

# Dollars and Sense

Most orthodontists will admit that the business aspect of running a practice is the most challenging. Whether you are finishing your orthodontic residency or busy providing excellent treatment to your patients, it is not always easy to set aside the time to prepare for the future, particularly a practice transition.

Because a practice transition encompasses every area of your practice, we asked our panelists to share their insights into important considerations for practitioners on either side of the transition process. Sonny Elliott of Elliott & Associates, Reno, NV, emphasizes open lines of communication; Bill Sutton of Sutton Consulting, Greensboro, NC, discusses the importance of recall value; and Randall K. Berning, JD, LL.M., of Berning & Affiliates, Inc., Naples FL, advises about the most common transition pitfalls. (Provided below is Mr. Berning's Roundtable article content as it appeared in the magazine - with permission.)

## Avoiding Pitfalls

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Without a defensible practice valuation there will likely be no practice transition consummated between a practice owner and a prospective buyer or partner. Yet even with the importance of this linchpin to transition success, I routinely see parties that take little or no time to understand and avoid common valuation pitfalls. To help secure a good valuation work product and a smooth practice transition, keep the following in mind:

**Owners & Associates.** To avoid an unexpected discount to an

earnings based valuation, have a signed employment agreement with a covenant not to compete. This is true even if you like each other and practice together swimmingly. A part of time honored earnings based valuation theory is that if there is a threat to the ongoing earning stream of the business then the capitalization rate should reflect the threat — consequently, the value would be discounted from what would otherwise be indicated by the current revenue stream.

What a mouth full! In the context of orthodontic practice transition, it means that when you start with an associateship, it can be helpful to have a written employment agreement with an arguably enforceable covenant not to compete. If the associate leaves, the orthodontist would presumably not set up within the patient drawing radius of the practice. The revenue stream of the practice would be preserved since there would be no credible threat. Even in the minority of states that do not provide for an enforceable effective covenant not to compete, a well drafted non-solicitation and trade secret provision can help, avoid a discount to value.<sup>1</sup>

**Going First Rate.** Don't incur significant discretionary expenditures prior to securing the valuation or you'll suffer the consequence of a lower value. For example, don't go for the neat facility build out or the fancy new equipment just prior to securing the valuation (but its fine to spruce up with paint and new carpet). Most professional valuation analysis will focus on a 3-year retrospective look at the expenses and earnings of the practice. With a stable earning and expense history for practice entity, projecting the result of a buy-in, buy-out, or sale can be very straightforward. But interject a recent sizable expenditure — one that can have longer-term payback leases or a note to the owner — and once again, the valuator must factor the risk of potentially lower earnings. This can be the case even with an orthodontist or a group saying that, with the additional expenditure, the practice will likely experience more starts with a new marketing plan for the new doctor. The valuator can not rely on good intentions, just actual numbers.

**Understanding A Good Valuation.** Once a buyer or a prospective partner and his or her

advisor reads, calculates, and considers the supporting information, you either will move on with the specific terms for the transition or be stopped. If you are stopped, it can generally be traced to a couple of areas. It might be because the owner secured the valuation from his or her own accountant or financial advisor. The buyer may feel, rightly or wrongly, that the work product is not objective and so will seek an independent valuation. You might be stopped because the valuator did not use a recognized valuation methodology. Odd ball approaches or rules of thumb just don't cut it anymore. In both the American Association of Orthodontists' monograph *Practice Transition Alternatives for Owners "Guide to Orthodontic Practice Valuation for Residents and Practitioners"* and the American Dental Association's publication *Valuing a Practice: A Guide for Dentists*, the earnings approaches are highlighted and for good reason. There is a recognition that earnings-based methodology versus the much less sophisticated rules of thumb or asset-summation approaches gives a more defensible valuation work product. Another potential road block can be owners that do not recognize that, rather than just a strictly financial analysis, the entire practice will be examined including practice location and lease, design and condition of the office, analysis of patient categories and percentage of patients with insurance, staff stability and continuity, management systems and marketing.

**The Important of Strategic Planning.** Ben Franklin had a favorite saying that I believe applies to astute practitioners, "Forewarned is forearmed." In the context of any CEO looking out at the future, including orthodontists, it means be alert to how others have traveled the transition and valuation byways. The most effective orthodontist CEOs plan years ahead for any major initiative. To do otherwise is to end up taking what you get rather than what you want. The method for approaching significant practice

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objectives, such as implementing practice associateship, buy-in, buy-out or phase-out, is though the knowledgeable use of strategic and business planning. When a well-developed multiyear plan is executed, productivity is targeted and profitability is maintained for a reason — to ensure the future of the practice and to provide a valuation result that reflects the true vitality of the practice. As a result, the futures of current and prospective doctors are assured. ■

## Reference

1. Berning RK, *Transitioning the Orthodontic Practice: Seller's Concerns and Perspectives*, Seminars in Orthodontics, 2002;8:243-248.

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*Randall K. Berning, J.D., LL.M., attorney and consultant, is president of Berning & Affiliates, Inc. The firm has served orthodontists and dentists for 24 years in planning and implementing the transition and expansion of their practices. Mr. Berning has authored over 100 articles and notes, is the co-author of two ADA publications, Associateships and Valuing A Practice, the co-author of the AAO monographs on valuation and practice financing and is the publisher of The Expert Series for Dentists™. He is past Adjunct Professor of Dental Jurisprudence and Director of Practice Administration at the University of Illinois, College of Dentistry and is adjunct faculty at UCSF School of Dentistry and the University of Maryland Baltimore College of Dental Surgery. Prior to entering private practice Mr. Berning served as an Assistant Attorney General for the State of Illinois. The firm has offices in Naples FL, Chicago IL, Washington DC, and Burlingame CA. He can be reached at 800-999-8121 or e-mail at [RKBerning@BerningAffiliates.com](mailto:RKBerning@BerningAffiliates.com) or at the firm's web site [www.BerningAffiliates.com](http://www.BerningAffiliates.com).*

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