Bill and Jane vs Fastee and Cleopatra

By Graham Middleton, BA, MBA

"It is apparent that those dentists who concentrated on purchasing their own homes and reducing their mortgage as well as purchasing practices.. as a group are far better off..."

Bill and Eddie graduated in the same dental class in 1988, both aged 23. Bill was a pleasant personality, tending to be conservative in his views. Eddie was eclectic in his tastes and left the class in little doubt that he intended to be successful. He regularly reminisced about the toys he would like to own. He undoubtedly spent too much time looking at magazines featuring expensive cars, European ski resorts, scuba diving in the Caribbean and the like, rather than on his dental studies, but he had a good brain and was always going to succeed on the course. He became known as Fast Eddie, which got shortened to Fastee. Bill stayed straight Bill. He was attentive to the course and the examiners and demonstrators thought he had the makings of a good dentist.

Given the demand for dentists back in 1988, both Bill and Fastee had offers of employment well in advance of graduation.

Bill joined a practice which exhibited the qualities he sought. It was run by a pair of experienced dentists who did good work, but who stayed a little behind the leading edge of dentistry, not wishing to be seen as exploitive.

Fastee joins Dasher

Fastee was attracted to a practice conducted by Dashing Dennis, or Dasher as he was known by his peers. Dasher often bragged about being on the leading edge of cosmetic dentistry. He told Fastee that he could outsell any other dentist in the city, if not the whole of Australia. Behind the scenes, Dasher had had a couple of uncomfortable visits to the Dental Board, who had warned him that further transgressions would involve him being suspended for a lengthy period. These things were hinted at in dental gossip. Dasher had also presented himself as an authority who could persuade other dentists to be successful like him. He even set himself up as an expert who could point out the advantages and disadvantages of various dental corporates trying to consolidate practices. His authority diminished when dentists found out that Dasher had failed to tell them he was personally associated with a corporate he had been recommending to dentists but that was still in the future.

The practice owners who employed Bill were experienced, competent dentists who ran a successful practice but were careful to advise clients and lead them through their treatment plans. They had earned the trust of their patients and patients were happy to accept their advice. Theirs was considered a leading practice and they had the respect of their peers. They recognised the potential in Bill and were happy to mentor him and encourage him to gradually expand the boundaries of the dentistry he was prepared to practice. They also encouraged him to attend in service courses. However, they had a poor view of dentists like Dasher, who they considered to be unprofessional in their mode of practice. Neither practice were preferred providers to health funds.

Conservative financial decisions vs spendthrift

Bill bought a modest car and was a natural saver. Fastee fed off Dasher's hubris and put a deposit on a much more expensive vehicle with significant monthly payments and a large residual at the end of the contract. Fastee also started dating Cleopatra, an attractive marketing consultant for a leading fashion brand importer. Cleo, as she was known, had expensive tastes so long as her beau of the moment was paying. Fastee's gross fees and dental commission were growing, even though the patients he saw were the ones Dasher couldn't fit into his own surgery. Dasher's receptionist had antennae capable of picking out candidates for his sales pitch, which invariably ended with a prospective patient signing up for an extensive makeover as well as signing up for a financing package, the applications for which were readily available in the practice with assistance in completing.

However, there were still enough not quite so lucrative patients being directed to Fastee, as well as some routine dental cases. Overall, he was able to generate higher fees than anybody in his graduating class at this early stage of their careers.

Despite his income, Fastee was always struggling to make his car payments and keep his credit cards under control. He consoled himself that one day he would succeed to Dasher's lucrative income, so could afford to spend his money faster than he earned it.

Bill had met Jane, who had graduated from university and had entered a business conducted by her family. The business was stable, but while it provided a steady living for family members, it was never going to make them rich. In Bill's third year after graduation, they married and put a deposit on a modest home about 25km from the CBD. They decided they would live on Jane's salary and put all Bill's earnings towards a rapid reduction in their home mortgage, but making modest superannuation payments.

Their financial adviser pointed out that if they could double their monthly payments on their home, their mortgage repayment schedule would shrink from 25 years to a little over seven years and if they increased it to three times the bank's mandated monthly payments, this period would go down to 52 months.

Their adviser also pointed out that when they had sufficient equity in their existing home, they could contemplate selling it and purchasing a home in an attractive professional suburb nearer to the CBD. This would be their long-term home. It would also be close to future private schooling options for their kids. He also said they could realistically afford to purchase a home which they could comfortably pay off inside 20 years; the reality was that those who purchased homes which they couldn't pay off in that time were usually paying too much, and put themselves under unnecessary financial strain, whereas those who could pay off their homes much quicker than that were probably buying too low in the market.

Fastee and Cleo's lifestyle

Meanwhile, Fastee and Cleo were living in a relatively high rent townhouse close to Dasher's practice. While Cleo earned an above average wage, it all seemed to get spent on clothes, jewellery, entertainment and personal items. She drove a sporty car and made very little contribution towards their joint expenses. Fastee's expensive car now had a few scratches and dents and was still being paid for. While his earnings were steadily increasing, his expenditures seemed to absorb all his income. His superannuation contributions were limited to the superannuation guarantee levy amounts, as were Cleo's. He made enquiries of Dasher as to when he was likely to retire. Dasher was careful in his replies to keep Fastee enthused, but was vague about when this might be or how much he was expecting Fastee to pay. Fastee's sales technique had improved under Dasher's guidance and while much of the dental profession now looked upon Fastee and Dasher with disapproval, that didn't worry them.

Bill's associateship

Meanwhile, the two dentists employing Bill had offered him a one-third associateship at a reasonable price. The purchase was endorsed by his adviser and he was able to borrow the acquisition price on interest only terms because his bank linked the loan to the increasing equity Bill and Jane had in their recently purchased second home, in which their payments were rapidly diminishing the mortgage. The interest on the practice acquisition loan was tax deductible, which made the net post tax cost much cheaper than the interest on their home loan.

Structuring Bill's associateship purchase

Bill structured the purchase of his practice associateship in such a way that Jane could access part of the income. They were also able to step up their superannuation funding.

Not only did Bill and his associates refuse to become preferred providers, they recognised that there was a long-term danger posed to dentists by health funds and with tasteful literature and personal advice from practice staff, they educated their patients concerning the blatant rip-off posed by health funds' ancillary/extras policies. They attracted plenty of good patients not tied to large health funds and their strategy ensured that in the long-term, their practice remained free of health fund influence.

Buying more of the practice

By the tenth year after graduation, Bill had been a practice owner for three and a half years. The three associates had been able to employ a hygienist and in due course Harold, one of the older associates, indicated he wished to retire. Richard, the other older associate, indicated he too wished to retire in a couple of years and wasn't interested in buying Harold's share. Bill arranged to purchase Harold's share of the practice and by agreement with Richard, personally employed a young dentist in Harold's surgery. He was now a two-thirds owner in the entire practice, with Richard one-third. The hygienist was jointly employed, basically to do work that Bill and Richard didn't want to fill their own lists with. Bill's skill level had expanded and he had great hands. He was now easily the top fee-generating dentist in the practice. Mortgage payments had been accelerated and both he and Jane had maximised their concessional contributions to superannuation and were even managing to put in a little extra in the way of non-concessional payments. They had now graduated to having their own superannuation fund administered and advised by their long-term advisers, who had guided them through the two steps in the practice purchase to date.

Fastee's get-rich investments

Meanwhile, Fastee had been looking for ways to overcome his lack of wealth. He shopped far and wide for advice and received an array of conflicting advice. In the end he decided to follow a mixture. Each of the advisers had a way for him to borrow money and get into their particular investment schemes. As a result, Fastee and Cleo ended up with:

a. A couple of high-rise apartments bought off the plan with a mainly borrowed deposit and the remaining 90% borrowed on completion. Little did they know that the accountant who introduced them to a property sales organisation got a nice kickback on each sale to someone he had introduced;
b. $600,000 of eucalyptus trees in Great Southern Plantations sold with the apparently caring advice of an accountant who covered a whiteboard with figures and arrows showing tax loops that neither Fastee nor Cleo understood. Buried in the back of the documentation they received was a statement indicating the advisor (introduced by their accountant) was to receive 5% of the large sum of money being invested and had the prospect of a further 5% if the advisers met their sales target and received a volume bonus. Fastee and Cleo didn't read the detail and signed up without realising 10% of the sum they borrowed went straight to the advisers; and
c. Their accountants persuaded them to buy into an olive plantation, which the accountants themselves were the managers and promoters off. The accountants also arranged the finance.

As both Fastee and Cleo were competent salespersons in their own right, they should have recognised that what they'd received was a series of clever sales pitches rather than sound advice, but they failed to pick up the signals.

Bill and Jane had asked their financial adviser whether they should contemplate these types of investments, as people around the dental circuit were talking about their plantation investments and rental apartments. Their financial adviser explained why each of these asset types was fundamentally flawed and did not meet the quality control tests of sound investments. They decided not to pursue this line of thought.

Dasher sells to Fastee

Meanwhile, Dasher had finally reached a decision point in his life and decided to sell his practice; although he did not disclose that this was being hastened by complaints about his treatments, which were inevitably leading to another appearance before the Dental Board. Dasher had come to the realisation that it was time for him to sell and to hand in his dental registration, thereby pre-empting a probable board finding against him.

Dasher offered to sell his practice to Fastee, but Fastee had a problem raising the money. Eventually, by stretching the truth about their assets and liabilities and with an amount of vendor capital left on loan by Dasher, they were able to make the purchase. There was a pleasing jump in income, but Fastee's temporary joy was tempered by a notice to appear before the Dental Board. In his case, the complaint was relatively minor, but the board, aware that he had bought Dasher's practice, was determined he receive a stiff warning leaving him in no doubt that if he had to appear before the board in the future, he might face a lengthy period suspended from dentistry. That would be financially disastrous for him. Still, his income was about two and a half times the average of his dental graduating class of twelve years ago and although all of his and Cleo's assets were financed by debt and many of the assets were of dubious value, he looked upon the future with a smile.

Bill now owns 100%

By this time, Bill had bought out the remaining associate, Richard. He had two good dentists and a hygienist working for him and was personally the most profitable fee generator in the practice by a big margin. His advisers pointed out that the lion's share of profit in the practice came from the amount of good work which could be generated in the owner's own surgery.

Their superannuation fund was coming along nicely and the mortgage on their home was now down to about 55 monthly payments at the rate they had been paying it down. Additionally, their home had appreciated significantly in value. Although they had two young children, Jane was still involved in her family's business and she was frugal by nature.

They had progressively financed the goodwill acquisitions in their practice with interest only debt, but given the rate of paydown on the mortgage of their home, which had itself appreciated substantially in value, they were considered by the bank to be A-grade borrowers. They had also done tasteful renovations.

The high-rise market crumbles

There were beginning to be rumbles about property spruikers in the press and high-rise building was in one of its periodic downturns. Bill heard rumours about various dentists who were caught up in a variety of schemes and knew some of them. He wasn't surprised to hear that Fastee had been involved.

Bill buys practice premises

Bill had obtained an option to buy the dental premises from the previous practice owners. After careful thought and realising that ownership meant renovation was going to be cheaper in his existing premises rather than having to plumb, wire and fit out new premises, he decided to purchase.

After considering the long-term aspects of both practice and premises being "active business assets" for the purposes of future capital gains tax, Bill and Jane decided not to buy the premises inside their superannuation fund but to own them direct. They conducted a modest refurbishment to maintain a good appearance to patients. The interest on their loan was no more than the rent they had been paying and indeed at the normal rate of increase of rent they quickly found themselves better off.

Good tax planning

By licencing the goodwill of the practice to a company, Bill and Jane had been able to push back some of their personal income tax by the timing of franked dividend payouts to themselves. They were now regularly topping up their superannuation fund with both personal tax deductible concessional contributions to their permitted limit and additional non tax deductible contributions. Their financial advisers were relatively conservative and the fund was growing steadily.

Fastee has to find new premises

After several years of practice ownership, Fastee received a shock when his landlord indicated they would not be extending the lease beyond expiry date, as the building had been sold to a developer who planned to demolish it and erect a high-rise building. Fortunately, he received a temporary reprieve when the developer indicated it would take at least two years to get all the plans and approvals in place. In the meantime, they were happy to have Fastee's practice continue to pay rent but they would not grant a long-term lease.

Although Fastee was able to find other premises, the rent was significantly higher and he got a huge shock when a new fit-out was costed at $850,000 for the type of layout and appearance Fastee thought was essential to his being able to sell to his type of patients. It was a huge expense for what was a two-dentist, 3-chair practice but was designed to be a selling environment.

Home equity

Fastee and Cleo had bought a home, but it was far inferior to that which they aspired to and they owed 90% of the purchase price of $1 million.

Meanwhile, Bill and Jane had done some renovations on their home and had extinguished the home loan debt, keeping only a redraw facility for emergencies.

Their home was now worth $2 million.

The dental practice was turning over $2.2 million, with Bill doing $800,000 in his own operatory. Dentist 2 was doing $600,000 and Dentist 3 about $500,000. A hygienist made up the balance. Bill made a huge margin in his own operatory. Dentist 2 produced about 10% profit and Dentist 3 about 6% profit.

The premises Bill and Jane had bought for $850,000 and given a modest renovation to had been revalued in the current market to $1.3 million. Bill and Jane now had $1.3 million in their super fund and at their current rate of both concessional and non concessional contributions, it was now growing rapidly.

Fastee's bleak finances

At this point, about 20 years after dental graduation, Fastee and Cleo's assets were:

1. A modest home worth $1,000,000;
2. An upmarket practice which they thought to be worth around $1.4 million but which would be a difficult type of practice to sell;
3. Two high-rise apartments which had fallen in value and which, after offsetting the loans against them, had zero equity and were costing them money because the net rental did not meet the interest on the loan;
4. A tree plantation which had given some temporary tax relief but which now appeared to be worthless. Enquiries revealed there were no buyers for the older timber lots and that entire industry was in trouble. In fact, the whole timber lot plantation industry was receiving negative publicity and there were uncomplimentary press reports specifically referring to Great Southern Plantations, which was threatened with liquidation. They still owed $500,000; and
5. Enquiries of their accountants who had sold them into an olive grove investment revealed that investment was struggling. They had been asked to tip in a little bit more money to meet temporary shortfalls and a number of investors wished to exit but there were no buyers except possibly at a fire sale price. In effect, they were locked in to an unprofitable investment owing $400,000.

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They were advised it was best to keep the investments and maintain tax deductibility of interest on the various borrowings. All of that looked bleak.

Meanwhile, they were two years into a chattel mortgage on a lavish fit-out costing $850,000. The monthly payments of $15,200 were a huge impost on top of the interest payments on the olive grove, eucalypts and high-rise apartments plus practice goodwill and they still had a home loan. In truth, at this stage, Fastee and Cleo's debts exceeded the realisable value of all their saleable assets and they had only $300,000 of superannuation between them.

Prologue

By their 28th year out of dental school, Bill is considering when to sell his practice to two good employee dentists then working for them for several years on a declining-time basis to allow him to fade into a comfortable retirement with Jane. After 28 years, Bill and Jane have net assets of $9 million and this is growing at a healthy rate. Their children have grown up and left home and they can afford overseas holidays of their choice.

Meanwhile, Fastee and Cleo had realised belatedly that they had made major mistakes early in their working lives. Fastee realises he will have to work hard for as long as possible in practice and he is also facing up to the fact that younger, well-presented competent dentists have invaded his former upmarket dental space in large numbers. It's getting much harder to sell his still impressive skills to patients, but he and Cleo have net assets of only $1.5 million, including their home. They still have significant debt and they don't own their dental premises. Their options look pretty ordinary.

The big lessons of 29 years

Having advised dentists for the last 29 years, it is apparent that those dentists who concentrated on purchasing their own homes and reducing their mortgage before mostly trading in their initial home to provide equity in their long-term home, as well as purchasing practices and practice premises and who were able to share income with a spouse, are as a group dramatically better off than their colleagues. This former group also have substantial superannuation savings. By contrast, their colleagues who have made a series of random financial decisions, including purchasing the aforementioned residential rental units, timber investments and olive groves, as well as hobby farms and beach houses, are as a group much worse off financially than their more conservative colleagues. Being well aware of the assets and liabilities of them, I've seen with my own eyes the empirical evidence of the soundness of a strategy involving home, practice, practice premises and superannuation fund assets prioritised over random assets.

About the author

Graham Middleton personally has been advising dentists on strategic, practice management, valuation and conflict resolution processes for 27 years, the last 20 as a founding partner and director of Synstrat Management Pty Ltd and Synstrat Accounting Pty Ltd. He was once a regular army officer, and later Director Human Resources Manager, Attorney General's Department of Victoria. He is considered an expert on dental practice valuation and practice performance benchmarking. He has spent many years advising dentists in respect of their business and financial strategy and measuring their practice and financial performance. He is the author of Synstrat Dental Stories, the Synstrat Guide to Practice Management, 50 Rules for Success as a Dentist and Buying & Selling General & Specialist Dental Practices. He is a long-term contributor to the Australasian Dental Practice magazine. The Synstrat Group is an independent data-based organisation providing management, benchmarking, valuation, financial and accounting services to the dental profession. Synstrat Management Pty Ltd is a Licensed financial services company. Both Synstrat companies are owned by the same directors who work within the Synstrat Group. For more info, call (03) 9843-7777, Fax: (03) 9843-7799, email dental@synstrat.com.au or see www.synstrat.com.au.

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