



S Y N S T R A T

Purchase and Sale of Dental Practices and Things That Happen

Preferred Provider Trap # 1

A well established and nicely profitable practice in a middle class suburb has been well managed. In addition to the owner, two experienced dentists work about three days each per week. For personal reasons, the owner needs to sell the practice and move. The new purchaser immediately turns it into a preferred provider. The other two dentists refuse to work under preferred provider rules, and move on. Other staff follow them out the door. A year later most of the pre-existing patients have gone elsewhere. The practice is no longer recognisable and the purchaser finds that he has destroyed his goodwill value.

Preferred Provider Trap # 2

A practice which has evolved as a preferred provider for many years comes onto the market. A series of potential dental buyers look at the practice, but on learning that it is contracted to health funds immediately discontinue their enquiries. The practice is extremely difficult to sell.

Preferred Provider Trap # 3

A dentist had spare capacity in her practice and signed up to be a preferred provider but mostly the patients were her own. Over a few years a greater proportion of patients became health fund patients, and her practice became overly busy. She decided to discontinue her contract with the health fund. The health fund advised her patients that she was no longer an approved dentist. This was interpreted in the community as though her practice had seriously failed to meet required standards. Lots of patients went elsewhere.

Preferred Provider Trap # 4

A health fund in a particular state had a relationship with most dentists but did not impose preferred provider conditions. It preferred to meet regularly with the local ADA sub-committee.

Suddenly and without warning, the fund announced that dentists had to become preferred providers or their rebates would not be increased. The announcement led to most dentists refusing to deal with the fund. Those who chose to become its preferred providers got more patients in the short term, but in the longer term their patient goodwill will be totally captive of the health fund concerned. Dentists in that state no longer trust the health fund concerned.

Embellished Figures

A young dentist seeks to buy a practice. The vendor presents her with a summary of figures for the past three years, but not the actual financial accounts or the actual tax returns. After purchase it becomes apparent that the fees are light on, and the expenses are significantly higher than represented in the sanitised financial summaries. The buyer has been conned. It doesn't happen too often, but we are aware of instances where it has happened.

At Synstrat, when valuing practices we insist on the actual financials as prepared by the vendor's accountant. Where representations are made that particular costs are of an elective nature, we consider the argument put forward and we also consult our own database before advising what allowance we are prepared to make in a valuation.

Privacy Issues!

Don't be conned.

Sometimes a vendor or their accountant try to avoid releasing the actual financials to a buyer's valuer on the grounds that they contain personal information. This inevitably turns out to be nonsense. Frankly we're bored witless by the inclusion of a rental property or Telstra shares, or travel costs for a dental conference at an exotic location in a dentist's financials. These things are easily adjusted out, but we need to see the whole financials in order to provide an appropriate professional service to both buyers and sellers.

A vendor who refuses to release full financials for a valuation is usually trying to cover up something negative.

Are Employed Dentists Entitled to a Concession on Practice Goodwill Purchase?

Generally the answer must be no. If the employed dentist were paid fairly to work in a practice, their employer is under no other obligation, be it either legal or moral, to sell them the practice at below market price. A corollary is that dentists working in a practice usually have the easiest take up of patients where they have already had a significant presence. They also have an advantage in being familiar with much of the detail of how the practice operates.

Why Do Corporates Pay a Premium?

The simple answer is because they've got no choice.

The only way a corporate can gain control of a significant number of practices quickly is to offer more than the market would normally pay.

- They also have to pay more because they're not only buying the practice but usually they are binding the vendor dentist to continue to work in a practice for several years. They are also binding the vendor dentist to provide ongoing managerial responsibility for the practice without extra pay. Therefore they are placing a lot more obligations on the vendor than is the case in a normal sale between two dentists where the vendor dentist typically leaves the practice after a modest handover period.
- Where significant elements of the payments are deferred to the end of the employment period there are additional factors:
 - a. The money has a time value and therefore deferred payments must be discounted back to their net present value.
 - b. There is a risk that the corporate may not be in a financial position to pay out the remainder of the contract at the end of the period. This requires further discounting. In debt markets, debt instruments are credit rated and sell at discounts depending upon the rating. Deferred obligations to vendors usually rank below bank borrowings.
- Where, as is often the case, part of the consideration of purchasing a practice is in share scrip, that value must also be discounted. The reason that some share consideration is being offered is that the corporate bankers refuse to provide 100% financing in cash. Therefore shares are offered as a second best alternative. The shares carry the risk that the company may not get to an IPO or may not get to an IPO in the timeframe originally envisaged, or that the IPO may strike a bad market, or that profit projections may turn out to be inaccurate.

If the condition of the buyout is going to place the shares in escrow for a period of time then the value must be further discounted, as there is a risk that the share values can fall during the period in which you are not allowed to trade them.

Some of the headline figures on corporate buyouts look much more impressive than they are, when evaluated using proper economic principles. Reducing them to net present values, risk weighting deferred payments, risk weighting share scrip and costing out vendor's labour inputs often reveals them to be fairly ordinary.

Are Young Dentists Better Off Buying Their Own Practices?

Provided that they've gained sufficient experience working in a privately owned practice and are prepared to work hard, the answer is yes. In the long term most practice owners are financially better off than they would be as employees. Not only are they rewarded for their dentistry but they gain the satisfaction of building up their own practices. Potentially they can also own premises and employ their spouse. Building up their own practice is a lot more satisfying than working to make a remote CEO of a corporate look more profitable.

Where Are the Good Practices?

They're widely dispersed, and many of the most profitable practices are in outer suburbs of capital cities or in regional centres and country towns, as well as in cities without dental schools, such as Hobart and Darwin.

How Do You Find a Good Practice to Buy?

A good practice won't find you unless you're already working in it. The popular listings of practices for sale tend to collect all of the practices that nobody wants to buy. On close inspection many turn out to have serious problems, and have often been on the market for a period before they went to the listing service. You ask your boss, you enquire among your dental study group and you approach older dentists direct. It may take time but if you're prepared to put in the hard work you'll end up finding a good practice for sale. Be prepared to look outside of your desirable home area.

Ambitious Dental Graduates

New graduates who aspire to ownership of a good practice need to think about their career preparation carefully. Their best option is to seek employment in a well thought of privately owned practice. This will introduce new graduates to much of the experience necessary to conduct their own practice in the future. This experience cannot be gained working for a health fund, a government clinic or working for a corporate, nor can an academic course give you the essential feel for running your own business.

Equipment Valuations – How Credible?

There's a wide gap between what a second hand dealer might pay for an item of dental equipment and what a dentist would have to pay for a similar article if purchased second hand. That's because dealers have to maintain a wide margin as they have a carrying cost and sometimes items don't sell easily. Many items, in particular furniture, have a limited second hand market. The only time a complete practice suite of equipment, furniture, fixtures and fittings is sold is when a practice changes hands.

The correct way to value a practice like other businesses is based on its proprietorship, which comprises equipment and goodwill valued as a single enterprise. It is a mistake to value equipment separately and usually costs the vendor extra tax.

Matrimonial Property Disputes

It is critical that if appointing a joint valuer that the person or organisation doing the valuation has lots of experience doing actual dental practice valuations. The requirements to doing a valuation are to have regular oversights of a large number of dentists' accounts, to have an oversight of a

continually updating database of dental practice performance, to have knowledge of lots of practice purchases or sales and to be dealing daily with dentists.

Often accountants, who have never valued a dental practice or have dealt with only one or two dentists, represent themselves as being able to conduct the valuation but come up with bizarre outcomes based on inappropriate application of experience in overseeing the sale of newsagencies, post offices or bread shop franchises. These have vastly wider pools of potential buyers, since it is not necessary to have a hard-to-get professional qualification in order to conduct them.

In every industry or profession there is usually an expert with significant knowledge and data. If you were valuing a restaurant you'd believe somebody who'd dealt with a couple of hundred restaurants over somebody with no restaurant clients, but who was applying some generalised accounting textbook. At Synstrat we are involved with hundreds of dentists as accountants, advisers, practice valuers and have a long established database, and we are amazed by the oddball valuations we see from accountants who don't have this base.

“Forensic” Accountants

Some accountants style themselves as forensic accountants and put themselves forward as experts in matrimonial property disputes in all manner of businesses. A close examination of their CVs indicates that they've looked at a hundred or more different businesses but never more than one or two of any type; often not even that. If you are in the unfortunate situation of having a matrimonial dispute and a lawyer puts forward the name of a forensic accountant, be careful to demand to know how many dental practices they've been involved in. If the answer is either none or hardly any, you should refuse to engage them, as:

- a. It will be expensive; and
- b. It is in danger of producing a result which is widely different to the market.

Buying a Practice and Employing the Former Owner

Both sides need to understand clearly, when arriving at a buy-sell agreement, the conditions under which a former owner may be employed in a practice. Whilst most ex-owners respect that their former employee is now their boss and give dutiful service, we come across situations which range from the bizarre to the untenable. These include:

- Instances of a former owner becoming unsociable toward everybody in the practice.
- Instances of a former owner varying their hours of availability for personal convenience to an extent which makes continuity of patient bookings extremely difficult. This includes announcing that they're going on holidays at short notice.
- Instances where the former owner acts as though they are still the boss.
- Instances where the former owner sets out to milk the patients they are seeing through heavily embellished fees and over-servicing, thereby driving patients from the practice.

Fortunately these circumstances are in a minority, but they highlight the need for the purchaser to insist upon appropriate protocols being agreed in respect to future employment prior to signing a contract to purchase a practice.

Buying an Associateship

The golden rule is to remember that you are entering into two separate arrangements:

1. You are buying out an existing associate.
2. You are entering into an ongoing relationship with the remaining associate(s).

Remember that your bargaining power is highest before you sign a contract to purchase into the associateship. Once you have signed on you have explicitly or tacitly accepted the existing associateship arrangements. Often other associates are concerned with continuity in a practice

and are happy to see a younger dentist step up and buy out their older colleague. If the desire for change is sufficiently strong they'll be prepared to discuss and modify rules in an existing associateship agreement. However once a deal has been signed they'll regard it as being a done deal and are likely to be uninterested in change.

Control Freaks

All successful small businesses are run by control freaks. Dental practices are small businesses. Every successful dentist we know has become successful by paying regular attention to a myriad of small things, which together add up to a successful ongoing practice. It also helps greatly if they have a pleasing personality and are able to bond with staff and patients.

The vital question facing dental corporates is how can they maintain this vital control at the micro level through employees rather than practice owners? The lesson for young dentists buying practices is that they need to be prepared to adapt fast to the demands of ownership and control.

Former Owner White-Anting the Goodwill

Again, while most dentists abide by the letter and spirit of their sale contracts, we are aware of instances where vendor dentists have set out to deliberately steal back their old patients. In particular instances we are aware of substantial sums being paid in damages following legal arbitration. Any dentist who sells a practice and promotes their services to old patients whose goodwill they sold, even though their new practice location may be outside an exclusion zone, is intentionally setting out to break their contract.

Up Market Practices and Wrong Location

We are aware of dentists who are high profile marketeers and salesmen and who have had practices in the wrong locations. Potential buyers have been confronted with the facts that:

- Unlike the vendor dentist, they are not expert salesmen and it is unlikely that they'll be able to sell the same volume of expensive dental treatments as did the vendor.
- The practice is so located that many of the existing patients were attracted in from outside the immediate area because of the vendor's marketing skills, whereas the socio-economic group surrounding the practice is such that it would be expected to be decidedly traditional in the treatments it provides.

Such practices can be very difficult to sell, and in particular instances we have observed some of them hanging around the market for several years. Younger dentists working in the practices have declined to buy and moved on to start up their own practices elsewhere.

If you bought a car yard off the best car salesman in Australia, you would not be able to sell the same number of cars next year that the previous owner sold last year.

Dog Goodwill

What provides goodwill value to a practice is the ability to transfer a stream of income to a buyer. Some specialist practices therefore have less goodwill than general practices if much or most of their work comes from referral. It is a similar case in the world of medicine. If a particular surgeon retires or dies, then the general practitioners who refer to that surgeon simply farm the referrals out to other surgeons that they know. The parallels of dentistry to medicine are imprecise, but nevertheless they exist.

Among dentists there are a few super salesmen who have an extraordinary ability to persuade patients to undertake extremely expensive treatment plans. If the super salesman moves on, it is highly unlikely that the dentist buying their practice can do this. The vendors have what is known as 'dog goodwill', i.e. the goodwill follows its master out of the practice. Consequently buyers of the practice find that it is impossible to replicate the previous owner's profitability.

Real Goodwill

A good example is a practice conducted by a couple of older dentists who mainly provided traditional dentistry. As they got older and were more risk averse, some of the advanced treatment simply didn't get done. The purchaser of the practice finds that not only is it easy to take up the existing work, but that a high proportion of patients have additional needs which they can service immediately. This is real goodwill as opposed to dog goodwill.

Buying Dog Goodwill

I am aware of a practice which has been for sale for about seven or eight years. The practice is conducted by a high end dentist who is a good salesman. Various dentists have consulted me about the practice over the years, and each time I have asked them whether they believe that they can take over the patient list and run it in the same manner. On each occasion the dentist has said that there was no way they could replicate the owner's mode of practice. The practice had become unsaleable to other dentists. Recently I heard that a dental corporate had purchased it! Inevitably the practice fees will dissolve once the vendor departs!

Wanting to Sell Your Practice?

- The first thing to do is to make sure your practice is in good order. This can be done by obtaining a valuation and seeking assistance with benchmarking. A sale is more easily achieved if you are confident that you have got good current financials, your practice is well presented and you have a realistic value in mind.
- Look close to home first. Do you have a buyer working inside your practice? Or do you have a friend in the city/country who wants to move? Are there younger dentists in your study group who are likely to be interested? Do any of your dental friends know of somebody who is looking?
- Remember that overwhelmingly buyers and sellers of dental practices are previously known to each other. Relatively few practices change hands via brokers or dental practices for sale bulletin boards.

Practice Size

In dentistry, big is not beautiful. Many of the most efficient and profitable practices are practices that consist of either:

- Solo dentists; or
- Solo proprietor with one employed dentist; or
- Two associated dentists; or
- Two associated dentists employing a third dentist.

Practice and Premises

It is sometimes the case that the ability to sell both a practice and its associated premises achieves a modest premium over and above the sum of the parts.

Donuts

If a potential vendor and a potential buyer are each using an accountant who does not have other dental clients, then what inevitably occurs is that:

- The vendor's accountant sees the icing on the outside of the donut and values the practice at a level at which no buyer would be interested; and
- The purchaser's accountant sees only the hole in the middle of the donut and comes up with a value which no sane vendor could accept.

The positions of both advisers are unhelpful to their respective clients, and often blow a deal away through their profound ignorance as to the true value. It's important that both vendors and buyers rely upon experienced dental valuation advice.

Future Associate Relationships

Some things are more important than the last dollar of price. An employed dentist working in an associateship is offered an opportunity to buy in. After advice to both sides and a little bit of haggling, the vendors and the purchaser are reasonably close in price. However there may be other aspects of the deal which need attention. If the deal is this close, then a potential purchaser is often wise to use the leverage of the situation to get some aspect of the associateship agreement which is not entirely palatable changed, but make a small concession on price.

The vendor associates should recognise that their former employee will be their new associate, and that they must develop a good long-term relationship. It's worth their while to address problematical issues and make a small compromise as well.

If both sides hold out for the last dollar and the last point of principle, they risk jeopardising their future working relationship.

Associate Dispute Resolution

In over 20 years of dealing with dentists I have never seen an acrimonious dispute between two dentists or dental specialists solved by a lawyer – never.

Lawyers can threaten court action but no judge can force two dentists to like each other. Nor do the judges see any urgency in these type of matters, and they are apt to be continuously pushed to the bottom of court waiting lists, as matters of more publicly immediate importance supplant them.

In the absence of lawyers we have advised pairs of dentists and pairs of dental specialists toward practical resolutions of their difficulties.

Corporate and Stockbroker Spin

The dominant reason for corporatizing dental practices is to enable the promoters to make fat profits from the IPO. Stockbroker reports concerning the inevitability of corporate models achieving dominance are self serving spin. In 20 years time the vast majority of dental treatment will still be provided by privately owned and operated dental practices.

Matrimonial Property Resolution

The issues which delay property settlements are the ones with an intangible element. The value of Telstra shares is easily determined. The value of respective superannuation fund accounts is also easily determined. The value of the matrimonial home can usually be determined to within a narrow band, or preferably by a single jointly appointed valuer. However, the value of a professional practice may not be understood by lawyers, and because it has a subjective content can be the cause of prolonging the property negotiation.

Where we've valued a practice jointly for both parties it has greatly speeded up the settlement process. We do so on the strict understanding that we'll value it the same way regardless as to whether we are valuing it for a purchaser, a vendor, a bank lender or for the parties in a matrimonial property settlement.

Solicitors engaged in family law practices fall into two distinct camps:

1. A few who are genuinely interested in negotiating quick settlements and invariably save both sides a lot of money. They attract more clients because they have a no nonsense approach.

- Others inflame disputes and make endless demands, sometimes writing to the other side several times in a week. That adds up to lots of legal fees. Often they encourage their clients to keep fighting long past the point at which the possibility of gaining a slightly higher proportion of a settlement is outweighed by the increased cost. By this time the protagonist's family members and friends are sick of hearing about it.

The parties are often unaware that only 2% of matrimonial property disputes actually get to a court hearing. Often solicitors who are participating in a drawn out matter suddenly start to advise the parties to settle immediately prior to a court hearing. Many solicitors and barristers are afraid of taking a weak case to court because they risk being severely criticised by a judge. Cases on the Family Court website give ample examples of lawyers being criticised by judges for wasting their time.

Often solicitors recommend some forensic accountant value a practice, even though that person has never dealt with a dentist before. Having a valuation which is wildly out of line with the market builds and prolongs the dispute and adds to legal fees.

Getting a joint valuation done by an authoritative organisation with lots of dental clients is a critical step in limiting the legal costs and duration of Family Court disputes.

In Retrospect

I have spent 21 years consulting to dentists and dental specialists and trawling through their financials on an almost daily basis. It's apparent that few if any of the problems or issues surrounding purchase and sale of practices and proprietorship values are new. They reoccur with embellishments. Technology has got better and management jargon constantly creates new names for old things, but the underlying issues are recurring.

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