



American Counseling Association

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SELLING OR BUYING A PRIVATE COUNSELING PRACTICE

“As a service to members, the American Counseling Association has partnered with Robert J. Walsh, NCC, LCPC and Norman C. Dasenbrook, LCPC, who have over 50 years combined experience in the mental health field (including over 30 years in private practice) and are consultants in counseling practice management, to offer a series of bulletins on various private practice topics. This series includes timely information on starting/expanding/ending a private practice, informed consent, HIPAA requirements, managed care and insurance companies, and strategies for enrolling on provider panels and responding to claim denials. The material presented is copyrighted and should not be reproduced without the permission of the American Counseling Association.”

Walsh and Dasenbrook have co-authored, *The Complete Guide to Private Practice for Licensed Mental Health Professionals 3rd edition*. Their Guide contains the latest information on marketing, advertising, office procedures, dealing with managed healthcare and insurance billing. It also contains a CD-Rom with all the forms necessary for your practice. The Guide can be purchased through their web site at Counseling-PrivatePractice.com. For more information you can contact the authors at 3703 N. Main St. Suite 100 Rockford, IL. 61103 815.877.0399

The Private Practice Market: Selling or Buying a Private Counseling Practice

Mental Health clinicians have succeeded in establishing thriving practices. Most states have licensure and good working relationships with managed care and insurance companies. The hard work of counselors' organizations at the state and national level has put the licensed counselor in equal footing with other mental health professionals, and the American public is more likely to seek counseling now than ever before. Many counselors have been enjoying helping clients and reaping economic benefits from their profession for a number of years.

Now the baby boomer demographic has brought the reality of retirement to many private practice clinicians. They are ready to enjoy the fruits of their work and in many cases are beginning to look at the possibility of selling their practices. Another interesting demographic is the emergence of the children of the baby boomers. We as private practice consultants have found hundreds even thousands of these younger licensed counselors are very interested in private practice. We begin to see a mutually beneficial partnership in this picture.

Retiring clinicians and beginning clinicians can work together for their mutual benefit. The parallels to the real estate market are obvious. Retiring homeowners and young families have partnered in much the same way. Just as an individual must plan ahead when selling or buying real estate, a counselor must plan well ahead when thinking about selling or buying a practice. It would not be to the seller's advantage to try to sell a home within a time frame of one or two months. Trying to buy a home in two or three weeks would not get the buyer the best deal and might lead to disappointment or even disaster later. Taking time and planning well ahead is the ticket for selling a private practice, too. We plan here to help both the therapist who wishes to sell a practice as well as the therapist wanting to buy a good practice.

(Two years ahead of projected sale date)

Getting ready

- Establish a group name so as to identify the group other than you personally. Ex: The Counseling Group of Wilton, or BB Josephs and Associates.
- Arrange all of your Managed Care and Employee Assistance contracts as a group or corporate practice. This makes your practice more attractive because a potential buyer can inherit your managed care and employee assistance contracts without having to establish them anew. Many times MC or EAP's have closed their panels to new clinicians. Magellan Behavioral Health, one of the nations largest managed care contractors, has been very helpful with information on establishing or changing contracts that will be identified as a group or corporate contract. Calling Magellan provider relations, 800-788-4005, 800-430-0535 #4 and their website (www.magellanhealth.com) is the way to begin this process. Many other managed care companies offer this change as well. My practice has several

contracts that are considered group or corporate contracts including Managed Health Network, Health Maintenance Corporation, and Aetna. See the list of managed care companies on ACA's website (www.counseling.org) under Private Practice Pointers, for a comprehensive provider relations contact list.

- Register as a corporation, obtain a corporate tax ID.
- Incorporate by your tax ID or new tax ID. Get W-9's for each employee, or do so when you include new employees. Have the potential to pay them as group employees. They will receive a W-2 for each tax year. Send letter to each of your managed care companies and EAP's changing status from individual provider to group; be specific. You can add members later and expand with new partners.
- Write or obtain employee contracts, and be specific about their relationship to your group and future group if you sell the practice.
- Make sure your equipment is of high quality. Good accounting software and an excellent billing program is essential for your records to be reviewed by a potential purchaser. Always protect your client's confidentiality.
- Consult a lawyer and an accountant.
- Appraisal-The use of a valuation professional to appraise your practice may be an important consideration. We have explored this concept and will cite the work of a valuation expert here. This is to be used by the therapist as informational only and is the work and research of Mary Warmus, CPA, MBA. Ms Warmus is the President & CEO of Kensington Financial Consultants, Inc. located at 200 West Adams Street, Suite 2150, Chicago, IL 60606. Ms. Warmus' direct line is (312) 263-3874 and her email address is mwarmus@kensingtonconsultants.com.

The Valuation of a Closely Held Counseling Practice

The valuation of a closely held professional counseling practice, one that is owned by an individual or individuals and not owned by stockholders, is complicated by the personal relationships that a practitioner has with his/her patients. The practitioner's reputation is the primary driver of the Practice that in turn leads to referral opportunities. This is closely followed by the patient's ability to pay, which directly impacts the financial performance of the Practice. Payment resources may include: private insurance and/or managed care programs. Therefore, it is critical that a Practice have established relationships with managed care and other insurance providers. Reference is made to ACA's bulletin on Working with Managed Care by Walsh and Dasenbrook, found on the Private Practice Pointers section of ACA's website, www.counseling.org. Further, in a sale situation successful transition is tantamount for the continued success of the Practice. Therefore, the selling practitioner must endorse the new therapist and may be involved in the practice for a discrete period of time after the sale to ensure a healthy transition.

Purpose of the Valuation

The purpose of the valuation is to establish the fair market value of a subject business to provide the basis for an arms length transfer price, selling or buying, between related or unrelated parties for sale/succession, divorce, litigation, death and/or estate planning.

Valuation Procedures

In the analysis of a subject practice, historical financial statements provided by management for the past five years, preferably, are utilized. The counselor may also provide the valuation expert with an inventory of clients (anonymous) currently in the system, expected treatment period and fee expectations. This forecast of future revenues can be augmented by the counselor supplying the valuation expert with a history of new clients based on historical performance. This data source may contain the following information:

- Patient – (identifying number only)
- Condition
- Covered treatment period and expected treatment period
- Fees generated
- Cash collected
- Referral Source

Personal interviews with the therapist and members of his/her management team will enable the valuation expert to gain an insight as to the business operations and policies. It is assumed that the financial and other information provided, including business projections, and various statistical data, fairly reflect the business operations of the business and will be used by the valuation expert without further verification.

In summary, the value drivers that materially impact the value of a counseling practice include:

- Reputation
- Area of Specialization
- Referral Sources
- Established EAP and Managed Care Relationships
- Marketing Programs – including research and speaking
- Good, professional billing software and a sophisticated accounting system
- Above average collection rate
- Professional support staff

Again it should be emphasized that practices that operate like a business, with established managed care and EAP relationships and strong referral sources, generate a higher price.

In the conduct of a valuation assignment, the documents typically requested include:

- Financial Statements – 5 Years;
- Projections of future revenues and expenses;
- Leasing arrangements and terms;
- Historical patient analysis by duration, fee, billing and collections;
- History of referral source;
- List of Managed Care Providers and history of relationship with them;
- Practitioners marketing efforts including his/her Curriculum Vitae;
- List of professional events in which the practitioner attended and/or spoke in the last 3 years;

- History of cases and fees generated through speaking engagements or through outside referral contact;
- Previous valuations performed, if any;
- Any offers to buy the business

The valuation analysis attempts to analyze the earning power of a company and the ability of the company to convert this earning power into value. Earning power is related to the rates of return expected in the financial markets for various types of investment alternatives, with consideration given to past history, expected growth rates and risk.

The valuation expert will attempt to measure the financial performance and the earnings capacity of the subject Practice, by comparing historical operating results to independent financial and transactional statistics. Statistical reference is made to SIC (Standard Industrial Code) 8049: Psychologists and other non-physician health practitioners, not elsewhere classified and/or NAICS (North American Industry Classification System) 621330 – Officers of Mental Health Practitioners except Physicians.

It should be noted that someone interested in buying a professional counseling practice will most likely request the same type of information. A confidentiality agreement should be signed by both the selling party and the prospective buyer. It should also be noted in a sale situation that some of the purchase price consideration may be allocated to a covenant not to compete. Other transaction specific details may include how payment will be made for the practice: owner financing, and whether the price will be determined on an earn-out basis, as examples.

Valuation Principals

Fair market value is defined as:

The price at which the property would change hands between a willing buyer and a willing seller, when the former is not under any compulsion to buy and the latter is not under any compulsion to sell; both parties having reasonable knowledge of relevant facts. (Treas. Reg. § 25.2512-1).

Valuation of closely held securities requires consideration of all pertinent factors influencing the value of the securities. The Courts, the IRS, and individual investors look at the following factors that can materially impact the value of the underlying security being valued. They include:

- The nature and history of the business enterprise;
- The economic outlook in general and the condition and outlook of the specific industry of the business in particular;
- The financial condition of the business and the book value of the business;
- The earnings capacity of the business;
- The dividend or cash flow generating capacity of the business;
- Intangible values such as goodwill, patents, etc.;

- Prior sales of stock and the relative size of the ownership interest to be appraised; and,
- The market price of companies engaged in the same or similar lines of business having their stocks actively traded in a free and open market.

These considerations are outlined for companies and described in Revenue Ruling 59-60, which has served as a limited guideline for the valuation of closely held securities for estate and gift tax purposes since 1959. As stated in Revenue Ruling 59-60, a determination of fair market value of closely-held securities will depend upon the circumstances in each case and no formula can be devised that will be generally applicable to the multitude of different valuation issues arising from case to case. Depending upon the circumstances in each case, certain factors may carry more weight than others because of the differing nature of each business.

VALUATION THEORY

Three approaches are traditionally employed in the valuation of a closely held business: the Income Approach, the Market Approach, and the Asset Based Approach.

Income Approach

An Income Approach is a general way of determining a value indication of a business or equity interest using one or more methods wherein a value is determined by converting anticipated benefits.

Market Approach

A Market Approach is a general way of determining a value indication of a business or equity interest using one or more methods that compare the subject to similar investments that have been sold.

Asset Based Approach

An Asset Based Approach is a general way of determining a value indication of a business's assets or equity interest using one or more methods based directly upon the value of the assets of the business less their respective liabilities. It is analogous to the Cost Approach of other disciplines and is almost never used to value a consulting practice, as most of the capital is human capital not fixed assets.

An Example using actual transaction data for practices reporting under SIC 8049 include:

Transactions under SIC Code 8049

No	Source (1)	Business Description	Sale Date	Sale Price in \$(000's)	Annual Revenues in \$(000's)	SDE in \$(000's)	Price/Revenues	Price/SDE
1	BizComps	Psychologists Practice	8/20/2004	\$160	\$379	\$150	0.42	1.07
3	Pratt Stats	Hypnotist Office	4/2/2004	\$72	\$348	\$21	0.21	3.42
Average							0.31	2.24

(1) www.BVResources.com

(2) SDE = Sellers Discretionary Earnings = Pretax Income plus Interest Expense, Owners Compensation and Depreciation
 FMV = Fair Market Value

Invested Capital = Debt + Equity

(3) Example: Your practice has revenues of \$200,000, SDE of \$28,000 and debt of \$15,000. Using this transaction data, the fair market value of your practice is estimated as:

	<i>in \$(000's)</i>	
	Revenues	SDE
Subject Company	\$ 200	\$ 28
Average Multiplier	0.31	2.24
Estimated Fair Market Value (FMV) of Invested Capital	63	63
Less: Debt	(15)	(15)
Estimated FMV of Equity	48	48

It should be noted that two private transactions are not enough to support a meaningful valuation conclusion. However, the information can be used by the business valuation expert to establish a value range, thus serving as a sanity check to other approaches applied.

Conclusion

After consideration of each of the approaches listed above, it is most likely that an Income Approach methodology will be the most appropriate valuation methodology given the lack of publicly traded comparable guideline companies and the relative lack and/or reliability of transactional data available. Again, each case warrants its own treatment.

(One year ahead of target sale date)

- **Test the Market/ Begin to Advertise**
 - Place ads in counseling newsletters and newspapers.
 - Market at annual convention.
 - Direct call to local large groups/psychiatrists.
 - See what's offered (what will the market bear).
 - Ask those who've bought practices or may want to expand/combine.

- **Contract**
 - Once a prospective buyer is serious, present a good contract. Just as when selling or buying real estate, a contract is essential.
 - Make sure some form of non-competing clause is included.
 - Have payment provisions spelled out.
 - Review by a Lawyer.
 - Review by an Accountant.

- **Other Considerations**
 - Write a letter to all clients, current and past explaining what is about to take place with your practice. Spell out if you intend to stay involved with the practice. Write an introduction of the new owners and a short resume. You may want to include specific niches of practice and expertise of individuals.
 - Introduce new owner and members/counselors/ employees to all referral sources, personally or by announcements.
 - It may be prudent for the seller to stay in the group in some capacity. The amount of time and the capacity of the past owner are to be negotiated by buyer/ seller.
 - Have the selling price paid in a lump sum or over a specified time period.

We hope this helps potential sellers as well as purchasers of a private practice. We have compiled what we have learned over the years in our own practice management including some examples of buying and selling a practice as well as excellent information on valuation by a Valuation Professional, Mary Warmus, CPA, MBA, who has graciously allowed us to cite her extensive work on valuation in this bulletin. The information herein is the opinion of the authors and is in no way legal opinion and is not the opinion of the American Counseling Association. This information may be used as a guide for practice selling or purchase and by no means is it the only information on the subject.

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