Chapter 5:
Buying a Practice

Where To Go
To begin the process of buying a practice, be sure to consider the following potential sources of information: dental schools; dental societies; professional journals; dental dealers; and practice brokers.

Evaluating The Practice
It goes without saying that you’ll want to examine a practice carefully before you buy. In addition to evaluating the location based on the considerations discussed in Chapter 2, consider the following factors:

Is the practice active and healthy? Examine financial records for at least the past three years. Project realistic revenues and expenses for the next two years based on those records. Examine the relationship between gross and net practice income.

Is the fee schedule up-to-date? When were the fees last increased? You may lose patients if you suddenly increase fees upon assuming ownership control.

Verify the number of active patients, not patients of record. Generally, an active patient is one that has been seen within the past 12-14 months.

The 1991 ADA House of Delegates adopted the following definitions for this use:

Active Dental Patient of Record:
An active dental patient of record is any individual in either of the following two categories: Category I – patients of record who have had dental service(s) provided by the dentist in the past twelve (12) months; Category II – patients of record who have had dental service(s) provided by the dentist in the past twenty-four (24) months, but not within the past twelve (12) months. Each of these categories of active patients of record can be further divided into: 1) new or regular patients who have had a complete examination done by the dentist and, 2) emergency patients who have only had a limited examination done by the dentist.

Inactive Dental Patient of Record:
An inactive dental patient of record is any individual who has become a patient of record and has not received any dental service(s) by the dentist in the past twenty-four (24) months.

How will ownership of records be transferred and patients notified? A personal introduction can facilitate a smooth change of providers for the patients. Will the seller introduce you personally or through correspondence to the patients? Several other things can also facilitate a smooth transition: if possible, auxiliary personnel should be retained, along with the practice’s telephone number.

Fair Market Value
If results of the above evaluation indicate the practice is suited to your needs, you must next negotiate the purchase price. You may wish to retain the services of a professional practice appraiser at this point. According to the Internal Revenue Service (http://www.irs.gov/publications/pssl/goOl.html), “fair market value” is “…the price at which property would change hands between a buyer and a seller, neither having to buy or sell, and both having reasonable knowledge of all necessary facts.”

In most cases, the circumstances of the local market for dental practices will have a great influence in the determination of the actual price for a dental practice. The market characteristics often change in time and may vary from locale to locale. In addition to the valuation factors described, it is important to understand the local market in order to develop a reasonable value for a practice. Market conditions may make such practices less valuable, e.g., in markets with greater numbers of mature dentists looking to sell than new dentists looking to buy.

Purchase price includes both physical assets (fair market value of dental and office equipment, furniture, supplies and leasehold improvements) and goodwill (value of the practice beyond its tangible assets: the likelihood that patients will remain with the practice). Consult with local dental supply dealers, management consultants and your local attorney to assess the appropriate goodwill value.

When purchasing a practice, the typical buyer expects to be able to meet all practice related
expenses, draw some reasonable salary and service the debt to buy the practice (principal and interest) from the expected revenue generated by the practice. In addition, you as the buyer should be able to retire the debt incurred to purchase the practice in a reasonable period of time. If a buyer perceives that there is a good probability of accomplishing these things, in light of a specified asking price for the practice, this price should be viewed as fair. If, on the other hand, the buyer cannot see that all of these things can be accomplished, he or she would probably conclude that the price is too high and is not fair.

Calculating goodwill

Goodwill is “the probability that the old customers will report to the old place. It is the probability that the business will continue in the future as in the past, adding to the profits of the concern and contributing to the means of meeting its engagements as they come in.”

Because the goodwill value of a practice is intangible, it is difficult to measure and even more difficult to establish its price for any particular dental practice.

You must consider the desirability of office location and if it will be possible for you to retain and renew the office lease. Another factor, as noted, is the number of active patients and likelihood of their staying with the practice. You must also evaluate recent or anticipated trends, positive or negative, in productivity, overhead, and overall office profitability. Retaining key staff and the practice telephone numbers are important factors in maintaining patient comfort. Try to keep from making too many changes. The reputation of the practice will also have an impact on the value of the goodwill.

As you review the practice records, note the rate of influx of new patients and determine the practice’s usual referral sources. You will need to generate referrals from these same sources and may want to ask the selling dentist to introduce you to referring dentists to maintain goodwill.

Significant economic or demographic trends and elements of supply and demand of market competition will also enter into your negotiations of goodwill. Finally, your introduction to patients by the seller will have tremendous impact on patient retention.

Be wary when considering the purchase of a dental practice that has been idle for some time, as when the practice is being sold by the estate of a deceased dentist. While it may be the least expensive way to acquire equipment and a file of potential patients with whom you can build a successful practice, patients often seek new dentists immediately when they hear their dentist has died.

Your attorney or other advisor should participate in drawing up the formal sale agreement, protecting your interests and explaining what you will sign.

Finally, be sure you understand the relationship among price, down payment and financing terms. Shop around and compare interest rates as you negotiate financing. Again, your attorney or practice advisor should be consulted.

Price

The asking price is the amount the seller initially stipulates he/she wants for the practice. (The asking price may or may not be identical to fair market value.) Sales price is the actual amount paid for the purchase of a practice.

There may be a significant difference between the asking price and the eventual sales price, as the result of several factors. First, the asking price may have been established without first performing a practice valuation. It may be that the seller applied an inappropriate rule of thumb for determining asking price or may have based the asking price solely on what he or she perceived would be acceptable. In most cases, the circumstances of the local market (i.e. area demographics – patient, dentist and employment) will have a great influence in the determination of the actual price for a dental practice.

Another reason that the actual sales price may be lower than the asking price is that the circumstances of the dentist who eventually purchases the practice may significantly impact the amount he/she is able and willing to pay for a practice.

The price a particular dentist is willing to pay for
a practice is dependent on his/her personal financial situation, perceived ability to manage and handle the practice and the ability to obtain acceptable financing. To a particular buyer, a practice may be worth less than the appraised fair market value or asking price, but to a different buyer the practice may be worth more than the practice’s fair market value. It is important to understand the local market in order to develop a reasonable value for a practice.

Another reason for this difference may be that both sellers and buyers expect that the eventual sales price can be negotiated down from the asking price. Similar to a real estate transaction, this expectation can result in a seller establishing an asking price that is higher than the price he/she expects to receive, knowing that some negotiation will be necessary. This expectation leads some buyers to assume that unless they can negotiate the sales price lower than the original asking price, they will have paid too much.

**Accounts Receivable**

There are basically three types of arrangements in handling existing accounts receivable during the transfer or sale of a practice.

In the first the seller retains the accounts receivable and is solely responsible for their collection. A second option allows the buyer to purchase at a discount (to allow for uncollectibles) outstanding accounts less than one year old. All others remain the property of the seller, who is responsible for their collection. Or, the buyer may continue to collect the outstanding accounts and remit to the seller, less collection costs. After one year, outstanding accounts are transferred back to seller for collection.

No one of these options is better than the others. Which one you select is a matter of personal choice and negotiation.

**Tax Implications**

As in any capital transaction, tax consequences of buying a dental practice are of critical concern to both the buyer and the seller. It is imperative that both parties seek expert professional assistance in this area throughout the negotiations and before a contract is signed.

**Restrictive covenant**

When negotiating a buy-sell agreement, you may consider including a restrictive covenant (noncompetitive clause). This restriction will prohibit the selling dentist from relocating and setting up a new practice in the area within a reasonable period of time. Without such a clause, you may find you have purchased only used equipment and a lease, while your patients go down the block to make appointments at the new practice of the selling dentist.

Restrictive covenants are not enforceable in all states or under all conditions. Be sure to check with your legal advisor to be sure any such element of the contract is in keeping with locally-accepted legal standards. In states where restrictive covenants are enforceable, they must be considered reasonable in the eyes of the law. As a general rule, if the following questions can be answered in the negative the restriction can be considered reasonable.

1. Is the restraint on the seller greater than is necessary to protect the buyer’s legitimate interest?
2. Is the restraint on the seller unduly harsh or oppressive?
3. Is the restraint harmful to the public interest?
4. Is the restraint unreasonable in terms of geographic area?
5. Is the restraint unreasonable in terms of the length of time during which it is effective?

Again, these are only general guidelines. Your attorney is your best advisor in this situation.
For more information on this topic, you may access the article “Restrictive Covenants and Associates” in the Law Article Database, http://www.ada.org/members/law/SHOWARTICLE.ASP?ARTICLEID=173.

Other Considerations
Wherever possible, try to structure the purchase within a time frame that allows the selling dentist to spend a minimum of four to eight weeks in the practice with you, to help you become familiar with the practice and the staff, and to introduce you to patients. This will help in making a smooth transition.

Be patient
After you have bought a practice, it might be best to hold back from making major changes right away in practice policy and philosophy, in staff or in fee structures. You want to maintain the highest percentage of returning patients; make your changes slowly and with considerable thought. This approach will also benefit you in gaining the full support of staff members. If you come in and institute a general house-cleaning, installing a philosophy of practice that contrasts sharply with that of the selling dentist, you will probably lose more patients than normally associated with a change of practice ownership. Remember, people don’t like change. They like consistency. You can make the changes you want within the first year and do it with the full support of your staff if you plan your changes carefully and in a positive way by involving your staff in the decision making.

Finally…
Buying an established dental practice is a positive way to begin your dental career or may be the outcome of a successful associateship with the selling dentist. In either case, negotiating the sale or purchase of a practice will begin with the evaluation of the many facets that comprise a practice’s “success quotient.” The advice of an experienced attorney, practice management consultant and/or tax advisor will be important to your success; these consultants should be brought into the process in its early stages.

For further information on evaluating a dental practice, see the Council on Dental Practice’s Valuing a Practice: A Guide for Dentists. It also features an extensive reading list. Call the ADA Salable Materials Department for ordering information at 1-800-947-4746. A Directory of Appraisers and Valuators is also available through the Council on Dental Practice at 1-800-621-8099 x2895 www.ada.org/prof/resources/topics/dentalpractice.asp.


BUY-SELL AGREEMENTS

Practice Sale Contract

Generally used topic headings for the contract provisions.

Note: The headings below are not uniformly used and the headings themselves usually have no force or effect within the contract itself. For the purpose of this publication, they simply provide an overview of the items that dentists should anticipate seeing in the contract.

- Parties involved and date of the contract
- Time and place of sale
- Total purchase price
- Allocation of purchase price
- Goodwill
- Payment of purchase price
- Security for purchase
- Phase-out agreements
- Non-competition clause
- Risk of loss
- Duty to maintain supplies
- Custodian of records
- Transfer of records
- Use of seller’s name
- Insurance, utilities, taxes, laboratories
- Accounts receivable
- Overall tax ramifications
- Rework
- Hold harmless agreement
- Seller’s warranties and representations
- Buyer’s warranties
- Life and other insurance
- Warranty on equipment
- Contingencies
- Appointment of escrow
- Prorations – Costs and expense
- Entire agreement
- Binding on heirs
Other sales documents

Documents in addition to the contract of sale that are generally part of the transaction include:

*Bill of sale:* an instrument that lists and transfers title to the property sold.

*Assignment of lease:* either a provision in the sale contract or a separate instrument that serves to assign to the new tenant a presently held lease.

*Release:* an instrument executed by the buyer upon taking over the current lease to cut off the present lessee’s (seller’s) liability.

*Promissory note:* a written promise to pay any amount borrowed.

*Security agreement:* used in conjunction with the promissory note to secure the promissory note with the collateral of the assets transferred against the claim of other creditors.

*Employment or independent contractor agreement:* used when the selling dentist is hired back after the sale agreement.

*Real property sales contract:* a separate contract transfer used where a property (the building housing the practice) is agreed to between the parties.