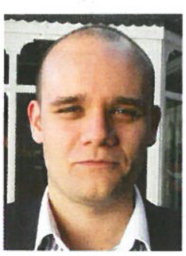
A spotlight on finances

Luke Moore continues his series on the potential pitfalls associated with practice sales and acquisitions.

The money involved in a dental practice sale is obviously a major aspect of the transaction. Firstly, the practice's accounts must all be present and correct. Secondly, the valuation of the practice will play a significant role in the asking price for the business and therefore it is important to be able to justify and maintain it. Within each of these areas are some problems that commonly occur and knowing how to avoid them is crucial.



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Quality

It goes without saying that quality accounts will facilitate a smooth transaction. They should be easy to read and understand so buyers can quickly access the information they need to secure funding. The accounts also need to be up-to-date; old accounts are a cause for delay in approximately 20-30 per cent of practice sales. Further still, extraordinary costs need to be recorded correctly so that they don't impact profitability and EBITDA (Earnings Before Interest, Tax, Depreciation and Amortisation). For example, capital purchases must be recorded for what they are and not added into material costs.

Restated accounts

By keeping on top of the accounts in the years preceding a sale, a vendor can avoid the need to restate anything. Seeking early advice on the 'ideal' set of accounts can avoid delays and aborted deals. However, where accounts are restated, it is advisable to provide a detailed explanation as to why, reducing the risk of potential buyers questioning the validity of the figures and other aspects of practice management.

Cash

An accountant without experience in net asset value adjustments may be ➲

nervous about leaving too much cash in the dental practice, however, this is not a problem regarding the sale. It is also more tax efficient to have a cash-rich business, as taking cash out prior to a sale will induce large tax bills. Working with an accountant who has both dental-specific and corporate experience is therefore a must.

Renumeration trusts

Remuneration trusts are tricky because they can fail years after they were first set-up and then there is the risk of not just having to pay the avoided tax, but also penalties and interest on the same. This is not so much of an issue for an asset sale but where a share sale (limited company sale) is sought, quantifying this potential liability and accordingly an indemnity for the same can be very difficult. In some cases there can be retentions for huge chunks of the purchase price. I am even aware of one practice sale where the sale had to be aborted because the indemnity required was more than double the practice purchase price.

Entities and liabilities

It's important to ensure that all the assets in an incorporated practice belong to the limited company and not an individual. This goes for everything from equipment leases to staff employment contracts, all of which should be moved to the limited company before a sale. Similarly, it is beneficial for buyers to check what contracts the business is signed into before completing a purchase, including any agreements for phones, IT systems and other on-going services. This can help avoid pricey cancellation fees if the buyer wishes to change service providers.

Valuations

There can often be discrepancies between the vendor's and the buyer's valuation – the bank will always err on the side of caution. The difference between the two has to be made up by the buyer, which is when price negotiation often starts. The more viewings and offers a vendor receives, the better supported the higher valuation will be. It's also necessary to note that many banks, and even some principals, don't fully understand the impact of having a dental therapist on the accounts – this needs to be calculated and presented clearly in the preparation for a sale. For example, at Dental Elite we always provide the reasoning and calculations used to reach the valuation provided, which can also be used to support bank valuations and help vendors achieve the optimum price. We also have access to the bank's valuers, so we can present the relevant information to them directly.

While all of the above hopefully offers insight into the key problems to avoid during a practice sale or purchase, perhaps the most common mistake made by vendors is that they decide to sell and then take their foot off the pedal. Reducing workload can have dramatic consequences on revenue and profits, especially in a smaller practice. This can provide an opportunity for purchasers to renegotiate the sale price even towards the end of a transaction, delaying completion. The most important advice that can be given is to keep going – once the sale has gone through you can relax, but until then, it's full steam ahead to make sure you get the best possible deal for your business!