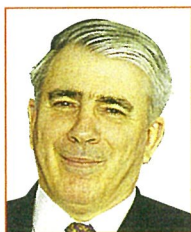


Don and Joe average dentist

A 30-year comparison of the vastly different financial outcomes of two average practice owning dentists

By Graham Middleton, BA, MBA



“A combination of good fortune and good decision making very early in dental careers coupled with hard work is critical to reaching an optimum long term situation...”

Don and Joe (not their real names) could have been described as average dentists as they approached retirement in 2018, having owned practices for 30 years. Their practices had the following characteristics:

- Each owned a practice with three chairs, but the third was rarely used except for emergency pain relief;
- Each was sole owner of their practice;
- Each had grown to around \$1.3 million of dental fees at the point of their imminent retirement;
- Don worked four longish days plus a half day in his practice and employed a second dentist for four weekdays and alternate Saturday mornings. Don had a third part time dentist, one day per week and on alternate Saturdays;
- Joe worked slightly less hours than Don, employed a full time dentist four and a half days per week and a hygienist for one and a half days per week;

- Each owned their premises. Although they had purchased at different times and under different conditions;
- Each was located in a capital city in a middle suburb; and
- Each were long established with a steady patient flow and each practice typically received bookings for about six or seven new patients per week.

However, their financial situation as they approached final practice sale and retirement after a 30-year practice ownership period were dramatically different, yet each had purchased their practices about eight years after dental graduation and had ended up with a similar fee base!

Don's purchase

Don carefully sourced advice from the outset and had been advised early on that in order to put himself in line to buy out the practice owner, he needed to make himself indispensable within the practice in which he worked. Don had worked for

Antonio during his formative years as a dentist and had carefully polished both his clinical and chairside skills and gradually pulled ahead of Antonio in patient bookings and personal referrals as Antonio reduced his workload. He was careful to maintain cordial relationships with Antonio and to maintain the respect of chairside nurses and receptionists who alternated between chairside and reception.

When it came time to sell, Antonio realised that in order to get a fair price for the practice and the right to be able to work after his sale, his best option was to deal with Don. The two jointly approached a trusted third party to value the practice and to advise on aspects of the deal. In due course, Antonio gradually wound down before retiring three years later. Don carefully selected a dental replacement who gradually built up her patient list as Antonio wound down from four days to three days; to two days and finally one day per week then retired. The transition was smooth.

Joe's purchase

Joe had worked in several practices in his early years after graduation and while his skills were comparable to Don's, he had not worked up to a full time position and ended up working part time in two practices. A couple of practices he had worked in were sold without him being invited to negotiate with the owners and each time the new owners had spilled him to create full time space for themselves whilst continuing to employ the practice vendor part time. Joe didn't quite have Don's empathy with his bosses, or with other staff and was frustrated in his pursuit of a practice to buy. In his eagerness to buy, he had pursued practices offered for sale by practice brokers and had been gazumped a couple of times after making serious offers. The practice brokers seemed reluctant to produce full financials and he was told by one broker: "You ask too many questions". The broker had then

contrived to sell the practice in question to another buyer who asked fewer questions!

Eventually in his eagerness, Joe paid too much for a practice and found out, after taking possession, that there had been a loss of fees over the past 12 months under the previous owner, who had taken a lot of time away from the practice due to illness. The previous owners' replacement locum dentist lacked appropriate chairside skills and burned a lot of patients off. Unfortunately for Joe, this locum, who was a previous practice owner himself and who had been punished by the Dental Board, overcharged and over-served whenever he was engaged. He took the attitude that he wasn't in any particular practice for the long term and being paid a percentage, would push patient treatment and fees to the limit. He did not care about the harm to a practice's reputation, providing that he made a good income before he moved on. He was in a practice for a limited time and what occurred subsequently did not concern him.

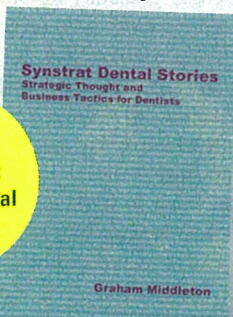
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The inevitable result was that Joe paid 50% more for his practice than had Don and then taken a couple of years to rectify the problems which had been created in the practice in the year prior to purchase. Unfortunately, the set of financials he had been given by the practice broker were almost a year old at the time that he bought and the damage had not been obvious.

The result was that Don's profit from his own surgery plus a modest yield on his employed providers was about 50% greater than Joe's during their respective first two years of practice ownership. Fortunately, back in the late 1980s, it was still relatively easy to rebuild a practice patient list but it took Joe a couple of years.

Comparing their profit in the first two years

Purchasing practice premises

Don had been able to extract an undertaking from Antonio that he could purchase the premises, which were in Antonio's family trust, within three years of practice purchase. This was arranged on the basis of independent valuation by a licenced real estate valuer not previously known to either, but who was on the approved panel of valuers of a bank, which financed the acquisition. Since the interest paid was offset by the rent saved, the purchase's impact on Don's cash flow was manageable in the first few years of ownership and gradually improved as the annual rent increases now went to Don's Family Trust rather than to Antonio. Importantly, Don was also able to make some structural alterations to the fit-out secure in the knowledge that he had long-term ownership.

Joe had been in a weaker bargaining position when buying his practice and had not been able to secure a promise to buy the premises. The former practice owner had succumbed to his illness and the premises were left under the control of his widow, who wanted to keep it as a rental income producing asset, but was reluctant to spend any money on upkeep and enforced annual rental increases. Eventually, when she did decide to sell, she put the sale in the hands of an agent. The premises were between properties which had been land banked to the left and right respectively. Both of the land bankers had their eye on her

premises to add to their land banks of two properties each and produce a more cost-effective plot ratio for the redevelopments they had planned. Joe had his Synstrat adviser do his bidding at the auction. His adviser had pointed out that a relocation involving a total new fit-out and a lot of dislocation to the practice would be a huge expense and that he must secure the premises. The result was that having to outbid the two land bankers meant that Joe paid about 60% more for his premises (inflation adjusted) than had Don. Furthermore the landlord had neglected the maintenance and external appearance and Joe immediately spent a significant amount on repairs and maintenance to bring appearances up to an acceptable standard.

"Joe had been in a weaker bargaining position when buying his practice and had not been able to secure a promise to buy the premises. The former practice owner had succumbed to illness and the premises were left under the control of his widow..."

By this stage, Don and Joe had each owned their practices for seven years. The fees of each were now about equal but their respective financial positions were diverging rapidly. Don had maintained interest only debt on his practice and premises loans but accelerated his non-tax deductible home loan repayments. His practice premises gained about 40% in value in those seven years. It wasn't spectacular but it was steady. He had managed to pay superannuation at a modest rate and topped up his wife's super. His wife, Victoria, worked as a primary school teacher and acted as part time practice bookkeeper. As a result, Don paid her a wage and super on top of her schoolteacher salary. They had accelerated their non-tax deductible home loan repayments at a rate which would mean that the loan would be paid out within twelve years from inception. They had five years to go on a loan which had reduced from \$800,000 to \$404,000.

Don and Victoria had been advised to avoid investing in residential rental property which they learned had an extremely poor net rate of return after landlord's expenses of agent letting fees, insurance, municipal water rates and property maintenance charges. They understood that both their home, which was a capital gains tax exempt asset and their practice premises, which gave them long term control of their fitout and had a higher commercial rental value than residential properties, were each far superior assets. Joe thought about investing in a residential rental property, but fortunately his bank refused to lend him more money.

Differences after seven years

After seven years, Joe's situation was appreciably different. While his practice was now turning over a similar amount to Don, he had started with a significantly higher debt on practice purchase and had found the practice in a much worse state than was Don's at that stage. Because he had started with a much higher debt, he had been forced to take an interest and principal reducing loan. As a result, he'd been forced to minimise his home loan repayments. When he eventually purchased his premises, he had again started with a much higher debt than had Don and again had to agree to a principal reducing and interest loan. Joe and Rose only made minimal home loan repayments. Whereas Don and Victoria's home loan would be paid out in 12 years from inception, Joe's was likely to take about 30 years.

Don's situation after seven years

Don had optimised his staffing so that he worked one surgery personally four and a half days a week with fairly longish days. Importantly, he realised that profit was greatest at the margin and always set himself a goal of assuring that the last 15 minutes of each session was productive. He produced about 63% of the fees in his practice. His other staff produced 37%. He had made regular modest fee adjustments and had refused to have any preferred provider arrangements but had honed his chairside manner and clinical skills and ensured that all staff were attuned to good practice communication.

By contrast, Joe did about 50% of fees in his practice himself which meant that he was paying two other part time providers to do the other 50%. The difference of 13% meant that compared to Don, his payments to providers were significantly higher and his profit commensurately lower. He had tight cash flows because of the principal reduction payments on his practice and premises loans and struggled to make home loan repayments. His superannuation payments were minimal. While Don and Joe had practices of identical overall fee size, their financial positions were diverging at a substantial rate. Don and Victoria had about \$500,000 of superannuation at the seven year point and their superannuation contributions were accelerating while Joe and Rose (also a teacher) had about \$200,000 between them. The capital value of their practice and premises were similar but Don had paid less and kept his loans on an interest only basis while approximately halving his home loan. Joe had been forced to pay a lot more and despite principal and interest payments, had a greater debt on the practice and premises at this point than had Don. Joe's home loan had only reduced by \$80,000.

Diverging rapidly

The differences which were significant at the seven year point had become dramatic by the 15 year point. Don and Victoria had cleared their home mortgage at the twelve year point and had significantly stepped up their superannuation payments including both concessional (tax-deductible) and non-concessional contributions. Joe and Rose had continued to make minimal payments. As a result, the combined super of Don and Victoria was over \$1 million more than Joe and Rose at this point!

Don and Victoria had kept rolling over their practice and premises loans on a non-capital repayment basis and because of their excellent financial situation, the bank was prepared to accommodate them. Their practice and premises were now worth more than twice what they had paid. Joe had made repayments but his outstanding business loans which had been much bigger at the start were still about 90% of Don's. Joe and Rose still owed \$568,000 on their home.

The properties either side of Joe's premises had since been developed and his premises no longer had the same premium value that had been the case when the land bankers had been eager to buy it to add to their existing titles so they could amalgamate to create a single larger development site.

Overall, Don and Victoria's family cash flow position was much stronger than that of Joe and Rose. Because their superannuation fund was much larger by this stage and they were funding it at a significantly higher rate, their fund was growing by much more per annum than that of Joe and Rose.

The gap was widening at an ever increasing rate.

"Joe's understanding of his finances were much poorer than he realised and while he had reached the stage where he could have restructured his loans to make his business borrowings interest only and pay down his home loan at a faster rate, he had not and was still paying off his home loan at the minimal rate. His accountants knew little about dentistry as a practice business, not having other dentists on their books and assumed that his practice and personal outcomes were normal..."

Financial knowledge

Joe's understanding of his finances were much poorer than he realised and while he had reached the stage where he could have restructured his loans to make his business borrowings interest only and pay down his home loan at a faster rate, he hadn't. His accountants knew little about dentistry as a business, not having other dentists on their books and assumed that his practice and personal outcomes were normal. They did his accounts but gave little thought as to whether his situation could have been improved. Don had had good advice from the outset and even if Joe had rectified the weaknesses in this practice and in his personal structures at the 15 year point, it was now impossible for him to catch up to Don by their ultimate retirement at the 30 year point. Don's net worth was greater and was compounding at a greater rate than Joe's.

People don't change

There is empirical evidence that people's individual characteristics stay with them long term. Don continued to produce about 63% of the fees in his practice and Joe continued to produce around 50% of the fees in his. Don continued to be disciplined in respect of squeezing in an extra procedure near the end of each session while Joe tended to look at the overall practice fees rather than his own production.

Their second 15 years of practice ownership

Don's income from dentistry continued to be significantly higher than Joe's

and he and Victoria were able to carry out extensive home renovations. Joe's core debts on home practice and premises were all paid out but in his 30th year, he had business overdrafts and financing for replacement equipment and updated fit-out totalling about \$500,000. Don had been able to periodically replace items of equipment and update pieces of fit-out without significant debt and at the 30-year point, he had no business loans outstanding.

Don and Victoria's superannuation fund had passed the point of having \$1.6 million each several years before retirement and had been restricted in their contributions in the last year or so of practice ownership to only putting in the concessional contributions of \$25,000 each. Their overall fund stood at a healthy \$3.5 million on the eve of practice sale. They were in the process of selling their practice and premises. Because the bulk of

their assets were held in their home and in their superannuation fund, they easily pass the test to access the Small Business Capital Gains Tax concessions. They were able to transfer a substantial portion of the sale proceeds to their superannuation fund under that relevant legislation despite having passed their superannuation caps in respect of pension accounts. At retirement post practice sale and rollover of part of sale proceeds, their overall assets as shown below:

Don and Victoria's situation

Home - current.....	\$2,500,000
market value	
Superannuation fund	\$4,900,000
- current asset value	
Non-superannuation.....	\$700,000
investments	
TOTAL*	\$8,100,000

* Personal assets such as cars, furniture and personal effects are excluded.

Joe and Rose used part of the proceeds of sale of their practice and premises to clear up the \$500,000 of overdraft and miscellaneous finances on practice

equipment and renovations, etc and were able to hand over clear title of assets to the buyers. They had received a similar amount for their practice and premises as had Don and Victoria but having struggled with finances as their home was in a much poorer overall condition. It was worth about \$1.8 million.

Their superannuation fund was worth \$1 million combined prior to rollover of part of the sale of their practice and premises, having paid out \$500,000 of debt

Joe and Rose's situation

Home - current.....	\$1,800,000
market value	
Superannuation fund	\$1,700,000
- current asset value	
Non-superannuation.....	\$700,000
investments	
TOTAL*	\$4,200,000

* Personal assets such as cars, furniture and personal effects are excluded.

and put aside an amount to be invested in their own names to absorb their low tax thresholds in retirement. As they entered retirement their assets are shown above.

About the author

Graham Middleton personally has been advising dentists on strategic, practice management, valuation and conflict resolution processes for 31 years, the last 24 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 Management of the 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. Call Tel: (03) 9843-7777 Fax: (03) 9843-7799 visit www.synstrat.com.au or email dental@synstrat.com.au.

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The lessons

- I have been advising dentists for 31 years and have seen many examples of dentists with similar sized practices entering retirement with vastly different overall assets. Some of the differences are much wider than illustrated above. It is apparent that those who started out well, were well advised and remained focused reached a point at practice sale/retirement in much better financial condition. This applies across the spectrum of dentistry. We see similar situations with those who each operated practices with \$2 million of turnover or each operated larger practices with \$3 million of fee turnover or for that matter operated solo practices of \$700,000 of fee turnover. In each size range, there is a vast difference between those who got the basics right and those who didn't;
- A combination of good fortune and good decision making very early in dental careers coupled with hard work is critical to reaching an optimum long term situation;
- Dentists need to sit back and ask themselves whether they or their accountants or financial advisers truly understand their financial position compared to other dentists of similar age with similar size practices. The long term financial consequences can be huge;
- Not all accountants are equal. While thousands of them understand the basic tax rules, many accountants and advisers are incapable of giving good strategic advice to dentists and this is one of the causes why many dentists end up millions of dollars worse off than their peers. If a dentist starts out poorly at the point of practice ownership, they are unlikely to catch up financially with their peer group;
- Financial planners working for large institutions such as banks rarely if ever understand the basic drivers of dental financial success;
- Practice size is far less important than many dentists realise. It's the efficiency of a practice, particularly the efficiency of the practice owners' personal operation and the fees generated within which is the dominant factor in most practices' success; and Profit is earned at the margin. Best wishes to all dentists.