The Doctor’s Guide
to Buying and Selling a Practice
August 2013
The Doctor’s Guide to Buying and Selling a Practice

Introduction

This manual has been developed to help explain the issues involved in buying and selling a medical practice. It contains numerous practical tips and advice and identifies the main issues related to buying the practice. It has been identified as an area where practice managers and doctors alike have a keen interest, and a lot of important information is contained in the guide.

Purchasing a practice could be the best investment in a doctor’s professional life. Given the impact of this investment and the rewards it could bring, it is vital that the purchase of a new practice is done with the assistance of a legal practitioner. This will ensure all the rights and responsibilities of the purchaser are considered.

The value of a practice, and especially how much goodwill can be applied, is something doctors consider frequently. A mark of a good medical practice is a demonstrable ability to produce an above
average return on investment for its owners. Prospective buyers will be prepared to pay a premium over the value of the practice's tangible assets in order to share in that above average rate of return.

This premium is called "goodwill". Goodwill is an intangible asset: it does not have a physical presence and will differ in amount and nature from practice to practice.

This guide gives information on the basic knowledge of important matters to be aware of when contemplating purchasing a medical practice. It also considers a variety of aspects that should be examined upon acquiring the practice, and how to obtain the right advice, providing assistance with the decision making process. The guide also introduces the concept of goodwill in regards to adding value to the practice and discusses essential knowledge required when valuing practices for the purpose of buying and selling.

Topics covered in this module include:
- whether to buy or not;
- considerations of what is being bought;
- staffing issues;
- finance;
- taking over;
- an explanation of goodwill;
- the importance of goodwill;
- market value; and
- improving the profitability and goodwill of a practice;

Further reading is encouraged on these topics and will be identified throughout the guide.
3.1 TO BUY OR NOT TO BUY?

Specialists
For specialists the question of whether to buy or not is easy to answer, as specialists rarely buy practices. The specialist’s service is usually just too personal to justify a goodwill figure, and location is not critically important. The capital cost of starting up is too low to justify buying an existing practice as a going concern, as opposed to starting one from scratch. Goodwill may be found where the specialist practice derives a large part of its income from plant and equipment, and/or the efforts of other practitioners. Radiology, sleep disorder units and cardiac assessment centers are a few good examples.

Although in some specialties, for example periodontics, large sums may change hands in order to take over the referral base of retiring periodontists; generally, there is little goodwill in specialist practices. Specialists usually start their practices from scratch, (typically on a part time basis while keeping other part time jobs elsewhere), and gradually build up to full time private practice. The pattern may be accelerated by joining an existing specialist group, and getting some “spillover work” or extra sessions through this connection.

There are some exceptions, and in the case of specialist dentists, the goodwill values can be surprisingly high: $300,000 for a busy periodontist practice is not unusual. The rule of thumb, however, is that most specialist medical practices do not have a financial measure on goodwill.

General practitioners
For general practitioners the position is different. There is a serious shortage of GPs throughout Australia. It is not hard to find a practice that is prepared to take on an owner doctor, if that is their intent. The laws of supply and demand are firmly in favor of buyers, and practice prices, i.e. goodwill, are commensurately low.

Low values skew the “to buy or not to buy” decision firmly in favor of “Buy”. Both options, however, have their advantages and disadvantages.

Starting from scratch is probably the harder and more daunting option, but it has the advantage of not having to pay for goodwill. It also has the advantage of having control over what happens, not being restricted by what has happened in the past, or what business partners may decide to do. Location, staff and premises are an open book, allowing decisions to be made autonomously.

Goodwill can be created to enable the possibility of selling to another practitioner down the track: the 50% discount on all assets held for more than 12 months, the 50% exemption for capital gains on the sale of active assets, and the rollover rules for the remainder, means in most cases the amount received is capital gains tax (CGT) free.
On the other hand, buying into an established practice has more certainty; it allows practitioners to be more confident that the patients load will be there. This lowers the risk factor, and heightens the prospect of a good income from day one. Often the practitioner will have worked in the practice for a period of time, so they will be familiar with the patient load. They may have actively contributed to the growth of the practice, which may be reflected in negotiations of a discounted buy-in price. The downside to buying into an established practice is the financial outlay, and there are no guarantees of being able to get the money back in the future.

There is no definite right or wrong here: some practitioners are better suited to starting their own practice, and some are better buying an established practice, or buying into an existing practice as a partner or associate. It depends on the circumstances of the practitioner, the circumstances of the practices available for purchase, and the type of practice the doctor wants to be associated with professionally.

McMasters’ advice is “buy if at all possible”. Starting a practice from scratch in a brand new location can still be done, but will incur higher risks and costs than purchasing a perfectly good practice down the road for a minimal cost. This is the logic that confronts many GPs at this turn in the road.

**Buying an Established Practice**

Buying an established practice can have a number of benefits, and the amount of work required is significantly reduced compared to starting a practice from scratch. Benefits include:

- Time saving relating to acquiring new assets;
- No need to hire a new team of staff members;
- There is an established customer base i.e. patients;
- There are reduced marketing requirements;
- There is an established reputation; and
- There is no need to launch extensive new opening campaigns.

The disadvantages are:

- The reputation of the practice may not necessarily be as positive as you would like it to be; and
- The staff may have work practices that you do not like.

Assuming the decision is made that advantages exceed disadvantages, (which will usually be the case) the following paragraphs will assist with the technicalities involved in buying an established practice. This section is written from the point of view of a prospective purchaser, however, it also gives interested vendors some insight into the sale process. A checklist of things to consider when buying a practice can be accessed in appendix 1 at the end of this guide.

The phrase "buying a medical practice" should be interpreted not only as buying a practice outright, but also to include buying a share in an existing practice. This can be either as an associate buying a
right to practice, a partner buying a share of a partnership's assets, or as a shareholder buying shares in a practice company. It also assumes the purchaser will take over any rights to provide management services to the practice, which are commonly owned by a separate service trust, and this is included in the assets being sold with the practice.

**What Assets are Being Purchased?**

The first thing to consider is what assets are being bought. Typically they include:

- The practice's goodwill. This generally includes patient lists and records, the benefit of expected repeat business from those patients, the benefit of the reputation and name built up by the practice, and the benefit of the relationships established by the practice's owners and staff with patients over the years;
- The practice's plant and equipment. A detailed schedule of plant and equipment should be prepared. The vendor should be asked to confirm he has good title to these items, and they are not subject to any charge or other encumbrances that restricts his ability to deal with them. If such an encumbrance exists, the vendor should be asked to arrange for it to be lifted as a condition of the sale proceeding.

Care needs to be taken with leased equipment. When buying leased equipment it is necessary to ensure either:

- part of your purchase price should be forwarded directly to the leaser as payment of the amount owed on the lease; or
- the amount of the purchase price should be reduced by the amount of the lease liability responsibility is being assumed for; and
- medical supplies and other supplies. The value of supplies will vary greatly between specialties, and where applicable to general practice will vary upon the size of the practice.

**Staff Contracts and Provisions**

The practice is also purchasing the benefit of the staff contracts. Normally the purchaser agrees to take over all liabilities owed to staff, including any sick leave, annual leave or long service leave, and an estimate of these liabilities is deducted from the agreed sale price. In one recent sale McMasters saw the value of these liabilities exceed the value of the goodwill, which meant the purchaser was in the unusual position of receiving a cheque from the vendor on settlement day.

A purchaser will normally be interested in keeping on the practice's staff. They can represent a large part of the goodwill of the practice, and continuity of staff can be very important for practice systems and patient relationships. However, there can be many sensible reasons why a purchaser may choose not to keep existing staff. The staff may not be efficient, there may be too many staff, or
the purchaser may have a preferred person in mind for the job, such as a spouse who is a qualified nurse or receptionist.

The question of which staff to keep and which not to keep is an important one that should be answered (at least tentatively) before you agree to buy the practice.

Purchasers need to know whether they will be liable for any employee liabilities, such as annual leave, sick leave, and long service leave. If there is doubt, some adjustment to the purchase price needs to be negotiated. For example, an employee who has thirteen years employment will probably become entitled to three months’ long service leave in two years time. In this case an adjustment would be made on a pro-rata basis for long service entitlements.

This is a notoriously difficult area. One possible solution is to have an amount of the purchase price equal to thirteen fifteenths’ of the expected long service leave paid into a special bank account and use it to help fund any long service leave payment. If for any reason the long service leave payment is not made, then the amount in the bank account will be handed over to the vendor. But this will not be appropriate in all cases, particularly where there are a few employees and some have, say, five years to go before they are eligible for long service leave.

3.2 THE RIGHT PRICE

Valuations are examined in detail in later in this guide. We assume here the valuation of the practice is reliable and all the normal enquiries and investigations into the practice’s financial history have been completed. Suffice it to say here, questions should be asked whether it is cheaper to take the risk of setting up the practice from scratch. If it is not, then consideration should be given to whether it is possible to reduce the purchase price. This is essentially a matter of negotiation. Bear in mind if the purchase price drops by, say, $10,000 that is $20,000 of future profits that do not have to be earned (an excellent day’s work has just been completed). On the other hand, the vendor may decide to sell to another buyer.

Negotiations are a dynamic, and backing intuition is typically the best thing to do. It is a good idea to get someone else to double-check the reasoning. This will ensure that decisions are not rushed. At the end of the day the purchaser must be satisfied on the matter of price. It is perfectly acceptable to ask for more time to think things through. Alternatively, where confidence is lacking, someone else could be appointed to negotiate the deal. Emotional indifference can be a wonderful asset in a negotiation, and can throw an objective perspective over the whole proposal.
Once a price is agreed, it should then be set aside. Negotiations are difficult, and in most cases it will never be known whether a better price could have been reached. Once the price is agreed, it is time to begin making the practice work.

**Deferring Payment**

One thought to bear in mind is the potential for some part of the purchase price to be deferred for a period of time, e.g., a year. If this is done, and for any reason results from the practice are not what was expected, the door is at least open to withhold all or part of the final payment due to the vendor, unless an appropriate adjustment is made.

Whether this can be done will depend on the practice circumstances. It is worth bearing in mind, however, that adjustments are a lot harder to make if the entire purchase price was paid up-front. This process will remove all bargaining power later on.

**Apportionment of purchase price**

How to apportion purchase price is a frequent source of argument between the vendor and the purchaser, particularly if the plant and equipment is significant.

The vendor will typically be interested in minimising the amount of the total consideration apportioned to plant and equipment. This is because the extent this amount exceeds written down value will be assessable income in the vendor’s hands for taxation purposes. Alternatively, the purchaser will be interested in maximising the amount of the total consideration apportioned to plant and equipment, because this will maximise the depreciation expense able to be claimed by the vendor in subsequent years.

There is no hard and fast rule as to what to do here. The matter is often settled by giving plant and equipment a value equal to the vendor’s written down depreciation values for income tax purposes.

Common sense comes into the settlement of this question. Caution should be shown to adopting values that are plainly unrealistic. These will be problematic in a tax audit: the practice could find some part of the depreciation claim being disallowed, on the basis the original cost of the plant and equipment is artificially inflated.

**Financing the practice**

Finding a cost effective way to finance your practice is imperative to your long term financial prosperity. It is sometimes confusing to shop around for a loan, as there are many providers in the market, each assuring the best deal. Some people choose to delegate the research process to a financial adviser, who in turn, will also promise to provide the best deal. Many brokers fail to disclose the extent of personal financial gain made by recommending one financier over another. Put simply, it is not possible to receive the best deal, if it is arranged by a subjective broker, who receives commissions.

McMasters’ offers expert financial planning advice, as well as a specialty loans tailored for doctors. Any commissions McMasters’ receive from outside financiers are reverted back to the clients around December each year, making it a nice surprise for Christmas. Financing your loan can be
incorporated into your tax planning, reducing financial strain and ensuring you can spend more time concentrating on medicine.

**Council zoning**

It might sound obvious; however, it is amazing how often this simple check is overlooked. A failure to check zoning permissions is one of the most common mistakes in a sale of business transaction. It should not be assumed that a practice is eligible to run from the premises because one is run from there now. Gaining confirmation in writing from both the vendor and the council (or any other relevant body) is strongly advised.

McMasters’ discovered a situation where a large two story 8 doctor practice had a permit for only one practitioner. The sale settlement date was fast approaching. Eventually the situation was overcome; however, the sale settlement was temporarily in doubt. It could happen again. Check all council zoning rules, and do not assume anything is in order unless you have it in writing.

**Preparation of the sale of practice agreement**

It is conventional for the sale of practice agreement to be prepared by the vendor’s solicitor. Related documents such as a consulting contract, (when the vendor practitioner is staying on for a while as part of the deal), should also be prepared by the vendor’s solicitor.

The purchaser’s solicitor checks the sale of practice agreement and related documents and advises the client whether they are in order to sign. If not, advice will be given about what changes are needed in order for them to be signed. A solicitor should handle these documents. A draft sale of practice agreement is included at appendix 2. This gives an idea of what these documents look like and an understanding of the legal process behind the sale.

The solicitor’s role should not be to “do the deal”. This should be done by the practitioners, perhaps with some assistance from accountants or solicitors. The solicitor’s role should be to document the deal agreed to by the practitioners, and make sure the sale transaction proceeds smoothly in accordance with the practitioners’ deal. Many examples have been seen of over-zealous solicitors and other advisors ultimately disrupting the sale process and causing detriment to all concerned.

**Assumption of responsibility for the vendor’s debts**

Great care needs to be taken in this area. Few advisors recommend buying the shares of a private company that carries on a small business such as a medical practice. Not only are the assets of the business being bought, but also the liabilities of the business are purchased. This includes liabilities that are not shown in the balance sheet, such as litigation not yet commenced, guarantees not yet invoked, liabilities for undisclosed (or as yet unknown) income tax liabilities, etc.

For this reason it is unusual for one practitioner to buy the shares in a medical practice company owned by another practitioner. Implementation of specific professional advice and appropriate safeguards are vital, such as written guarantees and indemnities from the company’s directors. This is standard advice given by any solicitor or accountant who is experienced in helping clients buy businesses. It is not something particular to the purchase of a medical practice.
When buying into an existing practice company a better alternative is to roll over the assets from the old company to a new one, and then subscribe for fresh shares in the new company. Provided certain rules are observed, this means the roll over will be ignored for tax purposes. It provides certainty that the shares will not be tainted by any latent liabilities not appearing on the balance sheet, or that current shareholders may be unaware of. Gaining specialist tax advice is essential.

It can be sensible for the purchaser to assume responsibility for specified debts of the vendor. For example, the practice may be one year into a five-year lease on computers that cost $30,000. The lease is at a competitive interest rate and is with a reputable financier. Provided the financier consents to the transfer of the lease and there are no unpaid arrears. Taking over the lease can be a smart way to part pay for the practice. If this is done the sale price of the practice should be reduced by the amount of the liability assumed by the purchaser. In our example this means $30,000 will be taken off the purchase price of the practice.

**Restraint of trade clauses**

A restraint of trade clause is an essential part of any agreement to purchase a practice. It helps to make sure the buyer actually gets the goodwill paid for, and the patients do not suddenly disappear.

In cases where there is no restraint of trade clause, it is possible for a practitioner who sells the practice to appear a month later and begin practicing in a neighbouring location. The practitioner would not be able to directly approach the patients from the previous practice; however, word would soon spread. The restraint of trade clause should put in place a reasonable restriction on the vendor of the medical practice regarding each of the following:

- the type of activity restricted (i.e. medicine and, perhaps, health care generally), whether as a principal, a partner, an associate, an employee or otherwise;
- the geographic area restricted. A reasonable geographic restriction is usually not more than, say, between 2 and 3 kilometres from the practice premises; and
- the time period restricted. A reasonable time restriction is usually three years. This period could be longer if an unusually large amount is paid for goodwill.

Deferring part of the purchase price is a good way to add business efficacy to restraint of trade clauses. It gives the purchaser of the practice some bargaining power should anything go wrong.

The Courts are not very supportive of restrictive covenants. There have been a number of recent cases where buyers have realised the vendor has begun working nearby, and when they went to trial the courts were unwilling to take action. For these reasons we suggest to clients that the traditional restrictive covenant be supported by a particular promise to not provide medical services to the practice’s patients for, say, 12 months. A Court is far less likely to find a specific and narrow clause like this to be against the public interest and therefore unenforceable.

**Premises**
The right to use the premises, whether as an owner or as a tenant, is a critical part of the purchase agreement. It would be a disaster to pay, say, $100,000 goodwill for a practice only to find three months later the landlord is not willing to renew the lease. Unless there was a specific term in the agreement stating tenure was guaranteed, there is very little that can be done. For this reason the purchase agreement should ensure reasonable tenure and, if for any reason this is not able to be given, the goodwill should be reduced heavily.

Tenure can be provided to a purchaser in a number of ways. These include:

- If the vendor leases the premises, assigning the vendor's rights as a tenant under the lease agreement to the purchaser. The landlord's consent is required and is normally given without too much trouble; and
- If the vendor owns the premises, arranging for a fresh lease to be granted to the purchaser for, say, five years with options to extend the lease, as required.

It is advisable to get an experienced solicitor to check the lease carefully before proceeding too far with buying the practice.

**Warranties and Guarantees**

It is a good idea for a purchaser to obtain third party guarantees from the vendor. For example, if the vendor is a practice company or a practice trust a guarantee from the directors is appropriate. This guarantee can be obtained indirectly, for example, by having each of the directors' names on the purchase agreement. This adds confidence to the purchaser in the decision to buy the practice.

One common warranty is a clause to the effect that the vendor has disclosed to the purchaser all known matters that are relevant to the valuation of the medical practice. If for any reason the vendor is reluctant to agree to such a clause, then the deal should probably be walked away from. If something is being hidden, it is not likely to be good news.

**Notice to Patients**

Doctors do not own patients. Patient relations must be managed properly as the practice changes hands. The purchaser will be particularly interested in making sure this is done properly because this is why he is being asked to pay goodwill. Appropriate written notice should be given to all patients and this notice should stress the skills, experience and other attributes of the incoming doctor.

At the least, a notice should be put up in the practice, say, one month from the change in ownership. The purchaser should consider notices in the local paper and, perhaps, writing to each patient to advise them of the change.

If the new doctor is buying into a partnership it can be a good idea for the retiring doctor’s patients to be invited to see the remaining partners as well as the new practitioner. This gives them a choice, and should be reflected in a better retention rate for the partnership as a whole.

In the case of a solo practice, the need to manage patients through a changeover is even more important. The purchaser should insist on a phase-in phase-out arrangement where the vendor
fades out of the practice over an extended period. When this is done properly, the patients may virtually not notice the change.

A purchaser should be prepared to pay more for goodwill where there is a phase-in phase-out arrangement as there is a greater prospect of retaining the patients’ loyalty. Consider a deposit of, say, ten per cent and then twelve instalments of the price over the phase out year. If after a few weeks (or months) it is clear patients are not happy the arrangement should be discontinued. Yes, the deposit may be lost. But it is better to lose 10% of the money than 100%.

Patient relations throughout the changeover are the most important factor for the purchaser to consider. Mistakes can spell disaster. Some attrition is normal, but it should be limited to no more than 10% of patients. The aim should be to grow the practice by more in the first year, so this balances itself out.

Potential of the practice
When making a decision to buy, the potential of the practice should be given a great deal of thought. A new face can be a breath of fresh air in a medical practice. A new coat of paint can help too. Many people in the area may decide to try just to see what it is like. The matters dealt with in other modules of this manual can, if effectively applied, greatly enhance the value of the practice and hence the value of the investment in it. It is strongly recommended that these matters be taken into consideration, and applied in practices where appropriate.

Word of mouth is a strong form of advertising, and positive first impressions cannot be underestimated. It should always be remembered that the patients’ loyalties are a valuable part of the purchase price, so looking after them well is crucial.

FURTHER RESOURCES

3.3 GOODWILL

Accountants define goodwill as the excess of the market value of a practice over the sum of the values of the individual tangible assets, such as office equipment used in that practice. This is a conventional and technically correct definition. The market value of a practice will only be greater than the sum of the value of the individual tangible assets used in that practice when practice profits are higher than the amount the prospective purchaser can earn as a non owner doctor.

Case law identifies three types of goodwill. They are:

- personal goodwill, i.e. goodwill that is attached to a particular doctor because of his/her personal manner/personality, medical knowledge, clinical experience, and patient loyalty. There is an interesting technical question as to whether personal goodwill can be transferred to
another person. The general view is that it cannot, although strategies can be devised to ensure that over time a doctor buying personal goodwill ultimately receives the benefits. This is particularly the case in some specialist practices, especially specialist dental practices. This occurs when the vendor specialist uses their best efforts to ensure the benefit of referral arrangements with GPs and passes it on to the purchaser doctor;

- location goodwill. Some sites are more likely to generate higher patient attendances than others. Generally these will be sites with high traffic, high visibility, ample parking (preferably not paid for by the practice: an example is a practice next door to a large shopping centre where patients can use the shopping centre car park), and the right aesthetic/professional presentation. Such locations are likely to generate high patient numbers. Security of tenure is the critical issue when buying such a practice. It is a good idea to either buy the premises as well, or make sure there is a very safe and long term lease. This then raises the question as to whether the goodwill belongs to the practice or the premises. It is a good question, and we think it belongs to the premises, unless there is a very good long term lease in place; and

- name goodwill. Some practices have stronger reputations than others. Name goodwill is likely to exist in a group practice situation where the purchaser immediately enjoys the benefit of the practice’s reputation, as built up over many years, and the continuing professional relationship with the vendor doctors.

In each case the amount of the goodwill depends on the size of the maintainable profits above the normal return for a doctor. Therefore, if the profit is only around $300,000 there will be no goodwill, no matter what the reputation of the vendor doctor is, (i.e. there is no personal goodwill), no matter what the location is, (i.e. there is no location goodwill), and no matter what the reputation of the group practice is, (i.e. there is no name goodwill). Further information on the types of goodwill is available at appendix 3 at the end of this guide.

The Importance of Goodwill
It is important to understand the relationship between a practice’s maintainable profit and a practice’s goodwill. As profit increases and begins to exceed the amount a doctor could earn working similar hours as a non-owner, practice goodwill is created.

A practice that yields a maintainable net profit per principal of $300,000 a year will not have much goodwill. This is because $300,000 a year does not exceed the amount most prospective owner doctors could otherwise earn as employees, or at least as assistants or consultants. A practice that yields a maintainable net profit per principal of $500,000 per year is a different proposition. This is because an amount of $500,000 exceeds the amount most prospective owner doctors could otherwise earn. Therefore, in most cases, a prospective purchaser will be prepared to pay a premium to acquire all or part of that practice. This premium represents goodwill. It is solely connected to the profitability of the practice; more particularly, to its expected long term maintainable profits.

These comments have to be qualified with a warning that at present, for reasons discussed in more detail in the following paragraphs, few doctors are prepared to pay significant goodwill on becoming an owner, despite the underlying economic theory. This phenomenon often causes conflict between
the expectations of potential sellers and potential buyers, and often leads to break-downs in previously harmonious relationships.

This relationship between practice profit and practice goodwill is fundamental and should be borne in mind at all times. It means any plan or strategy to improve a practice's goodwill must first increase its maintainable profit. Without something above a basic time reward, with some special premium representing a maintainable return on the equity invested in the practice, the practice will not have any goodwill.

When discussing medical practice goodwill, we are discussing doctor to doctor transactions and not transactions involving large corporate service providers paying considerable sums to doctors for the sale of their practice, and for signing a five year service agreement. These transactions are not discussed in this manual and we recommend any doctor who has been approached by a large corporate service provider seek expert tax law advice before accepting such an offer.

**Improving the Profitability and Goodwill of a Practice**

The best way to improve the profitability and goodwill of a practice is to pay close attention to each of the qualities described in this module. Consideration should be given to these qualities from the point of view of each particular practice, and questions need to be asked regarding what can be done to improve them. The purpose of this exercise is to allow practices to systematically put in place a process aimed at maximizing profitability and goodwill. It is important to be honest. The practice that cannot be improved is yet to be created. (And if it has it should be patented!)

As a suggestion, it may be a good idea to ask another doctor, or external practice consultant, to prepare a critique of the practice and to list ways the practice can be improved. The external objectivity provided by such a person can be a powerful motivator as they will often see opportunities not previously considered.

A further suggestion could be to identify other practices and ask:

- What (if anything) about this practice would appeal to a patient? What (if anything) about this practice would appeal to different types of patients?
- What hours is this practice open? How does it deal with afterhours calls?
- What type of services does this practice offer its patients? Is there a special niche this practice provides creating a unique demand for its services?
- How many doctors are involved? Are other services (for example, physiotherapy or a pharmacy) offered from the same premises or nearby?
- Do the assistants and associates engaged by this practice have their own patient following and loyalties?
- Are home/hospital/aged care facility visits available?
- How effective is this practice’s support staff? Do they have an efficient and personable rapport with the patients? How well do they complement the professional staff?
- Do the practice’s premises have easy access and good parking facilities?
- What type of patients does this practice attract? Does it rely on repeat business and build up strong personal relationships or is it a high turnover practice? Are the patients loyal?
- How are patients billed? What proportion (if any) of patients are bulk billed?
- What is the average time spent with a patient?
- Does the practice qualify for the PIP and other blended payments?
- What other advantages or disadvantages does this practice appear to have?

The answers to these questions may not describe the concept of an ideal practice. Personal preferences are important, however the process of reflecting on what others are doing can be a fruitful source of new ideas as well as change and renewal. The answers to these questions should provide a readymade guide to the question of how practice profitability and the goodwill of the practice can be improved.

It is important to remember the essence of goodwill is whether a practice has a maintainable competitive advantage, that generates above average profits that can be passed on to a new owner, and for which other doctors will be prepared to pay a premium. The potential purchaser has to be convinced it is worthwhile paying that premium rather than starting a new practice from scratch. The vendor should think about these matters years before selling, to ensure the practice commands a premium for goodwill upon ultimate sale.

**An example**

If a practice is operating from premises that are not as ideal as the premises occupied by other practices in the locality, it could pay to up-grade them. This can be done either by renovating or moving to more suitable premises. If the cost of doing this is a problem, consideration should be given to sharing the premises with other doctors or with an allied health professional. Perhaps the renovation could create space for another assistant, whose fees can be thereafter shared. It is important to remember the idea is spend money, to make more money. If the extra fees generated by attracting new patients do not exceed the cost of renovating or moving, then it should not be done. (This is rare: generally we find doctors spend too little money on their premises. Spending more will generally make more.)

If the practice is overly reliant on one doctor, it could be a good idea to engage someone to take over a group of patients. Ideally a practice will have a principal to staff ratio of at least 1:1, and
usually a lot more. That is, for every owner doctor there will be the equivalent of at least one other
doctor or other fee earner. The profit leverage created by the smart use of other doctors will
enhance practice goodwill. This is because of the obvious increase in profit, but also because the
practice is less dependent on the proprietor: personal goodwill, which is not worth much, has been
traded for practice goodwill, which can be worth a lot.

3.4 PRACTICE GOODWILL

Practice premises have a significant effect on practice goodwill. Modern, well located premises with
good access and parking, and with appropriate facilities, attract patients.

Patients do not like visiting sub-standard practice premises. There can be a symbiotic relationship
between a good practice and good practice premises. Certainly, appropriately presented practice
premises improve profitability and therefore increase goodwill. They can also be viable as
standalone investments.

Practice premises and the relationship with the practice’s goodwill should be given close and
detailed study by each doctor. Strategies for acquiring and holding practice premises are dealt with
in detail in “The Practice Managers Guide to Location and Premises” which can be accessed on

The valuation of practice goodwill is a difficult measure. Benchmarks and rules of thumb exist, but
they should be used with some discretion, because they may not be specifically applicable to the
particular practice under review.

The essence of goodwill is whether the practice has a maintainable competitive advantage that is
able to generate maintainable, above average profits that can be passed on to a new owner. If it
does, other doctors may be prepared to pay a premium over the cost price of the practice’s tangible
assets, to acquire the practice.

Giving the definition of goodwill may be straightforward, but it leaves open the question of how to
calculate the value of goodwill. The AMA suggests a rule of thumb to follow is that goodwill should
be equal to one third of a practice's gross billings. A half share of a practice with gross billings of
$600,000 would therefore be valued at $100,000 (i.e. $600,000 times 50% times 33.3%). Plant and
equipment will be purchased separately at market value.

In some cases this may be an accurate approach that satisfies both the vendor and the purchaser,
and any other interested person. But this approach should be used with care. For example,
questions should be asked about what happens if:

• the practice is only grossing $200,000 and has costs of $150,000. Its profit is therefore only
  $50,000. Would you pay $100,000 for a practice that makes less than the market value of an
  owner's salary?
• the practice is relying predominantly on the bedside manner and personal qualities of a sixty five year old principal, who has cared for most of the patients for years. His patients are his (old) friends. Should a thirty five year old doctor take the plunge with this practice?

• the practice has gross fees of $500,000 and is based in rural Victoria. The local community could easily absorb another two, or even three practices, before the supply of medical services will begin to exceed demand. Most locals now travel 30 kilometers to the nearest regional centre for medical treatment. Would you pay $80,000 for a half share, or would you set up a practice next door? What happens if you do pay $80,000 and then someone else sets up next door?

Clearly each of these examples is problematic. We would not advise a client to buy into any of the above three practices (unless the price was very low, say $40,000 to $60,000, and it really was the practice they wanted to spend the rest of their life working in) unless the client had a very strong connection with the practice. For example, the doctor had worked there for five years and did not want to start afresh elsewhere. Otherwise we would be inclined to say “set up your own practice” as in each case it is just not worth paying anything for a share of the practice. The DIY option can be the best option. So the application of rough benchmarks and rules of thumb should be undertaken with care. They are meant to be rough guides to market value. They are not suggested as immutable laws, to apply to all situations regardless of the facts at hand.

Current Trends
Goodwill values are definitely down at present. This is bad news for vendors, but good news for buyers. There have not been many examples of goodwill above about $100,000 over the last few years, except for sales to corporate practices.

In one recent sale the value of the employee liabilities (i.e., sick leave, annual leave and long service leave) was more than the goodwill value of $50,000. This led to the unusual situation of the vendor paying the purchaser on settlement date. (At least the vendor got a small tax break: the $30,000 goodwill was capital gains tax free but the $35,000 payment was 100% deductible.)

There are many cases when the value doctors perceive is just not achieved. There are many reasons for this particular situation, but mostly because of supply and demand imbalances between:

• the number of doctors interested in selling their practices and the number of doctors interested in buying those practices. There just aren’t many buyers. The reasons for this are complex but most analysis include:
  o the increasing feminisation of the medical workforce, and the fact that traditional age entry points for general practice ownership conflict with the motherhood years;
  o an increasing preparedness for younger doctors to prefer lifestyle over extra work, and a perception that owner doctors work harder and longer than non-owner doctors. Many younger doctors do not see proprietor status as being relevant to their professional status, and many see it as a negative, reducing future location options and lifestyle flexibility;
  o a tendency for younger doctors to marry/partner other doctors, or other high income earners, thereby reducing the need to work harder and longer hours; and
  o the shortage of non-owner doctors, the engagement of whom is the key to increasing maintainable practice profits and hence creating goodwill value; and
the large number of patients and the small number of doctors, which means virtually any doctor will have an instantly busy workload if they decide to set up on their own practice. Therefore, the cost of setting up a solo practice, which can be as low as $80,000, provides a natural cap on the value of an established practice.

Goodwill values are virtually nil in most rural locations, and the less fashionable metropolitan suburbs. Doctors just do not want to work in these locations. Normally these practices cannot even be given away (although, perhaps paradoxically this makes them excellent options for younger doctors setting up their own practices, particularly if the older vendor stays on as a part time assistant). This creates a substitution effect across the market and reduces the goodwill values in alternative areas.

The shortage of doctors almost creates a bidding process to attract and retain good quality doctors to a practice. If the doctor is tired, facing family pressures, and sick of working 12 hour days, it is worth selling a half interest in the practice for just $50,000. This could mean going home at 5.00 pm most nights of the week, and sharing the fixed costs with another doctor. It would also provide peer/professional support in the practice.

There are many examples of excellent practices changing hands for virtually token goodwill values. It defies common sense, and creates a great buyers’ market, which reflects the current market. This situation is unlikely to change until the first generation, or two, of alumni from the new medical schools matures and enters this phase of their medical careers.

A real life example of low goodwill
Dr John and Dr Betty are married and are both GPs in Sydney’s southern suburbs. They are both in their mid-thirties. Three years ago we recommended they set up their own practice. After some discussion, and some soul searching, they bought a practice from a doctor returning to the UK. The practice came complete with a practice nurse and GPs. It cost $50,000 on a walk in walk out basis.

The practice consisted of Dr John and Dr Betty, the practice nurse and the two other doctors, who were more than happy to stay on. This means there are more non-owner material fee earners than owners, and the practice can be run through a practice trust using a standard discretionary trust deed. The practice is now making more than $600,000 a year and a large part of this profit is taxed at no more than 30%, since it can be distributed and paid to an investment company. John and Betty are making more than $200,000 more than they were before they became owners, are working shorter hours, are able to take time off when the children require support, and are building up valuable investments every week.

Buying a practice was the best financial investment Dr John and Dr Betty will ever make.

A selected list of sales is displayed in appendix 4 at the end of this guide. This appendix is not a complete list of the sales McMasters’ have been engaged in over recent years, and further evidence
of the market values of general practice goodwill can be supplied on request. This list has not been updated for a few years. But we can say the position and trend has not changed in 2013.

A special note for specialists
The position of specialists and goodwill is more difficult than it is for general practitioners. The stronger emphasis on a refined and focused body of knowledge, and the greater need to rely on a body of referring doctors, means the specialist doctor is less likely to be able to sell the practice at a price that shows goodwill.

But there can be exceptions. For example, a medical-legal specialist could be able to gather together a small team of professionals to provide services under a common letterhead. Here the letterhead is important, and not the particular doctor who signs that letterhead. Goodwill exists here.

In certain specialties, such as radiology and pathology, the need for a wide distribution network and the need for a large amount of capital expenditure create almost insurmountable barriers to entry. A doctor has little choice but to join an established practice and, after having earned his or her stripes, buy in to the practice at a price which reflects goodwill.

Some ophthalmologists achieve large goodwill payments, particularly where laser techniques are used. However, some periodontal practices have also done very well in the goodwill stakes.

Generally, though, specialists should discard goodwill and look to maximising their long-term wealth by increasing profits, and by directing excess cash into other investments.

3.5 PRACTICE VALUATION

McMasters’ are frequently asked to comment on the value of a client’s medical practice. The questions are asked for a variety of reasons: the client may be interested in selling all or part of his practice, the client may be interested in buying all or part of a practice, a divorce might be imminent, or the client simply wants to know what his practice is worth.

The question is asked more frequently for a partnership than a sole proprietorship. For obvious reasons there are more changes in partnerships than there are in sole proprietorships. Value needs to be calculated each time a partner leaves, or joins, or the fractional shares of the partners change.

Whatever the motivation behind the question, it is one that is frequently on the minds of clients. The question of how to value a practice is closely related to the question of goodwill, which is often the most valuable asset in a practice. The theoretical concept of goodwill is considered in the preceding part of this module. In this section we examine the mechanics of valuing goodwill and put forward a sample valuation to give some idea of what to look for in a practice and, perhaps, some idea of what advisors are talking about when this topic arises.
Different types of value
The first port of call is a brief consideration of what is meant by "value", and how valuers and other professionals use this word.

Broadly speaking there are at least three types of value referred to by valuers. These are "market value", "going concern value" and "economic value". Ultimately there is only one important value, being the amount a person is prepared to pay to acquire the business or part of it. More hypothetically, the value is the amount a willing but not anxious buyer, and a willing but not anxious seller, would agree on as the sale price of an asset, provided all relevant information is available to each of them. However, these three terms help to explain how this amount may be computed depending on the practice’s relevant circumstances.

<table>
<thead>
<tr>
<th>Market value</th>
<th>A term that implies an identifiable market of buyers and sellers. This allows the valuer to determine the price to be paid for the practice by reference to comparable sales.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Going concern value</td>
<td>The price a buyer will to pay on a walk-in walkout basis</td>
</tr>
<tr>
<td>Economic value</td>
<td>Exists if a buyer is prepared to pay a premium above the price suggested by the market in order to access or obtain some special advantage connected to the practice. Such an advantage might be the opportunity to access a particular type of patient or to practice in a particular geographic area where barriers to entry are high and custom takes time to develop.</td>
</tr>
</tbody>
</table>

It is possible; even likely, these three values will be different in any given situation. This is quite normal. The only real value will be the value a person is actually prepared to pay to acquire the practice under consideration or, more hypothetically, what a willing but not anxious purchaser, and a willing but not anxious buyer, would agree upon as the sale price in this situation.

When a medical practice is being valued, the valuer will make recommendations based on these three terms. Each of the three concepts of value have some role to play in making an assessment, but none of them, on its own, will be determinative of the final outcome of the valuation process.

A real life example may help explain the valuation process. The example used in the following paragraphs is based on an actual client situation and the figures involved are realistic. They have been altered to simplify the presentation and to preserve client confidentiality.

The practice is well located in an upper-middle class area in Melbourne. It has five owners, who have a history of amicability, and resolving issues cordially and fairly. The practice owns its own building, is a training practice, has a team of four full time practice nurses, has five full time equivalent non-owner doctors, (ranging from part time male doctors in their seventies to part time female doctors in their early thirties), and covers the full range of general practice sub-specialties. The owner
doctors work four days a week, including rostered evenings and Saturday mornings.

The practice is a business for tax purposes and is run via a practice trust, with all the owner doctors’ rewards derived through their family trusts, and paid to superannuation funds, relatives, and company beneficiaries in a tax efficient manner.

The practice is regarded by other local doctors as excellent, the best in the area. It is also well regarded by patients: so much so that it no longer accepts new patients, unless they are family members of existing patients.

The practice’s finances are well resourced, and it privately bills (some exceptions) with a strict pay on the day policy. The practice has a very competent practice manager, who runs a small team of staff, and the owner doctors have little to do with the day to day management of the practice. They meet once a fortnight, as owners, to discuss clinical matters, and once a month to discuss administrative matters. The practice manager attends the management meeting (unless requested by the partners).

One of the owner doctors wants to leave the practice to re-join her family interstate. It is very amicable, and regretted by the remaining owner doctors. We were asked to value her interest in the practice to obtain a sale price for an in-coming owner doctor. The prospective new owner doctor has worked at the practice (run her own practice and paid a management fee of 35% of billings) for the last five years, and has a lot of energy and time invested in the practice. She likes the practice and wants to make her career there.

**Market Value**

Market value has been defined as the price that a willing but not anxious buyer, and a willing but not anxious seller, will agree on as the price of a particular business. This definition assumes the buyer and the seller each have the same information regarding the asset, and each of them have other alternatives that they may pursue if the sale is not completed. That is, it assumes that, both the buyer and the seller come to the negotiation table with equal knowledge and bargaining power.

This basic definition is rooted in legal precedent and history. It is now used as a basis for defining "market value" in a number of other commercial disciplines, such as economics and accounting.

In the context of a medical practice, goodwill exists when the expected future profits from a practice exceed the amount the doctor can otherwise earn as an employee. Here, a willing but not anxious buyer will be prepared to pay a premium to acquire a right to receive or to share in the practice's
profits. Typically this will occur when the practice has a special quality that cannot be easily replicated, which is not personal to the proprietor(s), and which can be passed on to a buyer with a reasonable level of certainty.

There is no complete list of the qualities that may give rise to practice goodwill. An infinite number of possibilities exist, depending on the circumstances of the individual practice. The qualities that typically reflect (or create) goodwill in a medical practice include:

- efficient support staff that enjoy a friendly rapport with patients;
- clean modern premises that are easily accessible, have adequate car parking space and, preferably, a play area for children, with some form of entertainment for adults, so patients find the ambient surroundings comfortable;
- stable and personable assistants and associates, who have their own lists of patients, and who are able to operate at a maximum capacity, with minimal supervision and control (and who do not intend to, or who are contractually prevented from, setting up an opposition practice in the same locality);
- established relationships with allied health care professionals, such as physiotherapists, pathologists and chemists, ensuring the practice attracts a continuous stream of new patients and is able to provide a broad range of medical and health services to its existing patients;
- increasingly, a market niche or practice specialty that attracts a particular type of patient, as well as the general practice patient. Examples of this include skin cancer, geriatrics, sports medicine, a language expertise, and women’s medicine;
- good location, both within a particular suburb and as to the choice of suburb or region itself, and the related issue of a practice’s physical presentation; and
- in some cases, specialist equipment, that has a high cost or market interest, creates a barrier to entry for a particular type of procedure or service.

These qualities distinguish a medical practice from its competitors, and create a maintainable competitive advantage that can be passed on to a new owner. This creates goodwill. Other doctors will be prepared to pay a premium over the value of the practice’s tangible assets, in order to acquire all or part of that practice.

**Step 1: Calculate future maintainable earnings**

The first step is quite straightforward. The task is to calculate how much profit each owner is making from the practice. Historical accounting reports prepared by accountants and used for income tax returns are used to estimate the "real earnings" of the practice. "Real earnings" is the actual reward from all sources accruing to the owners from the practice. These historical “real earnings” are used as a basis for predicting future earnings, and will need to be adjusted for the effect of any known changes in the practice or the general medical environment. For example, the increase in Medicare rebates in 2005 generally increased future earnings above what they had been over the previous three years. Any calculations of future real earnings would have needed to be adjusted for the increased rebate payments at that time.

To compute future maintainable earnings per doctor, averages of at least three years are normally used, and profit is adjusted for the effect of:

- transactions with the persons who own the practice, or who are related to the practice; and
transactions that will not be experienced by the new owners.

The average full time non-owner doctor at the practice is earning about $200,000 a year, net of costs. So, $200,000 was subtracted from the departing owner doctor’s share of net income to determine the return on her investment. The $200,000 was taken as a measure of reward for her actual time in the practice in 2009, with a small discount for the two prior years.

The figures looked like this:

<table>
<thead>
<tr>
<th></th>
<th>2011</th>
<th>2012</th>
<th>2013</th>
</tr>
</thead>
<tbody>
<tr>
<td>Share of net income</td>
<td>$346,000</td>
<td>$320,000</td>
<td>$415,000</td>
</tr>
<tr>
<td>Reward for time in the practice</td>
<td>$180,000</td>
<td>$190,000</td>
<td>$200,000</td>
</tr>
<tr>
<td>Reward on equity</td>
<td>$166,000</td>
<td>$130,000</td>
<td>$215,000</td>
</tr>
</tbody>
</table>

The average is then computed:

2011 $166,000  
2012 $130,000  
2013 $215,000  
Total $511,000  

Average $170,333

The amount of $170,333, represents the average return on investment for the three prior years, and was accepted by all concerned as a reasonable estimate of future maintainable earnings. This is thought to be the best measure of renewable profit connected to the practice. This amount is then used as a basis for all subsequent calculations.

**Step 2: Determine the value of the multiple**

The second step is less mechanical and more subjective than the first step. It requires the valuer to determine an appropriate multiple to apply to true earnings, in order to estimate value. The determination of the multiple requires the valuer to apply logic, business experience, and intuition. It is more art than science. Any two valuers will probably come to a different multiple and this is quite acceptable: the difference reflects their differing perceptions of the strength of each component in the determination of the multiple.

The higher the multiple, the lower the valuer’s assessment of the risk attached to the business and the greater the value of the business.

One method of determining the appropriate multiple for a medical practice is to identify each of the factors that are believed to be critical to a practice's success, and then to allocate to each of these factors an optimum score reflecting the relative importance of that factor in the valuation process. Each factor is then scored and the sum of the scores compared to the sum of the optimum score to determine the strength of the multiple.
This approach is very flexible. It allows the doctor to weigh each factor according to the doctor’s own view of their relative importance to a practice, and to add or delete factors as they deem appropriate. This calculation might have looked like this:

<table>
<thead>
<tr>
<th>Attribute</th>
<th>Optimum</th>
<th>Score</th>
</tr>
</thead>
<tbody>
<tr>
<td>Patients</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Loyalty</td>
<td>10</td>
<td>9</td>
</tr>
<tr>
<td>New Patients</td>
<td>10</td>
<td>5</td>
</tr>
<tr>
<td>Activity</td>
<td>10</td>
<td>5</td>
</tr>
<tr>
<td>Number</td>
<td>10</td>
<td>9</td>
</tr>
<tr>
<td>Premises</td>
<td>10</td>
<td>9</td>
</tr>
<tr>
<td>Aesthetic Appeal</td>
<td>20</td>
<td>15</td>
</tr>
<tr>
<td>Functional Appeal</td>
<td>20</td>
<td>18</td>
</tr>
<tr>
<td>Tenure</td>
<td>20</td>
<td>10</td>
</tr>
<tr>
<td>Location</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Access</td>
<td>20</td>
<td>12</td>
</tr>
<tr>
<td>Population Growth</td>
<td>30</td>
<td>20</td>
</tr>
<tr>
<td>Socio Economic Factor</td>
<td>20</td>
<td>18</td>
</tr>
<tr>
<td>Geographic Location</td>
<td>20</td>
<td>18</td>
</tr>
<tr>
<td>Competition</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Distance</td>
<td>30</td>
<td>25</td>
</tr>
<tr>
<td>Other</td>
<td>20</td>
<td>15</td>
</tr>
<tr>
<td>Referral Sources</td>
<td>20</td>
<td>15</td>
</tr>
<tr>
<td>Staff</td>
<td>30</td>
<td>25</td>
</tr>
<tr>
<td>TOTAL</td>
<td>300</td>
<td>208</td>
</tr>
</tbody>
</table>

A perfect score of 300 would give a multiple of three, which is believed to be a maximum for a medical practice like this. So a score of 208 gives a multiple of 2.08. Again, it is stressed that this is a subjective value and each assessment may be different, and for good reasons.

There is no reason why doctors should not create their own list of factors to be considered, and give them an optimum score that reflects the relative importance of each factor to them personally. This makes the valuation their valuation. Guidance can be given through the formal thought processes underpinning the valuation. There is every reason why different prospective purchasers would attach different relative importance on each factor, and then score them differently. This should be expected to happen. This is the advantage of the approach: it is very flexible and can be adjusted to meet different circumstances.

**Step 3 Determine value**

This multiple is then applied to the estimate of future maintainable earnings of $170,333 obtained earlier to calculate goodwill of $354,292.

<table>
<thead>
<tr>
<th>Maintainable future earnings</th>
<th>$170,333</th>
</tr>
</thead>
<tbody>
<tr>
<td>Multiple</td>
<td>2.08</td>
</tr>
<tr>
<td>Goodwill value</td>
<td>$354,292</td>
</tr>
</tbody>
</table>
In other words, in the valuer’s opinion a willing but not anxious buyer, and a willing but not anxious seller, would agree to a price of about $354,292 to acquire the goodwill of a practice with the above characteristics, and that has produced an average earnings for its owner on a four day week over each of the previous three years of $170,333.

This is a very high valuation, based on observed market results. In this situation, the purchaser was prepared to pay because she had already invested five years of her life in this practice, and realistically was not able to re-create the same practice elsewhere herself. The emotional and financial cost of starting again elsewhere was significant, and it was important to her sense of self-esteem that she be seen as a member of a leading general practice.

This value includes a share of the plant and equipment. Second hand plant and equipment values and furniture and fittings values are generally very low, and are rarely significant components of a medical practice sale.

**Alternative valuation methods**

There are alternative methods of valuation. For example, we understand some valuers suggest a reasonable valuation of a medical practice can be obtained by multiplying a factor of between 15% and 35% of gross fees generated. A typical factor for these valuations appears to be about 30%. This approach, as simple as it is, seems to be historically entrenched in the minds of doctors and is often used in valuing medical practices, without any real attempt to analyse the practice’s profile in a more scientific way.

The difficulty is that it is too mechanical, and does not deal with issues other than gross fees. These issues may well have an overwhelming influence on the valuation of the practice. For example:

- it does not consider costs. Some practices will have a much more favorable costs profile than others. It seems sensible to take this into account by basing the valuation methodology on net earnings rather than gross fees. If this is not done different practices will be valued similarly just because they happen to have similar gross fees. For example, taking on an associate who bills what he costs will increase value but will not increase net earnings. This is not sensible; and

- it does not consider non-financial matters. For example, it does not take into account expected future competition. A potential purchaser may well be cognisant of this but the valuation process will not highlight the problem.

If this approach had been used in the above example the client would have paid too much for the practice, as average gross revenue was more than $360,000 a year. Based on a factor of 30% this would have valued the practice at $108,000. In our view that would have been too little. We believe this valuation approach is too simplistic, too rigid, and fails to take into account all relevant matters that may affect value. McMasters’ does not recommend it to our clients. Further information regarding valuation is available at appendix 5 at the end of this guide, and a sample of a valuation letter can be viewed at appendix 6 at the end of this guide.
**Capital gains tax and goodwill**
The Australian Government has created a number of special concessions to reduce what would otherwise be the tax charge on capital gains that are connected to the sale of a small or medium sized business. The rationale is that small and medium sized business are the engine room of the Australian economy, employing more staff than each of the big business sectors and the government sectors, and generating more wealth for the economy.

Small and medium sized business operators need incentives to encourage their efforts, and exempting capital gains on the sale of a business (provided certain conditions are met) is one way of encouraging entrepreneurial efforts and energies.

Small and medium sized business operators are also required to invest in the businesses, and this often means cash is short for superannuation and similar investment strategies. The CGT concessions are seen as compensating small and medium sized businesses for not being able to use these other tax concessions to build up wealth for retirement.

Many books have been written on the question of capital gains tax and goodwill. It is a very complex area, and doctors selling goodwill as part of a practice sale should make sure they access experienced tax solicitors to confirm that the receipt is a tax free capital gain, and is not taxed either as ordinary income or under the general CGT rules.

**Suffice to say:**

- the CGT concessions are one reason why doctors are recommended to invest in their own practices. Doctors receive a large tax free cheque on the sale of all or part of their practice;
- most doctors who sell practices for capital gains are able to treat the capital gain as a tax free capital, under a combination of CGT concessions; and
- doctors who sell their practices to, or otherwise contract with, large corporate service providers and then enter into a long term service agreement with the corporate service provider, may not be able to treat the receipt as a tax free capital receipt. The Australian Taxation Office has issued a ruling, indicating in some circumstances these payments may be taxed as ordinary income. The ruling is private ruling 25443 and a copy of it can be downloaded directly from the ATO’s website here: [Private Ruling IT 25443](https://www.ato.gov.au).  

It is important to stress that there is no such thing as off the shelf tax advice, and each case must be considered on its individual merits. Any doctor contemplating selling their practice, or any similar rights, should seek specific legal advice about the CGT consequences, before proceeding with the transaction.
APPENDIX 1  CHECKLIST FOR BUYING A PRACTICE

It is not possible to cover all matters that should be considered by a practitioner before buying a practice. The list is endless and differs markedly from case to case. What is important in one case may not be important in another.

In this appendix we have simply set out in question form a checklist of matters to be considered by a practitioner contemplating buying a practice or buying into a practice, whether as an associate or a partner. Buying into a practice can be a very big step that involves one of the largest cash outlays made by a practitioner. Unlike buying physical assets, such as a home, goodwill is not something physically tangible. A practice, and the goodwill within a practice, is an intangible asset without a physical existence. It can also be a very transitory asset, that is here one day and gone the next. For this reason caution at the beginning is prudent and can help avoid problems further along the way.

This checklist applies to solo practices and group practices. When buying into a group practice, considering these matters can lay a firm basis for future dealings between the practitioners.

Professional advice

A solicitor or accountant who has experience on the sale and purchase of practices should be consulted as early as possible once a sale or a purchase is in contemplation.

Before you start

- What are your reasons for going into practice as a principal?
- How does the practice compare with alternatives, either as an associate or an employee?
- Are you suited to being a principal?
- Do you have the financial stability to be a principal?
- What hours will be involved?
- Have you spoken to an accountant?
- Have you spoken to a solicitor?
- Have you spoken to your spouse?
- Have you spoken to a bank manager?
- How long have you known the vendor for?
- How long have you known the practice for?

Assessment of value of the practice

- Has an expert valuer been consulted?
- How has the practice performed over the last three years?
- How is the practice expected to perform over the next three years?
- Does the practice have a potential that is not yet being tapped?
- What accounting records, tax returns and source documents are available to support the financial performance of the practice?
- What is the value of the plant and equipment included in the sale?
- What is the value of the furniture and fittings include in the sale?
• Are comparative figures available for other practices?
• What is the existing and proposed competition?
• Are there any key employees or associates?
• How long has the practice been operating for?
• How did the current owner acquire the practice?
• How has the practice grown under the current owner?

The premises
• Are the premises leased or owned?
• Who owns them? Who has security over them?
• How will you occupy them, as a tenant or an owner?
• What does the lease look like?
• Have you seen a title search?
• Have you had an architect or other building expert look at the premises?
• Who is or will be the tenant?
• Who will own the premises?
• Does a lease need to be assigned?
• Is a real estate conveyance involved?
• Is a caveat required?
• What covenants, easements or other restrictions apply?
• Are all rates and taxes and other outgoings paid up to date?

The documents
• Have you seen a proposed contract of sale?
• Have you seen a proposed partnership agreement?
• Have you seen a proposed associate agreement?
• Have you seen a proposed service contract?
• Have you seen a proposed unit holders’ agreement?
• Have you seen a proposed lease?
• Have you seen a proposed licence agreement?
• Is there a buy-sell agreement?
• Is there a restrictive covenant/restraint of trade clause?
• When is the money paid? How?
• Does a lease need to be assigned?
• In Victoria, do the provisions of the Estate Agents Act regarding the sale of a business or part of a business need to be complied with? These rules apply to businesses with a total value including goodwill of $200,000 or less.

Generally
• Have you read the draft legal documents included in this manual, so you know what the documents should look like?
• Have you read the sections in this manual dealing with legal structures and tax planning, so you know you have an optimum position?
• Have you read the section in this manual on owning practice premises?
• Have you read the section in this manual on leasing practice premises?
• Is the vendor bankrupt?
• Have you signed a confidentiality agreement?
• Should the benefit of any other contracts pass to the purchaser?

If the vendor is a company?
• Does it have the power to sell?
• Who are the directors?
• Who are the shareholders?
• Have any charges been given by the company?
• Does a bank have to consent to the sale?
• Have the company’s other activities been taken out of the financial information?
• Is the company being wound up?
• Are you being asked to buy shares in a company?
• Will you be responsible for the debts of the company?
• Are the directors guaranteeing the performance of the company?

Other matters
• Does a business name need to be transferred?
• Do any trademarks or logos need to be transferred?
• Are staff needed? Who pays for long service leave, annual leave and sick leave?
• Should there be new employment agreements?
• Have you seen the patient files?
• How many patients has the practice seen this month? This week?
• Do telephones need to be changed?
• Do specialists and allied health professionals need to be advised of the change?
• What medical services (eg pathology and radiology) are used in the practice?
• How will patients be advised?
• Do leases on plant and equipment have to be adjusted against the purchase price?
• Do plant and equipment lessors need to be contacted?
• How can you be sure the vendor owns the practice?
• Should you place a caveat on the premises?
• Are any special licences or advices required?
• Who will collect patient debts?
• Have all legislative disclosure requirements been satisfied?

Some details
• Who is the vendor's solicitor?
• Who is the vendor's accountant?
• Who pays for the sale documents?
• Is stamp duty payable? If so, who pays stamp duty?
APPENDIX 2 Sample Sale of Practice Agreement

SALE OF BUSINESS ASSETS AGREEMENT

THE VENDOR PTY LTD A.C.N. 000 000 000

THE VENDOR

AND

THE PURCHASER PTY LTD A.C.N. 111 111 111

AS TRUSTEE FOR THE PURCHASER PRACTICE TRUST

THE PURCHASER

MCMASTERS’ SOLICITORS & CONSULTANTS

A.C.N. 093 279 835

71 TULIP STREET

CHELTENHAM VICTORIA 3192

TELEPHONE 03 9583 6533

FACSIMILE 03 9583 6733

E-MAIL TERRY@MCMASTERS.COM.AU
THIS AGREEMENT is made at 17 Brown Road Brownsville Victoria on the day nominated in the Schedule by the person nominated as the Vendor and the person nominated as the Purchaser in the Schedule. This agreement is intended as a guide only and should not be used without specific legal advice.

1. **PRELIMINARY**

1.1 **Definitions**

In this Agreement:

*Approvals* means any and all approvals, licences, permits, or other things required by any Authority or by any law necessary for the operation of the Business;

*Assets* means:

(a) the plant and equipment used in the Business;
(b) the Stock;
(c) the right, title and interest of the Vendor in the Contracts;
(d) the goodwill of the Business, including any business name specified in the Schedule; and
(e) the Debtors;

*Authority* means any statutory, public, governmental, semi-governmental, municipal or other authority, body or department;

*Business* means the business specified in the Schedule;

*Business Day* means a day not being a weekend or a public holiday in Victoria;

*Claim* means any claim, action, proceeding, demand, cost, expenses or liability whatever and however arising (and includes legal costs on a full indemnity basis);

*Completion Date* means the date specified in the Schedule;

*Contracts* means the contracts specified in the Schedule;

*Debtors* means the share belonging to the Vendor of the accounts rendered by the medical practitioners practising at the Premises up to and including the Completion Date and remaining unpaid at the Completion Date,

*Dispose* means assign, transfer, otherwise dispose of or grant or permit to suffer the grant of any legal or equitable interest (either in whole or part) whether by sale, lease declaration or creation of a trust or otherwise;

*Employee Entitlement Deduction* means the amount set under clause 5.1(d);

*Encumbrance* means any interest or power:
(a) reserved in, or over any interest in, any asset; or

(b) created or otherwise arising in, or over any interest in, any asset under a bill of sale, mortgage, charge, lien, pledge, trust or power,

by way of security for the payment of any monetary obligation, or the performance of any other obligations and whether existing or agreed to be granted or created;

*Insolvency Event* means the happening of any of the following events:

(a) an application is made to a court for an order or an order is made that a body corporate be wound up;

(b) an application is made to a court for an order appointing a liquidator or provisional liquidator in respect of a body corporate or one of them is appointed whether or not under an order;

(c) a receiver, receiver and manager or controller is appointed in respect of any part of the property of a body corporate.

(d) an administrator is appointed to a body corporate the *Corporations Law*;

(e) a body corporate enters into, or resolves to enter into a deed of company arrangement, a scheme or arrangement or composition with, or assignment for the benefit of all or any class of its creditors, or it proposes a reorganization, moratorium or other administration involving any of them;

(f) a body corporate resolves to wind itself up, or otherwise dissolve itself, or gives notice of intention to do so;

(g) a body corporate is or its directors state that it is unable to pay its debts as and when they become due and payable;

(h) a body corporate is presumed to be insolvent under the *Corporations Law*;

(i) a judgment is entered against a body corporate for a sum in excess of $20,000 and remains unsatisfied or un-appealed for a period of 15 days;

(j) a person becomes *insolvent under administration* under the *Corporations Law* or action is taken which could result in such an event; or

(k) anything having a substantially similar effect to any of the events specified above happen under any law of any applicable jurisdiction;

*Other Adjustments* has the meaning given to this term in the Schedule;

*Parties* means the Vendor and the Purchaser;
Prescribed Occurrence has the same meaning as in the Corporations Law as if the reference to target company was a reference to the purchaser;

Purchase Price means the purchase price for the Assets as stated in the Schedule;

Purchaser means the person described as the Purchaser in the Schedule.

Records means all documents relating to the Business and includes:

(a) all records of moneys received from any Debtor; and

(b) all records of the Business to enable the Vendor to answer or defend any matter which may arise out of the operation of the Business;

"Schedule" means the schedule to this Agreement;

Settlement Place means the place specified in the Schedule or such other place agreed in writing by the Parties;

Stock means the stock-in-trade of the Business situated at the Premises on the Completion Date;

Stock Value means the amount nominated in the Schedule;

Vendor means the person nominated as the Vendor in the Schedule.

1.2 Interpretation

In this Agreement, unless the context otherwise requires:

(a) a reference to this Agreement and any document referred to in this Agreement is a reference to this Agreement and that document as amended, varied, novated or substituted from time to time;

(b) a reference to any legislation or to any provision of any legislation includes:

(i) all legislation, regulations and instruments issued under such legislation or provision; and

(ii) any modification, consolidation, amendment, re-enactment or replacement of such legislation or provision;

(c) a word importing the singular includes the plural and vice versa;

(d) words denoting individuals includes corporations, firms, authorities, unincorporated associations and instrumentalities;

(e) a reference to a Party to this Agreement or any other instrument includes that Party's successors and permitted assigns;
(f) if this Agreement would otherwise expire on a day which is not a Business Day then that time limit shall expire on the next Business Day;

(g) where a word or phrase is given a defined meaning in this Agreement, any other part of speech or other grammatical form in respect of such word or phrase shall have a corresponding meaning;

(h) a reference to any thing (including without limitation, any amount) is a reference to the whole or any part of it, a reference to a group of persons is a reference to any one or more of them and a reference to a class is a reference to any one or more of the members of the class;

(i) a reference to a clause or Schedule is a reference to a clause of, or Schedule to, this Agreement;

(j) any words following the words *include, includes* and *including* are not limited by reference to any words that precede those words;

(k) where general words are associated with specific words which define a class, the general words shall not be limited by reference to that class; and

(l) references to time are references to Melbourne time.

1.3 **Headings**

Any heading or take of contents used in this Agreement is for convenience only and does not affect the interpretation of this Agreement.

1.4 **Schedules**

The Schedules of this Agreement form part of this Agreement.

2. **CONDITIONS PRECEDENT**

2.1 This Agreement is subject to the following condition precedents:

(a) appropriate due diligence and other investigations regarding the assets by the Purchaser.

(b) the Vendor arranging for the Purchaser to get the benefit of the Contracts.

3. **SALE AND PURCHASE**

3.1 **Sale**

(a) The Vendor sells and the Purchaser purchases the Assets free from all Encumbrances for the Purchase Price.

(b) The Purchase Price is allocated to the Assets as set out in the Schedule.
3.2 Exclusion

All express and implied terms, representations and warranties which otherwise might apply to or arise out of this Agreement are excluded except as provided for:

(a) in this Agreement; and

(b) in any law which cannot lawfully be excluded or modified by Agreement including the *Trade Practices Act 1974 (Cth).*

3.3 Pre-completion conduct

The Vendor agrees that until settlement it will:

(a) manage and conduct the Business as a going concern with all due care, skill and diligence and in a businesslike manner; and

(b) not, except with the prior written consent of the Purchaser Dispose of or permit or allow any Encumbrance (other than the Permitted Encumbrance) to exist in respect of the Assets in favor of any person.

4. COMPLETION

4.1 Place

Completion will take place on the Completion Date at the Settlement Place or such other place as the parties may agree in writing before the Completion Date.

4.3 Completion

At Completion, the Purchaser will pay to the Vendor by bank cheque an amount equal to the sum of:

(a) the Purchase Price less the Deposit; and

(b) the amount of all payments made by the Vendor in respect of any of the Assets for any period on or after the Completion Date as notified to the Purchaser prior to the Completion Date,

less the amount of the Employee Entitlement Deduction and plus or minus the Other Adjustments.

4.4 No deduction

All amounts payable by the Purchaser under this Agreement must be paid without any deduction, withholding or set off whatever except for the Employee Entitlement Deduction and the Other Adjustments.

4.5 Default

Each of the following events are Default Events;
(a) a Party breaching any provision of this Agreement and failing to remedy that breach within 5 Business Days of the breach; and

(b) an Insolvency Event or Prescribed Occurrence occurring in relation to the Purchaser.

4.6 Vendor's Options

If a Default Event occurs in relation to the Purchaser then at the option of the Vendor (but without prejudice to the Vendor's other rights and remedies under this Agreement or otherwise);

(a) all moneys payable by the Purchaser become immediately due and payable and the Vendor is entitled to interest on those moneys at the rate charged by the Vendor's principal bankers on its facilities; or

(b) the Vendor may terminate this Agreement, retain the Deposit and either:

(i) retain the Assets and sue the Purchaser for breach of contract; or

(ii) resell the Assets in such manner as the Vendor thinks fit and recover from the Purchaser any deficiency in the price obtained for the Assets in the resale and any resulting costs and expenses.

4.7 Consequences of termination

If the Vendor terminates this Agreement pursuant to clause 4.6(b) then, without prejudice to its other rights and remedies:

(a) The Vendor is not obliged to complete the sale of the Assets; and

(b) the Purchaser has no claim against the Vendor.

4.8 Title

Upon payment of the Purchase Price and the amounts referred to in clause 4.3(c);

(a) title to, and risk in, the Assets passes to the Purchaser free from all Encumbrances; and

(b) the Vendor will deliver to the Purchaser:

(i) all documents evidencing the Assets; and

(ii) all documents reasonably required by the Purchaser to transfer title to the Assets to the Purchaser, duly executed by the Vendor.

4.10 Delivery

The Assets are to be delivered to the Purchaser where they are situated at Completion.

5. THIRD PARTY ARRANGEMENTS
5.1 Employment of staff

(a) The Purchaser must offer in writing to employ each of the Employees of the Business with effect from the day after the Completion Date, on terms and conditions no less favourable than those under which the employee is employed by the Vendor immediately prior to Completion.

(b) The Vendor must release from employment with it all employees with effect immediately from the close of business on the Completion Date and pay all amounts then due to each of those persons on termination other than leave entitlements of transferring employees.

(c) From the date after Completion the Purchaser must assume the Vendor's obligations to pay the transferring employees' leave entitlements. The purchaser indemnifies the Vendor against liability in respect of such Leave Entitlements and against all claims in respect of or in any way connected with the termination of employment with the Purchaser of such Employees.

(d) On Completion the Vendor must allow the Purchaser to set off against the Purchase Price an amount equal to the monetary value of leave entitlements of transferring employees, "monetary value" being the amount to which the transferring employees would have been entitled had they resigned on the Completion Date except for long service leave which shall be calculated on the basis of Australian Accounting Standards.

(e) Provided the Vendor has complied with clause 5.1(d), the Purchaser must indemnify the Vendor against all claims by the transferring employees except for breaches of the Vendor's obligations prior to Completion.

(f) No adjustment or allowance shall be made against the Vendor on account of sick leave other than for Employees on sick leave on the Completion Date.

5.2 Debtors

All amounts payable or to become payable to the Vendor in respect of the Business at Completion (Debtors) will become the property of the Purchaser.

5.3 Remitting of Moneys

(a) Any moneys received by the Vendor in respect of the Debtors (Debtor Moneys) will be paid to the Purchaser promptly and, in any event, within 3 Business Days after receipt.

(b) The Vendor holds the Debtor Moneys as trustee for the Purchaser and, pending payment to the Purchaser, will deposit the Debtor Money in an account in the Purchaser's name at a bank approved by the Purchaser.

5.4 Assistance
(a) The Vendor will provide the Purchaser and its agents with any information and
documents reasonably necessary to enable the Purchaser and its agents to collect all
amounts owing by the Purchaser.

5.5 Assignment

(a) Before Completion, the Vendor will use its best efforts to assign, novate or transfer
the benefit of the Contracts to the Purchaser.

(b) Where a Contract requires the Purchaser as assignee or transferee to be bound by
it, the Purchaser must on Completion execute all documents reasonably required by
the Vendor for that purpose.

5.6 Liabilities

(a) The Purchaser is solely responsible for and will indemnify and keep indemnified the
Vendor in respect of all liabilities and debts incurred in connection with the Assets
and the Business on and after Completion.

(b) The Vendor is solely responsible for and will indemnify and keep indemnified the
Purchaser in respect of all liabilities and debts incurred in connection with the
Assets and the Business before Completion.

6 MUTUAL WARRANTIES AND INDEMNITIES

6.1 Vendor warranty

The Vendor represents and warrants to the Purchaser on Completion Date that:

(a) the Vendor has full power and authority to enter into, execute, deliver and perform
the various promises and covenants made under this Agreement;

(b) it has good title to the Assets free from all encumbrances except as disclosed to the
Purchaser prior to Settlement;

(c) the Vendor has allowed the Purchaser access to all Records and other sources of
information, including accounting records, bank records and other financial
information relevant to the Business to allow the Purchaser to assess the Business;

(d) the Vendor shall transfer the benefit of the Contracts to the Purchaser

(e) the Assets:

   (i) are fully paid for;

   (ii) are at the Business Premises;

   (iii) will be able to be used by the Purchaser after Completion; and

   (iv) together with the Contracts are sufficient to carry on the Business as
        presently conducted;
(f) this Agreement does not conflict with, or constitute or result in a breach of or default under any provision in the Vendor’s Memorandum and Articles of Association or any material term or any provision of any Agreement or any deed or any writ, order or injunction, trust, judgment, law, rule or regulation to which the Vendor is Party or is subject or by which the Vendor is bound;

(g) the execution and delivery of this Agreement has been duly and validly authorized by all necessary corporate action on behalf of the Vendor, and the Vendor has full corporate power and lawful authority to execute and deliver this Agreement and to consummate and perform or cause to performed the Vendor's obligations herein;

(h) the Vendor is not aware of any claims, demands, litigation or disputes in respect of the Assets or of any disputes, claims or demands in respect thereof which may give rise to litigation;

(i) there are no facts or circumstances known to the Vendor which are likely to result in a material industrial dispute involving the employees or otherwise affecting the Business nor are there any material pay or other industrial claims which have been made by or on behalf of the Employees or otherwise affecting the Business;

(j) the Vendor is not aware of any facts or circumstances which are likely to result in the revocation or non-renewal of or the variation in any material particular in respect of any permit or licence held by the Vendor in connection with the carrying on of the Business;

(k) so far as the Vendor is aware, all requirements of local government, health, rating, building and other statutory authorities have been complied with;

(l) so far as the Vendor is aware, the Vendor has complied with all relevant laws in conducting the Business including laws relating to the environment (and there are no circumstances which with the passage of time would result in any non-compliance or breach of any law or contract);

(m) so far as the Vendor is aware, there are no outstanding notices or orders served or made by any person, body or authority affecting the Business and/or the Assets and the Vendor is not aware of any proposals or circumstances which may result in a notice or order being served or made or which may otherwise affect the Business and/or the Assets;

(n) so far as the Vendor is aware, the particulars of the Employees are true and correct in all material respects;

(o) so far as the Vendor is aware, the Vendor has in relation to each Employee complied in all material respects with all obligations imposed on it by statutes, orders, regulations, collective Agreements, awards and codes of conduct relevant to conditions of service and to all the relations between it and the Employees and any trade union and has maintained adequate and suitable records regarding the service of each Employee;
so far as the Vendor is aware, the Vendor has complied with all statutory requirements as to workers compensation, insurance, payroll tax and income tax instalment deductions in relation to all Employees or past employees of the Business;

so far as the Vendor is aware, the Vendor is not in default under any of the Contracts nor has it any knowledge of the invalidity of or grounds for rescission or avoidance or repudiation of any of the Contracts;

no appointments have been made of a controller or similar officer of the Vendor or its assets nor have circumstances occurred which could justify such an appointment;

no petitions for winding up the Vendor have been presented, no orders have been made or effective resolutions passed or proposed for the appointment of a provisional liquidator or the winding up of the Vendor, and no proceedings have been instituted nor a meeting called with a view to obtaining any such orders or to pass any such resolutions;

the Vendor knows of no reason why the third parties with whom the Contracts have been entered will not conduct business with the Purchaser;

so far as the Vendor is aware, the information set out in the Schedules to this Agreement is true and correct and not misleading;

so far as the Vendor is aware, the Vendor has met all of its superannuation obligations arising before the Completion Date; and

the facts set out in the Agreement and the information which has been given by or on behalf of the Vendor is and will be at the Completion Date true and complete and accurate in all material respects.

6.2 Purchaser warranty

The Purchaser represents and warrants to the Vendor on the date of this Agreement and at Completion that it has full power and authority to enter into, execute, deliver and perform this Agreement.

6.3 Vendor indemnity

The Vendor will indemnify and keep the Purchaser indemnified from and against any Claims suffered or incurred by, or brought, made or recovered by any person against the Purchaser:

resulting from any event occurring to circumstances (including, without limitation, any act, omission, negligence or default of the Vendor) arising before Completion in connection with the Assets or the Business; or

resulting from any breach of this Agreement by the Vendor.
6.4 Purchaser indemnity

The Purchaser will indemnify and keep the Vendor indemnified from and against any Claims suffered or incurred by, or brought, made or recovered by any person against the Vendor:

(a) resulting from any event occurring or circumstances (including any act, omission, negligence or default of the Purchaser) arising on or after Completion in connection with the Assets or the Business; or

(b) resulting from any breach of this Agreement by the Purchaser.

7. NOTICES

7.1 Form of notices

A notice, approval, direction, consent, offer, demand or other communication with this Agreement must be:

(a) in writing;

(b) signed by the relevant person; and

(c) given to the recipient by hand delivery or by pre-paid mail sent to that person or by facsimile transmission to that person.

7.2 Change of details

A Party's details specified in the Schedule may be changed by not less than two Business Days notice to the other Party.

7.3 Proof

(a) Proof of posting by pre-mail is proof of receipt on the second clear Business Days notice after posting.

(b) Proof of transmission of a facsimile message is proof of receipt on the date of transmission provided that if transmission is not on a Business Day or not before 4.00 p.m., then it is deemed to have been received on the next succeeding Business Day after transmission.

8. GENERAL PROVISIONS

8.1 Entire Agreement

This Agreement constitutes the entire Agreement between the parties as to its subject matter and supersedes all prior Agreements and understandings.

8.2 Amendments to be in writing
No amendment of, or addition to, the provisions of this Agreement is binding unless it is in writing and signed by the parties to this Agreement.

8.3 Indemnity

Each indemnity is a continuing obligation, is separate and independent of the other provision of this Agreement and survives the termination of this Agreement.

8.4 Time

Time is of the essence in performing each Party's obligations under this Agreement.

8.5 Costs and expenses

Except as otherwise expressly provided for in this Agreement, each Party is responsible for their own costs and expenses incurred in carrying out their obligations under this Agreement.

8.6 Stamp duty

The Purchaser will pay all stamp duty assessed on this Agreement and the transactions contemplated by it.

8.7 Disposal and Encumbrances

No Party may Dispose of or Encumber its right, title and interest in and to this Agreement without the prior written consent of the other Party, which consent may be refused in that Party's absolute discretion.

8.8 No waiver

(a) No failure to exercise or any delay in exercising any right, power or remedy by a Party operates as a waiver.

(b) A single or partial exercise of any right, power or remedy does not preclude any other or further exercise of that or any other right, power or remedy.

(c) A waiver is not valid or binding on the Party granting that waiver unless made in writing.

8.9 Severance

Each word, phrase, sentence and clause (provision) of this Agreement is severable and if a court determines that a provision is unenforceable, illegal or invalid the court may sever that provision which becomes inoperative and such severance will not affect the other provisions of this Agreement.

8.10 Further assurances
Each Party agrees, at its own expense, to do all things and execute all such documents as may be necessary or desirable to give full effect to the provisions of this Agreement and the transaction contemplated by it.

8.11 Governing Law

This Agreement is governed by and will be construed in accordance with the laws of Victoria and the Commonwealth of Australia.

8.12 Submission to jurisdiction

Each of the parties submits to the non-exclusive jurisdiction of the courts of Victoria and the Commonwealth of Australia.

8.13 Execution

The parties execute this Agreement unconditionally.

8.14 Records

(a) The Purchaser will retain all Records for a period of six years after the Completion Date and the Purchaser will allow the Vendor and its professional advisers (Inspecting Party) to inspect and copy the Records.

(b) Subject to any written Agreement between the parties to the contrary, an Inspecting Party may inspect the Records during the hours of 9 am to 5 pm on any Business Day provided that the Inspecting Party gives not less than 48 hours notice to the Purchaser.

(c) If the Vendor requires the Purchaser to copy the Records, the Vendor must pay the Purchaser's reasonable costs of doing so.

8.16 Confidentially

(a) Subject to clause 8.16(b), the parties must not disclose the terms of this Agreement or any information provided to them in connection with the Assets without the prior written consent of the other Party. This consent may be granted or refused in that Party's absolute discretion.

(b) Clause 9.16(a) does not apply to any disclosure;

(i) required by law or the rules of any applicable stock exchange;

(ii) to the Australian Securities Commission;

(iii) to a Party's professional advisor in respect of any matter arising in connection with the Agreement; or

(iv) where the relevant information is generally known to the public otherwise than as a result of a breach of clause 8.16(a).
8.17 Announcements

Subject to clause 8.16 and except to the extent required by law or the rules of an applicable stock exchange, a Party must not make any announcement concerning the Assets, this Agreement or the transaction contemplated by this Agreement unless the other Party approves the consent and timing of that announcement.

10 EXECUTION

THE COMMON SEAL of )

THE VENDOR was affixed in )

according with its Constitution )

.............................................. .............................................

Signature of Director Signature of secretary

THE COMMON SEAL of )

THE PURCHASER was )

affixed in accordance with its )

Constitution )

.............................................. .............................................

Signature of Director Signature of secretary
SCHEDULE

PURCHASE PRICE

The written down value of the plant and equipment and other assets in the accounts of the Vendor as at 1 January 2007.

PAYMENT

As agreed in writing by the Parties.

DEPOSIT

No deposit is payable.

PREMISES

The premises occupied by the Vendor as its usual place of business.

NOTICES

Vendor: Offices of Terry McMaster, Solicitor

Purchaser: Offices of Terry McMaster, Solicitor

COMPLETION DATE

As at 1 January 2007

CONTRACTS

All contracts with all contractors engaged at the Premise.

All contracts with employees engaged at the Premises.

Any lease over the Premises.

All other contracts held by the Vendor in respect of the practice

SETTLEMENT PLACE

The office of Terry McMaster, Solicitor, 144 Church Street, Brighton, Victoria.

OTHER ADJUSTMENTS

Other Adjustments include a reduction for any expenses incurred by the Vendor paid for by the Purchaser including rates, rent and other occupancy costs and annual leave, long service leave and other employee entitlements.
THE VENDOR
THE VENDOR PTY LTD. with is registered office at 144 Church Street Brighton Victoria

THE PURCHASER
THE VENDOR PTY LTD with is registered office at 144 Church Street Brighton Victoria

BUSINESS
The medical business and related activities conducted at the Premises by the Vendor.

BUSINESS NAME
The Purchaser obtains the benefit of any business name used by the Vendor.

STOCK VALUE
Any amount shown in the Vendor’s balance sheet at the Completion Date.
Appendix 3 Goodwill as a Component of Value

The nature of goodwill
Every successful business enterprise has an inherent component of goodwill. This quality may arise from any one or any number of factors which may be stated:

- Profitability – consistent and continuing;
- Good management;
- Favourable location;
- Sole distribution rights – valuable franchises;
- Capable staff – competent, efficient, courteous; and
- Possession of trademarks, patent rights, copyrights and similar protective devices.

Goodwill, therefore, may be locational, personal or corporate. It could be a combination of all of these. It is a quality difficult to quantify, and in a sense is abstract rather than tangible. It exists whether it is represented in the balance sheet in dollars or whether it is not. In fact, more often than not is has no representation in the balance sheet. It may or may not have exchangeable value. Locational goodwill and personal goodwill may and probably would change with a change of either. It may be purchased or built up over a period within the enterprise.

Definition
It is difficult to define goodwill precisely. Perhaps it is easier to describe it. This appears to be the view expressed in judicial opinions going back to the earliest part of the last century.

As far back as 1901 Lord MacNaghten described goodwill as “the attractive force which brings in custom... goodwill is composed of a variety of elements”: Inland revenue commissioner v Miller & Co’s Margarine Ltd (1901) AC 217 at 224 P D Leake on 1947 described goodwill in these terms (at 21): “Goodwill in its commercial meaning is the transferable right which grows out of all kinds of past effort in seeking profit, increase in value, or other advantage. The term ‘commercial goodwill’ covers the whole field of rights growing out of all past effort of this nature.”

Rich J in the high court made this observation: “To determine the nature of goodwill in any given case, it is necessary to consider the type of business and type of customer which such business is inherently likely to attract as well as all the surrounding circumstances”: F C of T v Williamson (1943) a AITR 454.

He went on to say that: “the goodwill of a business is a composite thing referable in part to its locality, in part to the way in which it is conducted and the personality of those who conduct it, and in part to the likelihood of competition, many customers being no doubt actuated by mixed motives in conferring their custom”.

H E Seed puts it this way (at 8): “Good will is the advantage which arises from the good name, reputation and connection of a business, alternatively the benefit which accrues to the owner of a
business from the likelihood that such business will earn, in the future, profits in excess of those required to provide an economic rate of remuneration for the capital and labour employed therein.” Weston and Brigham in the glossary appended to their book Essentials of Managerial Finance use a specific definition of goodwill in relation to the acquisition of a business and state the definition in these words: “The intangible assets of a firm established by the excess of the price paid for the going concern over its book value”.

In the observations of Lord MacNaughten and Rich J there is an emphasis on the combination of location, personal and corporate conduct.

P D Leake looks more particularly at past performance as a strong contributing factor to existing goodwill. The preservation of goodwill depends on continuity of performance and may quickly dissipate if not nurtured.

H E Seed has regard to the good name and connection which have been built up by performance but looks also to the future and the expectation of continuing profits. He also suggests that the profits must be something more than a mere economic return on investment. As some writers have described it – “the earning of super-profits” the latter being in turn described as “those profits over and above those required to provide an economic rate of remuneration for all labour and capital employed in the business”. The Weston and Brigham definition is entirely relevant in merger and takeover situations where the excess price paid must be featured in the subsequent balance sheets as “Goodwill on Consolidation” or “Goodwill on Acquisition”.

In a “Glossary of Accounting Language” appended to his book Accounting Reports R G A Boland applies a strictly accounting concept to “goodwill”. He describes it in these words: “Value of the name, reputation, intangible assets of a business. In accounting it is only recorded (at cost) when it is purchased; not depreciated; often written off to nil; never valued at market price; generally a hidden asset of the business.”

Some aspects of this definition could be criticised. Sometimes goodwill, inherent in the business, is bought to account and represented in the balance sheet at some selected figure although not purchased. In some cases bonus share issues have been made out of the capital reserve created by the value placed upon goodwill. Admittedly this may not be wise or desirable. As stated by Boland, more often goodwill is seen as a hidden asset. If it is recorded by purchase it is usual to write it off to nil over a reasonable period of years.
Appendix 4 Results of recent sales of medical practices

The following sales are selected because of their relevance to valuation. This appendix is not a complete list of the sales with which we have engaged. We can provide further evidence of the market values of general practice goodwill if requested. Details have been changed to avoid identification, however, all examples are indicative of actual transactions.

Sale 1 2006

5 GP busy practice established for more than 30 years in a fashionable location.

This practice was owned by the one doctor and was making more than $250,000 a year profit. The practice was sold for $90,000 plus plant and equipment to a country doctor coming back to the city. It was offered for sale to the doctors engaged in the practice over the preceding two years but none were interested. Health was a big factor in the doctor’s decision to sell. He was very disappointed with the final sale price. The vendor also received the benefit of a “good” lease of the premises, which are owned by his superannuation fund.

I regard $90,000 as a very low price for this practice, and cannot understand why none of the assistant GPs was prepared to pay a higher price for this practice.

Sale 2 2006

This was the sale of a one quarter interest of a south east suburban practice. One of the 4 owners wished to leave. He was initially offered nil exit price by his ex-colleagues, on the basis that their profits would fall if he left. This was despite having paid $80,000 to join the practice five years earlier. Eventually a sale price of about $40,000 was agreed to, including plant and equipment. The practice did not enjoy a harmonious work environment, and I can understand why the GP wished to leave.

Sale 3 2006

A busy 5 GP practice that was part of a larger group was bought by the lead GP. His consideration was a nominal fee only, as he was required to give up a minority holding of shares in the larger group. It was considered that these shares had nil value because there was no realistic expectation of a dividend for many years due to operating losses.

The larger group was prepared to accept this deal, because it realised the practice would fall apart if the buyer left the practice. This would have left the larger group liable for staff costs and the remaining lease on the building and the plant and equipment. The buyer took over these obligations as part of the practice.

Sale 4 2007

A GP bought a 1/3 share of an outer eastern suburban practice for $50,000. This was after an initial asking price of $100,000 plus plant and equipment. The GP had worked in the practice for a few years, and brought his own patient base to the practice when he joined from a nearby community medicine practice.
We expect the GP to make an extra $30,000 a year as a result of buying in.

**Sale 5 2007**

A profitable 5 GP practice located in semi-rural location was sold to the landlord pharmacist for $180,000. The vendor GP has agreed to stay working there and to pay a 50% management fee for five years, along the lines of corporate sales.

The pharmacist kept the premises occupied, which adds to value, and retained a close source of prescriptions by buying the service trust and then agreeing to provide services to the GPs. The pharmacy is located in the same building.

**Sale 6 2007**

I expect this is the last sale to a corporate health provider that I will see.

A corporate vendor paid $200,000 for the service entity of a large female health practice located in a fashionable inner eastern suburb. The vendor is a fifty year old female GP who has practiced from the site for more than twenty years. The vendor signed a five year service agreement.

The vendor owns the premises and she will also receive the benefit of a very good lease from a public company tenant. This will increase the value of the premises should she wish to sell them.

**Sale 7 2007**

A one doctor practice in a country town sold for $50,000 all up after the untimely death of original doctor. The practice is easy commuting distance from Melbourne and was bought lock stock and barrel as a going concern: a friendly larger local practice staffed it with a GP until a purchaser could be found.

**Sale 8 2007**

A foreign trained doctor bought a 20% interest in a rural practice for $90,000. She will make at least an extra $60,000 a year profit from being an owner. She trained at the practice and had a high regard for the other doctors and was not interested in working at another practice in the region, or moving to another practice.

**Sale 9 2008**

A five doctor practice was for sale in Geelong for $100,000, deferred for one year. The buyer will almost certainly make $100,000 a year from the service trust. No buyer can be found. Apart from the general reasons explained earlier, the particular reason appears to be a concern regarding signing a new lease and concerns as to what would happen if the doctors left the practice.

**Sale 10 2008**

A half share of a Mornington Peninsula practice was for sale for $40,000. It appears that an assistant in the practice will buy the half share for this amount.
Sale 11 2008

A married couple, both GPs, bought a two and half GP practice for $50,000 in Melbourne’s south eastern suburbs. The vendor GP sold on a walk in walk out basis and immediately returned to the UK. The purchaser’s also bought the building for $450,000. The practice is well located on a main road and is quite profitable.

Sale 12 2008

A doctor in Queensland bought a ¼ share in a semi-rural practice for $10,000. The vendor doctor left the area six months earlier and the remaining 3 owners invited the purchaser to join the practice after working there as an employee for 12 months.

Sale 13 2008

A large practice in eastern Melbourne bought a local three doctor practice for $30,000. The vendor doctors are in their sixties and will continue to practice at the site indefinitely. The adjustment for employee’s long service leave and similar entitlements was more than $30,000, meaning the vendors paid money to the purchaser on settlement date.

Sale 14 2008

A very large medical centre (20 consulting rooms) in an outer eastern suburb in Melbourne sold for $1,400,000. The sale price was made up of $1,200,000 for the building and $200,000 for the practice. The vendor is not a GP and was earning $200,000 a year from running the service entity.

Sale 15 2009

An established one doctor practice in Melbourne’s south eastern suburbs closed its doors and moved in with a larger local practice after a failed sales program. The owner was not able to sell the practice to another GP.

Sale 16 2009

A 35 year old one doctor practice in southern NSW with total patient fees of $600,000 and low costs sold for $450,000 including all plant and equipment and the surgery premises. The vendor believes the goodwill component is about $60,000. The practice is very profitable and the purchaser is expected to make more than $400,000 a year profit.

Sale 17 2010

A half share of a well established outer suburban practice owned by a female doctor was sold for $140,000. The vendor was making more than $400,000 profit.

Recent formal valuations by McMasters

January 2009
The goodwill of a 6 doctor practice in Melbourne’s outer north western suburbs was valued at between $100,000 and $150,000. Plant and equipment was valued separately.

The valuation was required to assist in a legal action between the unit holders.

**February 2009**

The goodwill of a 10 doctor practice on the NSW central was valued at between $150,000 and $200,000. Plant and equipment was valued separately.

The valuation was required to assist in valuing the practice prior to admitting a new owner.

**May 2009**

A Queensland GP bought a practice on the Gold Coast for $30,000, including all plant and equipment, patient files, computer systems and staff, including a full time assistant GP, with another full time assistant GP (FTD) expected to arrive soon.

**May 2009**

A Melbourne outer eastern suburbs practice was offered for sale to a client for $10,000. We advised against purchasing the practice on the grounds that there was insufficient room for growth, with just two consulting rooms and one procedure room.
Appendix 5 Capitalisation of future maintainable profits (FMP)

Extracted from The Valuation of Businesses, Shares and Other Equity by Wayne Lonergan, published by Allen and Unwin 2003

For industrial and commercial entities, it is generally assumed that they will have an almost infinite life. It is also considered too difficult and subjective to make forecasts of future cash flows for any more than a small number of years in the future. In the alternative, even if this information is available for the entity being valued (such entities are usually companies, but may include trusts, joint ventures, partnerships etc.), it is normally very difficult to obtain cash flow information for other entities for the purposes of comparison. Therefore, it is usual in valuing an ongoing entity to estimate a figure for FMP as a surrogate for the future cash flows and to multiply this earnings figure at an appropriate price earnings ratio (PER). This process of multiplication is called the “capitalisation” of FMP.

The risk and real growth prospects associated with the FMP are taken into account in setting the PER. The appropriate PER is normally based on industry norms in the marketplace, adjusted to reflect the unique circumstances of the company or business that is being valued.

Where the assessment of the fair market value of an entity is undertaken by reference to the capitalisation of its underlying profitability, this will initially entail the valuer determining the core underlying profits or the FMP of the entity. These profits do not necessarily represent either the latest historical, or immediate forecast earnings. For example, a company may be in a position of short-term decline, either as a result of industry pressures, or internal managerial difficulties, and it is therefore important that a long-term view be adopted that discounts any short-term irregularities in profitability. In valuing on the basis of the capitalisation of FMP, the value of the underlying net assets will also be reviewed, although this is normally only to ensure that the profitability of the entity will be maintained in the future and to assess the implied value of goodwill.

The capitalisation of FMP is very widely used as a valuation method. This is primarily because of the widespread availability of information about comparable transactions.
Appendix 6  Sample short form valuation letter

1 November 2010

Dr John Smith and Dr Betty Blue
Red Centre Medical Pty Ltd
5 Smith Road
Smithsville 1234

Dear John and Betty

Valuation of the Red Centre Medical Practice (‘the Practice’)

I have been asked to value the Practice and to this end I have reviewed the Practice’s financial accounts, considered its history and the current state of the market and in particular comparable transactions and the attitudes of potential purchasers.

In summary, I believe the Practice has a market value of between $250,000 and $350,000, including all plant and equipment and the value of its fit out, on a walk in walk out basis.

General practice goodwill values are very low. There are many reasons for this, and ultimately they relate back to demand and supply. There is a shortage of GPs, particularly GPs who want to own practices, and virtually any GP who sets up a practice will be instantly busy, and profitable. The cost of setting up a practice can be as low as $80,000, with brand new equipment, and a good lease. So the set up costs of an alternative provide a natural cap, or base, for valuing the Practice.

In your case I am influenced by the higher than usual plant and equipment costs, and the fact that there are significant fit out costs and similar costs in the balance sheet. A reasonable purchaser would be prepared to take over the benefit of these expenditures as they will enjoy the benefit of a well presented physical practice and avoid having to spend a larger amount themselves to complete the picture.

Your Practice is more profitable than most, with less owner hours worked each week than many. Financially it’s quite good, and I expect the non-owner GPs and the practice nurses are contributing here. However, the Practice’s profits depend on your continued presence, efforts and energies and do not represent a secure, passive income stream for a potential purchaser. One option to consider is selling say a 25% interest to a new owner. Here, because of your continued presence and contribution, a value of up to around $150,000 may be achieved, which equates to a value of $600,000 overall. But I stress this is not on a walk in walk out basis: you will need to sign a co-owners’ agreement securing the efforts of all owners into the future. I like this option because it has the added advantage of increasing the overall profits of the practice: the new owner’s billings will be virtually all profit as there are few extra variable costs connected to a new owner. The challenge will be identifying the right GP.

I attach a copy of an Australian Doctor article and a Medical Observer article concerning general practice goodwill valuations. Their content is consistent with my thoughts.

I trust the above thoughts are of some interest and assistance. Please do not hesitate to contact me should you wish to discuss them or require any further assistance.

Yours faithfully

Terry McMaster
Director