

What Every Dental Practice Owner MUST Know to Maximize Value When They Sell and the Most Common Mistakes They MUST Avoid When Doing So

Most dentists will only sell a practice once during their professional career – typically as they approach retirement. Thus, it is no surprise that they are naïve and uninformed about the ins and outs of achieving the best value.

The most common value-crushing mistake practice sellers make is waiting to sell their practice when it is declining. Most dental practices follow a predictable lifecycle – early years of consistent and steady growth, followed by years of plateaued performance mid-career, and ending in steady decline as the owner dentist decreases his or her psychological, emotional, and time commitment to the practice. Far too many dentists choose to sell their practice when it is in this end stage, at a lower value and for far less money than would otherwise be the case.

So, the first and most important lesson is to be thoughtful and deliberate about planning your practice transition and exit strategy. This is the path that will enable you to achieve maximum value consistent with your financial, retirement, and life goals. What follows are important things to know and consider as you do this planning.

Here are some questions to consider as you embrace the transition/exit planning/thought exercise:

1. Why am I selling? Examples might include retirement, bringing in a growth partner, or diminishing the administrative burden, among any number of others.
2. How does the sale of my practice integrate with my overall retirement planning?
3. Do I want to continue working after the sale, or do I prefer to sell and walk away?
4. Would I consider working longer if I could unload the burdens of practice ownership?
5. What is my target financial outcome, and more broadly, what is vitally important to you as you pursue a sale?
6. What is my ideal timeline?

Answering these questions will help you focus on your desired transition's why, when, how, and who. This leads to the next consideration – how to obtain maximum value at the time of sale.

The first and most important thing to understand is that the central foundation of value in selling your practice is free cash flow, the dollars on your bottom line. It is not your state-of-the-art facility, wonderful staff, or loyal patients.

In the final analysis, these variables are important only to the degree they help/hinder net income production. There is a principle at the core of every approach to valuing a practice, and it is this: the primary driver of practice value is the cash flow generated by the practice that will be available to the purchaser to pay himself/herself a living income and to support the cost of the purchase. Consequently, net income is the basis for the purest measure of practice value.

This is true not only for the dentist buyer but also for a DSO buyer seeking a return on the capital they invest to acquire a practice.

The implication is clear: If you want more value when you sell, you need to think creatively and aggressively about how to increase profit in your practice.

One of the easiest and most accessible ways to do this is to increase the number of high-fee elective procedures, such as implants, you perform in your practice. This falls into the "working smarter, not harder" approach.

Proven marketing models are available to achieve the desired outcome. A great example is the range of services available from firms like Aim Dental Marketing. You can learn more at americandentalmarketing.com. They help dentists grow their revenue.

This is an important note on the issue of creating additional profits. Depending on who the buyer is, each additional dollar of profit can potentially result in \$5, \$6, or even more in increased purchase price, creating a "multiplier" effect (more detail on this later).

A corollary consideration related to the profit question is the quality of your financial records. Every buyer will use these records to calculate their profit, and it is imperative that they are clear, accurate, and understandable. Any inconsistencies will sow doubt in the mind of the buyer – which inevitably leads to a lower valuation or no deal at all.

Another pathway to improved profits is implementing more efficient operating systems and better expense control. The fastest way to achieve this is with the help of a coach/consultant. Most of the world's highest-performing athletes and many prominent business leaders work with external coaches and mentors. It only makes sense to do the same in your

dental practice. Again, there are many proven performers available to you. Some of the leading examples include Dr. John Meis, Fortune Management, MGE Consultants, and ivquarter coaching. Any of these would be great candidates to help you raise and accelerate your practice's performance.

Who the buyer is matters greatly. There are profound differences in how two types of buyers value practices. These differences can result in hundreds of thousands and, in some cases, millions of dollars more being paid to the practice seller. Let me explain.

When you sell your practice to a dentist, unless you are willing to hold the paper, and finance the sale yourself, the dentist buyer relies on a bank loan for the purchase. In this situation, the gating variable is how much a bank is willing to lend. Historically, banks have capped their loan limits at 60-80% of topline revenue, independent of all other considerations. In some rare cases, they would loan 100%, but this rarely happens in today's higher interest rate environment. The dentist buyer's primary concerns at the time of purchase are how much I can pay myself and how I will be able to repay the loan.

The bank's primary concern is the latter – is there sufficient cash flow to enable predictable loan repayment?

On the other hand, the DSO buyer is making an allocation of capital investment decision and is focused on ROI - return on investment. There are three drivers that enable the DSO to pay much higher values.

1. They are not as dependent on bank debt to finance the purchase. Most DSOs are private equity funded and have ready access to capital.
2. They benefit from the arbitrage opportunity in the difference in value for a single stand-alone practice and the much higher value of a practice as a constituent member in a large integrated network.
3. Their confidence in their ability to bring economies of scale to reduce expenses and their operating and capital capabilities to grow revenue and profits.

Let's examine how this difference played out in a real transaction. The practice in question is a single-site practice located in the central Mid-Atlantic with revenues of \$2,374,003 in the twelve months preceding the sale. Below is the price actually paid by a DSO and the expected price in a traditional bank-financed sale to a dentist.

DSO Option – The sale closed with \$7,275,000 in value being paid to the owner dentist.

Dentist Buyer Option—To make a strong comparison, let's assume the dentist buyer was able to secure a loan at 100% of revenue (more typically in the 60-80% range), \$2,374,003.

Admittedly, the profit margin in this practice was well above average, but we're still talking about a difference of nearly \$5 million to the seller. Going back to the "multiplier effect" mentioned earlier, in the DSO option, each incremental dollar of profit would result in an increase of a little over \$7 dollars in the purchase price and no increase at all in the dentist buyer option.

This "multiplier effect" makes it a no-brainer to spend money to improve your procedure mix or to get help improving your performance.

So, you can easily see that who the buyer is matters greatly. Having said that, a DSO transaction is not for everybody, and not every practice will be attractive to a DSO buyer. Most DSOs require the seller to commit to a 4-6-year employment agreement post-transaction. If your goal is to sell and walk away, then a DSO buyer is not for you, no matter the financial differences.

Let's talk about other significant mistakes to avoid, particularly when dealing with a DSO buyer. It is critically important to get experienced, capable advice. You don't know what you don't know.

The folks sitting on the DSO side of the table are very sophisticated, and they negotiate deals all day, every day. You will benefit immeasurably from having an advisor with similar knowledge and experience by your side and advocating in your interest.

Not having this kind of help often results in a valuation lower than would otherwise be the case. The good news is that there are advisors available on a no-fee basis to the seller. In the example case above, the practice owner paid no brokerage commission, saving himself the 5-9% typically charged by sell-side brokers. If you do the math, that's a savings of \$363,750 at 5% and \$654,760 at 9%.

Another common mistake is to not use legal counsel experienced in these kinds of transactions. As tempting as it may be to use your attorney neighbor or relative because they will do it at little or no cost. Now is not the time. These are large and complex once-in-a-lifetime transactions. You can be assured that the DSO buyer will have expensive top-tier firms representing their interests. It is vitally important that you have representation by someone experienced in going head-to-head with them.

The last piece of advice is to ensure that you do adequate due diligence on the buyer – they will certainly do thorough due diligence on you and your practice. Given the continuing employment relationship with a DSO buyer, it is even more important. You want to be sure there is a cultural fit and that the buyer (whether DSO or dentist) will treat your staff and patients in ways that are important to you. Most DSOs pay some portion of the purchase price in rollover equity, and you need

to evaluate the prospects for a positive return on that equity based on historical performance.

The biggest takeaway here is that you, as a practice owner, can proactively make decisions to enhance the value of your practice in your own interest. The first step is understanding the fundamentals outlined in this chapter. The second and most important step is putting them into action. As always, it matters not what you know but only what you do.

If you need advice or assistance with a sale, whether to a DSO or a dentist, send an email to stan@everythingdso.com, or call me at 703-298-1690, and I will help in any way I can.