

THE ART OF PRACTICE TRANSITIONS

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Transitioning your practice, whether to Private Equity, a corporate acquirer, or another optometrist, comes with a myriad of opportunities and pitfalls. The key to accomplishing what you desire is awareness, which takes exposure and experience. Just as your professional skills develop over time, so do deal-making skills.

This article will explore the many issues associated with practice transition. While it largely focuses on the sell-side, if you're seeking to acquire a practice, the issues are similar--albeit from a different perspective. Buying or selling is like looking through the same window but from different directions.

Deal-making is about preparation. Before you embark on any kind of transaction, it's important to think strategically. Here are three questions that I use to explore my clients' objectives:

- a) What are you really trying to accomplish? Really!
- b) What is the right way to accomplish it?
- c) Are you "partnership material?"

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Here are a few anecdotal case studies that will help you more clearly understand the importance of a strategic exploration before you attempt to explore a transaction:

CASE
#1

Sarah is 40 and grossing \$700k on 4 days a week. She's wired and in control...a "Type A" personality. "I'm busy and I need assistance with managing my practice," she says. "I just don't have the time to do all that needs to be done. I need a partner."

Sarah is strong-willed and loves to be in control. Sarah likely needs a manager experienced with working with entrepreneurs, not a partner.

CASE
#2

Jordan is 62 with a \$400k practice. He nets about \$90k. "I want to hire an associate so I can retire when I'm 65," he says.

Jordan more likely needs to build his practice profitability to maximize his earnings and value; then sell outright. The practice can't now support 2 optometrists. Hiring an O.D. will drain his income and retirement resources in the short-term, resulting in a significantly lower return on his life's efforts.

CASE
#3

Joseph and Martha gross over \$2mm per year. They own their facility. They're good leaders and partners. Just in their late 30s, they've enjoyed a history of year-over-year growth. "We need to bring on another partner, as we need more capacity."

This married team has made considerable investment to get where they are. A third partner would likely change their dynamic, create relationship challenges and reduce their return on their hard-fought gains. Their need, at least for now, is an employed associate, not a partner.

CASE #4

Jason is 58 and owns 4 locations grossing about \$3.5mm and netting about \$750,000. He owns his own buildings through a real estate holding company and earns \$50,000 per year from that endeavor. Jason employs 3 ODs and is exploring his succession opportunities. "I'd like to sell to my associates, but only one of them is passionate about business and has indicated any kind of interest in ownership. That associate is only 32, has a pile of student debt and 2 very young children."

Jason is at a point where he is financially secure and must plan his exit. Selling to his associate(s) would represent a potentially risky endeavor, and there's no assurances that the associate is prepared to take on such a significant business operation. Further, there's a significant difference between what we term to be Fair Market Value and Strategic Value. In this case, properly packaging the opportunity and seeking a private-equity backed acquirer would likely realize a significantly higher return on Jason's equity than a sale to a private optometrist.

Choosing the right strategy for your specific situation is critical to your success. Often, just as you experience with patients, what you think you need and what you really need are sometimes not the same.

Regardless of your specific situation, there are some fundamental steps to prepare for any transaction.

- **Know Your Numbers:** Accurate financial controls are paramount. Clearly understand your financial picture, both personal and professional. Sloppy accounting results in lower valuations and mistrust... and kills deals.



- **Operate for Profit:** Your practice value will be largely based on cash flow for the prior 3 years. If you're not operating at maximum profitability, you'll not achieve maximum return.
- **Eliminate Nepotism:** Employed family members can be problematic. Your buyer must look to replace multiple parties. Nepotism can cause mistrust and introduces unique dynamics. Prepare early for the exit of family members.
- **Know What You Want:** Explore and define, in advance of any deal, what it is that you want. That said, your objectives must be realistic. Just because you have invested 30 years in your business doesn't mean that it carries a value beyond that of Fair Market.
- **Ensure That Your Assets Are in Prime Condition:** There are four legs to the value of your business; you, your team, your physical plant and your financial performance. Make sure you're ready to transfer your brand equity. Get the right people on your team and the wrong ones off. And make sure that your equipment and facility are in top condition.
- **Get Time on Your Side:** You will invariably make a mistake or two with initial forays. Give yourself the time to make them and recover.

There are four legs to the value of your business; **you, your team, your physical plant and your financial performance.**



Preparing your practice for any deal and then running the rapids to completion is no simple feat. Don't underestimate the complexities. Surrounding yourself with the right resources will make your process easier, providing a higher return on your life's investment with less stress.

Once you've clearly identified your objectives, you can begin to look at the financial aspects of your situation and put together the resources you need for turning your vision into reality. Virtually every seller has a price in mind, which may be the result of a Fair Market Value ("FMV") appraisal. FMV is an estimate of the market value of a property, based on what a knowledgeable, willing, and unpressured buyer would probably pay to a knowledgeable, willing, and unpressured seller in the market." However, such FMV appraisals often don't take into consideration all elements of a transaction. Further, FMV appraisals generally focus strictly on the financial elements of the business and ignore the more important strategic implications of a transaction.

Deal design is far more important than value. The seller's request is a starting point. And while having a reasonable understanding that the request is "in the ballpark," investing in a counter FMV appraisal is generally not a good use of capital.


So how much is the practice worth? As the buyer, you think you want to pay as little as possible. As the seller, the opposite. Either case may be wrong from a deal-making perspective. While there are many elements of the valuation process, reality is that "value" comes out of the deal-making process. Price is intuitively the starting point but should be the end point.

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Consider that, within any practice purchase, you're buying (or selling) just three things:

- **A Cash-Generating Machine:** What's the practice's cash flow. The more cash that the business generates, generally the more you (or someone else) can afford to pay for it. Hard assets such as equipment and inventory are secondary to cash flow. Just because the practice is "shiny/pretty" doesn't mean that it's profitable. Hard assets are readily valued and their value is generally no greater than replacement cost.
- **An Opportunity for Growth:** If the practice hasn't demonstrated historical growth, why would it grow after you make the purchase (or sale)? What are the underlying operating ratios that would indicate opportunity? Where does the revenue come from? What assets are being under-utilized? What markets are being under-served? What can be done to change the financial performance of the enterprise?
- **A Lifestyle:** For a private buyer, too often they focus on the specific deal instead of the lifestyle that the opportunity represents. As a buyer, if you can't see yourself living and thriving in a community, don't buy the practice. You're not just buying an asset but are going to spend a significant amount of your life and energy in the community. Is it where you want to live and raise your family?

Designing transactions is an art form. While the



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numbers must make sense, there are many elements that go way beyond price. Is the seller staying on for a transition? Who's responsible for what aspects of the transaction? Can the cash flow support the debt and deliver a reasonable income and Return on Investment? Does the practice need to be re-branded? Is there a manager in place? What about family members? How will warranties be handled? What are the legal and tax considerations? What's the condition of the assets? The facility? What's the skill level and tenure of each team member? The answers to these and other questions drive the value of the business. But focusing on price up front can divert your attention; result in a higher cost, or worse, a missed opportunity.

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"No one agrees to anything until everyone agrees to everything."

At the end of the day, every transaction is unique. What appears simple WILL end up complex. Knowing the right questions to ask is mission critical. Make sure you've got time and experience on your side.

Once you've addressed how to prepare for a divestiture or acquisition and how to ascertain value, we can now discuss how to get your deal done.



Choosing the right strategy for your specific situation is critical to your success. And just like your work with patients, it's experience that counts. Whether you're buying or selling, hiring or being hired, you're engaged in a deal-making process which is the result of a combination of design and negotiations. Whether you succeed in this process is directly related to the experience levels of the members of your transaction team.

Here are some considerations:

What do I give; what do I get? Be prepared to answer these questions for all parties in the transaction, including secondary level parties. For instance, you may clearly understand what you get out of a transaction and what your future partner will get; but how will the deal impact your office manager? The staff? What about your respective spouses; or vendors, etc.?

Make Sure Time is On Your Side: Never allow yourself to be placed in the position of having to do anything. When time is on your side in a negotiation, you have a much better chance of coming out on top. But, more important, the odds that you'll make an error are significantly reduced. Deals take time. Even simple deals have as many as six parties involved (you, the other side, both of your accountants and attorneys). Even a simple employment contract can take six months to develop, review and execute. Don't be caught short on time.



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Document the Deal: Every transaction, partnership relationship and employment relationship should be backed by a written agreement (yes, even at-will employees should have a work agreement). If you can't get an agreement completed, the odds are that you're going to have a problem downstream. I've heard this response on many occasions: "Yes, we have a contract... it's just never been signed." Well, an unsigned contract is just a collection of thoughts. Get it in writing!

Too Many Cooks Spoil the Broth: While I always recommend surrounding yourself with good advisors, the inverse can be a problem, too. Deal making is an art form. As with all art forms, the process is subjective. There are certainly some rules on the tax and legal side but even those are often subject to interpretation. Thus, if you're not confident with your business skills and have little experience with complex transactions, you will find yourself having to navigate conflicting opinion. Find yourself one experienced trusted advisor who can help you navigate these uncharted waters.

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Always Look for the Win-Win: If you think you can pull the wool over the other party's eyes and get away with something, forget it. Likewise, if you are feeling that you're not getting the best situation for you, walk away. How individuals act in negotiations is very telling about the future of your relationship. In many respects, an employment agreement or transaction document is like a prenuptial agreement. If you can't work it out up front, the odds are that the relationship won't work, either. Further, in today's litigation hungry world, any deal is subject to turning ugly. If all parties to the transaction aren't focused on a balanced set of terms and economics, then it's a good sign that the relationship will not evolve as you desire. Beware!

Every transaction, every partnership and every employment relationship are unique. The sale of your practice will likely represent the largest transaction of your life. Make sure that you've done your homework. Surround yourself with a trusted advisor that can help you shoulder the responsibility that comes with significant transactions.



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This article has been adapted from: A Different Perspective; An Entrepreneur's Observations on Optometry, Business and Life by Alan Cleinman. Available from Amazon.

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