

## Issue Stories

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### For Sale. Your Sleep Lab?

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**Make the right decisions when selling your sleep lab.**



Selling your business is a big decision involving numerous parties and possibly large sums of money. Parting with your business may be difficult in light of your vested interest in your employees, community, and industry. The time and effort it takes to build a business could take decades, and letting go of the company involves emotional and financial considerations. If you are contemplating the sale of your business or think you will come to that fork in the road, you'll be at an advantage if you know what to expect and how best to prepare for this critical business decision.

When pondering the sale of your lab, one of the first questions to ask is: Do I need to sell my lab or do I want to sell my lab? If you find that you are in debt, cannot pay all the bills, have HR problems all the time, and you just want to get out, you probably need to sell, and that is far more of a disadvantage when selling.

But let's say that you are not in any real trouble; you feel that you have built significant value, and now you want to sell. If so, you must have your expectations in line, or the entire process will become even more frustrating than you can imagine.

**The first thing to know is that the process is going to be longer than you expect.** You should think in terms of months, not weeks. Buyers sometimes use "deal fatigue" to their advantage by extracting big deal terms from sellers in the home stretch when the seller "just wants to get it done." You must be prepared to walk away from the deal one or more times if the terms aren't acceptable—even if you have many months invested in the transaction.

**Legal articles available in *Sleep Review's* online archives.**

**Next, be prepared to spend money to sell your lab.** Often a buyer will require an audit. This means getting the books ready, cleaning up the HR problems, and, in some cases, doing work on the actual physical aspects of the labs. You also will need to hire an attorney to review the structure of the deal. Lawyers bring value by advocating the legal, reimbursement, tax, and other transaction aspects in your favor—but they are not cheap. Shop for counsel knowledgeable in health care transactions and clarify payment terms up front.

**Finally, you need to have a plan for what you are going to do when the deal is complete.** What are you going to do afterward? Are you going to continue as an employee? Are you going to start another business? These are all questions that need to be answered in order to move forward comfortably.

## PREPARING TO SELL YOUR SLEEP LAB

### Structuring the Transaction

Prior to making your sale decision, you must have a clear business goal for the transaction. You should then communicate that goal to your accountant, lawyer, and business broker who can assist you to arrange a legal transaction structure that will best meet your business objective.

Failure to posit your business goal into the legal structure could cause you to pay for unwanted tax or business liabilities after the sale—liabilities that proper structuring may have easily prevented.

### **Stock or Asset Sale?**

The threshold decision is whether the lab will sell some or all of its specified tangible and intangible assets (an asset sale) or whether the lab's stockholders or limited liability company members decide to sell all of their equity interests in the entity that owns the lab (a stock sale).

Which structure is preferable? Buyers typically prefer an asset sale. That way they can strip out the lab's liabilities (the bad apples) and walk away with the healthy assets. However, in health care, buyers may prefer a stock sale to continue the lab's licensure or reimbursement arrangements in the target's name. Sellers, on the other hand, usually insist on a stock sale, principally for tax reasons. Sellers who sell stock or other equity interests will likely pay taxes on the sales proceeds at the lower capital gains rate than if the sale's proceeds derive from the sale of individual lab assets.

### **Pricing the Lab**

A typical baseline method for valuing an ongoing business is to apply a multiple (such as two or three times) of the annual earnings of the business. Earnings are measured by an accounting formula known as the seller's "EBITA" or "EBITDA:" the "Earnings" generated by the business "Before" taking into account the organization's "Interest" expense, "Taxes" (for EBITDA, also "Depreciation"), and "Amortization."

As an example, assume your lab's EBITA is \$250,000 and labs in your area are fetching a multiple of two to two and a half times EBITA. You could reasonably set a purchase price of \$675,000, depending, of course, on a wide array of circumstances particular to your lab. Buyers will learn the contours of these individual situations through buyer's due diligence review. The positive or negative effect of these unique conditions will operate to increase or decrease the value of your lab through the party's ongoing negotiations until execution of a definitive sales agreement. Your accountant, investment banker, or business consultant can all assist to determine the EBITA and price for your lab.

### **Purchase Price Payment Choices**

The parties' agreement on the purchase price should reflect the method for paying the price. The parties can bargain for a range of options: all cash, stock plus cash, or an earnout.

Note that while earnouts may be customary in many industries, they can prove difficult in health care transactions—especially if the seller is a referring physician who derives a direct economic benefit for referring more and more Medicare patients to the lab. Parties considering earnouts involving government reimbursement should consult with a health care attorney prior to agreeing to such a structure.

## **BARING ALL IN DUE DILIGENCE**

Once the letter of intent is signed, the buyer will want to examine the seller's goods in explicit detail.

The buyer's pursuit of their due diligence review is often the most unexpected—and unpleasant—part of the seller's business. The buyer and their team of attorneys and accountants will request copies of all formation documents, minute books, employment arrangements, reading agreements, leases, debt documents, equity terms, financial statements and projections, accounts receivable and collection history and aging, licenses, referral patterns, litigation, and government investigations.

### **Who is interested in buying your sleep lab?**

- New publicly traded companies
- Privately held large companies
- Venture capital-funded companies
- Labs just getting into the business
- Branches of larger companies
- Regional players

As part of the due diligence review, some of the business aspects common to sleep that you can expect to be analyzed include:

**The scope and quality of your reimbursement agreements.** Which insurance companies do you have contracts with and when are they up? Ideally, you want a good long-term contract with at least a 2-year guarantee of pricing.

**Geography.** You want a buyer who not only wants to be in your area but needs to be in your area. Good prospects are those companies that have labs in all of the areas around you, but it is cost prohibitive for them to "grow their own lab." Prospects also include buyers looking for a hub in a particular area and who want to grow labs around this central location.

**Reimbursement.** Are you in a part of the country that has higher reimbursement than another? If you are in a rural area, this could mean that you have better rates and thus more value.

**Ancillary revenue.** Do you do your own DME? If the answer is no, you probably should not start this as a business just to sell your lab, but if you do, then it is an additional asset that could lead to a higher price and better terms.

**Accreditation.** Accreditation adds value for two reasons. First, it lets everyone know that you operate under certain known standards and quality. Next, it ensures that insurance companies will not turn to your lab in the future and give "lack of accreditation" as a reason for less than acceptable reimbursement.

**Doctor reputation and goodwill.** The real issue here is if the doctor or technologist has a poor reputation, in which case there is an image issue that the buyer will have to overcome to get that business back to the lab. This will take a significant amount of time and money and may be a contingent factor in the sale.

The decision and process of selling your business can be overwhelming, but it doesn't have to be. Ask the right questions, develop your goals, and surround yourself with the appropriate legal and financial experts. Taking these steps will help you move forward with confidence and close the deal knowing that you never have to look back and question the decision to sell.

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