

# Selling a medical practice: Strategies to improve outcomes for owners.

**Merritt** Healthcare <sup>1</sup>  
Advisors  
INVESTMENT BANKING

**Earned**  
Comprehensive Wealth  
Management for Physicians



## Ways to achieve the best practice transaction

**Socrates coined the phrase “know thyself” as a route to wisdom, and it’s a pretty good place to start when thinking about a potential practice transaction.**

Before you get started on a sales process, it’s a useful exercise to review some fundamental questions that extend beyond a valuation and a monetary event:

- What are my team’s core strengths and weaknesses?
- Why do I want a partner and how can that partner help?
- Are my current business partners aligned with a sales process?
- Does the core team have at least five years to work post close?

For most of our clients who initiate a sales process, the prospect to partner with a strategic buyer or private equity (PE) platform that can provide greater size and economies of scale, capital for growth opportunities and perhaps bring a sharper operational or strategic focus while physicians maintain clinical autonomy is attractive. Once you decide you would benefit from a partner, we have a few recommendations that you might consider to best position yourself in the market and improve outcomes for owners:

<sup>1</sup> Principals of Merritt are registered representatives of unaffiliated broker-dealer Burch & Company, Inc. Non-retail securities-related services are performed through Burch. Neither Burch nor Merritt offer or perform post-sale financial planning services.

### Focus on presenting your cash flows correctly.

Buyers and their advisors should carefully review historical financials and operations for normalizing adjustments including opportunities for expense savings. Growth plans that have been initiated but are still ramping and or have not had a full year to fully reflect in historical financials (like hiring new physicians or expanding ancillary services) should also be quantified and presented for buyer review and can add significantly to your valuation.

### Develop a compelling growth plan or at least a vision of what that might look like with the right partner.

It will not surprise anyone to hear that buyers will pay more for entities that they believe have compelling growth opportunities as well as leadership that can execute. It is highly advised that you think through your short-term and longer-term opportunities, including physician recruiting, office expansion, tuck-in acquisitions of smaller practices and launching new ancillaries.

### Maintain your value by continuing to execute on your business plan while negotiating a deal.

An M&A process may take six to twelve months and occupy a good deal of your and/or your staff’s time. Even after you achieve a great valuation, pick a partner, and execute a signed LOI the deal is not over until diligence is completed and final documents are signed. Buyers will continue to evaluate your business trends versus your stated plan throughout the process so be ready to keep running through the finish line.



# What to Think About When Considering a Buyer

**Most potential partners come with both positives and negatives. Endeavor to deeply understand each buyer, their vision and track record.**

Potential partners may include hospitals, national strategics, health systems and/or private equity. Each may bring a different vision, future opportunity set and execution track record for your consideration. While initial valuation is an obvious consideration, so is the ability to help add to future revenues and/or cost synergies as is the potential for future additional monetizations. The go forward compensation model also needs to be keenly understood. Make sure your vision and interests are aligned with your partner's.

## Governance & Partnership

Buyers should lay out how they intend to govern and work together with selling physicians. What decision-making will each have? How will each work together to be successful? Make sure you are asking these important questions before you pick a partner and that the answers are agreeable to you.

## Review potential partners for future upside and understand exit terms

Is there an opportunity to monetize again if a private equity firm sells in a few years? What happens to your shares if you want to retire or leave the practice? What are the terms of my non-compete?

# The Importance of Assembling the Right Team

**Assemble a great team to advise and advocate for you.**

**Steve Jobs once said: "Great things in business are never done by one person. They're done by a team of people."**

Buyers know this and have deep pockets and tremendous resources to review your practice and negotiate the best deal for themselves. Despite having smart finance professionals with MBAs who have done hundreds of deals, they still will assemble a team of accountants, lawyers and consultants that could number 20-40 people strong to review every aspect of your business before they complete a purchase. Help even the playing field and maximize your results by working with an investment bank, law firm and private wealth advisor all with deep healthcare sector experience. Owners who assemble a knowledgeable team will almost always generate more value than businesses that try and get the best deal for themselves. Experience has a big impact on deal outcomes. Don't go it alone.



## The Merritt Difference

Unlike other investment banks, Merritt's principals not only have deep healthcare experience as bankers but as physicians and owners of healthcare businesses who have monetized themselves. We understand how to effectively position your organization, help develop and validate projections for growth and create the most competitive bidding environment for your business. We also understand how to push potential buyers, making a significant impact on the financial and non-financial outcomes of your sale and ultimately reducing the risk for owners that they accept below market valuation or non-monetary deal terms.

# Maximizing Outcomes For Owners: The Value of a Marketed Transaction

## Situation Overview

- ✓ Physician practice ("Practice") approached by five potential buyers, receiving LOI's with a wide range of valuations and deal terms
- ✓ Uncertain if they were getting a fair deal, and the practice hired Merritt to review the LOI's and advise on how to best proceed.

## Merritt's Solution

### Recommendation

Upon Merritt's review of the LOI's, Practice's financial & operational data, and discussions with the Practice management and bidders, Merritt concluded the Practice was undervalued and recommended a full marketing process and re-introduction to the market.

### Process

Merritt worked with the Practice to construct a Confidential Information Memorandum and a detailed financial model that included adjustments for unrealized revenues, normalization of certain expenses, go-forward physician-partner compensation, and inclusion of various pro forma items. Merritt marketed the transaction to a universe of bidders previously unaware of the opportunity in market.

### Results

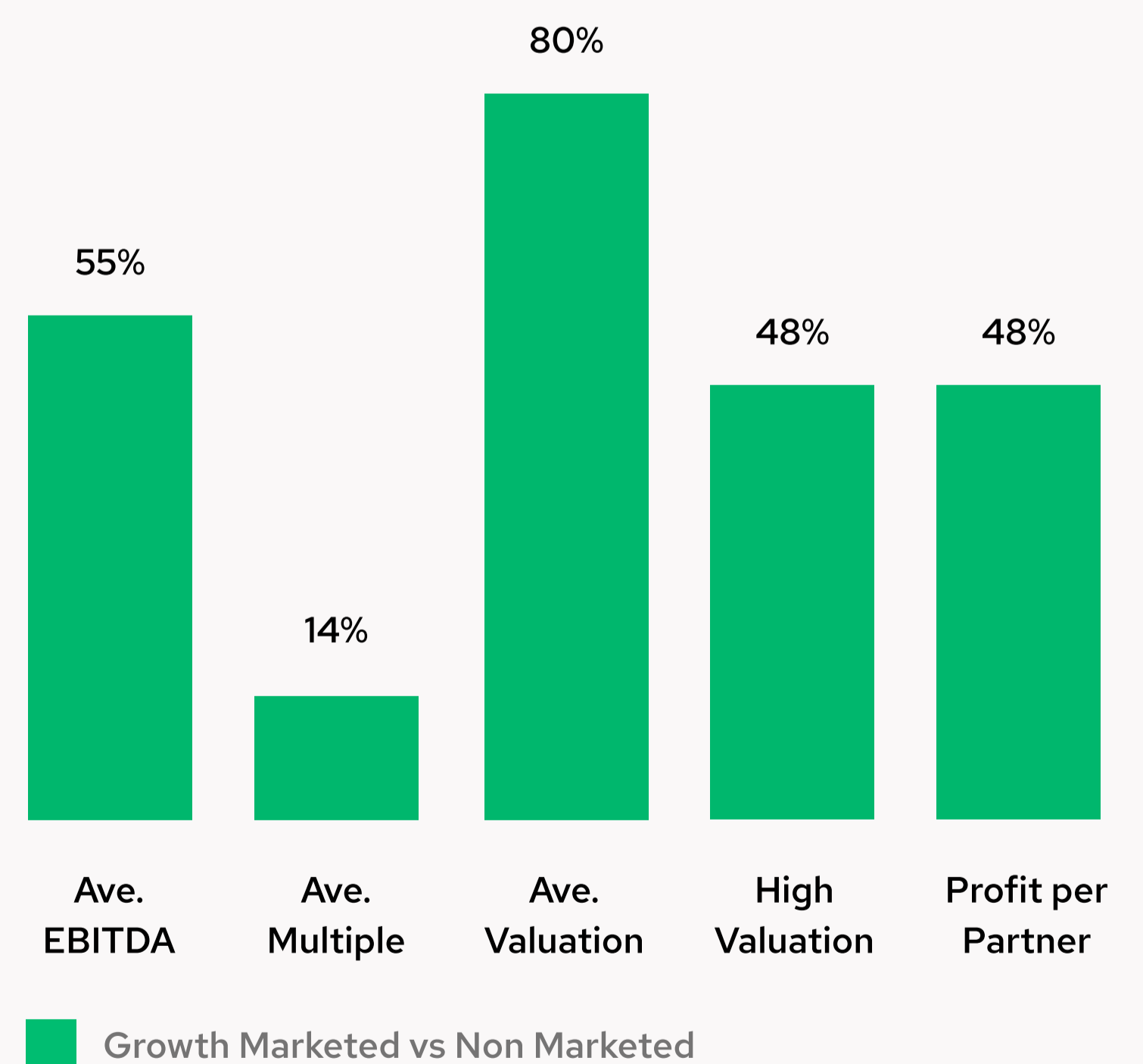
The process generated over 50 interested buyers and twelve highly credible offers, including 2 increased bids from original bidders. Merritt led the negotiation processes and helped the Practice compare & contrast the different partnership options available. Ultimately, the Practice accepted an offer 48% higher than the original best offer received with a non-original bidder that was more closely aligned to the Practice's objectives & philosophy.

## Illustration: Non-Marketed Process vs. Banker-led Marketed Process

Marketed deal value added 48% (\$30MM) to the Enterprise Value. Enhanced valuation was driven by both better analysis & presentation of financials and by offering a competitive bidding process.

	Non-Marketed/No Banker	Marketed/ Banker
Buyer Ave. EBITDA	\$3.8MM	\$5.9
Buyer Ave. Multiple	11.7x	13.3x
Ave. Valuation	\$44MM	\$79MM
High Valuation	\$62MM	\$92MM
Per Partner (10)	\$6.2MM	\$9.2MM

## Pre vs. Post Marketed Transaction Growth





# Strategies to Maximize After-Tax Wealth for Physician Partners in Pre-Sale and Post-Sale Planning

Selling a medical practice presents an opportunity for physician partners to maximize after-tax wealth. Effective pre-sale and post-sale planning strategies are crucial for minimizing tax liability and ensuring a smooth transition into retirement. Below are insights and examples of strategies to achieve these goals.

## Pre-Sale Planning Strategies

### ✓ Harvesting Losses

Physician partners can offset imminent gains by harvesting losses from their investment portfolio. For example, selling underperforming stocks or securities can help reduce overall tax liability by creating a “bank” of losses to offset current and future capital gains - including gains from a practice sale.

### ✓ Opportunity Zone Funds

Considering an opportunity zone fund allows physician partners to defer capital gains from the practice sale. Investing in institutional-quality real estate within these funds can generate tax-free income and potentially enhance wealth growth.

### ✓ Charitable Planning

Incorporating philanthropic goals into the pre-sale planning process can provide additional benefits. For instance, setting up a Charitable Remainder Trust (CRT) with various options like CRAT, CRUT, NICRUT, and NIMCRUT can benefit both the partner or their heirs and the chosen charities. Donor Advised Funds (DAFs) are also useful instruments to consider before finalizing a sale, as they offer tax benefits while supporting charitable causes.

## Post-Sale Planning Strategies

### ✓ Managing Reduced Income

Anticipating a reduced salary post-sale, physician partners should earmark a portion of the sale proceeds to maintain their pre-sale income level. Structuring this through portfolio earnings can help cover expenses and ensure financial stability throughout retirement.

### ✓ Diversified Portfolio

Establishing a well-diversified portfolio is crucial for post-sale planning. A portfolio with generally no more than 25% exposure to alternatives or private investments, balanced with public stocks and bonds, provides a well-rounded mix of return, safety, and liquidity.

### ✓ Estate Planning

The sale of a medical practice necessitates revising the estate plan to reflect the new financial circumstances. Updating beneficiary designations and considering tax-efficient wealth transfer strategies help minimize potential estate taxes while ensuring the smooth transfer of assets. Physician partners with rolled equity may also want to consider placing these restricted shares into certain trust structures to minimize future estate tax issues.



# Maximizing Personal Wealth For Physician Partners: The Value of Pre-Sale and Post-Sale Wealth Planning

## Situation Overview

- ✓ A 50-year-old physician partner (“Physician”) was set to receive \$9.2MM (pre-tax) from the Practice sale marketed by Merritt<sup>2</sup>
- ✓ The Physician was uncertain how to plan around this large inflow of cash and transition from practice owner to employee
- ✓ To help navigate the pre-sale and post-sale financial planning, the Physician hired Earned Wealth (“Earned”) to advise on how to maximize his after-tax wealth

## Earned’s Solution

### Recommendation

Upon Earned’s review of the Physician’s financial circumstances and the impact of the impending transaction, the after-tax proceeds of the \$9.2M sale without planning were estimated at \$7.1MM. With strategic pre-sale and post-sale planning, Earned identified tax, investment, and estate planning strategies to maximize the after-tax wealth for the Physician, designed a portfolio strategy to maintain the Physician’s pre-sale income, and began to set these plans in motion ahead of the transaction.

### Process

The Physician is paired with a dedicated Earned Wealth Advisor (“Advisor”) who works exclusively with physicians. The Advisor coordinates with the Merritt team and the Physician to understand the unique circumstances of the transaction. This initial step informs the construction of the financial plan to maximize the wealth opportunities for the Physician - both during this transaction and following it. With a clear blueprint in hand, the Advisor begins implementing the plan in collaboration with the Physician, helping to connect the dots across tax, investment, insurance, and estate planning.

### Results

With strategic pre-sale and post-sale planning, Earned was able to increase the after-tax transaction proceeds from \$7.1MM to \$8.5MM,<sup>3</sup> **representing \$1.4MM in additional net worth** for the Physician.

<sup>2</sup> For simplicity, this example assumes that 100% of the proceeds will be in cash. However, most transactions assume 20%-40% of the proceeds may involve roll-over equity in the newly formed entity. This rolled equity is often tax-deferred and presents another estate planning topic/opportunity for sellers and their wealth advisors.

<sup>3</sup> The after-tax proceeds of \$7.1MM assumes that \$7.3MM of the \$9.2MM sale were long-term capital gains taxed at a 30% rate. The improved after-tax proceeds of \$8.5MM assumes that the long-term capital gains were reduced to \$2.19MM through tax planning with Earned and taxed at a 30% rate.

**Results continued** To realize these results, the Advisor used Earned’s tax-smart technology to harvest losses from the Physician’s existing portfolio to offset capital gains from the practice sale. Also, the Advisor leveraged an opportunity zone fund to provide further tax savings and constructed the new portfolio with proceeds from the sale to generate tax-free income - helping to offset the Physician’s reduced salary post the transaction.

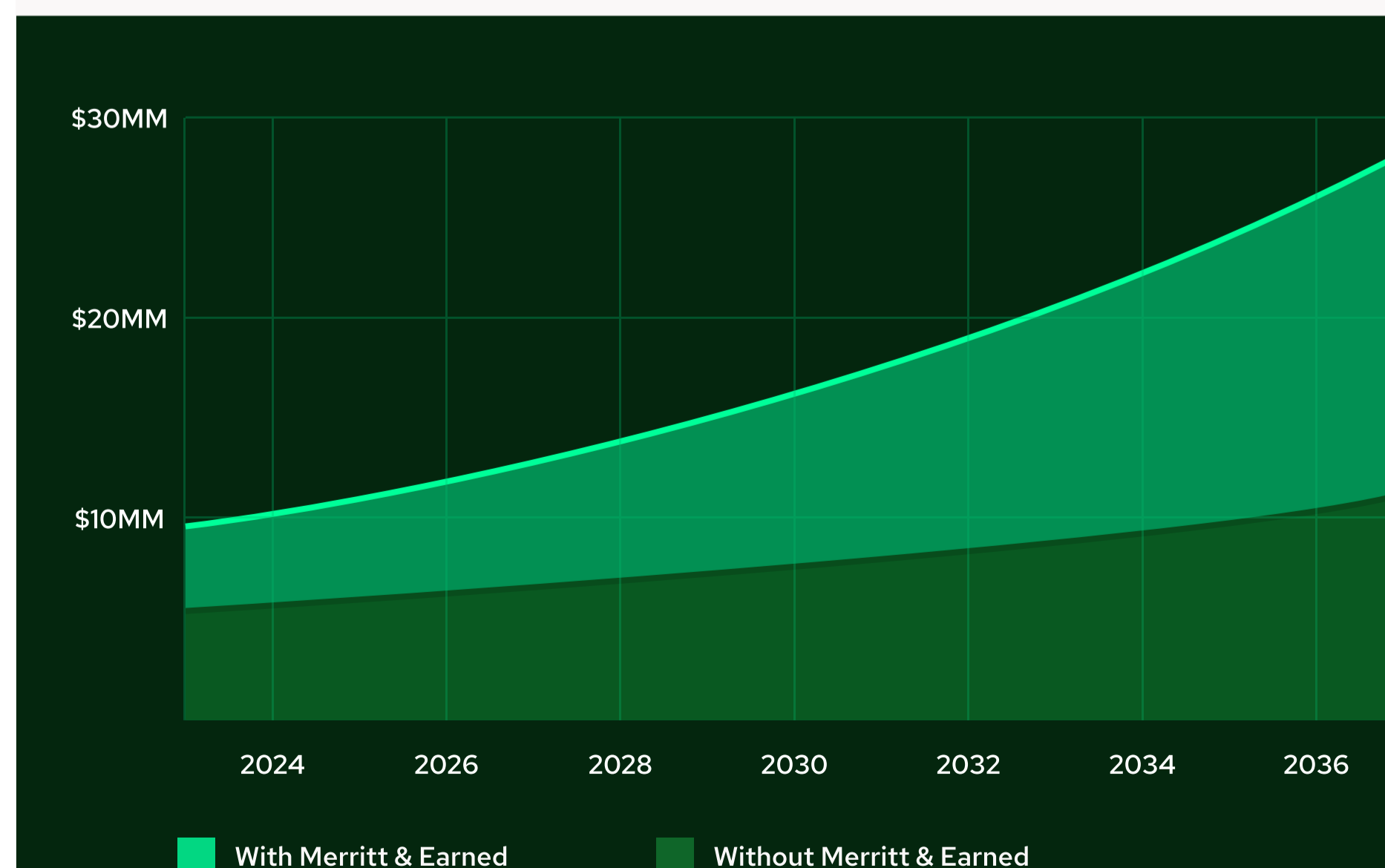
By working with Merritt, the marketed deal value added 48% (\$3MM) to the Physician’s pre-tax proceeds. Additionally, by working with Earned, the Physician added \$1.4MM in after-tax net worth.

It should be noted that this example assumes that 100% of the proceeds will be in cash. However, in reality, a percentage ranging from 40% to 20% of the proceeds may involve roll-over equity in the newly formed entity resulting from the transaction or in the parent company, or a combination of both.

## Illustration: Impact on the Physician’s After-tax Net Worth

	Pre-tax	After-tax
Pre-Marketed Value	\$6.2MM	\$4.8MM
Marketed Value	\$9.2MM	\$7.1MM
Tax-Aware Wealth Planning		\$8.5MM
<b>Total NW Increase (\$)</b>		<b>3.7MM</b>
<b>Total NW Increase (%)</b>		<b>77%</b>
<b>Projected NW Increase at Retirement</b>		<b>\$17.4MM<sup>4</sup></b>

<sup>4</sup> Assumes \$8.5MM after-tax sale proceeds are invested tax-efficiently with an after-tax annualized return of 7.5% with a 20% allocation to private investments with an annualized return of 11.5% vs the \$4.8MM after-tax pre-marketed sale proceeds are invested tax inefficiently at an after-tax annualized return of 5.5% w/o an allocation to private investments.



## As illustrated in this two-part case study, Merritt and Earned added 77% to the Physician's post-sale, after-tax net worth.

When professionally managed, this increase of \$3.7MM translates to more than \$17MM in NW over the Physician's remaining 15-year work horizon. The result is the difference of merely achieving a comfortable retirement for the Physician versus generating generational wealth.

In summary, enlisting the help of investment bankers and wealth advisors with deep healthcare expertise is essential to maximizing the value of a practice sale and personal wealth. It is not uncommon for such a team to add substantial value through a marketed transaction and pre- sale and post-sale wealth planning.

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