What Is a Dental Practice Worth?

By Mac Winston

Anyone who has ever bought or sold a dental practice knows that buyers and sellers have a different perspective when it comes to practice value. However, because no sale occurs until a compromise on value is reached the parties to these transactions are quite motivated to find common ground.

Very often, this common ground is reached less through movement, up or down, in the price of the practice and more through structural elements of the transition. The two most significant structural elements of a practice transition are:

- How the seller will be paid. Options include:
- All cash at closing.
- Some cash at closing followed by monthly payments on a seller note.
- Some cash at closing with the remainder paid depending upon client retention once the practice changes hands, and some cash at closing with the remainder paid to the seller in the form of a monthly consulting fee or above-market rent).
- What is being purchased? Options include:
    - The assets of the practice.
    - The stock of the practice.
    - The assets of the practice plus a consulting contract with the seller.

While the outcome of negotiations on these two factors can bring about agreement on value, consequent shifts in the tax payment obligations and the personal cash flow for both buyers and sellers after the sale can be significant. Therefore, buyers and sellers should make sure their personal accounting/tax specialists are involved in the negotiation of these aspects of the transaction in particular.

How Will the Seller Be Paid?

It is easy to see that if a seller receives cash at closing for 100% of the purchase price of the practice, his or her personal cash flow will be maximized. He or she will have liquidated the value in the practice, providing the opportunity to live off of the proceeds of the sale as needed. However, some sellers may be surprised at the negative tax implications of receiving all of their funds at the point of sale. They may be motivated to negotiate for the receipt of some portion of the sales price in installments following the sale. Such

CONTACT THE AUTHOR
Mac Winston, Managing Member | (800) 456-2779 | mac@ppcloan.com

installments might involve monthly payments on a seller note, monthly consulting fee payments, or monthly payments of above-market rent for the practice's office space owned by the seller and leased to the buyer.

From a buyer's perspective, the decision on how to pay for the practice is driven by the need for enough cash flow following the acquisition to cover the overhead of the practice, his or her own living expenses, and payments on the practice acquisition loan. Chief among all elements that must come together to ensure sufficient cash flow is a smooth transition (defined as a transition where the level of historic production and collections are maintained).

In instances where the seller has been generating a tremendous amount of revenue through the delivery of high-end cosmetic dentistry or some other form of specialized dentistry such as orthodontics or oral surgery, a buyer will often perceive increased risk in terms of the likely difficulty in maintaining historic production and collections rates through transition. In response to this perception of risk, buyers will often request some portion of the purchase price be paid by way of a seller note in order to ensure the seller has ample incentive to support the buyer in maintaining the practice's historic level of production following the acquisition.

In instances where the agreed-upon purchase price is perceived as testing the limits of the practice's likely cash flow after the sale, a buyer may ask to pay some portion of the purchase price by way of above-market office rent or a monthly consulting fee. Both rent and consulting fees may be fully expensed by the Buyer, which would allow fully tax-deductible payments for practice value and ensure the seller's commitment to a successful transition.

Finally, in instances where the buyer and seller are at an impasse in negotiating a price for the practice, an "earn-out" provision to the purchase agreement can bring about a meeting of the minds where no other solution seems to fit.

An earn-out provision simply notes that the seller will be paid, either in a lump-sum or over time, some additional amount of money should the practice hit agreed upon performance target(s) as measured at agreed upon interval(s). Performance targets often considered in earn-out provisions are number of patients seen in a given period of time, production and/or collection targets reached in a given period of time, and retention of specific specialty dentistry production. Some earn-out provisions allow for an agreement on the larger purchase price at closing and call for downward adjustments if the agreed upon performance targets are not met.

CONTACT THE AUTHOR
Mac Winston, Managing Member | (800) 456-2779 | mac@ppcloan.com

What Is Being Purchased?

The question of what is being purchased centers on the tax implications of the practice transition for both buyer and seller.

Let's take an instance where the transaction involves the purchase of the assets of the practice (typically classified as furniture, fixtures, equipment, and goodwill). The allocation of value between these elements can have a material impact on the post-closing tax position of each party and thus impacts the value they ultimately receive in the transfer of ownership. Furniture, fixtures, and equipment are assets whose sale can result in a much higher tax rate for sellers than that paid on goodwill. Conversely, buyers receive a more favorable tax consequence from attributing as much value as possible to furniture, fixtures, and equipment relative to goodwill, because those assets can be depreciated more rapidly than goodwill can be amortized.

Some ownership transitions involve the purchase of stock in the practice. Such purchases generally result in the seller receiving the best post-closing tax positioning and the buyer being left with one of the worst possible tax postures (i.e. 100% of the purchase price for the stock is not deductible as either depreciation or amortization post-closing). Transactions of this sort still occur, however, as they represent a potentially effective method for "balancing the scales" in the process of achieving a compromise in practice value. In particular, because a stock sale allows the seller to recognize virtually the entire sales price (except for some amount attributable to a non-compete agreement between seller and buyer) as a capital gain, and thus pay less tax on the proceeds from the sale, an agreement on a lower purchase price may be achievable.

In some cases, the transaction may involve the assets of the practice plus a consulting contract with the seller. As noted previously, consulting contracts with sellers offer buyers the opportunity to meet the seller's desired selling price with pre-tax income, as the full amount of each payment on the consulting contract is recognized as an expense when paid. For sellers the implications of receiving payment for a portion of the value of the practice through a consulting contract are that the monies received will be taxed at the personal income tax rate of the seller at the time the money is received.

So, What Is the Real Worth of the Practice?

It is common for buyers and sellers to get emotionally involved in the negotiation of the purchase price of a dental practice. However, both would do well to remember, that the devil is in the details and that most compromises on value are ultimately achieved through the terms of the purchase agreement signed at closing. And again, they would be wise to involve their personal accounting/tax specialists in negotiating the details of the transaction.

CONTACT THE AUTHOR
Mac Winston, Managing Member | (800) 456-2779 | mac@ppcloan.com

K.M. ‘Mac’ Winston, Managing Member, is co-founder of PPC LOAN, a nationwide lender with over 10 years of experience in providing financing for veterinarians. He can be reached at 800-456-2779 and mac@ppcloan.com to answer your questions and assist you with your practice financing needs.

CONTACT THE AUTHOR
Mac Winston, Managing Member | (800) 456-2779 | mac@ppcloan.com