

SELLING A MEDICAL PRACTICE

Part I: Preparing the Practice for Sale

MARCH 2014

The Physician Practice Group at Murtha Cullina is pleased to provide clients and friends with information about topics of interest.

If you have questions about the issues addressed in this newsletter, or any other matters involving regulatory issues you may face as a physician, please feel free to contact the following attorneys:

Heather O. Berchem
Marcel J. Bernier
Lauren Filiberto Hopwood
Robert V. Giunta, Jr.
H. Kennedy Hudner
William J. Keenan, Jr.
Paul E. Knag
Mark F. Korber
David A. Menard
Natale A. Messina
Hugh F. Murray, III
Elizabeth M. Neuwirth
Rachel Faye Smith
Stephanie Sprague Sobkowiak
Maria Pepe VanDerLaan

In Boston:
617.457.4000
In Hartford:
860.240.6000
In Madison:
203.245.9991
In New Haven:
203.772.7700
In Stamford:
203.653.5400
In Woburn:
781.933.5505

www.murthlaw.com

For many physicians, the time has come to sell their practice.

The reasons are many: financial pressures; changing regulatory landscapes; quality of life; and simply getting older. Whatever the reason, a physician interested in selling his or her practice must understand that in order to get the maximum return, they have to devote the time and attention necessary to get ready for the sale.

This article will explore the practical considerations associated with preparing for the sale of your practice.

Plan Ahead. It is essential to start the process early because a short time frame favors the buyer. A good estimate of the time necessary to organize the office and files, identify the best buyer and negotiate and close a sale transaction is two to five years. The size and complexity of your practice will obviously affect this estimate. The first step is to organize a team of professionals to assist in both the preparation and the sale. A certified public accountant, a corporate transaction attorney, a financial advisor and a business consultant are good choices.

Optimize the Financial Picture. You should begin the process with the help of your accountant. A good accountant will not only assist in the presentation of a comprehensive financial picture, but will also provide guidance on ways to strengthen that picture, thus increasing *your economic return*. A savvy buyer will request three years of financial statements (including balance sheets and profit and loss statements) and tax returns. Accordingly, if preparation for the sale is begun in advance, you can enhance those statements by optimizing productivity. For example, expenses that may be more personal

in nature can be eliminated or at least identified and added back to net income for the purpose of analysis. All overhead expenses should be analyzed for necessity and possible reduction. Consider reducing overtime and related payroll expenses; augment income by coding everything and collecting every dollar including co-pays, co-insurance and payments for services that are not covered by benefits but for which patients have been fully informed. Update your fee schedule. Institute a recall system and reminder calls to increase patient flow and practice income. These actions may appear basic, but they add up and can give your practice value a boost. The goal is to sell at the peak of performance, not when you have begun to slow down and ease into retirement.

Optimize the Physical Picture. In the same way that people prepare their house for sale, you should seek to impress buyers with your office space. Clear clutter; discard expired drugs and broken equipment. Tune up your equipment and make strategic replacements if necessary. Consider aesthetic and required improvements, but avoid major investments because those expenditures will not be easily recovered.

Set a Reasonable Price. A reasonable price will not only facilitate a sale but also make for more realistic personal financial planning projections. Rules of thumb or anecdotes from other physicians are not a good basis for pricing. Determining a reasonable price requires some basic knowledge of the components of a practice's value. The value of a practice is typically the sum of the tangible assets, intangible assets and the accounts receivable.

The value of tangible assets such as furniture, fixtures, and equipment is best determined by an appraisal. Other than any intellectual property

that you may have developed, your intangible assets would consist mostly of goodwill. The premise behind “goodwill” is that it is an intangible that somehow economically enhances the utilization of the practice assets.

Unfortunately, the concept of goodwill in healthcare situations has become more complex. If you are selling your practice and immediately retiring – so you will no longer be in a position to make any referrals to the buyer – then the buyer may be in a position to pay for goodwill. But if you are selling to someone – the local hospital, for example – and will continue to practice medicine, the definition of “Fair Market Value” under the Stark Act expressly prohibits ascribing any value to your ability to make referrals to the buyer after the sale. The Stark Act defines market value as “the price that an asset would bring as the result of bona fide bargaining between well-informed buyers and sellers **who are not otherwise in a position to generate business for the other party...**”

Federal enforcement under Stark has increased in recent years. Many hospitals today will not pay anything for goodwill in the acquisition of a physician practice. If the likely buyer of your practice is the local hospital, you need to be realistic about the value of your practice in light of these restrictions.

Where goodwill is a legitimate part of the valuation, it can either be “professional” or “practice” in nature. Professional goodwill is derived from the physician’s knowledge, experience and reputation. Practice goodwill is inherent to the practice as an institution and results from its structure and function. Key components to practice goodwill would be operating policies and procedures, staff, overhead, malpractice experience, referral base, third-party payor participation and mix, location and demographics. The excess income generated by goodwill can be quantified in a capitalization calculation by your accountant to provide a reasonable estimate. The final component of practice value, accounts receivable, is one that you should carefully manage during the practice sale preparation period. Bad accounts receivable should be written off and collection policies and billing systems reviewed and updated if needed.

Armed with this basic knowledge of valuation, you should then consult a business consultant to obtain an entity-based appraisal. Given that pricing for sale is often viewed as subjective, an appraisal provides a number of benefits: (i) some of the emotion is removed from the transaction because both parties can understand the genesis of the price, (ii) if the buyer is an institution, self-referral and anti-kick-back regulations can come into play and “fair market” needs to be established; (iii) goodwill – if it is allowed -- can be a material portion of the value and the opinion of an appraiser provides credibility.

Determine the Ideal Buyer. Identifying the type of buyer that would have the greatest potential for success will

generate a greater economic return. If the ideal buyer is one or more individuals, the key considerations are patient compatibility, and the sufficiency of professional, business and management experience. If a large group or hospital is a likely buyer then you will probably need to continue for some time as an employee. In this case, the organization’s core philosophy, vision and values will be as important as its capitalization position in the market and its overall financial future.

Unfortunately, in today’s market the ideal buyer may not be your local hospital, but the hospital may nevertheless be the only available buyer. Accordingly, your expectations must be reasonable. You should not let the pride you have in your practice, your sentiments for your practice, or your ego distort the objective analysis of your practice’s market value.

Establish a Plan for Transition. After the type of buyer has been identified, the proposed plan for transfer of ownership and transition of patients should be prepared. If you are willing to continue in the practice for some amount of time then patient retention will likely be greater, the transition easier and the economic value higher. Economic issues aside, planning ahead will also allow you time to contemplate the emotional issues associated with becoming an employee and eventually losing personal contact with your patients. Finally, do not forget the legal issues including the review and assignment of contracts and leases.

Communicate Your Intentions. Having put your house in order, determined a price range, a transition plan and a category of buyers, it is time for you to communicate your intentions. It is important to be discrete so as not to alarm staff or patients. Choosing a select network for communication is a good place to start. Local individual buyers will likely have a greater chance for success than those relocating. Also, local hospitals and health systems will tend to be better candidates than organizations trying to enter a region. Consider soliciting multiple buyers as a means of increasing your return through competitive bidding.

The End of the Rainbow. Maximizing the benefit from an existing practice requires patience, planning, preparation and the assistance of professionals. Although it would appear the end of the rainbow is near, the reality is that closing the transaction will be equally challenging. Part II of this discussion will review the relevant concerns.

If you have any questions about the information contained in this alert, please contact Natale A. Messina at 860.240.6027, or a member of our Physician Practice Group.

This newsletter is one of a series of publications by Murtha Cullina LLP and should not be construed as legal advice or legal opinion on any specific facts or circumstances. The contents are intended for general information purposes only, and you are urged to consult your own lawyer concerning your own situation and any specific legal questions you may have.