EVERYTHING DSO

The Definitive Guide to How Dental Service Organizations are Changing the Business of Dentistry Nationwide

Insider Secrets That You—the Private Practice Doctor with One or More Profitable Clinics—Must Know to Prosper!
Perhaps More Than Ever—in These Changing Times...

STAN KINDER

America's Foremost Expert On Dental Service Organizations

Is Stan Kinder A Man Worth Knowing? You Decide

"As a practicing dentist, I have been in the dental industry for almost 20 years. From my first startup, through to selling my group and working in partnership with a large DSO, I have had the privilege of working with some incredible talent and many of the industry's best minds. Luckily for me, I had the good fortune to meet and work with Stan Kinder who is, above all else, a man of integrity and honesty. Stan's experience and industry know-how are second to none that I have ever worked with, but what sets him apart, is his ability to connect with people and work ethic. My family and I will be forever be in debt to Stan, AND that is a unique accolade for someone with whom my only professional dealings have been from across the table. Needless to say, I have and will continue to refer friends and colleagues to Stan, he is without question someone you want on your team."

—**Dr. Scott Dudley,** general practitioner with
2 location practice in suburban location with
greater than $5 million in top line revenue

"I met Stan Kinder 5 years ago during the sale of my general dental practice to a DSO. Our initial conversations were solely business related, but I grew to appreciate our interactions and conversation. Stan could not have been more professional in an educated but sincere fashion. As the process moved on, Stan was there to help guide the ship. Although he was the buyer's representative, he was incredibly fastidious as well as expeditious with the details of the transaction. He was also a key ingredient while interfacing with my legal team to ensure the process went smoothly. I can honestly say that my deal was more than fair and that there were no midnight hour surprises.

I fully thank Stan for his efficiency and knowledge in getting things to the finish line. As our dealings continued, I learned more about Stan. On occasion, we would meet to discuss dentistry and future DSO involvement. He is very knowledgeable in the dental industry after over 30 years in the business. His understanding of the day to day management of a dental practice is supported by a graduate education in business. But his most important asset is integrity! Stan is honest and supportive while performing a task which can at times be hazy- but he stays the course.

Finally, I would be the first to refer a friend or colleague to Stan. I fully believe that his expertise in a rapidly expanding field is unsurpassed. His connection to the industry combined with his experience, lends to a fantastic combination for achieving success for what can be one of the largest transactions of your career."

—**Dr. Brad Freedman,** general practitioner
with a single site practice with 1 associate and
approximately $2.4 million in topline revenue

“I would recommend Stan to anyone who wanted to sell a large practice. Stan brought me a buyer and shepherded me through the negotiations. His vast and unique knowledge of the dental industry allowed me to receive not only the price I wanted but also afforded me favorable terms. After the sale he stayed with the deal assuring that there were no hidden surprises. Over the course of the sale process, I found that Stan was familiar with most of the major buyers. Throughout he was timely and responsive, and I found I could absolutely rely on anything he told me. His experience with these types of transactions facilitated keeping the lawyers and accountants moving forward to successful completion. I would recommend his services without reservation.”

—**Dr. Bernie Fink,** general practitioner with 6 location practice in suburban lo- cations with 16 associate dentists and $16.5 million in top line revenue

“I never dreamed I would partner with a DSO, but I had a problem that needed solving, so on a colleague’s advice, I spoke with Stan Kinder.

The problem was: after 32 years in practice, I didn’t have enough money to retire. My practice was profitable, but between payroll, expenses, a nice lifestyle, putting three kids through college without student loans, and taking several nice vacations a year, my retirement account was thin. So thin, retirement was out of the question.

When I met Stan Kinder, I had no clue affiliating with a Dental Service Organization could be so lucrative.

From signing a nondisclosure agreement with Stan, to receiving a nice seven-figure payment that gave me the freedom to retire whenever I want, the process took about six-months.

Stan helped every step of the way. He did a complementary practice valuation to determine the kind of offer a good DSO may make. He found a DSO well paired for my kind of practice. He helped craft a proposal, and negotiate fine points and complete the transaction. And even better, his help didn't cost me a dime, because the DSO paid his fee in full, separate and apart from my transaction.

Today, years after the fact, I remain delighted with my decision. Affiliating with the right DSO partner makes all the difference.

My retirement is secure. Professional management runs the business side of the practice. I work chair side with my main responsibility being to show up on time. And, none of this would have happened without Stan's help. He's a good man to know.

My advice is, get to know him."

—L. J. DDS

"Working with Stan Kinder has been the best decision of my career.

Besides getting top dollar and a high seven-figure cash payment for partnering with the DSO Stan introduced me to, I retained equity. I work chair side doing the dentistry I love. I earn mid six-figures a year. I have no management responsibility, far less stress, and money in the bank.

My life is better in every way. Thank you Stan Kinder!"

—R. W. DDS

"With over 25 years in business and three practices that net mid-seven figures, I had no interest in the details of how to partner with a DSO. But things change. And, sometimes they change faster than you expect. In my case, that change could have wiped out the entire value of my life's work.

One day, with no high risk factors and no warning, I had a heart attack. Fortunately, I survived. And, my associate doctors kept the practice running.

That heart attack was a wakeup call. If I had become disabled and couldn't practice, or had died, the practice would have been sold for a tiny fraction of its worth, or simply dissolved.

Fortunately, I was back to work in about six weeks. But, the decision was made: I had to protect my equity, so if there was another event and I wasn't so lucky, my family would be secure.

About that time, a colleague introduced me to Stan Kinder.

Before the heart attack, I had no interest in details on how to affiliate with a DSO. But after the unexpected struck, and I realized my risk of losing every- thing was real, I was happy to speak with Stan.

Today, in hind sight, I say in all honesty, and with no sugar-coating, listening to Stan Kinder explain the advantages affiliating with a DSO may give you, was the best decisions of my professional career.

I did not know a DSO may pay several multiples of bottom line profit for a good practice. That valuation formula would net me millions more than I would have ever received in a doctor to doctor sale.

Having never considered partnering with a DSO, I did not know you could take a huge cash equity out of your practice, and still retain a percentage of ownership that may give you another multi-seven figure payday a few years down the road if the practice continues to grow.

Most important, I did not know that once I partnered with a DSO, besides transferring huge equity from my practice to my bank account, if I became disabled, with the DSO as the majority partner running the business side of everything, the practice would continue uninterrupted, the value of my retained equity was secure, and if I passed away, my heirs would inherit my retained value.

And finally, working chair side with no limit on my ability to earn and with no management responsibility, there would be less stress, no employee-marketing or affiliate doctor concerns, and an agreeable work situation, with me doing the dentistry I love, and others handling daily operations.

Once I understood the details, and realized the value of my equity would no longer be at risk, and not subject to my ability to practice, or at risk of economic downturns that would hurt any dental practice, I decided to go forward. Stan made the entire process seen easy.

He did a practice valuation. He matched likely DSO partners with my practice, and my vision of an ideal practice scenario going forward. He helped prepare a partnership proposal. He helped negotiate everything, including a post-partnership employment agreement. And, he stayed with the process from start to finish. The answer to any question that came up, was one phone call away.

Bottom line: I couldn't be happier.

This would not have happened without Stan's help.

Today, my equity is secure in my bank. My family is financially secure come what may. And, I have an agreeable practice situation I enjoy, with retained equity and the possibility of another seven-figure pay day a few years down the line.

Stan Kinder has my highest possible recommendation. He is a man of integrity. He's a straight shooter. He tells you like it is. He gets things done fast. And, if you speak with him, you'll be glad you did, whether you decide to partner with a DSO or not."

—M. H. DDS

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Dedication: This book is first and foremost dedicated to my loving family, my wife Joanne and my three kids, Melissa, Colin, and Jake and certainly to the individuals who guided and mentored me in this work — most specifically Drs. Bernie Fink and Craig Abramowitz, two of the smartest businessmen I have ever known who just coincidentally happened to be dentists,.

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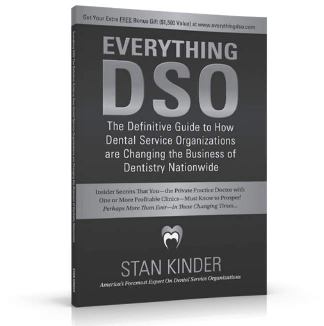

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Foreword

I am both pleased and honored that Stan has asked me to write a foreword to this book. I bring the perspective of having been a practicing dentist, the Chief Executive Officer of two different DSOs, and Co-CEO of a third, and having worked closely with Stan in two of these circumstances, I first came to know Stan when I hired him as a consultant to conduct operational reviews of several group practices we were interested in acquiring during my tenure at Northeast Dental Management, a DSO I founded. I found his recommendations and perspective to be invaluable. We acquired those practices and found them to perform in much the way that Stan predicted. Several years later I brought Stan on to our senior management team to manage our Mid-Atlantic book of business and to head up our business development function.

He played a key role when we recapitalized the company and brought on a new private equity investor. He went on from there to drive the growth of the company until we merged with a larger company several years later and continued in the same capacity with them.

I can say unequivocally that I have met very few individuals with Stan's deep understanding of dental practices and the DSO industry, and the many ins and outs of negotiating and consummating successful transactions.

Stan shared with me that his goal in writing this book was to address the problem of "information asymmetry" between dentists and the DSO buying community – a problem that he believes all too often works to the dentist's disadvantage,

If this was his goal, I can say that he has achieved it, and in spades. If you are interested in learning more about the DSO phenomenon and understanding what you need to know as a practice seller, look no further. In this easy to read book you will find a comprehensive summary of the DSO industry. This information will serve you well if you only want to educate yourself about DSOs, are more interested in tangibly exploring a transaction with a DSO or are simply thinking about working in a DSO affiliated practice.

I recommend this book to you as a great resource, and wish you good reading

Craig Abramowitz, D.D.S.

CHAPTER 1

Who Am I and Why This Book Matters and Should Be Read by You

As described in countless articles in the trade press and reiterated in some detail throughout this book, Dental Support Organizations (DSOs) are sweeping through and rapidly consolidating the dental profession. Estimates are that today, early 2020, approximately 20% of all dental practices are affiliated with a DSO and some estimates are projecting that number to grow to between 50 and 60% of all practices by the year 2025. That clearly qualifies as a phenomenon.

As you think about your future in the profession – whether you are early in your career or approaching retirement, it is important for you to understand this trend and its potential consequences. Does it represent a threat or an opportunity? Rather than answer that question for you, I want to give you as much factual information as possible on the DSO industry so you can draw your own conclusions.

It would be foolish to ignore the information provided on these pages. As the saying goes, “knowledge is power.” DSOs and their private equity partners are extremely sophisticated. If the possibility exists that you will ever compete with a DSO, consider employment in a DSO affiliated practice, or negotiate a transaction related to your practice, you want to be as knowledgeable as possible. My goal is to help you obtain this knowledge in as easy and as pain-free a way as possible.

The truth is, if you want to educate yourself about DSOs, most available information comes directly from the DSOs themselves. And that information can hardly be described as objective. With this book, I hope to remedy that.

A reasonable question to ask at this juncture is what qualifies me, Stan Kinder, to write on this subject. What does he know?

A few words on my background are in order. I have had the rare privilege of working as a senior executive (generally at the VP level) for three fast-growing and successful DSOs and have had an inside bird's eye view of the industry and its evolution over the past two decades.

My primary responsibilities with each company was in Business Development, although in one instance, I rose to become Chief Operating Officer. For the most part, I spent my time talking with dentists interested in exploring a relationship with a DSO, holding their hand through the entire process of affiliation.

This started with the early introductory conversations, to completing their practice valuation, assisting them in the due diligence process, and negotiating the definitive purchase and employment agreements, and finally closing. And eventually, to supporting them in their ongoing relationship with the company.

Over the years, I have been involved directly or indirectly in transactions resulting in nearly half a billion dollars being paid to dentists for selling or affiliating their practices. I have had only one instance in all this time where a dentist came to me after the fact and said he was unhappy with the result. And it was not related to a DSO transaction but rather from a dentist who purchased a practice I brokered on behalf of the seller.

During my career, I have owned practices indirectly in partnerships with dentists, done management consulting with dentists, brokered the buying and selling of practices in traditional dentist to dentist sales, and finally, to working in the DSO industry. I have been around the block a few times and as a consequence, have a ton of knowledge to share with you–hopefully to your benefit. So, read on.

CHAPTER 2

DSOs Are Bad for Dentistry and Other Misguided Beliefs Debunked

Perhaps the most common misconception regarding DSOs is that they are universally bad for the profession. This belief has been propagated by much of organized dentistry as well as by the universe of consultants who wish to sell their services to combat the influence of DSOs. The basic premise is that DSOs are unfair competitors due to their size and access to capital.

Let's examine the facts.

DSOs have provided a lifeline for many dentists interested in an eventual transition or who want to monetize the equity in their practice for whatever reason.

The harsh reality is there are fewer dentists interested or able to buy a practice. The reasons are straightforward. Today's dental school grads are finishing with enormous debt burdens. In 2019, grads finished with an average educational debt of $284,000. An insane amount and one that leaves them much less interested or able to finance a practice purchase.

Compounding this challenge is that 50% of graduating classes are female—not a problem. But… statistically, they are more interested in working part-time and less interested in practice ownership than their male counterparts. Not universally true as there are many successful female practice owners, but historically truer than not.

This shortage of potential buyers runs right into the face of a glut of baby boomer dentists interested in selling now or in the near term.

What to do? Enter the DSO.

DSOs are enabled by their private equity investors. Private equity has a long record and interest in consolidating highly fragmented industries—creating economies of scale, increasing efficiencies, and improving profitability. Dentistry certainly fits this description given its history of predominantly solo practice.

DSOs have been the fastest-growing segment of the profession over the last five to seven years to where today, approximately 20% of all dental practices are now affiliated with a DSO. The primary method of growth has been through acquisition.

For reasons detailed in a later chapter, DSO buyers also value practices above the levels of dental buyers. DSOs have been responsible for more wealth creation for dentists than any other means over the last decade.

Misguided belief—DSOs are bad for dentists.

Reality—DSOs have been a lifeline for many dentists and the only buyer when any alternative was difficult, if not impossible, to achieve.

Another common misconception is that DSOs bring corporate control of clinical practice and decision making to the detriment of patients. Their focus on the bottom line distorts the traditional values of private practice.

Again, let's examine the facts.

Nearly every state has statutory requirements that only a dentist can own a dental practice and further, that all patient care decisions are the exclusive domain of licensed practitioners, dentists and hygienists.

The "corporate" practice of dentistry is strictly prohibited.

As a result, most DSOs have a bifurcated ownership structure with a dentist owning all the clinical assets and employing the licensed practitioners and a management company that owns all the non-clinical assets.

It is through the management company that DSOs provide their business and administrative support services—supporting the so-called "back office".

Every responsible DSO draws a bright line marking the boundary between these services and any clinical decision making. Given the heavy scrutiny faced by the DSO community, any violation of the corporate practice of dentistry limitations would result in relatively immediate Dental Board sanction.

Misguided belief—DSOs lead to corporate intrusion into clinical practice.

Reality—State Practice Acts prohibit this possibility. If it occurs it is readily reportable and will cause State Dental Board sanctions.

A third widely held belief is that DSOs generally deliver an inferior quality of care because of their financial priorities.

There have been some instances of quality issues for some DSOs, predominantly in the Medicaid space. This has certainly fed the quality concern.

Most DSOs have well-established compliance and Quality Assurance programs. These often include a peer review component focusing on clinical practice and the performance of individual practitioners.

Why do these programs exist? Because the DSO's private equity investors demand it. They know that the reputational risk related to poor quality can damage or eliminate their investment returns.

They simply do not want that risk. The best way to mitigate that risk is with extraordinarily strong and well-structured quality assurance and compliance programs.

Private equity funds have a fiduciary responsibility to their investors to invest their capital in the most responsible way possible (control risk).

Attention to quality is hard-wired into the DNA of most professionally managed DSOs.

All the financial incentives that can potentially lead to DSO abuses resulting in poor quality also exist for dentists in private practice.

Non-DSO-affiliated dentists are being sanctioned by State Boards every week across the country for insurance and Medicaid fraud and practicing below accepted standards of care.

The primary difference between DSOs and private practitioners is private equity capital and the requirements for quality management programs that come with it.

Misguided belief—DSOs deliver an inferior level of care.

Reality—Most DSOs operate highly structured quality management and compliance programs to ensure that standards of care are being met.

Another misconception is that DSOs are not a good place for dentists to work and consequently have high rates of doctor turnover.

Given the high rate of educational debt for most dental school grads, many are looking for opportunities where they can be assured of earning a good living and can develop their clinical skills.

Many DSOs have clinical mentoring programs and internally provided continuing education programs to assist young dentists in the maturation process.

Professionally managed DSOs recognize that having a cadre of highly motivated, well trained, and capable practitioners is the engine that drives revenue and patient satisfaction.

Consequently, they offer competitive compensation and benefit programs coupled with above-average CE opportunities.

And the best young associates are often provided the opportunity to get into an equity position and to become the lead dentist in their own practice.

Helped by the DSO management company, they can achieve a better work/life balance and focus more of their time and attention on patient care.

Increasingly practicing in a DSO affiliated practice is becoming a first-choice career option for many young dentists.

Misguided belief—DSO affiliated practices are not good places to work for dentists and, as a result, experience high turnover.

Reality—The best DSOs offer competitive pay and benefit plans and robust CE and professional development opportunities making them highly attractive employers.

Implications for you:

Think through carefully the myths and realities related to DSOs. A clear-eyed sense of the truth will serve you well as you decide whether a DSO affiliation is right for you. DSOs will not be for everybody, and not every practice will be right for a DSO. Decide objectively in your own best interest.

CHAPTER 3

Why DSOs Exist and the Keys to Their Explosive Growth

Investors who recognized cell phones and the internet as *disruptive technology* and bought stock in Google and Apple for a few dollars a share, soon became multimillionaires.

The rapid growth of big corporate dentistry is disrupting the business of dentistry with the same intensity as smartphones disrupted the telephone industry, and Google disrupted search. Why, you might ask.

The one-word answer is: YIELD.

A well-run dental practice produces a great margin compared to most other businesses – even after paying the dentists working in the practice, far greater than a passive investor ever hopes to earn with bonds, treasury bills, or interest on a money market account.

Here it is on a napkin...

Money makes the world go around. Investors love yield. And brokerage houses and hedge funds can sell ANYTHING that promises a better than average yield on their money.

Wall Street has a love affair with consolidating high-profit businesses and then selling shares to investors who want a high degree of safety and higher than average returns on their money.

The investors behind consolidation seek to create value by bringing economies of scale and operational expertise to drive growth and increase profitability.

Real Estate Investment Trusts (REITS) are a perfect example.

Private Equity Firms own much of the skyline of every major city in America. They buy office buildings, warehouses, and apartment complexes. Manage them efficiently. Optimize revenue. And share the profits with the investors who own shares in the REITs.

This model of buying successful businesses, bundling them into a single entity (like a DSO or a REIT), and optimizing revenue – ***often to sell the entire enterprise to an even larger financial or strategic buyer for a MASSIVE PROFIT*** – is what drives the rapid expansion of DSO affiliated dental practices.

DSOs cannot continue their expansion without dentists being willing to sell or affiliate their practices with a DSO entity. Given the robust growth rate of DSOs, it's clear that increasing numbers of dentists are willing to do so. Once again, the question is why.

One answer is the fundamental economic rule of supply and demand. For several reasons, there are more sellers of dental practices than there are traditional dentist buyers.

According to the ADA, the largest demographic segment in the profession is dentists over the age of 55 – baby boomers.

While many of these dentists are not ready to fully retire from active practice. They ARE thinking about and plan their exit or transition strategy. So, there is a large and expanding pool of practice sellers.

At the other end of the continuum, there is a shrinking pool of potential dentist buyers.

According to the American Dental Education Association (ADEA), the average debt for a dental school graduate in 2018 was $285,184 – a ridiculously large number – and one that prohibits most young dentists from taking on the additional debt necessary to purchase a practice.

Most young graduates are more interested in a "job" – one where they can earn enough to service their debt and support their desired lifestyle and tend to be much less interested in financing the cost of purchasing a practice.

Another factor contributing to the shrinking pool of potential buyers is that 50% of today's graduating dental school classes are female. And female dentists are statistically much more likely to work part time and less interested in practice ownership than their male counterparts… not all but on average.

As you can see, the supply/demand curve is making life much more challenging for the practice seller.

DSOs are stepping into the vacuum created by these circumstances and have rapidly become the most desirable alternative, particularly for larger practices and small to mid-size groups, which are often unaffordable to individual dentists. Because of their private equity investors, DSOs have virtually unlimited access to capital – for them, the barrier of affordability simply doesn't exist.

One final factor contributing to the rapid rise of DSOs is their approach to valuation (which will be discussed in much more detail in a later chapter). DSOs can offer a premium to historical practice values resulting in a better financial outcome for the selling dentist than a traditional dentist to dentist sale.

While many in the profession think of DSOs in negative terms and as a threat to their future, they may be the best lifeline for a dentist interested in monetizing their practice equity.

Besides all the economic drivers discussed above, there are significant quality of life or lifestyle issues that attract many dentists into the DSO world.

In my forty-plus years of working with dentists, I have yet to meet one who said they wished they could spend more time paying the bills, dealing with staff issues, and the myriad of other business tasks that come with practice ownership.

Most DSOs have requisite capability and expertise in the following areas to support and assist their affiliated dentists:

- Finance and accounting
- IT
- HR, Recruiting, and Staff Development
- Compliance, Quality Assurance, & Risk Management
- Credentialing
- Marketing and Practice Growth
- Procurement

- Insurance Fee Negotiations
- Facility Management and Lease Negotiation

How great would life be with that kind of help and support? Better work/life balance and more time to focus on your patients would surely result.

All these factors have contributed to the robust growth rate of DSOs. And that growth is not expected to abate any time soon.

Implications for you:

How will the continued growth of DSOs affect you and your practice?

What will be the best method for transitioning your practice?

What do you most want to achieve in the next 3, 5, 10 years? Will it be easier or more difficult in a relationship with a DSO?

DSOs are here to stay. You should know why they exist and their potential impact on you and your practice.

CHAPTER 4

DSOs – a Macro View

With the explosive growth of DSOs over the last five years, there are now over seventy DSOs operating in the US. And they come in many types and flavors. Stealing a cliché… "if you have seen one DSO, then you have seen one DSO."

Having said that, it is still helpful to understand the main points of differentiation that distinguish one DSO from the next. Armed with this knowledge, you can select the DSO that best fits your own operating philosophy and approach to clinical care.

Most DSOs fall into one of two primary operating models, de novo (built from scratch) branded, and acquisition-based.

The de novo branded strategy is virtually a retail strategy similar to a store like the Gap or the Apple store. The retail operator selects desirable markets, builds out a location and operates a new store, or with the DSO, another practice location.

In the branded model, all the practices operate under a unified brand and usually pursue an aggressive direct to consumer marketing strategy.

Perhaps the best example of de novo branded operator is Aspen Dental Management Inc (ADMI). Headquartered in upstate New York, Aspen supports over 800 practice locations across the country.

Each practice is owned by a dentist who licenses the Aspen name from the ADMI parent and receives a variety of support services from the DSO. The local owner dentist remains responsible for all aspects of the delivery of clinical care.

Even though each practice is owned by a local dentist, the locations have a common look and feel and a similar operating model. Nearly all their locations have in house laboratories and strongly emphasize removable prosthetics,

Aspen has flourished by focusing on secondary communities (rather than big cities) where there is typically less competition, not uncommonly underserved dentally, and where media for marketing is less expensive.

An executive from Aspen's real estate team said that they know they have a high probability winning location when they find a newer strip shopping center with a Walmart, a Verizon store, and a Panera Bread. They plan on opening 75 additional locations in 2020 – a rate of approximately 1.5 per week, clearly a breakneck pace.

This rate of growth can only be sustained because of a highly developed operating model and a developed ability to drive new patient volume. This is achieved by the marriage of the right market and location selection, effective marketing strategies, and the ability to staff and operate for the successful delivery of clinical care.

Aspen has a very defined operating model and approach and is not for everybody as a result. Not everyone wants to practice the "Aspen way" but certainly works for those dentists who see this as a good fit.

The second primary DSO operating model is acquisition-based. This is driven primarily by acquiring or affiliating with an existing practice and most commonly contracting with the selling dentist to continue to operate the practice clinically with support of the parent DSO.

This is by far the most dominant operating model as compared to the branded approach. Most acquisition-driven DSOs keep an acquired practice's pre-existing identity to protect the goodwill that the selling dentist has built up over many years. As an example, John Smith DDS will continue to keep the same identity and operate as John Smith, DDS post-transaction.

There are a variety of acquisition-based DSOs, general practice only, mixed general practice and specialty, and increasingly specialty only. Many of these DSOs are adding de novo development to their strategy – adding locations to fill gaps in local markets and to provide ownership opportunities to successful associates.

One of the largest and most successful acquisition-driven DSOs is Heartland Dental based in Effingham, Illinois. Heartland was the first DSO to reach the threshold of 1,000 affiliated practices in December of 2019 and is now operating in 37 states. Heartland added 125 locations in 2019 and is planning a similar number in 2020.

Among the acquisition-driven DSOs, Heartland has one of the more prescriptive business models. One of the first orders of business for a new affiliate is for the dentist and his or her entire team to go to Effingham to attend "Heartland University" to learn and become acquainted with Heartland's operating approach, policies, and procedures.

For some, this is too confining, and they feel a little bit too prescriptive, but for many others, it is a very attractive alternative. No organization can achieve Heartland's sustained level of success without doing most things right and delivering strong results for its constituent practices.

Heartland was founded by a dentist in 1997 with 2 locations in Effingham and has grown over the last 23 years to its current scale and is now the largest DSO in existence. Heartland's private equity partner is Kohlberg, Kravis, & Roberts (KKR), a firm with $218B of assets under management. KKR is one of the leading and largest investment firms in the entire world and gives a sense of the level of interest from the financial community in the DSO industry.

Another way to differentiate DSOs is based on their size and years of operation. Aspen and Heartland are two of the largest DSOs and fall into the category of what is often called "enterprise" DSOs. Joining them is a handful of other DSOs, including Dental Care Alliance, Pacific Dental Services, and SmileBrands. To achieve this scale requires long-tenured operation. Not surprisingly, these enterprise DSOs are the longest standing.

As DSOs have proliferated, private equity has moved down market and invested in smaller group practices as a platform, meaning initial investment. They then plan on growing their platform and making incremental investments to build out the management teams and operating capability. The thing to remember is that private equity is ALWAYS focused on growth.

When it comes to size, you have the enterprise DSOs with as many as 1,000 practice locations (the Heartland example) down to the embryonic and nascent DSO with as few as 5 locations.

One last important point of differentiation is source of capital and how any particular DSO funds its growth. This typically falls into one of two buckets – either bank financed, or private equity financed.

Bank or debt-financed DSOs tend to be smaller in scale because banks have limits to the credit they will extend to any one borrower. These loans usually have recourse against the assets of the business, and sometimes, require a personal guarantee from the founder. So, there is an element of risk for the borrowing entity anytime there is a reliance on debt financing.

Another thing to be mindful of, access to bank financing often fluctuates with changes in the larger economy. In the Crash of 2008, bank lending came to a screeching halt overnight. It made no difference how creditworthy you were.

Private equity is the primary source of capital for many DSOs and without question, for all the larger operators. Private equity funds deploy their capital to generate an investment return for the investors in their fund.

Investors in private equity are typically in pension funds, university endowments, and high net worth individuals.

While macroeconomic problems may make it more difficult for private equity to raise additional funds, they still have the imperative of generating returns for their investors. Consequently, private equity is more stable than bank financing.

Most private equity funds have a target horizon of five years before they seek to sell their investment to generate a targeted return for their investors.

Understanding how private equity operates can be helpful.

Private equity funds differ in the number of dollars under management and available for investment. The consequence of this is for any given fund, there is a point at which a DSO outgrows the fund's ability to continue to finance growth.

This typically provokes a sale or recapitalization process. This usually results in a sale to a financial buyer, typically a larger private equity firm with more available capital. The second possibility is a sale to a strategic buyer, typically another larger company in the industry.

Most of the larger DSOs have been through several recapitalizations and have had multiple private equity partners over the years. With each change bringing a larger fund with more available capital to fund continued growth.

A relatively new phenomenon is often called a "duct tape" practice or DSO. This typically refers to some number of unrelated practices coming together prior to affiliating with a DSO to command a better valuation. This is sometimes successful and sometimes not depending on the level of integration there is in the newly aggregated enterprise.

If the aggregated practices are still operating in different locations with different practice management systems and with varying business practices, the value will be discounted. Integration matters.

Implications for you:

If considering a DSO, make your selection based on the DSOs ability to deliver against your goals. Be thoughtful about:

- *Operating Philosophy*
- *Organizational Culture*
- *Resources to support your practice*
- *Available capital to drive growth*

CHAPTER 5

How a DSO Values Your Practice and Why it Results in Hundreds of Thousands, Maybe Even Millions More for You

Let's start by understanding how banks value practices if a dentist to dentist sale occurs. This is the other option available to dentists selling a practice – if you are not transacting with a DSO, then you are selling to another dentist – these are the only buyers in the marketplace. There are no other alternatives.

In today's environment, banks are generally willing to loan 60 to 80% of topline revenue of the target practice to a creditworthy borrower. If you examined practice sales to dentist buyers over the last twenty years, you would find that the vast majority fell within this 60-80% of revenue range. Occasional exceptions exceed this range, but they are few and far between.

Factors that influence where in the range a practice might fall include profitability, trend (growing or shrinking), need for capital investment, fee levels, and new patient volume.

Practice appraisers' valuations independent of valuation methodology used almost always resulted in values that fell within this range. Why? Because that is the most that a dental buyer could borrow to fund the purchase. The limiting factor historically has been the limits on available bank financing.

If you are selling to another dentist, it likely will not be for over 80% of your topline revenue. This ceiling is driven by the artificial, but very real, limit of available debt from a bank.

The ultimate driver of practice-value in a doctor-to-doctor sale is: how much a bank will loan.

The ultimate driver of practice value in a DSO transaction, has nothing to do with what a bank will loan. DSOs don't need banks; they have virtually unlimited capital to buy good practices and are incentivized to do so. Their imperative is to drive investment returns. More on that in a minute.

The private equity investors in DSOs look at acquiring a dental practice as they look at buying a manufacturing business, or a distribution business, or any business – as an ongoing enterprise.

The valuation approach used by private equity is a **Multiple–of–Profit Valuation Model,** and profit is measured as adjusted EBITDA. EBITDA is an accounting term for earnings before interest, taxes, depreciation, and amortization and is a measure of free cash flow that a business generates. DSO buyers will pay a multiple of that number when affiliating with a practice.

An important fact – the higher the adjusted EBITDA, the larger the multiple that a DSO will pay. Your bottom line matters greatly.

This valuation approach not uncommonly results in values equivalent to 100 to as much as 150% of topline revenue.

I have been directly involved in several transactions that resulted in enterprise values of 150% of topline revenue.

In one instance, it meant an additional $2.2 million in purchase value above the 80% of topline figure. In another case it resulted in $9.8 million of additional value above the 80% of topline number (this was a multi-location group practice).

Those examples are not hypothetical but actual transactions that occurred.

The Multiple-Of-Profit Valuation Model versus the **How-Much-A-Bank-Will-Lend Valuation Model**, makes a massive difference in how much you'd net in a sale.

One additional limiting factor in a dentist to dentist sale is a dentist buyer almost always wants you to go away quickly. The purchasing dentist needs your production and income to service the debt required to buy your practice and to pay themselves a living income.

You must be ready to retire for a dentist buyer to acquire your practice. If you're not ready to take that step, then waiting or a DSO are the only alternatives.

Implications for you:

Understand the differences in practice valuation by type of buyer.

Be thoughtful about how to achieve the best financial outcome when you decide to sell.

Profitability is key, it's helpful to optimize your practice before selling.

No matter the buyer, question and understand their valuation approach and the results of their analysis.

CHAPTER 6

Your Step by Step Guide to Calculating Your Practice's Value Using the Exact Same Method Most DSOs Use

Introduction

Every dentist has an abiding curiosity about the value of their practice, and most are completely perplexed by knowing how to calculate that value. Until now. In these pages, I will show you step by step how to do those calculations yourself using virtually the same methodology that most DSOs use. How can I be sure? Simple... because I have either done it myself or seen it done by others countless times as I worked with dentists as they affiliated their practices with three DSOs (with whom I was employed).

Once you master and understand the underlying concepts, it is actually fairly easy. I understand you may not want to take the time to learn and do it yourself. If that's the case, I will do it for you simply as a reward for visiting my website. Just shoot me a quick email to stan@everythingdso.com and I will tell you what information I will need to do it.

Why is knowing the value of your practice important? Because knowledge is power and who doesn't want to be more powerful?

That last comment was a little "tongue in cheek". The real reason is that as the DSO phenomenon continues its march consolidating the profession and it will serve you well to understand how you and your practice might fit into the DSO universe.

As you consider a potential sale of your practice – no matter the reason – it will be helpful for you to understand your practice's value to a DSO buyer. This guide is intended to help you do that.

If I can answer any questions for you as you digest the information provided, please contact me at the email address above.

I hope you find the content useful – if you have any thoughts on how I can make it more so, I would be thrilled to receive your opinions. Fair warning… I may not take your advice, but please know that I am happy to have it!

Understanding the Concept of EBITDA

EBITDA is an acronym that stands for Earnings before Interest, Taxes, Depreciation, and Amortization and is commonly used by the financial and investment community as a measure of a business's free cash flow on a pre-tax basis.

EBITDA allows analysts to focus on the outcome of operating decisions while excluding the impacts of non-operating decisions like interest expenses (a financing decision), tax rates (a governmental decision), or large non-cash items like depreciation and amortization (an accounting decision).

By minimizing the non-operating effects unique to each company, EBITDA allows investors to focus on operating profitability as a singular measure of performance. Such analysis is particularly important when comparing similar companies across a single industry, or companies operating in different tax brackets.

Private Equity funds universally use EBITDA to evaluate the companies they invest in, and given the vast majority of DSOs are backed by private equity, the methodology rolls downhill and most DSOs use EBITDA to value practices.

Valuation analysts use adjusted EBITDA to arrive at a more accurate assessment of a practice's operating performance. What does this mean – adjusted EBITDA?

Standardizing EBITDA by removing anomalies means the resulting adjusted or normalized EBITDA is more accurately and easily comparable to the EBITDA of other companies, and to the EBITDA of a company›s industry as a whole.

KEY TAKEAWAYS

- The adjusted EBITDA measurement removes non-recurring, irregular and one-time items that may distort EBITDA.
- Adjusted EBITDA provides valuation analysts with a normalized metric to make comparisons more meaningful across a variety of companies in the same industry.

Adjustments to EBITDA are simply steps to make the number and any resulting conclusions more accurate. Don't worry…

I will show you how to manage the adjustment process and share some real-world examples so you fully understand.

As you go through the exercise with your own practice, if you have any questions, please contact me or if you would like me to review your work, I am happy to do so.

Understanding the Concept of Multiple – the Other Half of the DSO Valuation Story

Adjusted EBITDA gives an accurate measure of a practice's operational results and an assessment of the expected pre-tax free cash flow. But this is only half the story and not sufficient by itself to determine practice value. Generally, buyers of businesses, and in this case, your dental practice, are prepared to pay a multiple of adjusted EBITDA. Multiples are often expressed as a number and times or a number and x, thus a five times multiple is expressed as 5x. This means that the buyer is willing to pay five times the adjusted EBITDA in purchase price, or at a minimum, to ascribe that figure as the enterprise value of your practice.

Depending on deal structure, the buyer may not be paying all of the enterprise value in cash. Perhaps they will be buying a fractional interest with you retaining some interest yourself post transaction, or perhaps they ask you to hold a seller note for some portion of the purchase. The important thing to remember is that the term enterprise value refers to the total value of your practice – and I will teach you how to calculate it in this guide. Actual offers for your practice from DSOs will have variable deal structures in their proposals. The structures will play an important role in determining how the purchase consideration will flow to you.

Back to the concept of multiple. Multiples vary across industries based on profitability, performance in recessionary climates, need for CAPEX investment, and countless other factors. The average multiple across all industries is 3x. Fortunately, for dental, it is higher. Individual practices have been acquired for the most part for multiples ranging from 4 to 6x – sometimes lower and, in rare instances, higher.

There are a number of factors that influence where a particular practice falls in the prevailing range for dentistry. The first is scale, the larger the practice and the higher the adjusted EBITDA, then usually, the higher the multiple. Another factor is whether there is an expected requirement for capital investment; how old is the equipment, will the facility need to be renovated/upgraded. The greater the investment required, the lower the multiple. Other factors may relate to expectations around margin improvement and growth. If the DSO believes they have a clear line of sight to EBITDA improvement, then they will be more likely to pay a higher multiple.

Every transaction is a balancing act between perceptions around value and perceptions around risk. The logic is straightforward – higher perceived value results in a higher multiple and the higher the perceived risk results in a lower multiple.

Examples of issues that drive perceptions of risk include a high concentration of Medicaid patients. Government reimbursement can change with the stroke of a pen, plus there have been many examples of Medicaid fraud within the profession and most DSOs would rather not deal with it. Other examples of risk factors may include the recent departure of a high producing associate or problems with regulatory compliance or quality of care issues. It is easy to see how a buyer would be influenced by these concerns.

The schedule below gives you a rough idea how a DSO thinks about multiples.

ADJUSTED EBITDA RANGE	MULTIPLE RANGE
$250K–$400K	4x-5x
$500K–$700K	5x-7x
$800K–$1,000K+	6x-8x
$5,000,000+	8x-10x

Multiples are influenced by the competitive landscape as well as broad changes in the macro-environment. For example, with the impact of the recent pandemic, multiples have declined modestly and many DSOs are putting a portion of the purchase price into an earnout to ensure that future performance measures up to the historical – this is simply a way for the DSO to manage their risk. I tell you this so you understand that the ranges described above are generally accurate today they may fluctuate over time.

Step 1 – Calculating Unadjusted EBITDA

You will use either a Profit and Loss statement or your most recent tax return for the purposes of this calculation, both can work equally well. You will use one or the other and avoid mixing numbers from different sources as you complete your calculations. When a DSO performs this analysis, they prefer to use what is commonly called either an LTM or TTM P&L. This simply means the trailing twelve months (TTM) or the last twelve months (LTM) – these are the same thing. Using LTM numbers gives the analyst the most current snapshot of your practice's financial performance and this is the best predictor of near term, future performance.

E – Earnings

For this number, you will simply enter the bottom-line net income number from the P&L or tax return. I will give you an example at the end of this section.

B – Before

This simply means that the earnings number is **before** the following line items, interest expense, taxes (income), depreciation, and amortization are added back to earnings to give you your EBITDA number.

I – Interest

If your practice had any interest expense in the P&L, or in the tax return if you are using then you will enter that number as a positive value. If no interest expense has been recorded, then enter zero.

T – Taxes

This refers to any income taxes paid – it does not refer to payroll taxes or any personal property taxes. Given that most dental practices are pass-through entities, this is usually zero.

D – Depreciation

If there is a depreciation expense recorded, then you will enter it as a positive value. For example, if there was $25,000 of depreciation expense, then you will enter $25,000 here. If there is no depreciation recorded, simply enter zero.

A – Amortization

If there is amortization expense recorded in the P&L, then you will enter it as a positive value. If there is no amortization expense recorded, then enter zero. It is not uncommon that depreciation and amortization are not calculated until your tax accountant does the tax return for the practice. If so, it is not a problem because having the expense for these recorded and then added back is the same as not having recorded them in the first place.

The final step is to sum the total of all of your entries, and you will have completed the calculation of your unadjusted EBITDA. It is really quite simple.

Here is a quick example.

$423,000	Earnings (net income)
$23,421	Interest
0	Taxes
$12,346	Depreciation
0	Amortization
$458,767	Unadjusted EBITDA

I think you will agree, this part is easy.

Step 2 – Calculating Adjustments to EBITDA

This can be a little more complex. The primary purpose is to make the EBITDA conclusion more accurate by accounting for anomalies in the numbers that skew the results. Examples of some of the most common adjustments include expenses that accrue to the personal benefit of the practice owner that will be non-recurring in the future, such as auto expense, meals and entertainment, and travel among others.

Another common adjustment is to normalize the earnings of the seller post transaction to the terms specified in the employment agreement. The best way to do that is to add back any salary paid in the TTM period and then create a negative adjustment for the salary that would have been paid in the future based on the collections in the TTM period. You can see how this works in the example below.

Adjustments can be either positive or negative in value – a positive adjustment **adds back** any expense that will be non-recurring going forward and a negative adjustment **subtracts** any expense that represents an increase over and above what was recorded in the TTM P&L.

Think about adjustments as a series of pluses and minuses that will make the EBITDA number more accurate as a projection for the next 12 months.

As you go through your P&L, you should examine every line item and ask yourself if this expense will be the same next year assuming the collections remain constant and, in the alternative, will this expense go away in a partnership with the DSO.

This sounds daunting, but it really isn't. And as always, if you would like my help with this, just shoot me a quick email to stan@everythingdso.com.

I have included below an actual analysis for a particular practice.

Revenue	$ 1,956,929.00	
Earnings	$820,726.00	
Interest	$	
Taxes (income)	$	
Depreciation	$	
Amortization	$	
Preliminary Unadjusted EBITDA	$820,726.00	
Adjustments		
Total Dr. Comp Actually Paid	$366,911.00	Includes owners and associate
Total Employer FICA Paid	$27,738.47	Calculate at 7.65% of Dr. wages
Charitable Contributions	$12,544.00	Non-recurring
Legal	$2,183.00	Non-recurring
Business Meals	$10,284.00	Non-recurring
travel	$1,495.00	Non-recurring
Gifts	$3,000.00	Non-recurring portion
Dr. Comp to be paid	$(460,949.61)	Based on total Dr. collections of 1,396,817 @33%
Employer FICA to be paid	$(35,262.65)	Calculated at 7.65% of Dr. wages
Less 30% of labs	$39,749.82	added back as a reduction to DR. comp
Adjusted EBITDA	$788,419.04	

In this example, I added back the comp paid and then created a negative adjustment for the comp going forward and eliminated (by adding back) a series of non-recurring expenses. The net effect of all of these changes was to reduce the EBITDA from the P&L of $820,726 to $788,419. This is derived by totaling the Unadjusted EBITDA with all of the adjustments to resulting in a final Adjusted EBITDA figure.

One other adjustment that most DSOs will make is that they will adjust for the change in costs of moving from your benefit plans to their benefit plans. These adjustments are DSO specific and impossible for you to know in advance. Don't worry… this exercise gives you a reasonably accurate ballpark estimate of your practice's value to a DSO buyer. The final, most precise number will be the product of the DSOs own internal analysis.

The Final Step – Plugging in the Multiple

You have arrived at a calculation of the adjusted EBITDA for your practice – now you need to select the multiple. Repeated below is the schedule of EBITDA ranges and the corresponding multiple ranges reflecting current DSO thinking. I recommend you find the multiple range that fits your adjusted EBITDA number and select a multiple in the middle of the range – this will give a reasonably accurate value for your practice in today's world.

ADJUSTED EBITDA RANGE	MULTIPLE RANGE
$250K–$400K	4x-5x
$500K–$700K	5x-7x
$800K–$1,000K+	6x-8x
$5,000,000+	8x-10x

For example, if you have adjusted EBITDA of $525,000, select a 6x multiple (the middle of the range) and you arrive at an enterprise value of $3,150,000 for your practice.

There you have it, you have just calculated the value of your practice using the same method that DSOs use.

Again, if you need my help or would like me to review your calculation, just shoot me an email at stan@everythingdso.com. I will be happy to help.

Understanding the Difference in Traditional Approaches to Practice Valuation and the DSO Approach

At the risk of being repetitive, I want to repeat the comparison between the DSO approach to valuation and how a traditional bank lender looks at it. Let's start by understanding how banks value practices if a dentist to dentist sale occurs. This is the other option available to a dentist selling a practice – if you are not transacting with a DSO then you are selling to another dentist – these are the only buyers in the marketplace. There are no other alternatives.

In today's environment, banks are generally willing to loan 60 to 80% of topline revenue of the target practice to a creditworthy borrower. If you examined practice sales to dentist buyers over the last twenty years, you would find that the vast majority fell within this 60-80% of revenue range. Occasional exceptions exceed this range, but they are few and far between.

Factors that influence where in the range a practice might fall include profitability, trend (growing or shrinking), need for capital investment, fee levels, and new patient volume.

Practice appraisers' valuations independent of valuation methodology used almost always resulted in values that fell within this range. Why? Because that is the most that a dental buyer could borrow to fund the purchase. The limiting factor historically has been the limits on available bank financing.

If you are selling to another dentist, it likely will not be for over 80% of your topline revenue. This ceiling is driven by the artificial, but very real, limit of available debt from a bank.

The ultimate driver of practice-value in a doctor-to-doctor sale is: how much a bank will loan.

The ultimate driver of practice value in a DSO transaction, has nothing to do with what a bank will loan. DSOs don't need banks; they have virtually unlimited capital to buy good practices and are incentivized to do so. Their imperative is to drive investment returns. More on that in a minute.

The private equity investors in DSOs look at acquiring a dental practice as they look at buying a manufacturing business, or a distribution business, or any business for that matter – as an ongoing enterprise.

The valuation approach used by private equity is a **Multiple–of–Profit Valuation Model,** and profit is measured as adjusted EBITDA. EBITDA is an accounting term for earnings before interest, taxes, depreciation, and amortization and is a measure of free cash flow that a business generates. DSO buyers will pay a multiple of that number when affiliating with a practice.

An important fact – the higher the adjusted EBITDA the larger the multiple that a DSO is willing to pay. Your bottom line matters greatly.

This valuation approach not uncommonly results in values equivalent to 100 to as much as 150% of topline revenue.

I have been directly involved in several transactions that resulted in enterprise values of 150% of topline revenue.

In one instance, it meant an additional $2.2 million in purchase value above the 80% of topline figure. In another case, it resulted in $9.8 million of additional value above the 80% of topline number (this was a multi-location group practice).

Those examples are not hypothetical but actual transactions

Implications for you:

Know that you can develop a reasonable estimation of the value of your practice using the guide I have provided.

Understand the underlying concepts of EBITDA and multiple and why a DSO buyer will typically pay more for your practice than another dentist.

CHAPTER 7

Arbitrage – Private Equity's Secret Sauce

Arbitrage refers to the practice of buying an asset for fair market value in one market and selling it for a higher price in a different market where different factors drive value.

Private equity funds raise money from investors, usually pension funds, college and university endowments, and high wealth individuals. They then use that money to acquire companies to increase their value over time. The end goal is to sell at an increased value over the acquisition cost, thus generating a return for its investors and the operators of the fund.

Arbitrage is their core strategy for how private equity generates a return for their investors. They seek to buy low and sell high.

The capital available from private equity partners has fueled the explosive growth of the DSO industry. Investments in the dental space have proven remarkably successful for private equity over time,

Private equity itself has exploded in recent years. At the end of 1990, there were 312 private equity funds in existence. At the end of 2017, that number had grown to 5,391 funds with $2.83

trillion in assets under management. The net effect is that more cash to invest means more firms seeking more investments.

The dental profession has been ripe for consolidation given that most practices have existed as solo or small groups over the years.

As consolidation grew across other health care service sectors, inevitably, it would eventually reach dentistry.

As you may recall from an earlier chapter, most private equity firms have a targeted five-year horizon before they seek to get liquidity on their investment – this means selling their interest, either to a larger private equity fund or to a larger DSO seeking rapid growth.

There is a distinctly greater value to a fully integrated practice as part of a large well-organized DSO than as a stand-alone entity, often twice the value or more.

By well-organized, I mean a DSO with a strong management team, a well-developed capacity to grow, and a demonstrated ability to lower costs and grow revenue for its constituent practices.

To make it simple, the DSO acquires your practice for 4-7 times adjusted EBITDA and then sells it some years later for 1.5 to 2 times that amount.

The arbitrage between the Buy and Sell is the primary driver of investment returns for the private equity fund.

Arbitrage enables the DSO to pay a premium for your practice and to generate an investment return. This is commonly called a win-win.

Several DSOs will allow some rollover of the purchase price into an investment in the DSO parent company enabling you to benefit from the arbitrage.

This rollover equity gives you an opportunity for another bite of the apple and to improve your overall net return.

Arbitrage is at the core of private equity interest in the dental profession and many funds have used it with great success. Success that only intensifies interest in the DSO sector.

Implications for you:

Should you consider affiliating with a DSO, understand the role of arbitrage in the overall equation.

If you roll over some proceeds of the sale into the DSO parent, make sure you understand the terms and investment opportunity – how and when are you likely to achieve liquidity and where does your equity reside – at the practice level or at the holdco level.

CHAPTER 8

Understanding DSO Deal Structure

There are two kinds of purchase transactions when buying a business; an asset purchase where the buyer essentially buys all of the assets out of the seller's entity, and a stock purchase where the buyer buys all of the existing stock (or membership units if an LLC occurs or partnership).

Nearly every DSO transaction takes the asset purchase route. The reason for this is clear. In a stock purchase, the buyer assumes all of the liabilities, both known and unknown, of the seller's entity. Buyers generally want to avoid this risk as this could include everything from malpractice liability, unpaid bills or taxes, and virtually everything else under the sun.

A stock sale is always most beneficial to the seller because of differences in tax treatment of the money you receive. In a stock sale, usually, 100% of the proceeds above your basis are taxed as capital gains.

In most DSO asset purchases, the DSO can get 75-80% of the cash you receive as capital gains and 20-25% as ordinary income.

The consideration you will receive in a transaction with a DSO typically falls into some combination of five buckets – cash (paid at closing), deferred cash (cash in a hold back for some defined period), rollover equity in your own practice and/or rollover equity in the parent DSO holding company, or debt (a note payable to you over time).

There is another potential component and that is a contingent earn out provision that provides for the payment of additional cash consideration if certain benchmarks are achieved.

The deal structure is built on the valuation of the practice, commonly called the enterprise value. As described in a previous chapter, enterprise value is a function of the adjusted EBITDA (Earnings Before Interest, Taxes, Depreciation, and Amortization) of your practice and the multiple of EBITDA the DSO has agreed to pay.

Multiples have remained either stable or grown over the last several years. Because of the Coronavirus pandemic of 2020 and the impact on dental practices, valuations will likely come down – at least in the short term.

The reason for this is that every transaction is a function of two variables; value and risk. Every buyer tries to strike the optimal balance between the two, even in the best of times. The shuttering of practices due to the pandemic caused serious decline in practice revenues and it is unknown how rapidly and to what degree they will return to pre-pandemic levels.

The net effect is more risk and more ambiguity around value until greater certainty of practice performance returns.

Let's take a brief look at each category of potential consideration offered by a DSO.

CASH – This is self-explanatory, cash generally does not require a description. Cash is typically paid at the time of closing in the original transaction, what is important for you to understand is how much net cash you will have on an after-tax basis and after any debt has been retired. If you are carrying any debt on your balance sheet, it will need to be repaid concurrent with the closing. The number you need to know is the final net cash you will have available for your personal use going forward.

DEFERRED CASH – Deferred cash is just that, it is not a note or seller-financed loan. Most commonly, it is an escrowed amount held back as indemnification against your representations and warranties. In every transaction, the DSO usually asks the seller to make certain representations and warranties regarding the practice and information provided. Dollars are escrowed against the veracity of the reps and warranties. If there is no claim against the escrow, then the funds are usually released after 12-18 months. This escrow provision is a common feature in the purchase of a business, in this case, your dental practice. It is important for you to understand the terms of the escrow; how much money is deferred, is there a deductible below which a claim will be absorbed by the buyer, is there a maximum established for any individual claim, and lastly what is the term of the escrow and when will funds be released. I should note that in the dozens of transactions I have been involved in, there was never a claim against the escrowed funds and all of the money was returned to the selling dentists.

ROLLOVER EQUITY (PRACTICE LEVEL) – DSOs are increasingly pursuing a partnership model where the selling dentist has a retained equity interest and continuing "skin in the game". The logic is straightforward. It aligns incentives between the DSO and you as the lead dentist in the practice – if the DSO does well, then you also do well. If revenue and profit grows, then so does the equity value of your retained interest. Ostensibly, it will be more valuable in the future than it is today. If your retained interest is 30%, then you will be entitled to 30% of the profits that the practice generates. This will be besides dollars you earn as a chairside producer. It is important that you understand how the practice profit is calculated. Most DSOs charge a management fee to the practice for the services they provide and to support their corporate overhead. Will the profit calculation be determined after the management fee cost (most commonly yes)? Therefore, you must understand how the management fee is calculated and further, how does it impact profit calculation. Are there any other deductions burdening the P&L aside from normal practice level expenses? On what schedule will the profits be distributed? And last, when you are ready to retire from active practice, how will you sell this residual equity. Will the DSO buy it, will they assist you in selling it or will it be your exclusive responsibility. The way DSOs handle this varies widely and can be of a greater or lesser benefit to you as the seller.

One interesting variation of one particular DSO is that retained (or roll over) equity at the practice level can be sold when the DSO sells or recapitalizes. This gives you the best of both worlds – a joint venture interest at the practice level and a percentage of the profits as well as the ability to monetize it as if it was the same as equity at the Holdco level – which will typically be at a much higher multiple than the original purchase.

ROLLOVER EQUITY (MANAGEMENT COMPANY OR HOLDCO LEVEL) – Many DSOs will offer rollover equity in the overall DSO enterprise as opposed to the individual practice level. This puts you in complete alignment with the DSO and their financial sponsor. You will get liquidity on the holdco equity when the DSO either sells or goes through what is described as a recapitalization – so the financial sponsor sells their interest to another larger financial sponsor and the equity holders share in the outcome of that sale. Unlike the practice level equity there is no profit distribution or return until the sale or recapitalization takes place.

The potential returns can be significant with Holdco equity, but it is important that you understand certain aspects of your equity position. First, how is the dollar value of your rollover investment converted to equity. Sometimes, the closer the DSO is to a sale or recap, the less equity you obtain on a dollar for dollar basis than if you invested earlier in the lifecycle. The rationale being that as the DSO adds practices and increases revenue, it is then more valuable, and each dollar therefore buys less equity. Secondarily, where is the DSO on that sale/recap timeline? The answer to this question will determine when you will get liquidity. Mot private equity funds target a five-year holding period for their investment. It is also important to understand the class of your equity – do you stand side by side with the financial sponsor or do you stand behind them and only get paid after the sponsor achieves a certain investment return.

The main takeaway here is that all equity is not equal, and DSOs offer a range of equity structures. To the best of your ability, you want to be able to estimate the investment return on your Holdco equity and when you can expect to achieve that return.

SELLER NOTE – Some DSOs will pay some portion of the purchase price in a note to be paid to you over time, usually with a specified interest rate. If there is a note component to your deal, you simply need to understand the principle amount, the interest rate, and the term or schedule of payments (the DSO should provide an amortization schedule). Finally, you need to understand if there are other conditions of the note. For example, I have seen notes termed to run concurrent with the initial term of the seller's employment agreement with the condition that if the seller violated the terms of the employment agreement then some portion of the note would be forfeited.

CONTINGENT EARN OUT – Earn Outs are used most often when there is some ambiguity around expected future performance or the practice is fast-growing, and the DSO buyer wants to avoid penalizing the seller by giving them a pathway to full value if certain benchmarks are achieved. Many DSOs are adding an earn out component to their deal structure because of the pandemic of 2020. Uncertain about if and when a practice will return to pre-covid performance levels they use a contingency based earn out providing for additional purchase price if benchmarks are reached and if they aren't, then they have paid a fair price for value received.

If there is a contingent component in your deal, you need to understand the contingency, is it prorated or an all or nothing structure – meaning that if you hit 90% of the target will you get 90% of the earn out or do you have to hit 100% of the target to get paid? And finally, what is the defined time frame within which the benchmark must be achieved.

The primary purpose of an earn out is to ensure pricing that is fair to both buyer and seller based on actual performance.

Implications for you:

The headline dollar amount being offered can often be misleading due to differences in the structure of how the consideration will be paid.

Differences in deal structure can make it difficult for you when comparing offers. It is important to understand the details of each offer and how the net economic value to you compares from one to the next.

This issue alone makes it important for you to get independent objective advice when comparing offers.

CHAPTER 9

Understanding the Deal Journey from Beginning to End

The beginning of exploring a partnership with a DSO in a tangible way usually begins because of one of three events:

1. A decision by you as the owner dentist to explore a transition.
2. A referral from a colleague who has affiliated with a DSO and found the experience to be positive.
3. An unsolicited approach or expression of interest from a DSO or emerging group practice.

Independent of your entry point on the pathway to a potential DSO partnership, the process universally has a common set of waypoints – each of which I have described below.

STEP 1–INITIAL EXPLORATORY CONVERSATION

The process almost always begins with a conversation with you to get a high level of understanding of your goals and interests and whether your practice is a potential fit for their organization. From your side of the table, it should answer any preliminary questions you may have, help to give you a high-level understanding of the affiliation process and timeline, and enable you to decide if you want to advance to the next step.

This conversation is almost always with a member of the DSOs business development team. These individuals usually have a strong understanding of dental practices and are very experienced in the transaction arena. Most often, the person you interact with in these conversations will be the one to hold your hand and marshal you through the process to get to a closing.

The more clarity you can provide related to your goals and motivation for exploring a DSO partnership, the better it will be for you and for the DSO. This is key to understanding if any continued discussion makes sense for you. At each step of the process, there is a mutual decision to be made… "Do we advance to the next step?". Each additional step implies a deeper involvement.

Notwithstanding that fact, there is no obligation to move forward until definitive closing documents are executed. In other words, you can walk away without penalty anytime up to that point.

STEP 2–NON-DISCLOSURE AGREEMENT (NDA)

To move the process forward, there will be a requirement for you to provide financial and operating information about your practice to the DSO and for the DSO to provide certain information to you. An NDA is simply an agreement between you as the seller and the DSO as the buyer to keep any information disclosed by either party confidential.

The NDA prevents the DSO from disclosing to anyone that they are in discussion with you. And if the DSO submits a Letter of Intent or discusses the terms of a potential offer with you, it prevents you from disclosing those details to anyone other than your advisors,

Too frequently, I saw dentists waste time and money with their attorney trying to negotiate terms of the NDA. This is usually a fool's errand. The agreements are standardized, proven in use many times over, and usually fairly benign and balance the interests of both parties fairly.

Have your attorney review the agreement before signing it for any unreasonable provisions but avoid wasting time on immaterial issues.

The NDA provides a framework for the exchange of information with the surety of confidentiality.

STEP 3 – INITIAL DATA SUBMISSION

The DSOs first step in developing a potential offer for your practice is to complete a preliminary valuation analysis. To do this, they will request a set of financial and operating data on your practice. Below is a list of the information most commonly requested:

1. P&L's and Balance Sheets for the past three years and YTD
2. Tax Returns for the most recent three years
3. Production and collection reports by the provider for the same period
4. Production by category last twelve months
5. List of practice employees, wage rate, and benefits provided and associated costs

6. List of participating PPOs and allowable fee schedules plus UCR fee schedule
7. New patient volumes and marketing initiatives
8. Copy of facility lease
9. A list of any personal expenses expensed through the business and any non-recurring expenses in the P&L

The DSO will make a value judgment based on the timeliness and accuracy of the data you provide. Inaccurate data inevitably leads to questions regarding either competence or integrity.

The DSOs valuation analysis seeks to establish an adjusted EBITDA number for your practice, which drives their conclusions about value. Once they have completed their analysis there will usually be a discussion with you about their results and the terms upon which they would be prepared to go forward. These terms generally will include:

- The enterprise value of your practice
- A proposed transaction structure
- Definition of how the consideration will be paid (cash, note, rollover equity, etc.)
- Broad terms of your post-transaction employment agreement

If their terms are acceptable to you, then there is a move to the next step. If the terms are unacceptable, you certainly have the option to negotiate and to submit a counteroffer with terms you deem acceptable. Typical of all discussions between buyers and sellers, there is occasionally some push/pull on price. This is the appropriate point in the journey to resolve any differences, or not.

STEP 4 – FORMAL LETTER OF INTENT (LOI)

The LOI memorializes the terms discussed with you in the previous step. The LOI also signifies the DSOs desire to conclude a transaction with you. Until the LOI, for the most part, there has been nothing but "talk". The LOI is tangible evidence that the DSO does wish to transact with you and outlines the specific terms on which they are willing to proceed.

It is certainly a good idea to have your attorney and any advisors review the LOI before signing.

An important thing to understand is that most LOI's are non-binding regarding an obligation for either party to conclude the transaction. If you become uncomfortable or dissatisfied in any way you can walk away – usually without penalty. The same is true for the DSO, they usually have a due diligence out. Which means the same thing, if they become uncomfortable with moving forward for any reason, they can walk away.

If there is a termination of the transaction, usually there is a surviving obligation of confidentiality.

Sometimes, particularly with larger transactions or a formal auction process being managed by an intermediary, there is an interim step where buyers submit an Indication of Interest (IOI). This allows sellers to choose one or two final buyer candidates with whom they wish to negotiate the final terms of an LOI.

STEP 5 – QUALITY of EARNINGS ANALYSIS AND DETAILED DUE DILIGENCE

Most DSOs and Private Equity Buyers will want to complete a quality of earnings analysis, often abbreviated to QofE. What exactly is this?

It is a detailed, often exhaustive, review of the income and expenses that flow through your practice usually prepared by an external accounting firm. It also often adjusts for moving to an accrual-based accounting approach.

The goal of the QofE exercise is to validate all of the numbers that drive the valuation of your practice and the eventual transaction.

Buyers have a fiduciary responsibility to their investors and shareholders to ensure that purchases are based on accurate financial data.

Buyers will also conduct some level of operational and clinical quality review before proceeding with a transaction.

The operational review is usually conducted onsite and seeks to understand the systems and processes in place to run your practice(s) day to day. The Buyer will evaluate everything from your new patient acquisition strategies, revenue cycle management, regulatory compliance, to every other aspect of how you operate.

The review of clinical care may occur onsite but also may be handled remotely and most commonly involves a chart audit of a random selection of clinical records. The charts will be reviewed for the completeness and accuracy of the clinical notes, and compliance with established standards of clinical care. Frequently EOB's are compared with chart entries to ensure consistency.

The chief takeaway here is that the Buyer will probe every nook and cranny of your practice and you cannot hide any "blemishes". It is in your interest to be absolutely honest at all times throughout this process.

If there are problems or issues, you want to be upfront and disclose them. It is better to be proactive and ahead of the "story" than to be reactive and playing defense.

STEP 6 – FINAL PRICING AND BUYER DECISION

The information uncovered in the preceding step will be used by the Buyer to determine final pricing and terms of the proposed transaction. This may or may not result in change to the pricing and terms outlined in the Letter of Intent.

Most Buyers prefer not to adjust from what was outlined in the Letter of Intent because they know how unsettling it can be for the seller.

Most buyers, whether a DSO or a Private Equity Group, have some kind of structured internal decision process – usually review by their Board of Directors or an internal review committee before rendering a final decision on the proposed transaction.

Buyers will have spent considerable time and money to get this far in the process and have a strong bias to say yes. It usually takes some egregious problem identified in the

QofE or diligence work for them to retreat from the proposed transaction.

Both buyer and seller have the option to say red light or green light before moving to the final step – preparation and negotiation of definitive agreements.

Before you spend significant dollars with an attorney you want to be sure that the proposed transaction has received approval and will close once the legal agreements have been negotiated and are in place.

STEP 7 – NEGOTIATION AND PREPARATION OF FINAL LEGAL DOCUMENTS

The final step preceding closing is the preparation of the legal agreements enabling the transaction.

Most DSOs have consummated many transactions and usually will have a standardized form of legal agreements. These may need to be customized for your particular transaction, but typically at their core will conform to their standard approach.

The legal agreements will outline all of the specific elements of the transaction that will occur upon closing and will define the DSO's obligations to you and your obligations to the DSO. Everything that has occurred up to this point occurred solely to inform this step. It is essential that you get experienced and competent legal advice as you finalize these agreements.

A word of advice. This is not the time to use your brother-in-law, a real estate attorney, who will do the work for you for a reduced fee.

You may have a relationship with an attorney who has helped you with other practice-related legal matters. He/she may or may not be a good choice to represent you. It is important that you use an attorney experienced in health care transactions, and ideally one with specific experience representing dentists affiliating with DSOs.

One more thought on attorneys. In my experience, attorneys fall into one of two buckets. The first group is those that understand their client's ultimate desired outcome – mutually agreeable terms and a closed transaction. Attorneys in this group focus only on issues of material concern to their client. They are time-efficient, cost-effective, and attentive to their client's interests.

The other group makes mountains out of molehills – failing to differentiate between that which is material and that which doesn't matter. They are expensive because they waste time and generally do a poor job of acting in their client's interest.

This is why it is important to consider using an attorney with DSO transaction experience. The knowledge borne out of experience enables them to be more time-efficient.

STEP 8 – CLOSING AND TRANSFER OF FUNDS

This is the final stop on the long journey from initial conversation to a closing transaction. This process from start to finish takes 60-90 days, occasionally faster and sometimes slower.

Most DSOs can do a virtual closing – one where you do not need to be physically present to review and sign documents at the closing table. Most commonly both you and the DSO will sign documents before the closing, and they will be held in escrow by the attorneys until approved for release, consummating the transaction.

Any cash required to be paid is usually transferred via a wire transfer sending the funds directly into your account. If there is any practice debt to be paid at closing those funds are also typically paid via wire transfer

You will be receiving a substantial amount of cash at closing and it is vitally important that you work closely with your accountant to determine your tax liability. Paying any tax liability promptly will insulate you from any penalty or interest obligations.

Implications for you:

Be honest and forthright in all of the information you share with the DSO – your credibility depends on it.

You can avoid wasting time and money by using an attorney experienced in these kinds of transactions. Trying to pinch pennies on your legal representation will cost you more in the long run.

The timeline will be favorably influenced by your ability to provide information in a timely and organized way. Anticipate what will be required and work to assemble the information in advance.

Getting to a closing is time-consuming, sometimes, arduous. It will test your patience – keep your eye on the goal of getting it done.

CHAPTER 10

The Leading Reasons that DSOs Decide Not to Move Forward

DSOs are highly motivated to grow. For most, the primary method is through acquisitions. Remember, the DSO WANTS to consummate a transaction with you once they have issued a Letter of Intent.

There are a handful of circumstances where a DSO may decide not to go forward. Understanding what these are can help you avoid them or to work to remedy them before engaging the affiliation process.

Most DSOs operate with a geographic strategy in mind. ***Consequently, you may find that your practice is simply not a good fit for a particular DSO based simply on location.***

Most DSOs have a target acquisition profile for practices they wish to acquire. This profile often relates to revenue, level of profitability, facility size and condition, payor mix, and other factors. ***If your practice differs from this profile, there may be no interest in moving forward.***

The above issues are filters that DSOs use to screen candidates on the front end of the process – basically asking and answering the question of whether or not your practice is a good strategic fit,

There are several reasons that acquisitions fail to close once a letter of intent has been executed. Typically, this is the exception and not the rule. Most DSOs are very capable in their initial screening and analysis of acquisition candidates. Once an LOI is mutually executed the probability of close is extremely high.

Deals do occasionally go sideways, most often for the reasons cited below.

Initial assumptions regarding the numbers fail to hold up during the Quality of Earnings (QofE) analysis. This doesn't happen very often, but it does happen. When it occurs it usually leads to a re-pricing discussion with the outcome that either one or the other party finds unsatisfactory.

The QofE analysis is a deeper dive and more comprehensive review of your financials also usually adjusts from a cash basis method of accounting to accrual. It is not uncommon that this effort results in some adjustments from their preliminary analysis.

The DSO will sometimes conclude that the seller has been less than forthright or somehow acted in bad faith. DSOs are interested in partnering with individuals who they can rely on to act in the mutual interest of all parties. Faced with any evidence to the contrary. They will not uncommonly pull out of the deal. The lesson here is that if there are problems, disclose them. Always be forthright and honest in all of the information you provide during the diligence process. It is always better if you disclose any potential problems or issues rather than have the DSO uncover it in their diligence work.

> **Occasionally there is an inability to resolve differences in negotiating the final legal agreements. This is exceptionally rare, but it does happen.**

In the end, all the details of the proposed transaction will be addressed in the definitive legal agreements. Make no assumptions, be sure you read them carefully to be sure they conform to your understanding of what is supposed to happen.

You cannot rely exclusively on your attorney to do this for you. He/she has not been a party to all of the discussions leading to this point.

Your attorney will alert you to any issues of concern in the documents from a legal perspective – vulnerabilities or exposures if you will.

I am a believer that finalizing legal agreements is always well served by clarity. When you communicate your concerns, be clear about what is or is not a deal-breaker for you. This tells the other side the importance of the issue and whether flexibility is required.

In my experience, it is an exceedingly small minority of transactions that don't close once a Letter of Intent has been agreed to. But it does happen and knowing the leading reasons may help you keep your deal out of the ditch.

Implications for you:

In the same way that a DSO will screen you for strategic fit, you should screen them for a fit with you and your target goals in pursuing a DSO relationship.

Don't be alarmed if the first DSO you speak to is not interested. Try and learn why. There are countless DSOs out there and more entering the market every day. Each has their own unique approach to the type of practice they are interested in.

Familiarize yourself with the reasons deals go sideways. Most often, deal failure is preventable.

CHAPTER 11

What Happens to My Staff?

Every dentist who ever affiliated with a DSO has asked this question – for completely understandable reasons. Your team has been essential to you achieving whatever level of success you have attained. Given you will be required to remain employed in the practice for some period of time post-transaction you don't want your new DSO partner to do anything to upset the apple cart. It is in your interest for your staff to remain with you and to be happy and content with whatever changes unfold. Also, if you are like most successful dentists, you have many staff members who have been with you for many years and you want to do right by them.

Here's the truth. The best DSOs and their private equity partners are shrewd and capable businesspeople. They realize their success is completely dependent on having capable, motivated, and happy staff and their approach to staff issues reflect this knowledge. It starts with them making sure they communicate with your staff what is happening, why, and how it will affect them… before it happens. Usually, it boils down to the fact that the name on the paycheck changes and there may be some change in how certain administrative or financial tasks are managed. Your auxiliary staff will most commonly become employees of the DSO's management company entity.

The most common potential change is some adjustment to their benefits. The federal government requires that companies not differentiate the benefit package offered to individual employees within the same company so your employees will move to whatever benefit package the DSO offers. In some instances this will result in better benefits or lower cost and an improvement, or if your historical benefits were richer than what the DSO provides, it may result in fewer benefits. In the event of a negative change, many DSOs will take the dollar difference in the cost of the before and after and increase compensation accordingly to minimize the financial impact on staff. The DSO will seek to quantify these changes as part of their initial financial analysis.

Usually, you will retain hiring/firing authority post-transaction. The DSO knows you built the team and culture in place and you are the best person to maintain it going forward. They will have resources to help you in this area as most have very robust HR function designed to support you.

The universal fear is that compensation levels will change. This almost never happens. The DSO leadership recognizes that alienating staff in the pursuit of short term financial gain is short-sighted and a failing strategy. Plus, your existing levels of staff compensation are already baked into your historical performance and profitability. Their financial analysis and modeling will reflect these costs.

Does this mean that a staff member's compensation can never change? As stated this almost never happens but on rare occasions it might – usually in the case where a staff member is being paid well above market and you ask your DSO partner for help in correcting the situation. For all the reasons previously stated, DSO's almost never arbitrarily reduce compensation.

There are several ways that your staff can potentially benefit from a DSO partnership. The first is increased opportunity for promotion. Inside your practice promotion opportunities are finite. When your practice becomes part of a much larger organization additional "rungs on the ladder" immediately become available.

Let me give you two specific examples. An office manager in a practice that partnered with a DSO I was involved with demonstrated the ability to take on more responsibility. With the blessing of the dentist she worked for, she was promoted to a regional manager position with responsibility for a portfolio of practices. In another situation a very capable and high functioning person working in a practice was brought into the corporate office into a role supporting the business development team. She is now a Director of Business Development with a regional responsibility for a DSO at a dramatically higher level of compensation and responsibility than could ever be achieved inside a dental practice. Both of these outcomes could only be achieved with DSO partnership.

The second way that staff can benefit is through access to enhanced training and development opportunities. The largest DSOs all invest heavily in staff development and training programs. Improving knowledge and skills is the fastest way to achieving better pay and promotions for employees. Individual practices can't afford the investment required to build these kinds of programs but DSOs with their scale and resources can. Workforce development is critical to their long term success.

The third way was alluded to earlier. DSOs with their scale are often able to offer a richer benefit package at lower cost than individual practices can. In the example of health insurance, this may result in more comprehensive coverage, lower premiums, and/or lower copays and deductibles. Economies of scale are one of the underlying principles behind the DSO movement. DSOs, as a result of their size are able to make investments that individual practices, no matter their size, cannot. These investments commonly accrue to the benefit of your staff.

I want to acknowledge something – change is difficult and for some individuals nigh on to impossible. The nature of the change matters little. Some folks, and maybe one or more of your staff, find change of any kind intolerable. Know that if this occurs, it cannot be helped. The best that you and your DSO partner can do is to be transparent, communicate clearly about the potential benefits, and respond frankly to any questions or concerns.

In my experience once staff realize that you will still be involved they are generally reassured. They will take their cue from you – if you talk about the pending partnership with enthusiasm and paint a picture of how things will change for the better they will respond favorably. In the alternative if you talk about it in the context of your financial benefit (which they don't participate in or appreciate), they will be much more likely to respond negatively.

My message here is twofold. First, usually there are more benefits than detriments for your staff in a DSO relationship. Second, communication matters. The messaging from you and your DSO partner matter immensely. Do it right and your staff will respond with enthusiasm and commitment. Do it wrong and things will be more difficult than they need to be.

Implications for you:

Your staff will be apprehensive about the possible consequences for them of your decision to partner with a DSO. Their primary concern is "how will this impact me?" How you communicate with them will be critically important. Consult with your DSO partner how best to manage the communication and the optimum timing. Understand the DSO's policies relating to staff; specifically any available benefit package and cost, compensation, and any other relevant considerations. Be deliberate and thoughtful always be mindful that change can be unsettling and cause your staff to be anxious.

CHAPTER 12

What are the Characteristics of Practices that are Strong Candidates for Affiliation with a DSO?

Most DSOs are not seeking underperforming practices with a view toward "fixing" them. Rather they are seeking practices with a strong history of growth and profitability with strong reputations or brand identities.

As I have said many times, scale is good. They like larger practices with multiple practitioners. Single doctor practices have risk in the event of an unexpected departure of the doctor. This is less the case in multi-provider practices.

Most DSOs have little interest in high levels of Medicaid given that government funding can change with the stroke of a pen. There have been many examples of provider fraud in these programs and DSOs and their private equity partners would rather avoid the headline risk of a public scandal.

If you want to transition your practice and walk away then you are not a candidate for DSO affiliation. DSOs generally want the seller to remain for at least three years post-transaction.

DSOs usually prefer to avoid significant capital expense to update or renovate a facility if possible. If you have neglected to keep your physical plant and equipment up to date, it will be a challenge. You will be less attractive as an affiliation candidate. This doesn't mean you can't do a deal but you will likely face a discount if this was not the case.

Some DSOs have a strong preference for what is often described as bread and butter practices, primarily insurance-driven and family-oriented. There is less appetite for the boutique type of practice because it often requires a particular type of provider, who can be difficult to replace.

The ideal candidate is a mid-career dentist with associates with great patient reviews and reputation who is very interested in growing and sees value in a relationship with a capital and operating partner, If the practice has multiple locations, even better.

Implications for you:

None of these requirements are absolute – but to the degree you don't meet any of these requirements, your search for a DSO partner may be more difficult and require more time.

If you hope to achieve the highest possible value for your practice when you transition, a DSO affiliation will be the best option and the more you conform to their desired profile the more likely you will attain your desired outcome.

Conduct a SWOT analysis of your practice. Identify the strengths, weaknesses, opportunities, and threats. Be clear-eyed about the changes you will need to make to cross the threshold of DSO desirability. Get outside help or consultative assistance if you need it.

Armed knowing that a DSO will want you to remain several years post-transaction, be deliberate in planning your transition.

CHAPTER 13

Where Do You Go from Here?

"There is one quality more important than "know-how" and we cannot accuse the United States of any undue amount of it. This is "know-what" by which we accomplish our purpose, and what our purposes are to be."

Norman Wiener, American Mathematician and Educator

My goal in writing this book was to help you thoroughly understand the DSO phenomenon and its potential relevance to your future. And to close the knowledge gap between you as a potential practice seller and the DSO sitting on the other side of the negotiating table.

Consistent with the theme in the above quotation the "know-what" that I am most interested in you taking away from this book is simply this. If you explore a relationship with a DSO please, please seek expert advice. Doesn't have to be me, there are certainly other options out there.

DSOs have benefitted mightily from the historically asymmetrical knowledge between themselves and the dentists with whom they wish to affiliate. Knowledge IS power for negotiating complex business transactions.

Most likely, you don't have detailed knowledge of the many aspects of selling your practice to a DSO. Find someone who does to give advice and counsel based on firsthand experience.

My wish for you is that if you transition your practice that you do it so it maximizes the value you receive and allows you to achieve all of your goals, whatever they may be.

It has been my privilege to share my knowledge with you. I hope it has been helpful.

To learn more about Everything DSO, LLC please visit my website **www.everythingdso.com** or call me anytime at **703-298-1690.**

CHAPTER 14

DSO Affiliation in the Time of the Coronavirus

Given that I am writing this book in the midst of the pandemic, I would be remiss if I didn't spend a few words about the impact of the pandemic on DSOs.

It's no secret that dentistry in general was crushed by the forced shutdown earlier this year. DSOs were not immune. It's hard to generate revenue when you are unable to see patients. The negative impact is magnified if you are operating dozens, if not hundreds, of practices. The short term impact was predictable. Given that most practices are now open and seeing patients again, DSOs, like individual practitioners, are emerging from the chaos caused by the forced closures.

The more interesting questions are how has this affected continued growth and valuations or deal terms available to affiliating dentists.

Perhaps the most evident impact has been on the credit markets. Most private equity firms leverage their equity investments with debt to enhance their investment returns. Lenders hate uncertainty and the economic impact of the pandemic has raised uncertainty about the level and timing of full economic recovery. Consequently, credit markets have tightened as lenders take a wait and see posture.

While many of the DSOs I talk to say they expect practice valuations to experience a temporary dip, valuations on those deals getting done have not changed significantly from pre-pandemic levels. Given that every month seems to bring more DSOs seeking growth, I don't expect competition for practices to recede anytime soon.

One way that many DSOs are managing risk related to the pandemic is by including a holdback of some portion of the purchase price that will be released when the practice returns to pre-pandemic levels of performance. This is both reasonable and understandable.

The boom and bust of economic cycles are always there. Down times are always followed by good times and vice versa. The pandemic was certainly unanticipated and fairly unique, but it will surely be followed by more good times at some point. In fact, most of the practices with whom I speak, on a year over year basis are actually ahead of last year in the June-September timeframe.

Historical data suggests that dentistry fares better in recessions and emerges more quickly than most other industries. Current data would seem to support this conclusion.

So what does this mean? In my opinion, any impact of the pandemic on deal volume and valuations will be minimal and short-lived.

Unrelated to the pandemic but perhaps equally consequential is the pending presidential election. If Joe Biden prevails, as most are predicting, capital gains rates will surely rise. The impact is lower net proceeds on an after tax basis. The thought here is that if you are thinking about a DSO affiliation you may want to try and get it done before any increase goes into effect.

Implications for you:

It is more important than ever to entertain competing offers in the current environment. DSOs are responding variably to the questions of valuation and deal structure as a result of the pandemic. You may need to work a little harder to be sure you are getting the best possible deal.

About Stan Kinder

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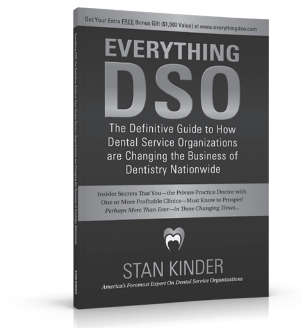

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