

Contemplating Selling Your Practice? Consider These First Steps

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In our last installment, we discussed that the dental services industry has undergone large-scale consolidation in recent years, primarily driven by Dental Services Organizations (DSOs) and private investors. We described what a DSO is and why it is a prevalent vehicle through which private investors are seeking to consolidate the dental services industry. We also identified some of the potential reasons why you might be interested in selling your dental practice to a DSO. In this installment, we will focus on some of the initial steps involved in a sale process, including preparing your practice for sale and finding a potential suitor.

Preparing for a Sale

You have decided it's time to sell your dental practice and find a potential buyer. Will that buyer be another practice or a DSO? A sale to a DSO will typically involve greater scrutiny into your practice's financial and operating history than when selling to another dental practice. With that in mind, if timing permits, one of the most beneficial things you can do is to begin working with your professional advisors early in the process before engaging in any meaningful conversations or negotiations with a potential suitor. Your goal is to prepare the practice for a sale, so that once you have found a potential buyer (whether that buyer be another practice or a DSO) you will be able to obtain the best possible deal for yourself. In addition, with early preparation, the transaction process will run smoothly, helping you avoid headaches, stress and additional expenses.

Your first step should be to work with your accountant(s) and financial advisor(s) to ensure that your practice has accurate and comprehensive tax and financial documentation readily available and address any accounting matters that might be of concern to a potential buyer. Typically, a DSO will provide you with an initial valuation and proposed purchase price after reviewing some basic financial information about your practice, including financial statements. In order to ensure that the practice's operations support the DSO's valuation and the purchase price they are willing to pay you, a DSO will subsequently conduct an extensive financial due diligence about your practice. When the DSO requests specific financial and tax information you will want to have those documents and information organized in a presentable and readily accessible manner. Working with your accountant(s) and financial advisor(s) early on will also allow them to mitigate any issues arising during the financial due diligence process and/or negotiations.

Similarly, you should begin to think about engaging legal counsel to assist you with preparing the practice for sale and advising on any proposed transaction. Now, perhaps you have an attorney that has handled some small matters for you in the past, or you remember that your cousin is an attorney (albeit a real estate attorney), and you are thinking to yourself that this individual should be able to handle the transaction. You

would be doing yourself a big disservice by engaging this individual. The sale of your practice is one of the most important events in your professional career, and your goal should be to find legal counsel that has experience in both the dental industry and transactional experience with selling a dental practice, particularly with selling to a DSO. By doing so you are ensuring that you will receive sound legal advice and signal to the buyer that you are taking the process seriously. We have seen attorneys nearly kill deals or not properly advise their clients of certain risks because they did not understand the transactions that they were advising on.

Once you have chosen competent legal counsel, you should work with them to help ensure that all of the practice's policies and procedures (e.g., HIPAA and data privacy policies) are up to date and documented. You and your counsel should also review the practice's operations to identify and address any potential compliance deficiencies. As you are aware, the healthcare industry is highly regulated and compliance matters can often be confusing and costly, so it is important to have competent counsel guiding you. Addressing these matters early on will allow you to provide diligence materials and responses to a potential buyer in a timely and efficient manner. In addition, if the buyer identifies a compliance defect during the diligence process, it will help to show that you are already aware of it and you either have corrected it or are in the process of correcting it with the advice of legal counsel. You do not want to learn about an operational/compliance deficiency for the first time during the due diligence process or negotiations because it could stifle any leverage you had with the buyer or, if serious enough, scuttle a transaction entirely. Even worse would be for a buyer to uncover it after the closing and look to you for indemnification for damages. Finally, you can work with your legal counsel to identify and compile documentation that a buyer will likely request during the due diligence process, such as third-party contracts and leases.

Again, the overarching idea with engaging your professional advisors at this point in the process is that you want to be "proactive" rather than "reactive." From the buyer's perspective, it shows that you are serious and committed to the sale process. For you, it means saving yourself time, money and headaches during the transaction and, potentially, after the transaction has closed.

Finding a Buyer

In years past, a dentist might only need to look to his/her associate dentists as a potential means to transition the practice or sell to any number of other local practices interested in expanding their footprint. Today, those opportunities are becoming scarcer, and practice owners are looking more and more to the growing number of DSOs that frequently bombard them with letters of interest and cold calls regarding a potential sale. However, it's important to identify the "right" suitor, and there are different ways of doing so.

One approach is to research and reach out to potential buyers on your own. If you have an established practice, it is likely that you have received a number of unsolicited letters or calls from various DSOs. Often, DSOs will send practice owners marketing materials highlighting their track record, the expected operational synergies when affiliating with

the DSO, how they approach transactions and the type of practices they are looking to affiliate with, and what a practice owner can generally expect following a transaction. A first step is to contact one or more of these potential suitors to begin preliminary discussions about a sale. Another resource to utilize are other local dentists that have already undergone the process of affiliating/selling to a DSO. This is a particularly useful approach because you will have someone facilitating an introduction to the DSO and, more importantly, you will have the ability to gain insight from a peer about their experiences with the DSO during the transaction and quality of life following the transaction.

Another approach would be to engage a business broker or investment banker to help you market your practice and find a buyer who would be the best fit for you. Both a business broker and an investment banker can provide immense assistance in preparing a confidential information memorandum regarding your practice (i.e., a slide deck summarizing the operations of the practice and highlighting its financial performance, which is provided to potential buyers), identifying potential buyers, evaluating multiple offers, and assisting with compiling necessary due diligence materials that potential suitors will request, particularly financial due diligence materials and information. Another significant service that both offer is assisting you with reviewing and negotiating a DSO's valuation of your practice (e.g., adjusted EBITDA calculations) and any negotiations relating to the financial terms of the transaction. This latter service is often a key differentiator between a business broker and an investment banker. As you might guess, these services come with a fee, which is often based on a mix of a fixed fee and "success fee" (i.e., a percentage of the sale price). Investment bankers typically seek larger percentage-based fees and will only take on transactions that cross certain purchase price thresholds. Your job is to evaluate the fees associated with engaging a business broker or investment banker to determine whether they are warranted in relation to the services that they will provide to you.

Regardless of the approach you take, when evaluating DSOs, you will want to perform some of your own basic diligence and ask the following preliminary questions:

1. Is this an organization (both the DSO and its affiliated dental practice) I want to partner with and be employed by?
2. Will this organization help to enhance my reputation or tarnish it?
3. What is the organization's track record with other sellers?
4. How is the DSO viewed in the market?
5. Will my patients receive an enhanced level of service?

You've worked hard to build a successful practice so it may not always make sense to select the buyer offering the highest purchase price. It often involves evaluating which buyer is the best fit for continuing what you have built.

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