Selling Your Ophthalmology Practice Before You are Ready to Retire
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* Financial Interest

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• Shareholders of and Consultants with The Health Care Group, Inc. and Health Care Consulting, Inc.
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Who We Are

- Business and legal advisors to physicians
- Publishers of the Goodwill Registry, used in valuation of ophthalmology and other medical practices
- Handle and advise re: practice buy-ins, buy-outs, sales, mergers and valuations

Introduction

- What’s Happening Now
- Valuation of Your Practice
- Basic Sale Structure and Process
- Post Sale Employment

What’s Happening Now

- The pressure of demographics: Baby boom doctors reaching retirement
- Uncertainty in the air
  - Obamacare/Trumpcare
  - Budget pressure/reimbursements
  - Watching other doctors get out
But there are positive factors to consider as well.....

- Ophthalmology is a well-positioned specialty
  - Lots of demand for services
  - Ancillary revenue sources: optical, ASC
  - Elective services: premium IOLs
  - New drugs, new technologies

Ophthalmology has been surprisingly resilient

- Per MGMA, median ophthalmologist compensation has increased 23% from 2010 to 2015, from $330,784 to $407,272

And selling connotes retirement....

- Many ophthalmologists like to practice, and are not yet ready to give that up....
The Best of Both Worlds?

- Sell, yet remain in place?
- Cash out your equity, but continue to work
- It is very doable, if you can find a willing partner
- ....and your expectations are reasonable

Recent Sample Transactions

- Solo and associate in practice
- Instead of doing a buy-in, solo and associate trade places
- Asset purchase, followed by employment of senior physician under 2 year contract
- Buyer rents the office space, owned by Seller, for 10 years

Another Recent Transaction

- One solo competitor takes over another, in a neighboring town
- Asset purchase with 5 year employment agreement for seller
  - Seller can remain in place, and practice as before, on his usual schedule
Should I Sell My Building Too?

- Be flexible: sell or rent, as buyer wishes
- The value of your practice is perishable
  - Not true of office building or condo
  - You can sell it later

What About My ASC?

- ASC enhances the value of your practice for buyer (ancillary profit)
- But if you have partners in the ASC…
  - You will need their permission to sell to buyer

Give Yourself Time

- It always takes longer than you think
- Time pressures negatively affect price
- Time for related transactions: e.g., lease or sell office space
- Buyer has been found: 3-9 months
- Buyer not yet found: 12-24 months, or more
What kind of value can you get?

What’s for Sale?

- The Big Three
  - “Hard Assets”
    - Equipment, leasehold improvements, supplies, software
  - Accounts Receivable
  - Goodwill
    - Includes going concern value, charts, phone number, staff, seller’s endorsement of buyer, seller’s restrictive covenant

Hard Asset Valuation

- Book Value
  - Nearly always too low
  - Assets “expensed” under Section 179
    - These have an immediate book value of zero
    - The rest have a book value of zero in 5 - 7 years
- Specialized Appraisal
  - Not available for all items
  - Needs updating frequently
Modified Book Value Approach

- Eliminate assets no longer in use
- Eliminate personal assets
- Recalculate depreciation
  - 8 - 12 year life (overall)
  - Straight-line depreciation
  - Floor value: 20% of original cost

Supplies

- Optical frames, contact lenses, drugs
- Physical inventory, or
- Estimated value, based on prior year’s expense
  - E.g., prior year expense divided by 12 times 2 (for 2 months’ supply)

Accounts Receivable

- Typically not sold in an asset sale
- So seller generally collects and keeps the accounts receivable
What’s Your Practice Worth?

• Goodwill: What is it?
  • Any kind of intangible value
    - Likelihood of patient returning to the practice
    - Practice name, location, phone number
    - Reputation in marketplace
    - Value as a going concern

Goodwill Valuation Methods

• "Income" Approaches
  • Excess Earnings
  • Discounted Cash Flow
  • Capitalized Earnings
• Comparable Sales or “Market”

Comparable Sales Method

• Same idea as pricing a house
  • Benchmark value, based on neighborhood comparables
  • Adjust for individual features
    - Good: high profit, nice location, lifestyle, modern facilities, moderate competition, good payor mix
    - Bad: low earnings, undesirable location, closed panels
Comparable Sales Method

- 2016 HCG Goodwill Registry
  - Ten year average for ophthalmology is 27.43% of annual practice collections
  - Five year average for ophthalmology is 28.81% of annual practice collections
  - Guidelines for ophthalmology

  THESE ARE (LONG RUN) AVERAGES!
  YOURS MAY BE HIGHER OR LOWER!

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<table>
<thead>
<tr>
<th>Year(s)</th>
<th>Goodwill %</th>
<th>10 Year Average</th>
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<tbody>
<tr>
<td>2006 - 2016</td>
<td>27.45%</td>
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<tr>
<td>2011 - 2015</td>
<td>28.81%</td>
<td>5 Year Average</td>
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<tr>
<td>2012 - 2016</td>
<td>29.17%</td>
<td>4 Year Average</td>
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<tr>
<td>2013 - 2015</td>
<td>28.44%</td>
<td>2 Year Average</td>
</tr>
<tr>
<td>2014 - 2015</td>
<td>30.39%</td>
<td></td>
</tr>
<tr>
<td>2016</td>
<td>37.45%</td>
<td></td>
</tr>
<tr>
<td>2007</td>
<td>22.10%</td>
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</tr>
<tr>
<td>2008</td>
<td>29.69%</td>
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<tr>
<td>2009</td>
<td>18.96%</td>
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<td>2010</td>
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</tr>
<tr>
<td>2011</td>
<td>27.44%</td>
<td></td>
</tr>
<tr>
<td>2012</td>
<td>29.33%</td>
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</tr>
<tr>
<td>2013</td>
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<tr>
<td>2014</td>
<td>26.11%</td>
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</tr>
<tr>
<td>2015</td>
<td>34.44%</td>
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</table>

Source: Goodwill Registry 2016

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Source: Goodwill Registry 2016
Sealing the Deal: Nuts and Bolts
Stock or Assets

• Sellers want stock sales
  • Typically all capital gain

Stock or Assets

• Buyers generally want asset sales
  • Better tax treatment for buyer
  • Avoids liabilities
  • Buyer can “cherry pick” assets
    • E.g. no purchase of accounts receivable or outdated or unwanted equipment, frames, supplies, etc.

Stock or Assets

• On occasion, buyer will agree to a stock sale, in order to avoid re-credentialling
  • E.g., buyers are associates who have worked for the practice for a long time
  • They are familiar with the Practice’s operations and not overly worried about contingent liabilities
Price

- For what?
  - Stock or assets?
  - With or without accounts receivables?
  - With or without liabilities?
- Develop a term sheet or letter of intent

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Tax Allocation: ‘S’ Corp or No Corp

<table>
<thead>
<tr>
<th>Item</th>
<th>Seller Wants:</th>
<th>Buyer Wants:</th>
</tr>
</thead>
<tbody>
<tr>
<td>Goodwill</td>
<td>$$$$$ (cap gain)</td>
<td>$ (slow write off)</td>
</tr>
<tr>
<td>Equipment</td>
<td>$ (ord. income)</td>
<td>$$$ (fast write off)</td>
</tr>
<tr>
<td>Inventory</td>
<td>$ (ord. income)</td>
<td>$$$$$ (immed. deduct)</td>
</tr>
<tr>
<td>Consulting Pay</td>
<td>$ (ord. income + FICA)</td>
<td>$$$$$ (immed. deduct)</td>
</tr>
<tr>
<td>Non Compete</td>
<td>$ (ord. income)</td>
<td>$ (slow write off)</td>
</tr>
</tbody>
</table>

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Tax Allocation: Seller Has ‘C’ Corp

- Objective: Avoid corporate double tax
  - Funnel some of sales price outside the corporation directly to shareholder/doctor
  - Personal goodwill or personal non-compete
  - Talk with your tax advisor – some tax risk
Sample Personal Goodwill Allocation

- Buyer ➔ 100,000 ➔ Doctor
- Buyer ➔ 200,000 ➔ Corporation
  300,000 Total

Payment Terms

- 100% bank financing is best, or at least
- Significant $$$ upfront down payment (50%)
- Buyer has “skin in the game”

Payment Terms and Security

- Personal guarantee of promissory note
- Collateral: all assets acquired PLUS buyer’s future accounts receivable
- Attorney’s fees, if Seller must sue buyer
- Life insurance on buyer
Target Sale Date

- Leave time for buyer to get credentialled with payors
- And extra time for real estate purchase, if applicable

Post Sale Employment of Seller

- Employment Agreement or Professional Services Agreement (contractor)
- This is seller’s sole source of contractual protection, for the remainder of career

Employee or Contractor?
Benefits of Employee Status

- Employer pays for ½ of social security taxes
  - Contractor must pay 100%
- Employee gets health and retirement benefits
  - Contractor does not

Concerns re: Employee Status

- Limited ability to take deductions against compensation
  - Much more freedom as contractor
- Employee doesn’t want benefits
  - Would rather have cash

Key Terms for Service Contract

- Compensation
- Contract Term and Termination
- Duties, days/hours/locations
- Assignment of patients
- Non compete restriction
Compensation

- Generally a percentage of collections
- Seller wants the % that he got pre-sale
- Buyer wants a lower %, so that buyer can realize some profit on seller’s services

Benefits and Expenses

- What benefits/expenses will seller receive?
- Will they be charged against his compensation share?
- Can seller opt not to receive some benefits, and get cash instead?
  - Health insurance
  - Retirement

Malpractice Tail Coverage

- Seller generally wants to maintain his current malpractice coverage
  - If he keeps this coverage until retirement, he generally gets a “free” tail
  - If he switches to buyer’s carrier, the tail won’t be free
Term and Termination

• Seller wants to retire on his own timing
  • Seller seeks long term contract (5-6 years) and no termination without cause
• Buyer is wary of long term commitment
  • Buyer seeks a shorter term (maybe only 1 year), with the right to non-renew or terminate without cause

Duties

• Seller wants control over his duties, esp.
  • Location
  • Hours
  • Time off
• Buyer seeks flexibility - things may change over the period of a long-term contract

Assignment of Patients

• Seller wants control
  • Should at least be able to see his current patients
  • And new patients who ask for him by name
Non-Compete

- This is probably more critical to buyer than to seller
- Buyer will not tolerate competition, after paying big dollars for the practice
- Seller doesn’t really want to start a competitive practice
- But seller may want the ability to teach or consult after cessation of active practice

Lease of Space

- Seller seeks a long term lease – e.g. 10 years
- Buyer often doesn’t want to be locked in that long
- Buyer wants rights of first refusal on future sale
- But these are problematic for seller
- They diminish saleability of the property

Due Diligence

- Call buyer’s references
- Can buyer be trusted to take good care of your patients?
- Does buyer have good business judgment?
- Run a lien and judgment search on buyer
- Does buyer pay his/her/its debts?
Transition

- Letters to patients and referrers
  - Text of letter often agreed prior to sale
  - Who prepares the mailing, actually?
  - Who pays for the mailing?

Transition (cont’d)

- Collection of seller’s accounts receivable
  - Will buyer help?
  - Does buyer get a fee for helping with this?
  - How long will buyer help?

- Staff:
  - What happens to staff’s accrued benefits, vacation, etc.?
  - Use of seller’s name (door, brochures, etc)
  - Custody and maintenance of medical records
QUESTIONS?

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