

WHEN IS DEFERRED CONSIDERATION WORTH IT? -LUKE MOORE

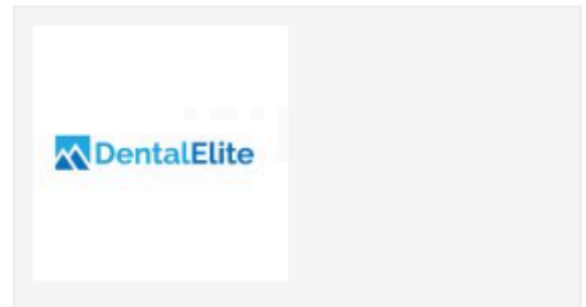
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Luke Moore, Co-founder of Dental Elite sheds light on deferred consideration and what it could mean for vendors.



'Part now and the rest later' is a billing strategy employed by businesses



and individuals all over the world to secure payment. There's a similar process in dental practice sales, except the money isn't transferred straightaway upon completion. Only once the business is performing to the agreed level will the remaining funds be released from the buyer's account. This is known as deferred consideration, and has become a common alternative to a sale where the entire purchase price is paid upon completion.

I know what you're thinking – why would you opt for deferred consideration if you could walk away from the deal with all the money? Well, for large private practices or practices with short-term orthodontic contracts a deal without deferred consideration is not always possible. Or if it is there is a significant financial penalty for a 'walk-away' deal. The main reason being that buyers often want to mitigate some of the risk, and the only way they can do that is to ensure that the vendor bears some responsibility for the output of the practice post-sale. Plus, deferred consideration can be a means of securing a sale at a higher overall consideration (depending on the performance of the practice, of course), which is why some vendors may consider this option.

The question is how do you decide if a lower deal paid entirely at completion is better than a higher sum of money that is paid following completion based on the practice's performance? One consideration that can help is the accounting principle of 'Net Present Values'. What this essentially means is that a pound in your hand in two years time is worth less than a pound in your hand now because of unearned returns. So if you're looking to purchase another practice or invest the money in other areas it might be more prudent to steer clear of deferred consideration.

Another thing to consider about this sale route is that you might be required to stay on in the practice part-time in an advisory role or as an associate post-sale. While this likely won't be a problem if you're not in a hurry to give up work, you will need to remember that the circumstances of the contractual agreement will be somewhat different to that of a self-employed associate. Any days off sick or fluctuation in performance would have no other impact than less take-home that month. If you were to stay on as an associate as a result of deferred consideration, however, you might be liable for underperformance – not just on an individual level, but practice-wide.

Indeed, there have been instances where dental corporates have imposed strict tapering clauses, whereby for every £1 in turnover lost, £1 of the consideration has been removed. Should you end up in a similar situation you run the risk of a reduced pot at the end of the pre-determined time period. Or worse still, you could leave without any of the remaining funds if the buyer was to impose a clause that if performance drops below a certain level then all the consideration is removed and there is no further tapering allowance.

For that reason, it is always advisable to negotiate a deferred element deal that is associated with individual turnover rather than the practice's combined turnover or Earnings Before Interest, Tax, Depreciation and Amortisation (EBITDA). That way, associates' retention and performance is the responsibility of the buyer. Alongside this, you could ensure that protocols are in place to protect you against illness and underperformance. Alternatively, if you are worried about the knock on effect of underperformance or quite simply you want to avoid this scenario, it may be that deferred consideration isn't for you.

It's also worth considering what would happen in the event the business were to fail or the buyer was unable to borrow any more money from the bank. Where would that leave you financially? Luckily, there are ways and means to mitigate this risk. For instance, arranging to personally take charge over assets until the deferred consideration is paid off, or if the buyer has other directors, use the sale agreement to make them personally liable if obligations aren't met.

Until you sell your practice you won't know what options are available to you and whether deferred consideration might be a good move – but you can do your homework to ensure you're prepared for all eventualities. Together with support from an experienced sales and acquisitions agency like Dental Elite you can be sure to choose the deal structure that will benefit you the most.

For more information on Dental Elite visit www.dentalelite.co.uk, email info@dentalelite.co.uk or call 01788 545 900