LEGAL HOT TOPICS

TIPS FOR PREPARING YOUR PRACTICE FOR SALE

James D. Wall, Esq
Co-Managing Partner
Waldrep Wall Babcock & Bailey PLLC

If you are contemplating a sale of your practice, you should thoughtfully consider the issues raised below. Selling a practice is in some respects like selling a house: that is, you wouldn't sell your house without first making sure the house presents well to potential buyers. The same is true for a professional practice.

Tip One: Corporate Hygiene
You should review corporate charter documents to make sure you have conducted your business as originally authorized. Further, you should make sure that your practice is registered with the applicable licensing board. If there have been any internal changes of ownership, those should have been reported to the licensure board. You should also review your practice's minutes to make sure those comply with state law.

Tip Two: Employment Review
You should review (or have someone review) the employment agreements of all the providers and key employees of the practice. Can the employment agreements be assigned? If a contract is silent on assignability, then it is generally considered to be assignable. Does a "change of control" provision trigger an employee's right to terminate the agreement? Further, you should review in employees' contracts any restrictive covenants regarding competition. North Carolina courts have interpreted a transaction to trigger the commencement of the post-employment restrictive term. That is, if the covenant prohibits competition for one year after employment ends, some courts have concluded that the period commences to run as of the date of a transaction pursuant to which the employer is sold. You should also confirm that all of your licensed providers are current with respect to license renewals.

Tip Three: Review of Third-Party Payor Agreements
Many third-party payor agreements restrict assignment. Thus, it is highly unlikely that provider agreements would be assignable. Upon a transaction, providers often need to be recredentialed, which of course takes time. Some third-party payors require prior written notice to any type of change in ownership.

Tip Four: Evaluate Third-Party Vendor Contracts
The same type of analysis must be done with respect to third-party vendors. The contracts of primary concern are leases of your office space and equipment. These contracts typically do not allow assignment without permission from the lessor. If permission is required, that needs to be noted prior to sale so that the acquiring entity can continue with respect to office space and significant equipment. Institutional lessors often need quite a bit of time to agree to an assignment.

Tip Five: Financial Information
You will want to meet with your accountant to make sure that you have financial reports up to date and in order for the previous three years. You should be able to explain any unusual peaks or valleys in profits, and any significant balance sheet items. If you received money as a result of the pandemic, you should have documents regarding your application for funds as well as the forgiveness of any loans due.

Tip Six: Consider Type of Sale
You should also consider the ramifications of selling stock or assets. In our state, a medical practice must be owned by physicians (there are certain exceptions with respect to physicians owning practices with other health professionals, such as optometrists, psychologists, and APPs). Nonetheless, an unlicensed third party will not be able to purchase the stock of your practice.

A management services organization (referred to as an MSO) can purchase certain assets of your practice, but a licensee must own a medical practice. An MSO makes its money by managing the non-clinical affairs of the practice for a fee. The MSO often embraces a "friendly physician model" wherein the practice continues to be owned by a physician who would be "friendly" to the MSO and enter into a long-term management agreement with the MSO.

You need to discuss with your tax advisor the ramifications of an asset sale and a stock sale before you enter into a letter of intent with a prospective purchaser. Purchasers typically like to buy assets because this structure is more likely to extinguish prior claims against the practice. Sellers often favor sales of stock or membership interests because of favorable tax treatment.

Tip Seven: Review Policies
Buyers active in the health care space will want to review significant policies of the practice in their due diligence. In this regard, you should make sure that HIPAA and other policies are up to date and are being followed. It is not uncommon for practices to have very well drafted policies, but very few in the practice know of their existence.

Tip Eight: Fine-Tuning EBITDA
If you have a time horizon that will permit some planning, you will want to use that opportunity to maximize EBITDA. EBITDA is an acronym for "Earnings Before Interest, Taxes, Depreciation and Amortization." Many transactions will be priced at a multiple of EBITDA. So, for every dollar that is created in EBITDA, purchase price will be increased by the multiple. For example, if the multiple is six times EBITDA, one dollar in EBITDA results in six dollars of purchase price. Typically, purchasers will look at a trailing 12 to 24 month calculation of EBITDA to determine purchase price. While these calculations routinely exclude extraordinary items, there may be opportunities within the practice to save money, thereby increasing purchase price. Also, in a professional practice, salaries of the owners are often normalized using national data, and then the excess is added to EBITDA. So, for example, if a doctor is making $350,000 in his or her own practice, and the national data suggests that earnings should be $280,000, the $70,000 is added back to earnings.

Tip Nine: Be Ready to Commit Post-Sale Employment
The purchase price can be significantly affected by the sellers' willingness to stay around post-sale as employees of the newly created enterprise. If you are willing to stick around, then that often creates a higher purchase price.

Tip Ten: Tell the Truth
Resist the urge to puff beyond the boundaries of truthfulness. If you try to cover up termites with plywood, the buyer will find the termites in its due diligence, and all trust will be lost. ■