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Private Equity: An additional option to exit your professional practice

In the past when a dentist or medical doctor wanted to retire, his options included selling his practice to his partner, or if he was a sole practitioner, selling to another unaffiliated professional or a hospital system.

Another option has presented itself: Selling to a private equity firm.

A private equity firm raises funds from investors and seeks to purchase privately owned businesses. Historically private equity has shied away from investing in professional practices in New York State due to its strict regulations preventing non-professionals from owning professional practices and its strict fee-splitting laws. Private equity has now cracked the code on how to properly structure the purchase of a professional practice in NYS and private equity firms are investing heavily in this area.

In order to adhere to the strict NYS laws referred to above, a private equity firm will form two separate entities to purchase the assets from a dentist or medical doctor. A professional entity (i.e. a PLLC or P.C.) owned by a dentist or medical doctor affiliated with the private equity firm, will purchase the professional assets (i.e. patient list, goodwill of the seller) and a separate business entity (an LLC or corporation) will purchase the non-professional assets (furniture, fixtures, equipment, supplies, etc.). A management agreement will then be established between the business entity and new professional entity whereby the business entity will be paid a fee for providing management services to the professional entity.*

Selling to private equity has many attractive features: (1) often the purchase price is higher than that offered by another buyer (typically based on a multiple of EBITDA), and is not constrained by the anti-kickback provisions which may be applicable to a hospital transaction; (2) the purchase price is typically allocated to capital assets being sold so that the seller will pay tax at the lower capital gains tax rates; (3) a portion of the purchase price is offered as equity of the buyer (so the seller can participate in the growth of the private equity entity); (4) the seller is typically offered an employment contract with the buyer so he can continue to work for a few years (typically a guaranty up to 5 years) before fully retiring.

Some of the items that the seller needs to be concerned with when selling to private equity: (1) the seller will typically be offered less compensation than what he was earning prior to selling his practice (the advantage to the seller is that he receives cash upfront at capital gains rates in exchange for a reduced income from his practice taxed at ordinary income tax rates); (2) the seller will typically not be guaranteed employment with the buyer for more than 5 years; (3) the seller will not be paid all cash for his practice at closing (the buyer will require a large portion of the purchase price be paid in equity in the buyer [i.e. "roll-over" equity]) which will have limitations on when and how that "roll-over" equity can be converted to cash.

Our office has been involved with representing sellers of professional practices to private equity firms as well as representing private equity firms in acquiring professional practices. Please contact Robert B. Danziger or Joshua Levine to discuss this exciting possibility at 914.948.1556

**The details of properly structuring a management services agreement is the topic for a separate article.*