

Australian Dental Practice Article July/August 2006

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Good & Bad Advice in Buying Dental Practices

As with most acquisitions, it is vital that younger dentists understand what it is that they are looking for. Regrettably a lot of the advice which is given to dentists purchasing practices is of very dubious quality. A basic list includes:

- The practice has a reasonable fee base.
- There are adequate premises available for long term lease and/or purchase at realistic price relative to gross fees.
- The practice is not dependent upon preferred provider fee arrangements.
- There is real potential for improvement.
- You are buying into a simple practice structure.
- The practice is free of complicated transitional arrangements.
- The vendor is offering genuine exclusion arrangements.
- The price is realistic.
- The buyer has the capacity to replace the outgoing dentist in almost all the procedures that they do.
- The practice is not dependent upon gimmicks to earn fees.
- Buyers opportunity cost.

Reasonable Fee Base

If you are buying a practice located in a tall building in Collins Street, or Pitt Street and there is an inadequate fee base to keep you busy, you have a problem marketing the practice to new dental clients because finding new clients in a CBD of a major city is one of the hardest steps in dentistry. Alternatively, if there is a strong fee base, then it is up to the buyer to utilise their skills both in dentistry and bonding patients so that sufficient additional patients are referred over time to replace those lost through attrition. Dependent upon location, some practices will have the capacity to grow quickly because of local demand whilst others are in areas that are over serviced.

Hint

Do an internet search for preferred provider dentists for major health funds in the city in question and see the areas in which they are concentrated. That is a sure guide that there are not enough patients available through normal means. Such areas are best avoided.

Tip for Vendors

For sellers, it is vital that you review your fees regularly and keep them up to the mark. Unfortunately, some would be vendor/dentists have let their fees fall to below personal opportunity cost. Having and applying good fee schedules is essential if you are going to present sets of practice financials which will get passed persons skilled in assessing dental practices for the purposes of providing advice to buyers.

Adequate Premises

If you have a \$400,000 fee base and have to rent premises worth \$1 million for \$70,000 to \$80,000 per year, there is no way that your practice will be viable, short of you at least quadrupling the fee base. Remember, in the long term, you are also a seller and will be near impossible to on sell a practice which has an exorbitant occupancy cost.

Avoid Preferred Provider Fee Arrangements

Preferred provider of fee arrangements are an anathema to buyers. Invariably over time, they have distorted the nature of the practice so that it becomes dependent upon the health fund or funds, instead of building up its own reliable patient clientele. In dentistry as in all forms of endeavour, bad business drives out good business. A third party provider arrangements need to be looked at carefully. Many dentists to their credit, are prepared to take on Veterans Affairs patients because they have a soft spot for the old diggers and they are easily identified as a group in genuine need. Many people subsidised by other schemes have not been in genuine need but, rather have been adept at picking up a subsidy from tax payers which they could otherwise pay for. Heavy dependence upon fees from third party arrangements creates problems with fee setting in the practice and with patient relationships. Practices which have become embroiled in third party arrangements find it impossible to achieve the level of profitability of the better practices.

Potential for Improvement

A practice run by an older dentist or dentists might well have many patients who are in need of upgraded work. The outgoing dentist has lost confidence in their ability to tackle some of it. A talented younger dentist buying in, has the capacity to substantially grow fees from the existing patient base.

Alternatively, the younger dentist who contemplates buying a practice conducted by a super salesman who has sold lots of expensive treatment plans may feel very uncomfortable in trying to replicate the sales spin of the dentist who is trying to sell. Under new ownership, the practice quickly reverts to a more modest form. There is no point in paying for something that they can't sustain. It is not only the skill levels that produce the treatment but your comfort level in selling treatment plans which needs to be factored in. It is invariably the case that the slightly run down traditional type of practice run by the older dentist is much better value to the buyer than the practice with high fees run by a super salesman. The only dentists who can step into the latter type of practice and run them to the same profit levels are almost certainly already running practices of their own elsewhere.

Simple Practice Structures

After many years of building a dental database, we note that there is a consistency among the dentists who consistently fall in the top quartile by performance. A feature is that they are all in very simple practice structures. We define these as being:

1. They are good solo practitioner dentists or
2. They own a practice and employ one other dentist but invariably no hygienist or
3. They practice in associateship with one other dentist (at maximum) and the two associates employ a maximum of one dentist (full time equivalent) in a third surgery.

The most profitable dentists actually fall into the one plus one category and not only do they not have a hygienist but the proprietor makes all the key management decisions. The staff in a one plus one practice should number three or four chairside assistant/nurses. Three or four full time people are much more efficient than eight or ten part timers filling in the same hours. As a dentist, proprietor and employer, you are constrained in your supervisory functions by the fact that you have to spend almost all of your working time in close proximity to your patients providing dental treatment. That doesn't give you the opportunity to see what staff in a larger more complex practice are doing, other than the assistant who is in your proliferal vision. As soon as structures get complicated, people want to add in an extra supervisory layer in the form of a practice manager (as opposed to a receptionist). That adds another layer of costs and destroys any profit that there may have been in employing more than one other dentist. Overwhelmingly our data shows that a common feature of highly profitable general practitioner dentists is that they work in very simple practice structures.

Too Many Associates Equals Potential Conflict

Be very wary about purchasing in an associateship in a large group, particularly one with four or more associates. If you have one associateship, you have one business relationship and the two of you can fairly easily make most joint practice management decisions. If there are three associateships, the relationships multiply to three. A to B, B to C, C to A. With four dentists the number of associateships become six and with five it becomes ten. In large associateships, it becomes very difficult to run a practice efficiently and take all decisions in a timely manner. I have never yet met a dentist working as one of three or more associates who is as profitable as the most profitable dentist in our database. In fact, I have never met one who is remotely nearly as profitable as the most profitable dentist in our database.

Remember one day you are going to want to sell out of your practice. The bigger and more complicated the structure of the practice becomes, the less likely it is that there is going to be a buyer who is willing to purchase your practice.

Avoiding Complicated Transition Arrangements

Some younger dentists have been persuaded to buy into practices on a complicated transitional arrangement over several years. The reality is that if a practice is worth buying, we can invariably raise finance to purchase the goodwill without these arrangements. From a buyers perspective, the best deals are the all or nothing deal. Either you buy what is on offer be it an associateship, or a practice, because it is a good practice worth buying, or

alternatively you don't buy because it doesn't satisfy all of the tests. Half way arrangements are best avoided.

Bargaining Power

It is usually the case that the younger dentist in a practice that they may want to buy is in a stronger bargaining position than is the older dentist who wants to sell. The younger dentist's bargaining position is best maximised by avoiding these type of arrangements.

Hints to Practice Vendors

It is vital that you phase out of such arrangements well before offering your practice for sale. The best deals are uncomplicated deals. At Synstrat we have been invariably able to source finance for intending practice buyers providing that the practice that they are purchasing is sound.

Complicated transition arrangements involving putting part of a dentist reward into a trust account are a turnoff to many young dentists. Persons experienced in advising dentists would invariably advise young dentists against these types of arrangements. They are best avoided by both parties.

Genuine Exclusion Arrangements

If the dentist who is selling has two practices, a couple of suburbs, or a few kilometres apart then the buyer must be alert to the probability that many patients are going to follow the vendor dentist to the alternate location. It can be very difficult to prove in law that a violation of a sale agreement has occurred. It can also be very expensive and very stressful.

Similarly, if a dentist is not of retiring age but wants to sell their practice but is coy about the exclusion arrangements they are prepared to offer to the buyer, it's a sign that the buyer needs to be cautious. Patients will follow "their dentist" over a considerable distance to continue treatment plans. If a new dentist is going to turn up with a Yellow Page listing fifteen kilometres away, or with a website page, then we can be confident that it won't take a lot of the patients from their old practice, very long to find them. Remember goodwill is the value of a transferable economic benefit. Unless there is a solid reason to believe that the transfer will be affected, it raises the question as to what the buyer is paying for.

We have recently seen examples where dentists had consulted other accountants prior to consulting Synstrat in situations where there was a significant doubt as to the strength of the exclusion arrangements. Unfortunately, the first accountants who tendered advice had been more concerned with gaining another dental client with a practice rather than giving sound advice as to the pitfalls of the transaction. If there is a significant doubt concerning exclusion arrangements, then the price of the practice must fall substantially.

We are aware of circumstances where dentists who deliberately misled buyers with a view to siphon off some of their patients were later obliged to make restitution after legal arbitration. Such experiences are harrowing for

both the vendor and the buyer. From a vendors perspective, if selling a practice it is essential that you be upfront about your plans.

A Realistic Price

No two dental practices are exactly alike nor, are two locations. After many years of valuing practices, we observe that whilst a dentist might readily buy a good practice in Melbourne's Bourke Street for a reasonable sum of money, they are most unlikely to be willing to spend on goodwill in the township of Burke in far West New South Wales. There are many things which affect the price of practices including the appeal of the location to prospective buyers. Regrettably, a number of persons who purport to value dental practices, don't tear apart the financials and find the weaknesses. There are many good practices for sale and it's important to take time to find the good ones, and it is critical that their financials are examined by somebody who has expert knowledge of dental practice financials as opposed to a dissimilar array of small businesses.

The accounting profession likes to pretend that it can value all sorts of businesses. This is not true. In every significant line of business or profession, there are relatively few persons with genuine expertise. The people with genuine expertise in particular professions recognise their limitations outside their field. When pulling apart dental practice financials, there is no substitute for having dealt with hundred of them previously. There is no substitute for observing many successful buy and sell contracts, as well as instances of practices that have failed to sell because they are over valued or had fundamental faults. Joe the public accountant around the corner might be a good bloke, and he would like to have a dentist or two as his clients but unfortunately he won't recognise whether the profit in a set of practice financials he is looking at, is above or below professional averages, or whether particular cost structures are abnormal. Many dentists are poorly advised when purchasing practices.

Buyers Capacity

An assessment needs to be done as to whether the practice will be viable when operated within the buyers capacity. In this area, there is no substitute for remodelling the practice, less the proportion of fees which will spill and determining whether it is possible to produce sufficient profit at the bottom line to justify purchase.

By way of example, if a young dentist is buying a practice with \$850,000 worth of fees, run by a solo practitioner, who does lots of first class work, there is a problem if the potential buyer is only experienced at working to a pace and selection of treatment plans, which produce \$400,000 per annum.

Those dentists who run practices of an advanced nature need to consider that at retirement they might have to take a significantly reduced price for their goodwill because buyers will factor in the probability that a proportion of the fees will be unsustainable. Such dentists need to make their long term financial plans on the basis that they are not reliant upon the sale of their

goodwill in their practice to fund their retirement, but rather what they realise from the sale of their practice is regarded as a bonus.

Avoiding Gimmicks

If the practice relies upon expensive gimmicks to generate fees and profitability, the near certainty is that unless the buyer has significant experience in using the same equipment and techniques that these expensive widgets will quickly be shelved and the buyer will conduct the practice in a similar format to that which they are used to whilst working in somebody else's practice.

Hint for Vendors

If you are planning to sell a practice introducing expensive new technology into the practice means that you are most unlikely to find a buyer who is prepared to pay you the goodwill you want in addition to a high second hand price for the equipment.

Buyers Opportunity Cost

Every dentist who buys a practice has a personal opportunity cost. That personal opportunity cost is what they are capable of earning in employment in another dentist practice. This is what they give up to acquire the new practice. Logically a buyer will purchase a practice if they are going to achieve the following:

1. Meet their personal opportunity cost.
2. Earn a return on the investment in assets of the practice; and
3. Earn a return on the personal management input that will be required in running their own practice as opposed to working in a practice owned and managed by somebody else.

Is Dentistry Sufficiently Profitable to Justify Purchase of a Practice?

The answer is almost certainly yes, providing care is taken with all of the above criteria. In particular, male dentists married to a wife who is likely to take time out for family duties, will be able to structure their income to share a portion of it with their spouse. This may not be possible when working in another dental practice. This together, with the ability to influence the future management style of practice including having practice décor and equipment to your own taste over time are considered to be good reasons for owning your own practice.

How Good is Practice Ownership in 2006?

On the evidence of the dental financials that we see on almost a daily basis and which are reflected in our database we observe that for the great majority of competent experienced dentists, dental practice is currently more rewarding than has been the case over the past fifteen years or so. It is to the great

fortune of dentists generally, that dentistry avoided Medicare type arrangements with government. It is also good that the vast majority of competent dentists have had the good sense to throw the overtures from health funds into the round bin. In most areas, there are sufficient patients for dentists to have adequate control over pricing and inject personal style into their practices.

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