FAQ:
Someone told me that my practice is worth 80% of a year’s gross collections. Is that true?

Percentage of Income as Value

<table>
<thead>
<tr>
<th>Practice A</th>
<th>Practice B</th>
</tr>
</thead>
<tbody>
<tr>
<td>$1 million revenue</td>
<td>$1 million revenue</td>
</tr>
<tr>
<td>3 chairs in open bay</td>
<td>6 chairs in open bay</td>
</tr>
<tr>
<td>“vintage” equipment</td>
<td>current technology</td>
</tr>
</tbody>
</table>

Are They Both Valued at $800,000?
Percentage of Income as Value

Practice A
• $1 million revenue
• 55.0% overhead

Practice B
• $1 million revenue
• 65.0% overhead

Are They Both Valued at $800,000?

Appropriate Valuation Methodology

1. Fair Market Value (FMV) is the Sum of:

A. Tangible Assets
   • Equipment
   • Furnishings
   • Leasehold Improvements
   • Office Equipment
   • Supplies

B. Intangible Assets
   • Goodwill
   • Covenant Not to Compete
   • Patient Records
   • Telephone Number(s)

Appropriate Valuation Methodology

Tangible Assets at Current, In-Place Value
- Less Than Original Cost
- More Than Cost – Depreciation
- Valuation Software Indices
  a) Type of Asset
  b) Original Cost
  c) Current Age
  d) Non-Reducing Residual

Intangible Value Indices
- Practice Growth Rate
- Profitability
- Location
- Procedure Mix
- New Patient Flow
- Related Factors (10-12)

Establishing the Fair Market Value

- General Valuation Theory
  - Cost
  - Comparable Sales (Market)
  - Earnings

- Earnings Based Approaches
  - Basic Value Equation

$\frac{\text{Financial Reward}}{\text{Risk %}} = \text{Fair Market Value}$
Establishing the Fair Market Value

- Risk Rate / Required Rate of Return
  1. Average Market Return
  2. Premium for Size (Illiquidity)
  3. Risk Specific
     • General
     • Specialty
  4. Discount Rate = (1 + 2 + 3)
  5. [Long Term Growth Rate]
  6. Capitalization Rate

Determination of Discount and Capitalization Rates

<table>
<thead>
<tr>
<th>Rate/Component</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Risk-free Rate (Long-Term Treasury Bond Yield)</td>
<td>2.47%</td>
</tr>
<tr>
<td>Equity Risk Premium (Stocks over Bonds)</td>
<td>6.62%</td>
</tr>
<tr>
<td>Average Market Return at Valuation Date (1)</td>
<td>9.09%</td>
</tr>
<tr>
<td>Risk Premium for Size (Small Stocks Risk Premium) (2)</td>
<td>6.20%</td>
</tr>
<tr>
<td>Subject Practice - Additional Risk Factors (3)</td>
<td>3.61%</td>
</tr>
<tr>
<td>Discount Rate</td>
<td>18.90%</td>
</tr>
<tr>
<td>Long-Term Growth Rate</td>
<td>-2.00%</td>
</tr>
<tr>
<td>Capitalization Rate</td>
<td>16.90%</td>
</tr>
</tbody>
</table>

Capitalization of Income

<table>
<thead>
<tr>
<th>Component</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Projected Professional Income</td>
<td>$1,000,000</td>
</tr>
<tr>
<td>Costs of Professional Services</td>
<td>$(225,000)</td>
</tr>
<tr>
<td>Operating Expenses</td>
<td>55.0%</td>
</tr>
<tr>
<td>Profit Before FIT</td>
<td>$225,000</td>
</tr>
<tr>
<td>Estimated Taxes</td>
<td>$(78,750)</td>
</tr>
<tr>
<td>Capitate @ 18.9%</td>
<td>$678,000</td>
</tr>
<tr>
<td>Fair Market Value</td>
<td>$865,400</td>
</tr>
</tbody>
</table>

Capitalization of Income

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</tr>
<tr>
<td>Operating Expenses</td>
<td>58.0%</td>
</tr>
<tr>
<td>Profit Before FIT</td>
<td>$195,000</td>
</tr>
<tr>
<td>Estimated Taxes</td>
<td>$(68,250)</td>
</tr>
<tr>
<td>Capitate @ 16.9%</td>
<td>$798,000</td>
</tr>
<tr>
<td>Fair Market Value</td>
<td>$865,400</td>
</tr>
</tbody>
</table>

Fair Market Value: Not The Whole Story (Partnerships: Buy-In)

- Valuation Studies Will Not Answer:
- For the Younger Doctor, Is it Affordable?
- For the Senior Doctor, Is It Financially Beneficial?
**Fair Market Value: Not The Whole Story (Partnerships: Buy-In)**

- How Is the Buy-In Made Affordable?
- Will it Be Tax Efficient/Fair?
- Answer is in Cash Flow Projections (Proforma)

**Structuring the Buy-In**

- Cash Flow Projections (After-Tax)
  - Illustrate Financial Outcome
  - Test Value
  - Increase Confidence
  - The ABC’s

**Fractional Sale: Structuring the Buy-In**

(A) Trigger Point
- Sufficient Collections
- No Decrease in Earnings

**This is the A of the ABCs**

**This is the B of the ABCs**
Fractional Sale: Structuring the Buy-In

(B) Financial Structure
- Simultaneous Objectives
  - Affordable for Associate/Purchaser
  - Fair/Tax-Efficient for Owner/Seller
- Push / Pull in Tax Code
- Dribbling Through a Minefield

Fractional Sale: Structuring the Buy-In

- Alternative Financial Structure I: Stock Sale
  - Most Practices Incorporated
  - Ownership Conveyed by Stock Purchase
  - Taxed at Capital Gains Rate (20.0%)

Fractional Sale: Structuring the Buy-In

- Alternative Financial Structure I: Stock Sale (cont’d.)
  - Inefficient for Purchaser
    - Non-Depreciable
    - Paid With After-Tax Income
    - Interest Not Deductible
    - High Cost Basis

Inefficiency of (All) Stock Sale

<table>
<thead>
<tr>
<th>Amount</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>$100,000</td>
<td>Purchase Price of x.xx% of Stock</td>
</tr>
<tr>
<td>$  18,800</td>
<td>Interest on Loan to Purchase Stock</td>
</tr>
<tr>
<td>$118,800</td>
<td>Sub-Total</td>
</tr>
<tr>
<td>/  0.65</td>
<td>Income Taxes at (Assumed) 35.0%</td>
</tr>
<tr>
<td>$182,700</td>
<td>Total Amount Needed</td>
</tr>
</tbody>
</table>

Fractional Sale: Structuring the Buy-In

- Can We Make This More Affordable?
  - Tangible + Intangible = Fair Market Value
  - Tangible Component Typically Much Smaller
  - Provides Benchmark for Stock Value
Fractional Sale: Structuring the Buy-In

- Stock Sale: Affordable and Fair
  - Modest Amount Paid for Stock with After-Tax Dollars (Tangible)
  - Majority Paid with Pre-Tax Earnings Shift (Intangibles)
  - Both Components Paid Over a Series of Years

Stock Sale: Affordable and Fair

Fair Market Value

<table>
<thead>
<tr>
<th>Tangible Net Worth</th>
<th>Intangible(s) Component</th>
</tr>
</thead>
<tbody>
<tr>
<td>Stock</td>
<td>Management Fee</td>
</tr>
<tr>
<td></td>
<td>(Pre-Tax Income Shift)</td>
</tr>
</tbody>
</table>

Components of Value

- Tax Differential
- Imputed Interest
- Management Fee (Pre-Tax Income Shift)

<table>
<thead>
<tr>
<th>Stock Purchase</th>
<th>Tangible Net Worth</th>
<th>Intangibles</th>
</tr>
</thead>
<tbody>
<tr>
<td>Capital Gains Tax</td>
<td>(20.0%)</td>
<td>Ordinary Income Tax</td>
</tr>
</tbody>
</table>

ASSET SALE STRUCTURE (Prior to Buy-In)

- $ Income (Overhead)
- $ Allocable Profit
- 100.0% of Fixed Assets/Supplies/Receivables
- 0.0% of Fixed Assets / Supplies / Receivables
- 100.0% of Intangibles
- 0.0% of Intangibles
- Partnership or LLC
- Seller's Entity
- Purchaser's Entity
- Seller (Individually)

Fractional Sale: Structuring the Buy-In

- Financial Structure II: Asset Sale
  - Generally Two Sellers
    - Practice Sells Tangible
    - Doctor Sells Intangible
**ASSET SALE STRUCTURE (After Buy-In)**

- **$ Income (Overhead)**
- **$ Allocable Profit**
- **50.0% of Fixed Assets/Supplies/Receivables**
- **50.0% of Intangibles**
- **Seller’s Entity**
- **Seller (Individually)**

**Partnership or LLC**

- **50.0% of Fixed Assets / Supplies / Receivables**
- **50.0% of Intangibles**
- **Purchaser’s Entity**

**Enhancing Affordability for Purchaser**

- Can Depreciate Tangibles
- Can Amortize (Depreciate) Intangibles
- Interest Deducted Pre-Tax

**Tax Efficiency for Seller**

- Most of Value Is Intangibles
- Sale of Intangibles Taxed at Capital Gains Rate (20.0%)
- Tangible Taxed (Primarily) at Ordinary Rates

**Fractional Sale: Structuring the Buy-In**

- Which Structure is Better?
  - Best Results From Looking at Both
  - Compare Financial Outcomes
  - Requirements for Comparison:
    * Depth of Experience
    * Software Capability

**This is the C of the ABCs**

**ABC**

**C (Income Distribution Formulae: Basic Types)**

1. Equity (Ownership)
2. Percentage (Productivity)
3. Multi-Tiered
**Orthodontic Distribution Formula Multi-Tier**

- **Days Worked** 50.0%
- **Productivity Diff.** 50.0%

<table>
<thead>
<tr>
<th>Period</th>
<th>Productivity Income</th>
<th>Ownership Income</th>
</tr>
</thead>
<tbody>
<tr>
<td>1st Year</td>
<td>$1,311,251</td>
<td>$1,507,123</td>
</tr>
<tr>
<td>2nd Year</td>
<td>$1,507,123</td>
<td>$3,014,246</td>
</tr>
</tbody>
</table>

**Orthodontic Distribution Formula Productivity Differential**

Period of Productivity Differential Can Be Varied

**Proforma: Previewing Financial Outcome**

<table>
<thead>
<tr>
<th>Year</th>
<th>Taxable Income</th>
<th>Pre-Tax Income</th>
</tr>
</thead>
<tbody>
<tr>
<td>1st Year</td>
<td>$1,311,251</td>
<td>$1,311,251</td>
</tr>
<tr>
<td>2nd Year</td>
<td>$1,507,123</td>
<td>$2,014,246</td>
</tr>
</tbody>
</table>

- **Assoc. Compensation:** $150,000
- **Management Fee Paid:** $150,000
- **Interest on Promissory Note:** $150,000

**Total Compensation:** $433,559

**Hygiene Allocation:** $228,729

**Total Allocation:** $433,559

**Pre-Tax Income:** $232,754

**Estimated Taxes:** $41,000

**After Tax Income:** $191,754

**Non-Financed Capital Exp.:** $0

**After Tax Cash Flow:** $109,000

**Fractional Sale: Structuring the Buy-In (Will This Dog Hunt?)**

- **Proforma: Putting It All Together**
- Tests Financial Outcome
- Sets Target for Associate
- Illustrates Financial Structure
- Pre-Defines Distribution Formula
Student Debt: What Can I Do?

- Types of Debt
- Strategies for Student Debt
- Why Are Some Types of Debt Helpful?

Student Loan Trends

- Record levels of student debt
- Many doctors cannot afford student loan payments

Payment Calculations

<table>
<thead>
<tr>
<th>Amount of Loans</th>
<th>Term</th>
<th>Interest Rate</th>
<th>Monthly Payment</th>
</tr>
</thead>
<tbody>
<tr>
<td>$250,000</td>
<td>30</td>
<td>6.80%</td>
<td>$1,629.81</td>
</tr>
<tr>
<td>$300,000</td>
<td>30</td>
<td>6.80%</td>
<td>$1,955.78</td>
</tr>
<tr>
<td>$350,000</td>
<td>30</td>
<td>6.80%</td>
<td>$2,281.74</td>
</tr>
<tr>
<td>$400,000</td>
<td>30</td>
<td>6.80%</td>
<td>$2,607.70</td>
</tr>
<tr>
<td>$450,000</td>
<td>30</td>
<td>6.80%</td>
<td>$2,933.66</td>
</tr>
<tr>
<td>$500,000</td>
<td>30</td>
<td>6.80%</td>
<td>$3,259.63</td>
</tr>
</tbody>
</table>

What Can You Do?

- Consolidate loans into one loan
- Utilize Income-Based Repayment (IBR) or Pay As You Earn (PAYE)

What Is the IBR Option?

- Monthly payment capped at 15% of doctor’s discretionary income
- Discretionary income: amount that exceeds 150% of the poverty line

IBR Qualifying Loans

- All Stafford, PLUS, and Consolidation loans
- Must be under Direct Loan or FFEL Program
- Does not include:
  - Loans in default
  - Parent PLUS loans
  - Consolidation Loans that repaid Parent PLUS loans
How Do I Qualify?

- Must have “partial financial hardship”
- “Partial Financial Hardship”: Standard repayment plan (10 year) payments are greater than amount required under IBR

Monthly Payment Example

- Based on Adjusted Gross Income (AGI) and family size
  - 2013: 150% poverty line was $29,295
  - AGI: $120,000 → Difference of $90,705
  - $90,705 X 15% = $13,605/12 = $1,134

Unpaid Accrued Interest

- Government will pay on subsidized loans
- Begins on repayment date under IBR
- Ends after three years

Public Service Loan Forgiveness

- Forgives remaining debt after 10 years
- Must be an “eligible job”:
  - Nonprofit, tax-exempt 501(c)(3) organization
  - Government
  - Serve full-time in AmeriCorps or Peace Corps

Pay As You Earn (PAYE)

- Requires Partial Financial Hardship
- Based on 10% of Discretionary Income
- Same Interest Benefits as IBR
- 20 Year Loan Forgiveness
- 10 Year Public Service Loan Forgiveness
- Must be a New Borrower as of October 1, 2007 with loan disbursements on or after October 1, 2011

Student Loan Resources

- IBRinfo.org
- Finaid.org
- Studentaid.ed.gov
Student Debt: A Perspective
- Make More Money as Owner
  - Buy-In (Fractional)
  - Full Purchase (100.0%)
- Even After Acquisition Cost
- Use Additional Earnings to Repay Student Loans
- Counter-Intuitive, But True

Fair Market Value: Not The Whole Story (Full Sale)
- Making it Affordable (Purchaser)
- Making it Tax Efficient (Seller)

Full Sale: 100.0% of Practice

<table>
<thead>
<tr>
<th>Decision to Proceed</th>
<th>Selection of a Transition Alternative</th>
</tr>
</thead>
<tbody>
<tr>
<td>(1)</td>
<td>(2)</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Full Sale</th>
<th>100.0% of Practice</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Structuring the Sale

Allocation of Purchase Price
- Assign Specific Value to Each Asset Class
- Seller and Purchaser Must Use Same Allocation
- Push / Pull in Tax Code

Asset | Seller | Purchaser |
-----|--------|-----------|
Contracts Receivable | Capital | Contracts Rec. 15 Year Depreciation |
Supplies* | Ordinary Income | Expensed in First Year |
Fixed Assets* | Generally Ordinary | Depreciable Over 5-7 Years |
Patient Records* | Capital Gain | Depreciable Over 15 Years |
Covenant | Ordinary if Isolated; Capital if Combined with Goodwill | Depreciable Over 15 Years |
Personal Goodwill | Capital Gain | Depreciable Over 15 Years |

* If the practice is incorporated these items must be sold by the corporation. Gain from these may be subject to both corporate and personal taxation.
Full Sale: 100.0% of Practice
Allocation of Purchase Price

Two Sellers
- Doctor Sells:
  • Assignment of Personal Goodwill/Covenant
  • Distinct From Corporation
  • Document Language Critical

Strategies for Reducing Tax on Gain

Tax Strategies for Full Sale
Reduce Ordinary Income Taxes on Proceeds
- Pay Sale Expenses Through Corp
  • Legal Fees
  • Commissions
  • Accrued Expenses Payable
  • Maximize Retirement Contributions

Reduce Capital Gains Taxes on Proceeds
- Capital Loss Carryforward
- Create New Capital Losses

Tax Strategies for Full Sale
Post-Sale Employment
- Keep Corporation and Use Service Agreement
  • Minimize Payroll Taxes for Both Parties
  • Continue to Fund Retirement Plan
  • Maintain Family “Perks”

The Golden Window
- Lenders Are Willing
  • Money Readily Available
  • Current Standards for Borrowers
    • Experience: 2 Years (0 for Orthodontists)
    • Cash on Hand
    • Credit Score: 680 or Higher
    • Production Capacity: 65.0% to 75.0%
  • Relaxed Standards Compared to Other Commercial Loans