similar areas in order to be able to assess how your practice stacks up against other opportunities. Otherwise, the value derived is no more scientific than having the selling dentist arbitrarily assign a percentage of practice gross income and call it the fair market value—a valuation technique frequently used in lieu of a professional appraisal.

4. Find the Right Buyer or Seller

For any practice sale to succeed, it must be a win-win situation for both buyer and seller. Matching the right purchaser with the right selling dentist is a key component to making it work.

Whether you're planning to buy or sell a practice, employing the services of a professional practice broker or transition consultant can be a smart move. These professionals are experienced in the process of finding, screening and introducing dental buyers to sellers with attractive practice opportunities, as well as handling the negotiating and structuring steps involved in putting together the

SAMPLE APPRAISAL

COMPOSITE METHOD (Rounded to nearest \$500)

This valuation method compares common elements found in dental practices to an ideal practice in order to develop a percentile rating which is multiplied by 1.0 to 1.5, a standard market factor for net receipts. In this appraisal, the market factor was 1.5 because of the desirable location of the practice and comparisons with similar practice sales in the area. The resulting percentage is then applied to the practice net income and the resulting value is added to the value of the tangible assets to obtain the fair market value of the practice.

Net Earning Composite Method¹

Net Earnings ²	\$161,000 ²
Net Composite Factor	x 1.28 (1.5 x .85—the practice percentile rating)
Value of Intangibles	\$ 206,000
Value of Tangible Assets ³	60,000
Fair Market Value	\$ 266,000

Practice Rating Sheet

	Model	The Practice
Gross Receipts	10	9
Profitability	10	10
Location	8	7
Growth Potential	7	4
Collections	3	3
New Patients	5	5
Lease	5	5
Equipment	6	4
Staff	7	7
Recalls	5	1
Competition	8	4
Patient Base	6	6
Transferability	7	7
Practice components (type of work)	7	7
Patient types	6	6
TOTAL	100%	85%

Notes:

1. This practice valuation was used for a Westchester, NY, practice in a desirable suburban location. Practice gross income is \$375,000.
2. 1998 reconstructed net income
3. Estimated value of equipment, instruments, supplies and furniture and leasehold improvements (does not include cash in bank, accounts receivable and personal items, i.e., cars, art work, books, etc.)

transaction. Obtaining professional advice can also save both parties a lot of time and unnecessary headaches along the way.

Our experience shows that lots of dentists like to look at practices for sale, but few make the final commitment. So dentists who look for their own buyer should be prepared to talk to several candidates before finding the right one.

There are various means of finding potential buyers for your practice. You can advertise your practice for sale in state and national dental journals and trade publications, in the practice opportunities classifieds of high circulation newspapers like The New York Times or by contacting the recruiting offices of area dental schools. Some dentists also ask their local dental supply dealers for referrals.

Many selling dentists are concerned about their confidentiality and may be reluctant to provide intimate details about their practice to any dentist that answers an ad. A good way to handle this is to develop a written practice description that provides all key information without disclosing your exact location. This is a document worth developing so that prospective buyers have the answers to basic questions and enough additional information to decide whether the opportunity looks attractive. The advertisement should direct interested candidates to submit a letter to a box number and in return, you can mail or fax them a practice description.

Once a mailing has gone out, the seller should follow up about a week later with a phone call to the prospect. The call provides the opportunity to determine whether the dentist has a serious interest in the practice before arranging a face-to-face meeting. Screening questions should probe for how long the candidate has been practicing, other practices he or she has seen and why they were not purchased, and whether the prospect has good credit. This conversation should help the owner form an impression of whether the dentist is serious about buying and is approaching the process systematically.

The prospective buyer should ask questions about how long the owner has been trying to sell and the results thus far, the amount of time the owner would be willing to stay on to introduce patients, and whether the seller owns or leases the office space and is willing to provide any buyer financing. Responses should give the purchaser an idea of whether the owner is ready to sell and is attracting serious candidates.

Once the prospective buyer and seller have successfully passed the phone screening, the next step is to arrange a meeting at the owner's practice. This is an important meeting and each party should have a clear agenda to assure that the visit is informative and productive.

For the purchaser, the first visit has two objectives: to form a qualitative impression of the practice, and to gather enough facts to decide whether to proceed. Before the meeting, the buyer should find out as much as possible about the community where the practice is located. Sometimes the seller provides this information up-front. If not, the candidate should contact the town library, area chamber of commerce or do a search on the Internet for a socioeconomic profile of the community.

The meeting should be scheduled either before or after the owner's office hours, with sufficient time allotted to tour the facility

and discuss daily operations, staffing, records and production. During the office tour, the candidate should note the size and condition of the operatories and equipment, view lab cases ready for insertion, check the amount and type of supplies, and assess the attractiveness of administrative staff and patient waiting areas. The prospective buyer should feel free to open closets, inspect lab areas and look at bathrooms. Once this is done, he or she should ask to look at the doctor's appointment book and active patient charts. The purpose is to find out what procedures the doctor is performing, how long each procedure takes, and how far in advance appointments are booked. A review of patient charts provides a snapshot of procedures being performed, how often patients use the dentist's services and where patients live or work.

While the prospective buyer is busy viewing the office and patient information, the owner should be forming an impression of

The prospective buyers should feel free to open closets, inspect lab areas and look at bathrooms. They should also ask to look at the doctor's appointment book and active patient charts.

the candidate's personality and potential "fit." The seller should feel free to ask the prospect questions about his or her practice mission and philosophy, personal values and work ethic. This will help the seller to assess how compatible the dentist is likely to be with existing patients.

The initial meeting should be viewed as a fact-gathering exercise. Negotiating the practice

price and terms is inappropriate at this point. Of course, the buyer should already know the purchase price from earlier conversations.

At the conclusion of the meeting, the owner should ask whether the prospective buyer thinks the practice represents a good opportunity. If the buyer expresses interest at this point, the two should exchange accountants' names, so they can begin the process of reviewing detailed financial information about the practice. The seller should also ask what other information the candidate needs to help make a purchase decision and provide it soon after the meeting. If the prospective buyer wants some time to think about the practice before taking the next step, the owner should follow up by phone within a week to maintain interest. Sometimes, the prospective buyer will want to visit the practice again to confirm certain features and ask further questions.

5. Structure the Terms of the Sale Effectively

Once the buyer has reviewed all available information and has decided to move ahead, the next step is to secure an offer and negotiate the terms. If you have retained a practice broker, it is that person's job to act as intermediary and handle the paperwork and negotiations among all parties and their respective accountants and attorneys.

If you're handling the transaction without outside help, the next step is to prepare an "offer memo," which stipulates the basic



terms of the transaction. The buyer and seller should collaborate on drafting this document. When thoughtfully prepared, the memo eliminates any confusion about what's being sold and helps increase the likelihood that the transaction will close smoothly.

The offer memo should spell out the following terms:

- Practice Price.
- Terms of Payment: All cash paid up front, or the amount of down-payment and how balance is to be paid; the amount of financing to be provided by seller or outside financial institution and terms.
- What's Included in Purchase Price: Equipment, supplies, leasehold improvements, all equipment in working order at closing, etc.
- What's Not Included in Purchase Price: Personal items, accounts receivable, cash in practice bank account, etc.
- Seller's Non-compete Agreement: The distance from current practice where seller cannot practice and amount of time agreement is in effect.
- Seller's Work in Progress: How unfinished work and any "redos" will be handled.
- Real Estate Consideration and Contingencies: Lease arrangements or purchase price and terms of real estate.
- Tax Allocation of Purchase: Accountants for each party should address the best way to handle the tax allocation of the purchase, since the transaction carries significant tax effects. The goal is to allocate the purchase price on a mutually beneficial basis.
- Transfer of Practice: All arrangements for introducing the new doctor, including introduction letters, the length of time the seller will remain, duties and remuneration for selling dentist.

Once both parties agree to the memo, it should be forwarded to the attorneys and accountants involved in the transaction. The seller's attorney will use the document as a guide for preparing the sales contract.

6. Transfer Arrangements

Both the buyer and seller have a vested interest in helping to ensure the highest patient retention rate possible, since this is a key variable to the success of the incoming doctor.

A seller's letter should be prepared that advises patients of the seller's impending departure and introduces the buyer and his or her qualifications (Appendix 2). It's important that the letter be prepared and mailed to patients immediately after the closing, before word gets out that their dentist is leaving. In the event that there is any lag between the time the letter goes out and patients are scheduled for appointments, the seller should decide whether to contact scheduled patients personally or advise each patient on the day of the visit.

A month after the introductory letter, the new dentist should send a follow-up letter to all existing patients. In this letter, the new dentist can tell existing patients more about himself or herself, and communicate any new benefits the practice is offering to enhance patient services, such as expanded hours and additional dental procedures.

7. When to Say Good-bye

How long should the selling dentist stay on with the practice? Many well-intentioned sellers plan to stay on longer than necessary, often creating unintended problems for the new dentist. The two biggest problems that arise are insufficient workload to support both doctors, and the perception of the incoming dentist by patients and dental staff as "second string." The old maxim, "there's only one captain to a ship" is very apt in this situation.

In most cases, the seller is retained for up to three months to assure a smooth transition and protect the cash flow of the practice. During this period, the seller helps introduce patients to the new doctor and complete work that's already in process. Remuneration for this period should be worked out in advance as part of the offer memo and sales contract.

Exceptions to the three-month period are made for practices requiring more than one dentist to perform the necessary work and in specialty practices, like orthodontics or periodontics. In these cases, the selling doctor may be retained for up to six months. Other exceptions are made when a purchaser intends to hire other doctors to work in the practice and would like to retain the original dentist until the new associates are in place.

In addition to communicating with existing patients, it's important for the new owner to schedule a meeting with the office staff after a contract is signed or immediately after the closing. The purpose of this meeting is to introduce the new dentist to the staff and to reassure them that they are valued members of the team, regardless of the dentist's future intentions. Also, the staff should be advised how to introduce the new dentist to patients phoning for appointments.

Conclusion

Most dentists find the process of buying or selling a practice an exciting one, at least at the outset. Yet they can become frustrated if the process drags on for several months or, worse, breaks down because of lack of communication, insufficient information or difficulty moving the transaction past the inevitable stumbling blocks.

In our experience with dentists buying a practice, the ones who are most successful know what they're looking for, are realistic about the cost of attractive practices and concentrate their search

on opportunities that meet their criteria. They also ask for and receive sufficiently detailed information from the seller to help make informed decisions.

Dentists who sell their practice successfully start with a professional practice appraisal so they know its value before setting a sales price. They also have a realistic grasp of the best selling features of the practice along with an understanding of how less positive features affect its market value. Finally, they are willing to spend the time to develop the detailed practice information needed to attract prospective buyers and then to demonstrate to these buyers that what they've told them about their practice is true when they visit the office.

In short, dentists who approach the process with the "end in mind" and follow the seven steps that have proven successful for hundreds of other dentists are most likely to make the kind of decisions that lead to a win-win transaction for both buyer and seller. ■

Mr. Mattler is founder and president of Countrywide Practice Brokerage, Inc., a firm that specializes in the appraisal and sale of dental and medical practices. The company has offices in Manhattan and Greenwich, CT.



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Appendix 2 **SAMPLE PATIENT LETTER FOR SELLING DENTIST**

DEAR VALUED PATIENTS:

For the past 20 years, I have worked diligently to provide you with the best dental care available. I am proud of the practice I have built and gratified by the many wonderful relationships I have developed with so many of you over the years.

Therefore, it is with mixed emotions that I am writing to advise you of my retirement from dentistry. My foremost concern in making this decision was to find the right dentist to assume the duties of my dental practice. I knew this would take a special person who could blend a high degree of training and experience with a caring approach to patient treatment.

I am pleased to entrust your continued dental care to the capable hands of Dr. Joseph M. Miller, whom I am certain you will find extremely competent and personable. A native of New York City, Dr. Miller is a graduate of the New York University College of Dentistry, the same school I attended. He has been practicing general dentistry for the last five years. He is committed to providing his patients with personalized care and state-of-the-art dentistry. He is also a strong believer in continuing education as a means to ensure that his patients receive the highest quality dental care. I am pleased to have found a dentist who can offer my patients this rare blend of diverse training and devotion to patient care.

I will be working with Dr. Miller for a short time to ensure a smooth transition and to help him get to know your oral health care needs. During this time, I will be available to answer any questions you may have. Our office location and telephone number will remain the same, and you'll be glad to know that our staff will be remaining with the practice.

I strongly encourage you to continue your care with Dr. Miller. I recommend him highly and know you will be in excellent hands. In closing, please accept my appreciation for the confidence and friendship you have shown me through the years.

Sincerely,

Dr. Stephen Smith