

Points to Consider When Buying a Dental Practice **By Darryl Bodnar, CPA**

Acquiring a dental practice on your own involves a number of steps that need to be followed in order for you to turn your dream into a working reality. It sometimes seems overwhelming, but most doctors looking to buy their own dental practice have had to answer the same questions. Whether you want to be your own boss, control your own future or work where you please, those looking to buy dental practices have one thing in common: to do things their own way.

Timing is a critical in purchasing a dental practice.

It is rarely a good idea to buy a practice right out of school. Instead, working as an associate for 2 to 3 years allows you to gain experience in the dental field and familiarize yourself with the business side of a dental office before opening one of your own. An opportune time to purchase a dental practice is when the owner you are working for has decided to retire. Purchasing the practice from someone you work for has the inherent advantages of knowing how the practice operates, understanding the staff dynamics and having realistic business expectations because you have worked there.

Buying an existing practice is usually a better path.

It is important to understand the differences between starting a practice from scratch and buying an existing practice. While starting up a practice from scratch may come with a lower price tag than buying an existing practice, the existing practice route is often less costly to your pocketbook. This is because you have the advantage of purchasing an already operational dental practice with an immediate patient base and revenue stream that comes along with it and you therefore don't have to sacrifice as much income to ramp up compared to

the ramp up of patient flow required in a start up practice. While the price tag of an existing practice can be higher than the out of pocket costs of a startup, the practice purchase is usually less costly overall as the purchase of a practice puts you into the swing of things faster, maximizing your Return on Investment (ROI) and getting dollars back into your bank account faster. Financing a practice purchase may also be easier than financing a start up practice. Overall, buying an already existing practice rather than starting a new one means a shorter time line to your future, as the first few steps are already done for you.

Knowing the dynamics of an area is a key factor.

Picture what type of practice you see yourself owning 10 years from now. Conduct a demographic study of the area to make sure it's a good fit. Know the dentist to population ratio - is there a demand for a new dentist in the area of your choice? Under serviced areas are advantageous to having a successful business. The best locations are those that are easily accessible and visible from the road. When you are buying an already existing practice, you want to make sure there is a large enough active patient base. Also, look into the future growth plans of the area you've chosen. In the coming years, know what the housing, infrastructure and businesses of the area will look like – your local Chamber of Commerce can help you with this information. Consider insurance plan integration within the community – this plays a key part in determining what type of practice you may have. Lastly, if you buy a practice, it is important that the one you purchase has an operating philosophy that you can work with. .

Finding practices for sale may be easier than you may think.

There are dental practice brokers who can help you with locating practices for sale. These brokers can also assist you in finding an associateship arrangement if you are not interested in immediately purchasing a dental practice. Asking local dental supply/equipment reps can also be a good resource to learn what practices might be available as sales reps typically visit practices more consistently than any other person and gain valuable information about their customers during their sales visits. Contacting dental schools in the region and

looking in dental association's/society's (both are easily obtainable via the internet) newsletters are another resource for identifying opportunities.

So you think you have found the practice of your dreams?

Know the asking price of the practice(s) you are interested in and expect to sign a confidentiality agreement - but understand what you are signing. Sellers are going to want you to keep their information confidential and not later use it to compete against them should you choose not to purchase their practice. If the selling practice has involved a broker, there may be a deposit requirement in order to weed out the casual lookers from those who are more serious about a possible purchase. Once you are in the door with the confidentiality agreement, ask for both a practice profile and a valuation report so you know the details of the business. Also request the historical financial information for the past 3 - 5 years so you can see what the financial results have been for the practice. After reviewing this information, determine if there is any other information you may need as your goal is to make an accurate prediction about the practice you are about to acquire.

If after reviewing all of the information you are impressed with what you see and you wish to proceed further, it is crucial that you get a second opinion from a qualified professional. Locate a dental CPA or another professional and a lawyer who has experience in evaluating dental practices – they will become your advocate. These professionals have significant experience in knowing the ropes of a practice purchase and can help you identify business issues which could affect the financial outcome of your purchase as well as help you negotiate the best deal for yourself. It is always prudent to involve an experienced professional before you commit to buying as you do not want to find yourself having made the purchase to then learn that the transaction was not properly structured and you paid more than you otherwise could have or that your purchase has become a losing proposition.

If possible, get a feel for how the practice actually operates. Make arrangements to spend time in the office and get to know the doctor(s) you are buying it from and do a few site visits to observe the practice in action. See how it operates. Get a feel for the atmosphere and the "personality" of the practice. You want to be comfortable that the environment of the practice fits with your goals, philosophies and personality.

Many questions and issues will arise during your review of the practice so write them down as you will want to have your own file with good notes to refer to. This ensures that no questions are left unaddressed by the time the purchase is completed.

Additional Information you will need to see in writing includes:

- At least most recent 3 years of federal income tax returns and financial statements
- At least most recent 3 years of annual production, adjustments, collections by provider
- At least most recent 3 years of annual production, adjustments, collections by payer
- Most recent 3 years of annual totals of production by procedure
- Patient demographic information from patient management software (age groupings, zip codes, etc.)
- Fee schedule
- Copy of the space lease
- Copy of any employment agreements for associates
- Employee census information
- Current employee benefit programs
- Listing of furniture, equipment, computers and software, with age or year of purchase

Analyze the financial information and consider your offer.

Is the asking price within the “range” of what you originally planned to spend? If so, where in the range does the asking price fall? If not, how far out of the range is the asking price? Will the anticipated practice revenue and cost structure allow you to generate enough income to pay the asking price and earn a satisfactory personal income? Know all procedures offered by the existing practice and make sure you are familiar with them. Are there any procedures you may do that the existing practice doesn't offer? Knowing the dentist production to hygiene production ratio may also help you determine if there is untapped production opportunity for you.

Make a list of the hard assets you will be obtaining in the business transaction, know the age and condition of each asset to figure out if new equipment is necessary. Most importantly, know the seller's intentions and make sure there is no gray area left in the deal.

Now comes the due diligence process.

There are a number of steps you must take in order to validate the legitimacy of the practice you are planning to buy. During your visit to the practice, review/audit some patient charts. Compare the monthly production and collection information you were given against the practice accounts receivable tracking to validate the data. Make sure all monthly figures are accounted for and that any production or collection adjustments were properly accounted for so that the information you are using accurately reflects the real figures for the practice. Have the hard assets inspected and the space lease evaluated, to make sure they meet your understanding. Familiarize yourself with the practice's billing/collection policies and scheduling procedures for patients. Request the employee handbook and any other benefit plan documents the practice may have. Finally, become familiar with the type of patient management software used by the practice.

Making a serious offer means presenting the seller with a Letter of Intent (LOI). Use a dental specific attorney to help uncover anything you may have missed. Clearly state your offer (price) and allocation in the beginning of the LOI. If the seller is the one financing, include terms of note. Understand the contingencies of the deal including: the lease, the financing, the facts, and the due diligence. Find out if the seller has decided to exclude any certain personal assets. Come up with an agreement of the seller's compensation and work schedule if they are planning on staying on board. Make sure the space lease, financing and covenants are all acceptable. Also be certain that the purchase transaction is contingent upon you being able to assume the space lease and all other contracts important to you which the seller currently has. Explain clearly in the letter how you expect to cooperate with the seller and how you expect the seller to cooperate with you. State any warranties that may exist and note any significant changes that may happen prior to the settlement.

Continuing the process with outside lending sources is important. Compile your personal and practice information for lenders. Contact various lenders and collect financing proposals from each to compare your

options. Also, decide on the type of business entity you will operate as your choice of entity will have an impact on your income tax situation. If any negotiations regarding the space lease have taken place, begin to resolve them. Think about your marketing plan for the upcoming year. Decide what you plan on calling your practice (a generic/geographic name rather than your name will make it easier to sell the practice in the future). If you are still employed with an outside practice, figure out a good time to give notice to your current employer, and review any employment contract restrictions before giving notice as this could affect your transition plan.

The money aspect may be the trickiest.

Knowing how much and when to borrow are especially important aspects. When borrowing for the purchase price, also take into account one month average collections and borrow for that as well to help support your initial cash flow since it will take time to get your revenue flowing while your expenses will start immediately. Borrow any capital expenses needed in the first year and ask for a Line of Credit (LOC). Types of lenders to contact include: dental specific, local banks and the seller. You'll want to know the terms, interest rates, life of loan, early termination penalties and flexible payment options of each lender. Evaluate the lender's fees and associated expenses. Examine any differences in collateral requirements and who the lender will require to be a loan guarantor as this could make a difference in which lender you choose.

How to allocate the purchase price.

Whenever a practice purchase price is established, the price must be allocated across the various assets being acquired. This allocation is important because it determines what the income tax consequences of the purchase will be to the buyer and to the seller. Different classes of assets are treated differently as far as income taxes are concerned - some assets are deductible more quickly than others by the buyer and some are taxed differently to the seller. There may be local sales and property taxes to consider which might be imposed on certain types of assets making the transaction costs higher and the ongoing annual property taxes higher. The assets typically considered in a purchase price allocation are: equipment and furniture, computer software and

hardware, supplies, patient charts, covenants, and goodwill. Also, some of the price may be carved out to pay for consulting agreements and professional fees (organizational and start up expenses). Coming to terms on the allocation is usually a negotiation between the buyer and the seller because what is best for the seller is not always best for the buyer and vice versa. There are guidelines of reasonableness which also must be considered in making the allocations.

Completing the purchase and the future.

Have all legal agreements reviewed by a knowledgeable dental attorney. Agree on who pays the costs of things such as broker fees, sales and transfer taxes. Some transitional issues which should also be addressed in the agreements include: how will the seller's accounts receivable be handled, who will bill it and who will collect it; how will transitional vendor invoices will be handled; how will unpaid staff vacation time be handled; what is seller's financial responsibility for patient redo's and how will they be handled; what access will the selling doctor have to the office, how much can he/she come into the office, how much time will he/she devote to patient transition; when will announcements be mailed, etc... These are just some of the transitional issues which will need to be considered and should be included in the final legal documents.

Beyond the agreements, you will want to be thinking ahead on things like becoming familiar with the patient management software you'll be using. Choose the type of book keeping software you want to use and get it set up. Find a payroll service provider and come up with HR policies including internal controls and employee training (if those are not already in place with the practice you purchased). Get your banking arrangements established and all accounts set up as well as your online links established (including payroll.) Get your vendor accounts established for your routine needs such as dental supplies, telephones and billing software contracts. You want to be prepared to hit the ground running the day you complete the purchase so you can be working at the chair and not spending time on administrative setup issues which should have been completed in advance.

Once the settlement is completed and you are the owner, it is time to start thinking like an owner. You will need to market yourself and your new practice. Think about joining local study clubs, referral groups and local societies. These all create positive buzz for your new practice. You may want to further evaluate your staff, the

compensation they'll receive and the timing of changes in your new dental practice. Are you going to raise patient fees? Make any necessary modifications to policies and procedures. Consider the physical appearance of the office - are there any changes you would like to make? Find business and personal insurance that fit your needs and your employees' needs. Get involved in the community - your personal image ultimately reflects the image of your practice. Continue studying business best practices and finally, plan for your successful future.

Darryl Bodnar, CPA, is a partner with the Dental CPAs, a division of Naden/Lean, LLC. Darryl provides his dental clients with expert advice on accounting, tax strategies, consulting, business and tax issues. He has expertise in cash flow and profitability planning, operational management, and associate/partnership agreements for his dental clients. Darryl also has a concentration of clients in the advertising/creative services, professional services and equine communities. In his spare time Darryl is an avid fly fisherman and enjoys riding his motorcycle.

Darryl can be reached at dbodnar@dentalcpas.com or (800) 772-1065.