Risk & Reward

The Art & Science of Buying or Selling a Private Practice

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Key takeaways for today

Why do people decide to buy or sell a practice?

Key Valuation Considerations

Optimizing Value

The Act of Selling

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Why do people decide to sell or buy?

Reasons for selling	Retirement	(Obviously)
	Opportunity	• Hot Market • Greater ROI Elsewhere • Job Opportunity
	Necessity	• Financial Hardship • Divorce • Illness
Reasons for buying	Opportunity	• Enhance Career • Grow Existing Business • ROI
	Necessity	• Save Job • Block Competitor

Timing the Sale of Your Practice

Personal Timing

Most people target a sale date based on Personal Timing. It is the ***LEAST*** important factor in deciding when to sell.

Company Timing

- Is your company growing and profitable?
- Risk Management
- Turnkey

Market Timing

- Hot Industry
- Presence of Buyers
- Tax Rates
- Interest Rates

Company Timing and Market Timing drive company value.

Q & A

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Why Valuations are Important

Q: What is the percentage of businesses that are listed for sale and never sell?

A: 80%

Q: What is the #1 reason that a business doesn't sell?

A: Incorrect Price

"It's far better to buy a wonderful company at a fair price than a fair company at a wonderful price."

-- Warren Buffett

How do you value an audiology practice?

Rule of thumb multiples:	Traditional Approaches:
1x Sales?	DCF?
5x EBITDA?	Income Capitalization?
$$$ per file?	Capitalized Excess Earnings?
$$$ per hearing aid sold?	Book Value of Assets?

IT DEPENDS!

Key Aspects of a Valuation

Financial

- ❖ Revenue/Earnings
- ❖ Growth
- ❖ Quality of Earnings

- ❖ Financial factors are the #1 driver of the valuation

Operational

- ❖ How easy will it be for a new owner to run your practice?
- ❖ What employees, policies, procedures, and strategies are in place?

Market

- ❖ A business is only worth what someone else is willing to pay for it?
- ❖ How have similar practices been priced?

Risk

- ❖ What is the downside?
- ❖ How reliant is your practice on you (as owner), third-party payors, and key referral sources?

Key Aspects of a Valuation

Financial

- Revenue Growth
- Earnings Growth
- Quality of Earnings

- Financial factors are the #1 driver of the valuation

The most valuable asset of a practice is its future income. Therefore, financial measures drive practice values more than any other factors. Valuations can be based on any of the following financial figures, and are typically expressed as a multiple:

Revenue – Net Sales (total sales less returns & refunds)

EBITDA – Earnings Before Interest, Tax, Depreciation, & Amortization

SDCF – Seller's Discretionary Cash Flow

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SDCF – Seller's Discretionary Cash Flow

Revenue Multiples

- Typically apply only to corporate / strategic buyers
- Multiple varies based on total revenue, cash flow, market, and demand

SDCF & EBITDA Multiples

- More relevant method for individuals, other small business owners, and financial investors
- "Traditional" way to value a business

EBITDA , SDCF, & Recasted Financials

SDCF =

Net Operating Income (Income before Interest & Taxes, or EBIT)

+ Depreciation & Amortization

+ One-time (unusual) expenses

+ Expenses not directly related to the operation of the practice

+ Owner's full salary & wages

EBITDA =

SDCF - Cost to replace owner (e.g. salary of owner during employment term, or cost of replacement Au.D. / Manager)

Calculate SDCF & EBITDA by recasting financial statements to add back certain expenses:

1. Owner's Salary
2. Personal Auto
3. Personal Cell Phone
4. Non-employee Family Salaries
5. Excessive Rent
6. Excessive Travel
7. Excessive Meals/Entertainment
8. Debt that won't transfer to new ownership

EBITDA , SDCF, & Recasted Financials

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SDCF - Cost to replace owner (e.g. salary of owner during employment term, or cost of replacement Au.D. / Manager)

Add backs must be verifiable, and buyers may discount or disregard certain add-backs based on the quality of your earnings.

- Are your add-backs based on line-item expenses, or are they buried within categories?
- Do you have receipts?
- Can a new owner realistically expect to:
  - Pay themselves a reasonable salary
  - Cover loan payments

Which to use?

Sellers are better off presenting their practice's SDCF. Let a buyer create their own expense models based on the total cash flow available. Buyers – always use EBITDA.

EBITDA , SDCF, & Recasted Financials

Key Valuation Considerations

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Advice

At least one year prior to selling, stop running expenses through your business and disclose all of your business income. Add-backs can be disputed; Net Income cannot.

EBITDA , SDCF, & Recasted Financials

Example: Dr. Jones provided you with his income statement and the following list of personal expenses. What is SDCF?

Net Operating Income:	$67,311
Owner Salary:	$120,000
Personal Auto:	$23,554
Personal Cell Phone:	$3,114
Rent:	
Actual Rent:	$36,000
FMV Rent:	$24,000
SDCF = ?	

Answer: SDCF = $225,979

SDCF = NOI + Owner Salary + Personal Auto + Personal Cell Phone + Rent Adjustment

Rent Adjustment = Actual Rent – Fair Market Rent ($12,000)

How to use this information as a buyer

$225,979 is the total cash flow available to you once your purchase this practice. This is how much money you have to pay yourself, make loan payments, and make any required investments in the business.

Key Aspects of a Valuation

Financial

- Revenue Growth
- Earnings Growth
- Quality of Earnings

- Financial factors are the #1 driver of the valuation

Operational

- How easy will it be for a new owner to run your practice?
- What employees, policies, procedures, and strategies are in place?

Market

- Geographic Market
- Market for practices similar to yours

- A business is only worth what someone else is willing to pay

Risk

- What is the downside?
- How reliant is your practice on you (as owner), third-party payors, and key referral sources?

Key Aspects of a Valuation

Operational

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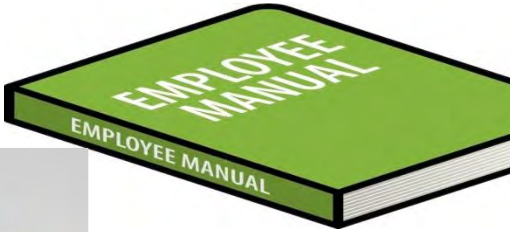
HF HearingFUSION



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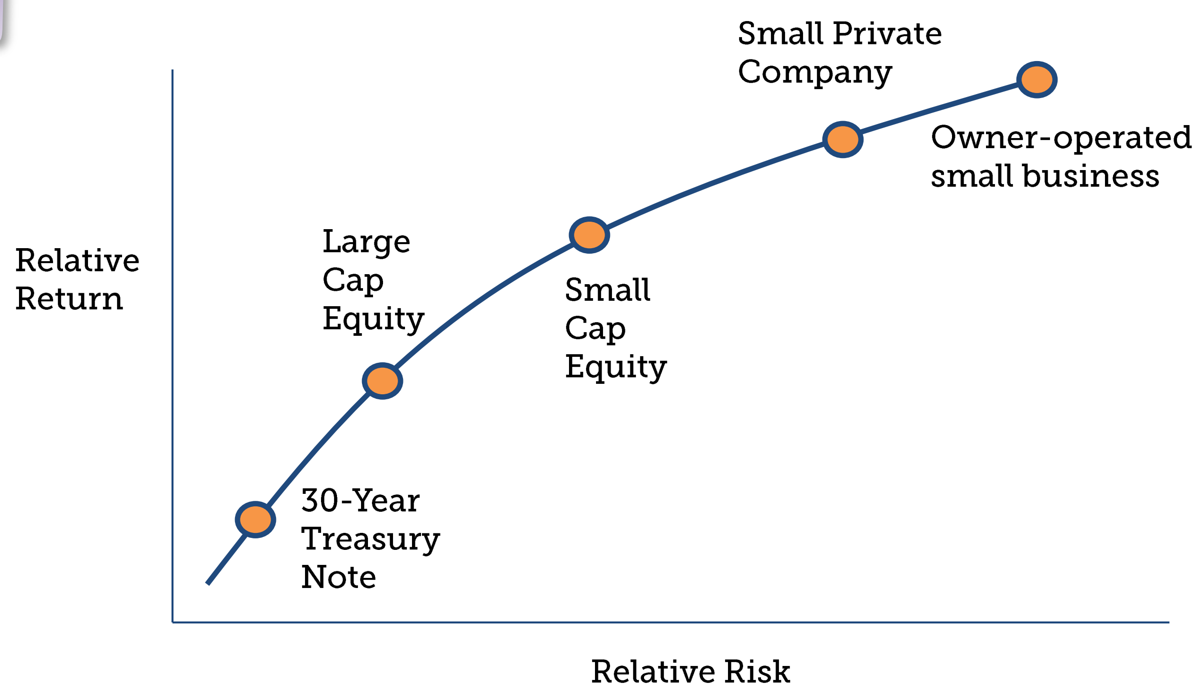

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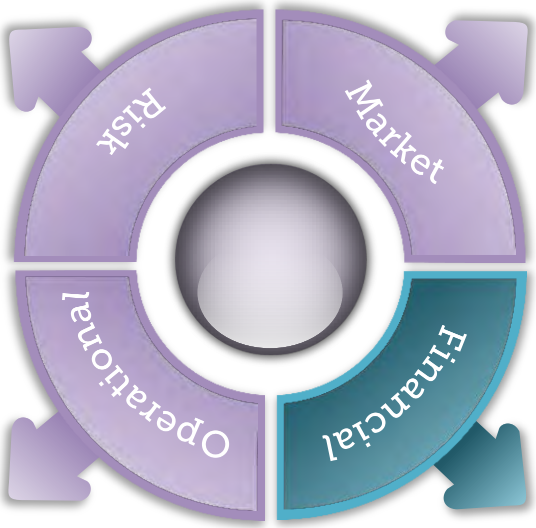

Market

- ❖ Geographic Market
- ❖ Market for practices similar to yours
- ❖ A business is only worth what someone else is willing to pay

Assume the average house sells for $150/sq ft

Bedrooms:	4
Baths:	2.5
Sq. Footage:	2,525
2,525 X $150 =	$378,750

Des Moines, IA
$299,900

Bedrooms:	4
Baths:	3.5
Sq. Footage:	3,300
3,300 X $150 =	$495,000

Malibu, CA
$2,750,000

Sources for Valuations

Source	Pros	Cons
Hearing Aid Manufacturer or Buying Group	• Free • Industry-specific	• Questionable objectivity • Lack of valuation expertise • Tend to include very basic analysis
Your CPA	• Knows your business • Someone you trust • Accounting credentials	• Lack of understanding of how audiology industry values practices and what is realistic FMV • Questionable objectivity
Free Online Resources	• Free • Fast • Customizable	• Too basic to use for anything other than satisfying your own curiosity
Independent, third-party valuation or M&A firm	• Valuation & transaction expertise • Industry expertise (you can find firms with hearing industry expertise) • Objective results	• Can cost $2,500+

How I Value Companies

Asset Methods
- Capitalized Excess Earnings

Income Methods
- Income Capitalization
- Discounted Cash Flow
- Multiple of Earnings

Market Methods
- Multiple of Sales
- Multiple of Cash Flow

Gut

Q & A

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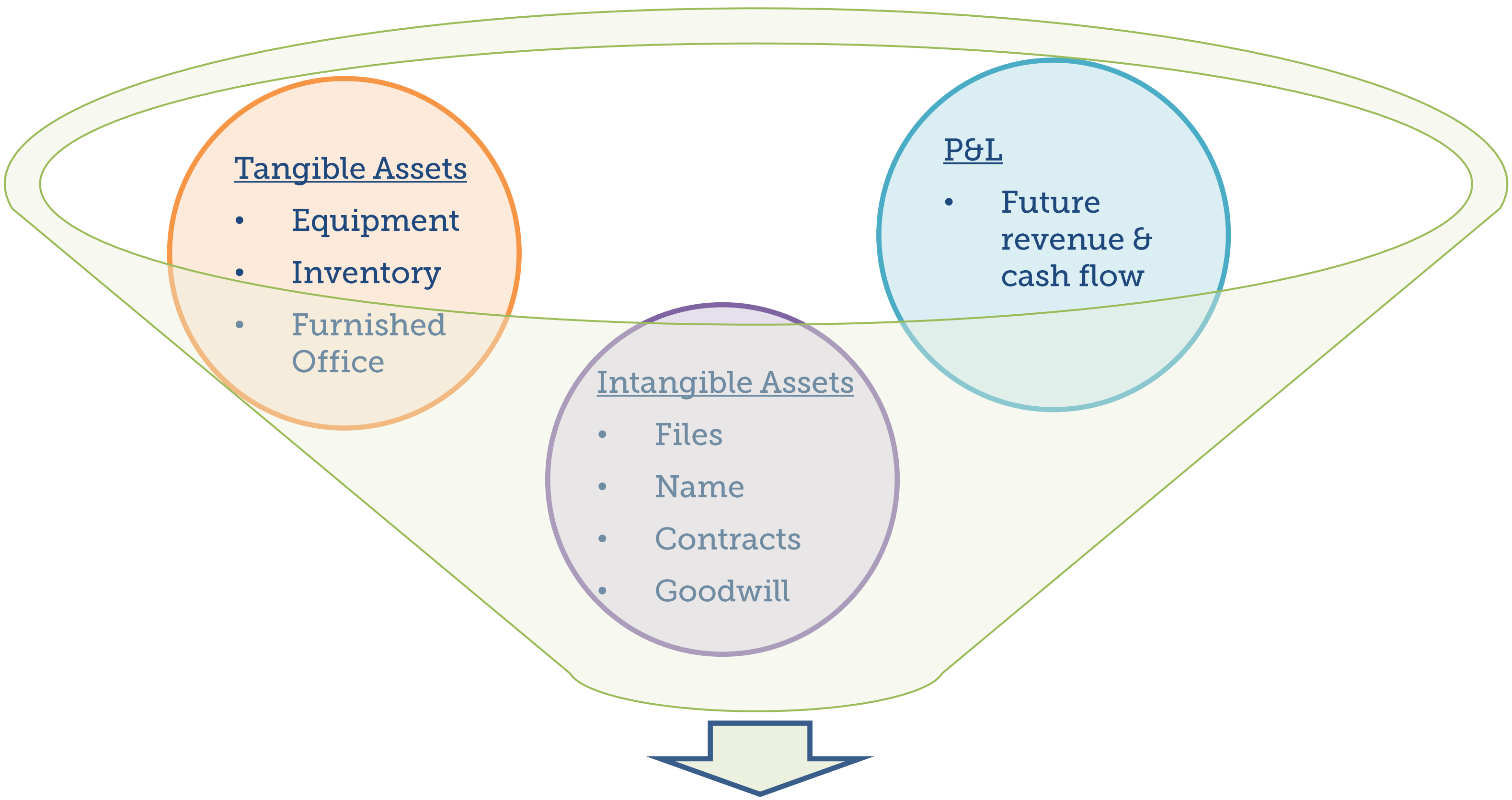
What are you selling?



Does any of it have value without you?

Building value independent of you

Sellability

- Sellability is the measure of a company's attractiveness to a buyer, and is independent of a company's value. Every business has a value, but not every business can be sold.
- Key aspects include:
  - Growth
  - Risk
  - Ability to function independent of owner

Recommendations

- Learn to think objectively about your business
- Understand the buyer's point-of-view
- Reduce key risk factors & make your business turnkey

Stop treating your practice like a career

Start treating it like an investment

Is Your Practice an Investment?

Investment

n.
An asset purchased with the idea that the asset will provide income in the future or appreciate and be sold at a higher price.

Generates annual income and a long-term gain

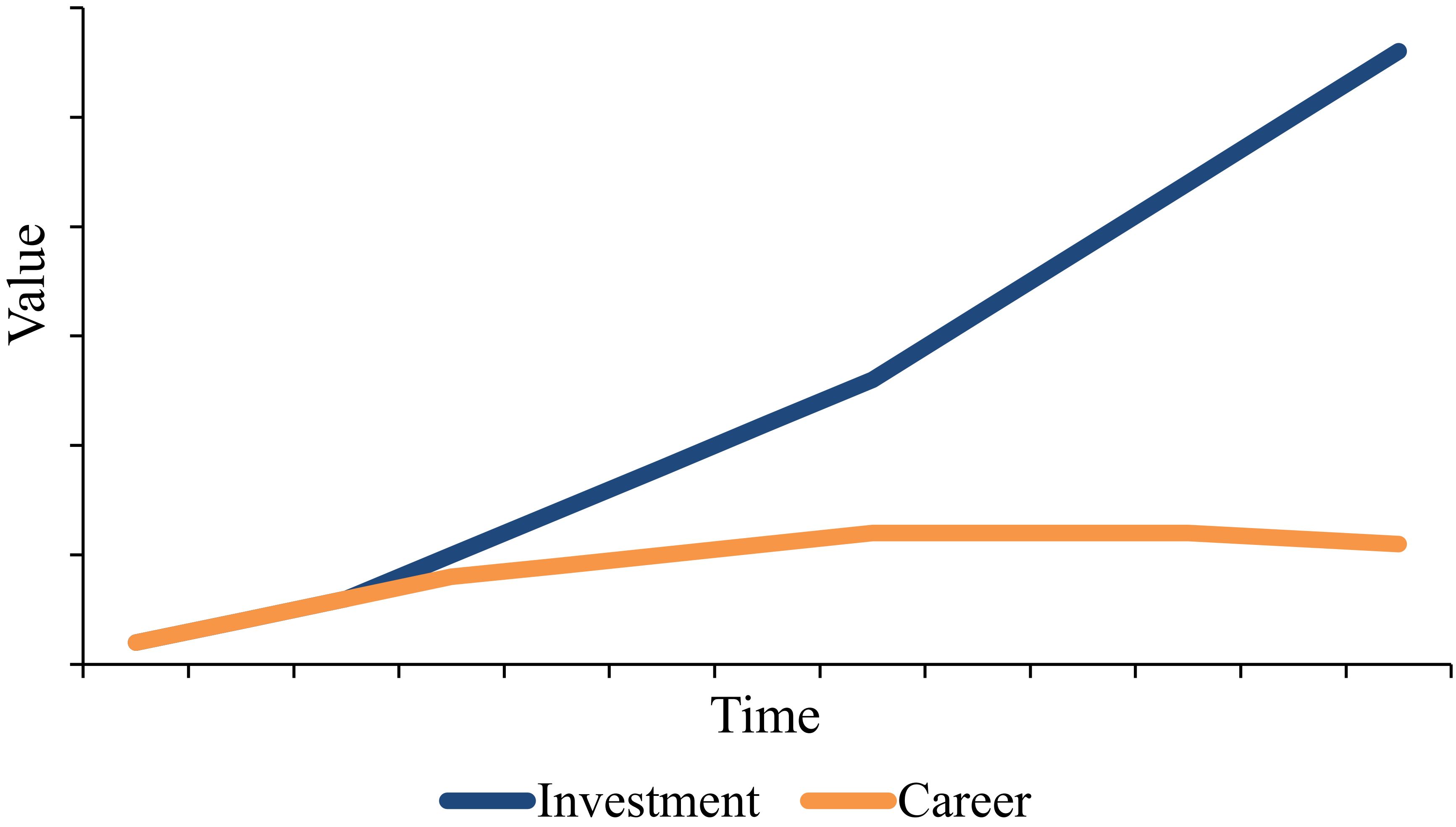
Career

n.
An occupation or profession, especially one requiring special training, followed as one's lifework

Generates annual income only

You retire from a career, but you exit an investment

Growth & Exit – Investment v. Career



Treating your practice as an investment

- Think objectively about your practice
- Understand the buyer's perspective
- Reduce Risk
- Make it turnkey

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SELF-SERVING BIAS

n.
People's tendency to attribute positive events to their own character but attribute negative events to external factors. It's a common type of cognitive bias that has been extensively studied in social psychology.

Examples of Self-Serving Bias

Most men rank themselves in the top half of male athletic ability.

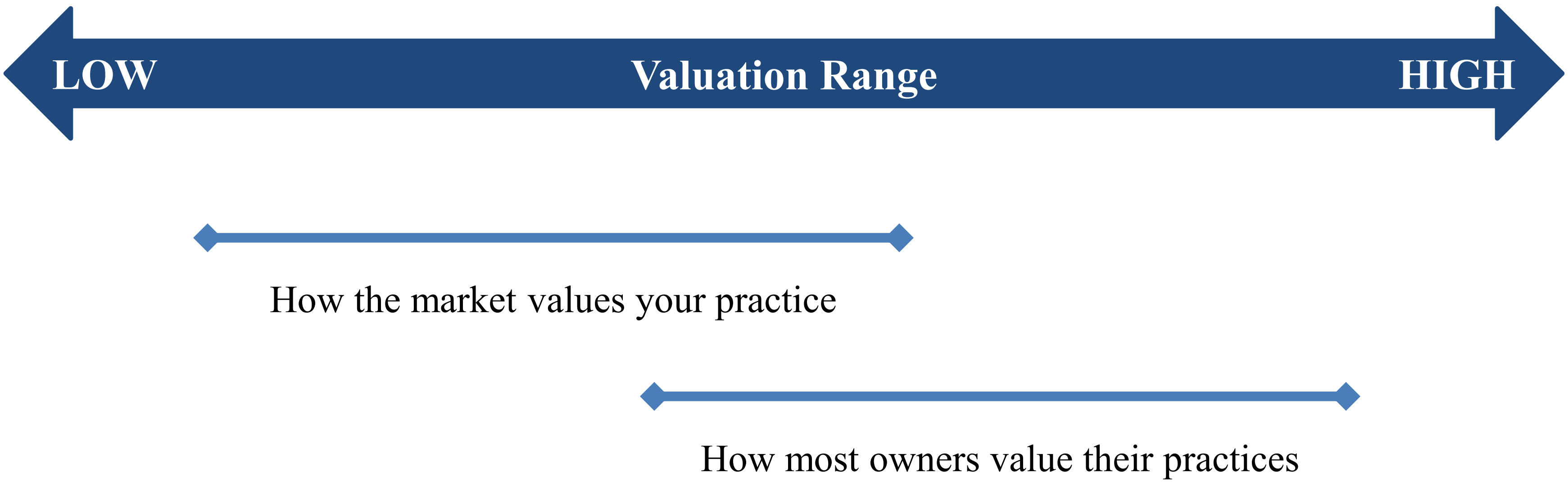
When my business grows, it's because I am such a great business owner, but when it declines it must be due to the economy!

You get an A on a test and attribute it to your own awesomeness!

You get a C on a test and you blame your professor – clearly he or she didn't explain what they wanted well enough.

Ask a married couple to each write down their individual contributions to household work, and the total almost always exceeds 100%.

Perceived Value – Seller v. Market



The #1 reason companies don't sell:

Seller's Unrealistic Expectations

Perceived Value – Seller v. Market

LOW Valuation Range HIGH

How the market values your practice

How most owners value their practices

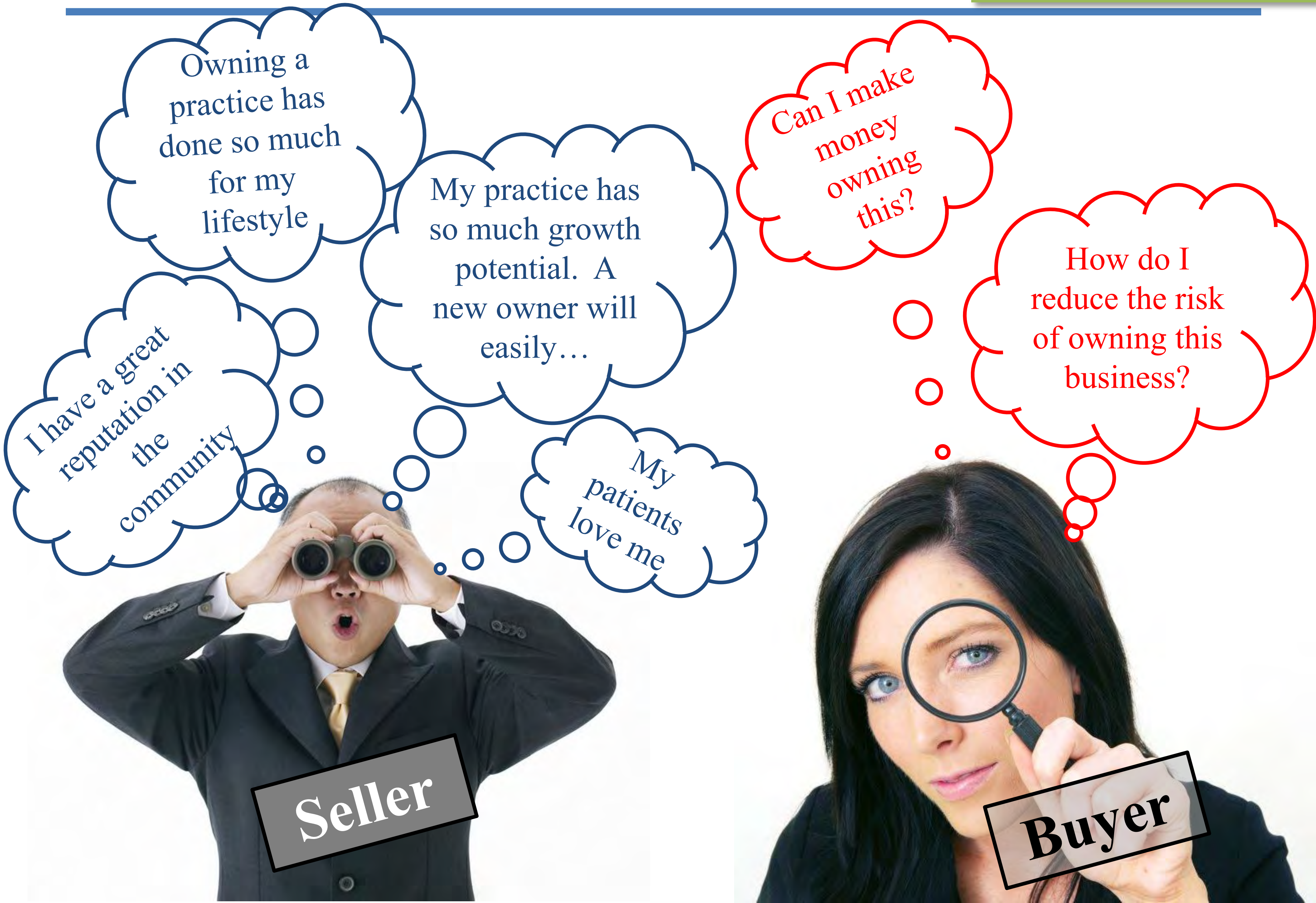
INVESTMENT

Owner takes steps to better understand company value so that expectations are aligned with reality and business priced properly for sale

CAREER

Owner does not understand company's value and bases valuation expectations on rumors, blue sky scenarios, or just wild guesses

Seller v. Buyer Perspectives



Take a buyer's perspective

If you were expanding, your concerns would be…

Cash Flow & ROI	▪ Is the business profitable? ▪ What kind of loan can the cash flow cover? ▪ Are revenue and cash flow growing?
Staffing	▪ Is the owner a major revenue producer – if so, how do you replace them when they retire? ▪ Is staff in place and willing to stay post-acquisition?
Ease of Operations	▪ Is marketing well-planned and easy to replicate? ▪ Are policies and procedures documented? ▪ How stable are employees?
Risk	▪ What happens with the owner leaves? ▪ Is the business reliant on dominant payors? ▪ Is the business reliant on referral sources?

Take a buyer's perspective

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INVESTMENT

Owner understands buyer perspective and balances personal goals with buyer objectives (e.g. win-win scenario)

CAREER

Owner ignores buyer perspective and focuses only on personal goals

"If you understood a business perfectly and the future of the business, you would need very little in the way of a margin of safety. So, the more vulnerable the business is, assuming you still want to invest in it, the larger margin of safety you'd need. If you're driving a truck across a bridge that says it holds 10,000 pounds and you've got a 9,800 pound vehicle, if the bridge is 6 inches above the crevice it covers, you may feel okay, but if it's over the Grand Canyon, you may feel you want a little larger margin of safety...."

-- Warren Buffett

Primary risks of ownership

Employee Risk

Owner Risk

Financial Risk

Legal Risk

Payor Risk

Economic Risk

Risk of Disruption

Referral Risk

Owner Risk

Owner Risk:

- Occurs when owner is key contributor to practice (i.e. patient care and revenue generation)
- Risk of losing patients/revenue when owner retires
- Two primary ways to reduce owner risk:

1

Owner moves out of a direct patient care role prior to selling and therefore generates a very small percentage of total revenue

OR

2

Owner agrees to a very long transition period and/or a multi-year employment agreement to work for the buyer

No Owner Risk

Owner Risk significantly reduced

Payor Risk

Optimizing Value

Payor Risk:

- Occurs when company is overly-reliant on third-party business
- Risk assessment includes both type of payor and payor concentration

Risk

Type of Payor	Payor Concentration
Medicaid	100% Third-Party
Other Government Agency	One Third-Party that generates more than 25% of revenue (on its own)
Private Insurance	Accepts private insurance but no Medicaid and individual payor > 5% of sales
Private Pay	100% Private Pay

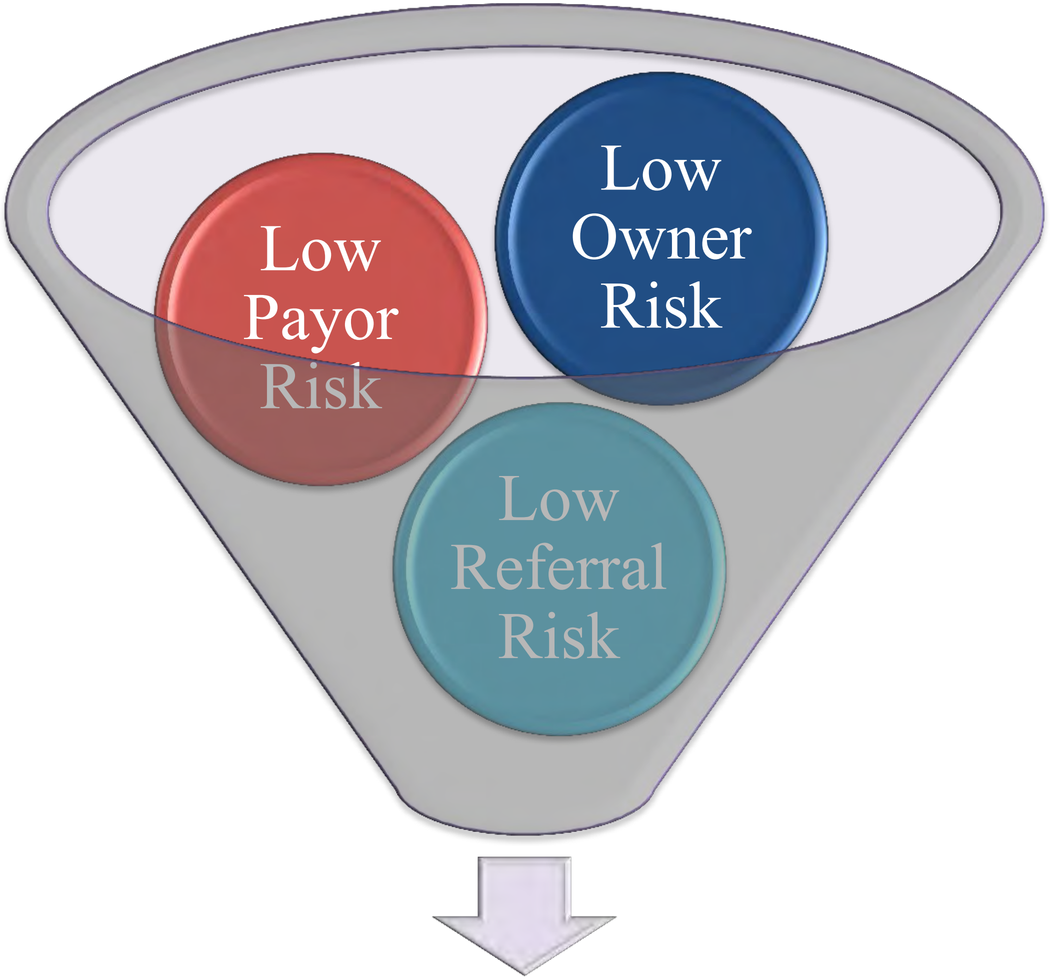
Referral Risk

Referral Risk:

- Occurs when company is overly-reliant on referral sources or has a referral relationship that is non-compliant or difficult to continue after transaction

Type of Risk	Explanation
RELIANCE ON REFERRAL SOURCE	Any referral source that makes up 20% of more of your revenue presents substantial risk to a buyer.
CONTRACT	Do you have a contract in place or is there just a handshake agreement? Can contract be assigned to new owner if your business is sold?
COMPLIANCE	Is contract/relationship compliant with federal and state laws? - Anti-kickback Statute - Stark

Turnkey Practice



Attractive Investment

Turnkey Practice

Once you reduce risk, focus on building a turnkey practice

What they are	▪ New owner can begin operating on day one – only needs to "turn the key" in order to be up and running ▪ Strategies and processes in place
How to build one	▪ Accounting System ▪ Practice Management System ▪ HR Systems ▪ Business profitable and growing

Think "Franchise"

INVESTMENT

Owner takes measures to make practice turnkey and understands both short-term and long-term benefits

CAREER

Owner is most likely aware they he/she should implement turnkey elements but is in denial of value and keeps putting them off

Q & A

Key takeaways for today

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The Four "Easy" Steps in the Sale Process

1. Preparation	2. Marketing	3. Deal Structuring	4. Closing
Plan for the sale	Initiate Buyer Search	Answer Buyer Questions	Schedule Due Diligence
Gather Company Data/Review Business	Distribute Teaser	Coordinate Site Visit	Assist in Loan Package Information Needs
Recast Financial Statements	Screen and Pre-Qualify Potential Buyers	Evaluate Buyer Interest	Review/Negotiate Purchase Agreement
Prepare Business Valuation Report	Determine Buyer Interest	Discuss Business Valuation and Deal Structure	Assist in Resolving All Issues
Prepare Company Information Memorandum	Sign Confidentiality Agreement	Review Written LOI	Definitive Purchase Agreement
Prepare 1-Page Marketing "Teaser"	Distribute Information Memorandum	Negotiate Acceptable LOI/Deal Terms	Review Final Documents

Close!

Asset v. Stock Sale

Most industry transactions – and most small business purchases in general – are structured as asset purchases.

Type	Definition	Pros	Cons
Asset	Buyer purchases the assets of the corporation (tangible & intangible), but does not purchase the corporation itself. Buyer establishes a new corporation with which to operate the business, and Seller dissolves existing corporation.	Limitation of Liability • Buyer chooses which liabilities to assume • Shields from risk associated with prior ownership (tax audits, fraud, lawsuits) Ability to select new accounting methods • Overall • Depreciation & Amortization	Double taxation for C Corps Portion of purchase price taxed as ordinary income (for all other entities) Difficulty in transferring contracts, licenses, leases, etc.
Stock	Buyer purchases the stock in Seller's corporation, effectively purchasing the corporation itself in addition to all of the assets.	Ease of transfer of licenses and contracts All purchase price allocated to stock is taxed as capital gains • Most, if not all, of price is typically allocated to stock • Some can be allocated to non-compete, training, or personal goodwill	All liabilities are assumed No change in asset basis – "tax basis" carries over Old depreciation schedules maintained Cannot amortize price allocated to stock

Tax Treatment in an Asset Sale

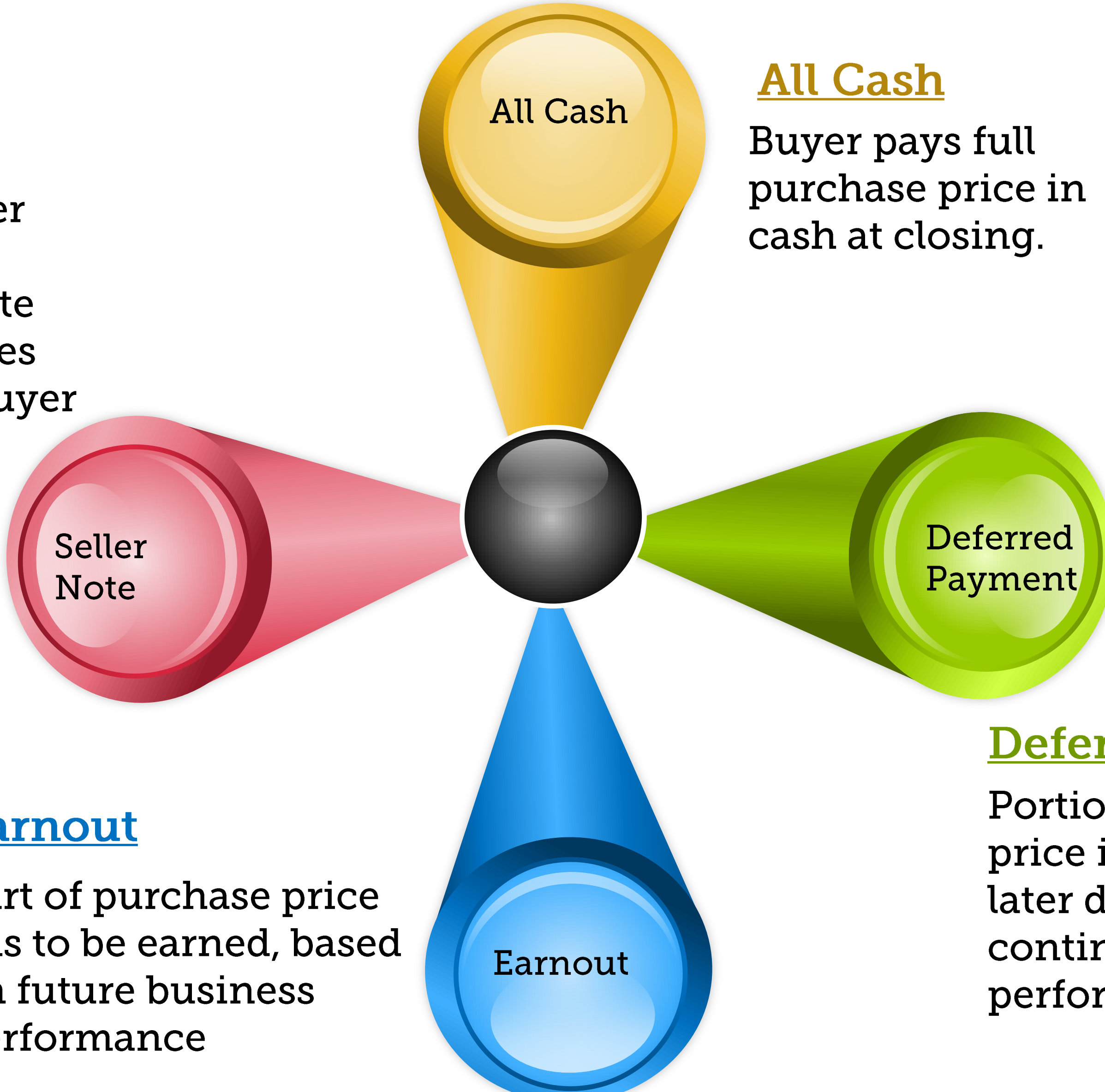
I am not a CPA and this does not constitute tax advice. Please consult with your accountant if you have questions about your personal tax obligations.

Item	Seller	Buyer
Physical Assets (FFE)	Ordinary gain or loss	Capitalize and depreciate (usually over 5-7 years)
Accounts Receivable	Ordinary gain or loss to the extent allocated value differs from tax basis	Ordinary gain or loss to the extent collection differs from allocated value
Inventory	Ordinary gain or loss	Capitalize – can impact earnings in first year
Goodwill	Capital Gain	Capitalize and amortize over 15 years
Non-Compete Agreement	Ordinary Income	Capitalize and amortize over 15 years
Consulting / Employment Agreement	Ordinary Income subject to FICA	Current deduction
Other Intangibles	Capital Gain	Capitalize and amortize over 15 years

Business Entity Types

	Sole Proprietorship	LLC	S Corporation	C Corporation
Definition	A business owned by one person for profit.	A business formed by statute, owners have limited liability like a corporation. LLC's do not issue stock or have shareholders, it's owners are called members.	A business formed by statute, owners have limited liability like a corporation. Limit on number of shareholders, and shareholders cannot be foreign persons or entities.	A business formed by statute, owners have limited liability like a corporation. No restrictions on ownership/shareholders, corporation go public.
Personal Liability	Sole proprietor personally liable	No personal liability of members	No personal liability of shareholders	No personal liability of shareholders
Restrictions on ownership	Only one sole proprietor	One member allowed in all sates	Most states allow one-person S Corps. No more than 100 shareholders permitted	Most states allow one-person corps; no maximum number of shareholders
Taxation of business profits	Individual tax rates of sole proprietor	Individual tax rates of members	Individual tax rates of shareholders	Split up and taxed at corporate rates and individual tax rates of shareholders
Self-employment tax	Assessed on business profit	Depends on how LLC chooses to be taxed	Salary subject to self-employment tax; distributions are not	Salary subject to self-employment tax; distributions taxed as dividends

Payment Structures



All Cash

Buyer pays full purchase price in cash at closing.

Seller Note

Buyer and seller enter into promissory note and seller makes payments to buyer over time.

Deferred Payment

Portion of purchase price is deferred to a later date, but not contingent on performance.

Earnout

Part of purchase price has to be earned, based on future business performance

Earnouts & Deferred Payments

Earnout

Portion of purchase price is contingent on future performance, such as revenue targets or profit margins.

Recommendations:

- Avoid when possible – risk of dispute is highest when earnouts are involved.
- Make sure target achievement is under seller's control
- Align with buyer objectives & seller performance history

Earnouts and deferred payments can bridge valuation gaps and hedge buyer risk, but they must be very carefully defined as the increase seller risk.

Deferred Payment

Portion of purchase price is deferred to a date following closing but is not contingent on business performance. Payment is either "hard" or contingent on employment term.

- Most useful when reliance on owner is high and future results are dependent on seller's continued involvement
- Need to carefully define employment terms and termination rights (of both buyer and seller)

Types of Transaction Financing

Cash

Buyer pays cash for the business and there is no financing required. This typically applies to a deal in which 100% of the purchase price is paid in cash at closing.

Seller

Buyer and seller enter into a promissory note through which buyer makes payments to seller over time. Seller earns interest but carries the risk of buyer's default.

Bank

Buyer seeks financing from a third-party lending institution. Most small business transactions receive SBA financing, in which the Small Business Administration of the federal government backs the loan.

Manufacturer (or other Industry)

A hearing aid manufacturer or buying group provides financing to the buyer in exchange for future purchase commitments. This is the most common financing used in the industry and is easiest to obtain.

Balance Sheet Items

Most transactions involve an accounting cut-off at closing – the seller "owns" all income and liabilities until the closing and the buyer owns everything post-closing. Balance sheet items, however, can occasionally be negotiated.

Assets
- Cash
- Accounts Receivable
- Inventory
- FFE

Cash & A/R are typically excluded from the transaction. The seller keeps all of the cash and collects the A/R. Occasionally, some or all of each will be purchased. Cash should be purchased dollar for dollar while A/R may be discounted.

Inventory may be purchased if it is new and sellable. Depending on deal terms, it may be included in the price or added to it. FFE is almost always included in the price.

Liabilities
- Accounts Payable
- Salaries Payable
- Taxes Payable
- Debt

Liabilities are almost always excluded from asset purchases. Sellers should plan to pay off all accounts, salaries, and taxes payable with the current liabilities (cash & A/R) that they are retaining.

Debt is rarely assumed by buyers. Instead, sellers should plan to use the proceeds from the sale to pay off any debt.

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The Deal Team

Selling a business is a team effort, and the team that puts the best players on the field usually wins.

	Decision to Sell	Prepare Financial Documents	Prepare Marketing Materials	Pricing	Marketing	Due Diligence	Negotiation	Closing
You	●	●	●	●	●	●	●	●
Accountant		●						
Attorney							●	●
Broker		●	●	●	●	●	●	●

Q & A

THANK YOU

How to contact me

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