The Top 10 Pitfalls to Avoid When Selling a Dental Practice

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Selling a dental practice should not be taken lightly. You have put in years of hard work and dedication to build your practice—you should do some extensive planning to transition the practice as well.

If done correctly, selling the practice that you have built can be one of the most satisfying accomplishments of your career. However, because this is the first (and likely last) time that you are selling this huge asset, you may not be sure where to start or how to finalize the sale.

Advance planning and a good support team can help you complete this significant transaction in a way that is the most advantageous for you. You can start by reviewing some of the most common pitfalls when selling a dental practice that we have set out below. Knowing these ahead of time will help you take action to avoid them.

Choosing the Wrong Type of Sale

Although you may think that selling your dental practice can only be accomplished using one method, you actually have several options when you choose to sell your practice. Misunderstanding or failing to explore all of these options is one of the most common pitfalls of selling a dental practice.

There are three main types of transactions.

Traditional Transaction

This is the type of sale that you likely think of first when you start thinking about selling your business. It involves a highly visible transfer, which often includes informing the public about the sale and letting your team members know as well. It is a full and final buyout. Keep in mind that a traditional sale can involve either a lump-sum payment or a payment based on a long-term contract.

Associateship Purchase/Buy-In

In this type of transaction, a buyer will work with the existing staff and current patients long before the purchase. They will often use a buy-in agreement to make the transition even more gradual and seamless.

The transaction will often later use the more traditional methods to purchase the dental practice, but the buyer may have been involved in the practice for months or even years before the transition.

Partnership Purchase

Sometimes the buyer will come in as a part-owner and then work his or her way up to purchasing the entire dental practice, often over a period of years. Unlike an associateship purchase, this buyer will move from partial owner to full owner, rather than from employee to owner.

Incorrectly Understanding, Valuing, or Reporting Your Goodwill

When you sell your dental practice, potential buyers want to see the numbers that support your asking sale price. However, goodwill is very difficult to value.

Your goodwill is what makes the business valuable as a going concern and makes it more than just the sum of its assets. Goodwill includes things like patient loyalty and referral relationships. It also includes the value of your good reputation in your local community and the dental community.

It is easy to make the mistake of assuming that your practice has the goodwill, rather than you personally. If the practice entity has the goodwill, then it is much more valuable compared to goodwill that will disappear when you leave the practice. For example, a dental practice that bears the name “Big City Dental, Inc.” will likely have more goodwill than a practice that bears your name alone. While this aspect is probably not something that you can change at the time of the sale, you should be aware that there might be a valuation issue that you should address with an expert before the sale.

Goodwill is also tricky from a tax perspective, as well. If you determine that the goodwill actually belongs to you, rather than to the practice, you may want to report it differently for tax purposes. Selling the goodwill separately can help avoid some double taxation issues that might crop up if the dental practice is incorporated.

Overlooking Office Lease Concerns

If you do not own the building in which you practice, you likely have a lease that you pay on a monthly basis. Keeping the same location is often a desirable part of the dental practice sale. However, you should not assume that your landlord will take on the new owner under the same lease terms in every situation.

Most commercial leases require that you get the consent of the landlord before you can assign the lease. If you cannot assign the lease, then you may end up being on the hook for the continued payment or a significant early termination fee or penalty. Your buyer may also be required to move if he or she cannot come to an agreement regarding a new lease with the landlord.

Not Sweating About the Small Stuff

Attracting a buyer for the right price is easily the most important part of the sale process. You want to make your practice look as appealing as possible for prospective buyers, and that process starts long before you start thinking about a sale.

A few examples of “quick fix” things to consider include:

- Consider how you can improve your team’s performance to impact your bottom line. There is always some room for improvement.

- Maintain or increase your new patient flow. Being able to attract new patients and show stability will be very attractive to buyers.

- Update the office décor and make improvements like updating furniture, putting paint on the walls, or redesigning the carpet.

Even simple changes can give your practice an update that will present well to prospective buyers.

Misunderstanding Your Practice's Finances

As a practice owner, you need to know your company's income, expenses, and everything in between very well. Having this knowledge will be very helpful in the sales and valuation process. Familiarize yourself with last year's tax return, examine your levels of reported income, and take a hard look at your discretionary spending.

You should also understand how to present your company in the best light financially to a buyer. For example, it is a bad idea to take on more debt before you sell the company. Going into debt to update the equipment, for instance, likely will not look good on paper to a new buyer. Balancing cash flow and debt is important.

However, when you know you need to make a change because your equipment is outdated or not functioning, then that type of update will actually increase the value of your company in most cases. That type of spending may be a good use of your capital.

You should also generally keep up with business as usual before the sale. Do not slack off simply because you know that you are going to sell soon. Having a solid book of business and good financials will help you market the company so you can get the true value of the business.

Staying on After the Sale or Selling Before You Are Ready

Some dental practice owners may think to themselves: "I'll sell the practice now and then just work as an associate under an employment contract until I'm ready to retire." While this might seem like a good idea, this type of arrangement will often backfire. If you have been running your dental practice on your own for decades, especially if you are solo, suddenly working under someone else with no say in the management can be a huge, unwelcome change.

It also is not a good idea for your team, either. They may wonder—who is really in charge? Who should I go to for questions? How do we address disputes? Lingering too long can make the transition very hard for the new owner.

An overlap to transition during a few weeks or months likely will not cause significant problems. Some sellers choose to go this route so they can get the new owner acclimated to the practice, the patients, and the team. But it is a good idea to remain “in charge” during this overlap period, so there is no confusion about this point. The new owner can then step in based on the predetermined timeline—this type of process creates a clean break that everyone can understand.

This line of thinking often goes hand-in-hand with the reality that a dental practice owner might not really be ready to sell yet. The emotional attachment to a business that you worked years to develop is often very strong. Even if you have the financial means to walk away, it is not always easy from an emotional perspective.

While planning ahead is very important, you also should not rush the transition if you are not ready. Think long and hard before you make the decision to sell.

Failing to Get an Appraisal of the Practice

While you may have a general idea of what your practice is worth, it is always better to get a third-party opinion for a valuation. As a practice owner, you will have a tendency to overvalue the company significantly, often for emotional or attachment reasons.

If you overestimate what the practice is worth, you will be disappointed when you get offers. Perhaps more importantly, you may feel obligated to take an offer that is far lower than what you expected. That lower offer could have a profound effect on your retirement for years to come.

Instead, you should get a dental practice appraisal from a professional who understands the value of dental practices generally and in your specific area. Having this valuation long before you make the sale transition can help you plan better and more realistically.

Using Only One Valuation Method to Value Your Practice

You should also use several valuation methods before you put your practice on the market. A dental practice, like any other type of business, will have a different value based on the method that you choose. Using several valuation methods to develop an asking price and overall valuation will help you get the most that you can when you sell the practice.

Income-Based Valuation Methods

An income-based valuation will look to capitalized earnings or discounted cash flows to determine value. It is one of the most common methods used by savvy buyers and sellers.

Income is the number one long-term driver of value over time, but these methods also indirectly take into account the tangible and intangible assets of a practice. If the dental practice has a strong base of regular patients and a proven track record, then one of these valuations is a good starting point.

In a **capitalized earning** evaluation, you will look at past earnings before interest, taxes, and amortization (EBITA) to get a modified net income. Then, you will divide that number by a cap rate, which is usually 25% to 31% for dental practices. That number will be the fair market value of the dental practice.

The **discounted cash flow method** also uses EBITA to project future years of net income. You can project out as far in the future as you would like, but ten years is often used as a benchmark. Then, you calculate the present value of that number using a reasonable growth rate. That rate is usually between 23% and 31% for dental practices. This is a complicated calculation, but you can use online calculators and professional help to assist with this calculation.

Market-Based Valuations

All market-based valuations are developed from the market. They look at the sale price of other dental practices in your area and compare those sales to your company's financials and assets. It will review just your collection efforts, rather than using an income multiplier. The collections component adds in a risk factor—if your collections rate is lower than a comparable company, for example, then your value would also be lower.

While this method can work very well for real estate, it can be tricky to use for a dental practice, especially if your practice is in an area where there are few other dental clinics.

Net Asset Valuations

You can also value your practice based on assets alone. You add up the value of all the tangible and intangible assets to get an overall valuation. While dental practices certainly have some equipment and other assets, most of their value actually comes from goodwill like patient loyalty. By some estimates, goodwill can be 80% to 85% of the value of the overall practice.

Net asset valuation methods are certainly good to review, but they often unreliable methods for correct valuation of a dental practice.

Creating Arrangements that Use Illegal Kickbacks or Fee-Splitting

A kickback is a fee or anything of value that you receive for a referral or continuation of care. In the dental practice sale context, it comes up in situations where you have a buyer that may be concerned that patients will not continue to come to the dental practice if you are not there. You may offer to send out a letter of endorsement for this new buyer, for example, in exchange for a portion of the collections or profits after this letter is sent out. Although this may be part of your transition process, it actually can violate kickback laws or fee-splitting restrictions.

Although you may not intend to violate these restrictions, they can end up costing you in civil penalties and even in criminal charges. It is essential to talk with a dental lawyer before you start considering these types of agreements as part of the sale.

Going It Alone

Selling your dental practice is likely the largest financial transaction you will ever go through. For some, it is also the most emotional. While it may be tempting to cut down on expenses and handle the sale yourself, this is rarely a smart decision.

The choices that you make during the sale process will affect you for the rest of your life. Having a team back you up and help you avoid these pitfalls and more will be invaluable.

Your “dream team” of professionals should include the following individuals. Keep in mind that every person that fulfills this role for you should have specific experience in dental practice sales, not just business sales. There are unique aspects of dental sales that need to be addressed by an experienced professional.

Your Accountant

Your accountant and tax preparer will know your books very well, maybe even better than you do. He or she will able to help you avoid expensive tax mistakes. Your accountant can examine how you can structure the sale so that it has the least impact on you from a tax perspective. Skimping out and not involving your accountant will likely cost you at least as much in taxes as the fees that you would spend to have him or her work with you to structure the transaction.

Your Lawyer

A dental lawyer will help you prepare and review the sale documents. He or she will ensure that the way you structure the sale is legally permitted and sound. Compliance with state and local laws is extremely important. A correctly drafted agreement will also help you combat or even avoid legal liability if anything goes wrong in the future, too. A lawyer will also assist you with your lease agreement. Whether you plan to terminate your lease early or need help with reassignment, a lawyer can help negotiate with your landlord.

Your Financial Advisor

Although your financial advisor helps you personally, he or she should be involved in the transition process. Selling your practice is a huge financial move that will affect your income for the rest of your life. You want to be sure that you have enough funds to retire, invest, or move on to other business ventures, whatever your next adventure may be. Your personal financial advisor will be able to tell you how this sale or any prospective sale will affect your overall financial future.

Your Broker/Transition Specialist

A broker will help you find a serious buyer if you do not already have one lined up. While they will take a fee from the overall sale, their networks, and access to information to attract the right kind of buyer can be invaluable.

Even if you do not need a broker because you already have a buyer lined up, it is still a good idea to have a transition specialist help you with valuation and general agreement development.

Conclusion

Selling the business that you worked hard to build for years is a huge change. Preparing for it, understanding what is happening, being realistic about the process, and involving a team of professional experts can make a huge difference as you work through this process.

Dental & Medical Counsel would be honored to be a part of your "dream team" if you are considering selling your practice. Call Ali Oromchian at 925-999-8200 or contact us using our contact form to get more information about how we can help.

Do you have questions regarding your practice sale?

Dental & Medical Counsel was built with doctors in mind. We understand that you already have a busy professional life full of stress, heavy workload, and constant liability. Let us help you reduce your stress levels, improve your work/life balance, and reduce your worries and concerns with legal matters.

Additionally, our comprehensive and unique approach enables the most entrepreneurial dentists, veterinarians, optometrists, and physicians to achieve their personal and business goals as they create massive wealth through smart strategies with the peace of mind of knowing that their practices are compliant with all federal and state laws.

Regards,

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