Winter | 2023

The Dental Transition

NEWSLETTER

In this issue

What Is My Practice Really Worth?

What is my practice worth? Well, it depends on who you ask because value is largely a concept of perception. According to the IRS, fair market value is defined as: "the price at which a [practice] would change hands between a willing buyer and a willing seller when the former is not under any compulsion to buy and the latter is not under any compulsion to sell, with both parties having reasonable knowledge of the relevant facts." Although the definition may be stuffy, the concept is sage: the fair market value will be determined by the marketplace and is subject to the economic forces of supply, demand, and transferability.

There are a number of popular "rules of thumb" used by doctors to estimate a rough value for their practices. For example, many practices will sell for a value equal to between 60 to 80 percent of the most recent year's gross collections. Similarly, a practice value will often fall into the range of 1.5 to 2 times net income, i.e., the doctor's take home pay before taxes, plus any expenses of the practice that would be considered as a direct benefit to the doctor. There are other simple formulas one can use to estimate value; however, remember that these formulas are just that—simple tools used for estimation only. They do not consider some of the other critical practice characteristics that affect value that will be addressed later in this article.

As a general rule, up to 80 percent of the value of an average general dental practice will consist of goodwill. The term "goodwill" is primarily connected with the existing patient load and corresponding cash flow of a practice. It is an intangible consideration that usually comprises the most valuable asset of any professional practice. It relates to the assembly of necessary equipment into a productive unit; the availability and existence of trained employees; the existence of systems, controls, and methods which are part of the operations of the practice; and the existence of a loyal patient base. Naturally, a practice with a high active patient count in relation to revenues will be worth more than a practice with fewer patients. Thus, the patient-production ratio will have a significant impact on the value of a practice. Another crucial element that effects practice value is specialty or sub-specialty practices which require the buyer to have a certain skill level or philosophy to take over the practice and retain patients.

The value of any professional practice can be summarized as its capacity to generate cash flow. That capacity is made of two essential elements: tangible and intangible assets. The tangible assets consist primarily of the clinical equipment, office equipment, furniture, fixtures, instruments, supplies on hand, and so forth.

The intangible assets consist primarily of goodwill, or essentially the relationships existing with patients, and

Continued on Page 2

PRACTICE SALES + APPRAISALS + TRANSITION CONSULTING + ASSOCIATE PLACEMENT

Brought to you by Practice Impact

What Is My Practice Really Worth?

Continued from page 1

referral sources that have been cultured and nurtured over the years, as well as the relationships between the doctor(s) and staff members.

The combination of tangible and intangible assets, when efficiently utilized in tandem, generate a "going-concern" that possesses value. That "going-concern" value is best demonstrated by a track record of generating a certain level of cash flow and profit. The method and means by which the cash flow and resulting profits are generated—and in what amounts—determines, in part, the price a practice will likely command in the marketplace.

As a general rule, most appraisers use income-based valuation methods to evaluate a dental practice. This income-based approach is not limited simply to an analysis of the historical financial information of a practice, but also takes into consideration many other elements of the practice that contribute or detract from value such as: the type, age, amount, and condition of clinical and office equipment and furniture; outstanding accounts receivable balances and strength of financial policy; office fee schedules; supply inventory on hand; management systems; patient profiles and demographics; active patient count; new patient flow figures; participation in discount insurance plans; practice location (both generally and specifically); office lease arrangements; facility size and condition, including tenant finishing; practice type and philosophy; production by treatment class analyses; status and employment history of staff and/or associate doctors; market and economic factors affecting the practice, et. al.

As evidenced by this list, there are a number of elements that can and will influence the value of a professional practice; however, as a general rule-of-thumb, a general dental practice will typically sell at a price in the range of 4 to 6 times its adjusted net income. By definition, adjusted net income is the net income after operating overhead expenses, not including certain expenses such as interest, taxes, depreciation, amortization, and certain discretionary items, and inclusive of compensation to the doctor, but only at a reasonable, going-market-rate. Practice appraisers often refer to adjusted net income as "Earnings Before Interest, Taxes, Depreciation and Amortization" or "EBITDA." The EBITDA of a dental practice gives an indication of the current operational profitability of the business. It shows them how much profit the business makes given its current set of assets and operations and the services it renders to patients.

All things considered; few things influence the selling price of a practice more than prevailing buyer perception. After all, a practice is only worth what a buyer is willing to pay for it. And a buyer's perception of value will be influenced by all of the factors mentioned above, as well as general market and economic conditions. That said, it is a good idea for a dentist who is serious about selling their practice to seek an appraisal by a professional who is both qualified and unbiased, regardless of whether the dentist plans to retain the services of the professional to sell the practice. Doing so will lend substantial credibility to the asking price and make the due diligence process much easier–for both parties.

Frequent Questions in a Practice Transition

Practice Transitions are often fraught with fear and questions by both buyers and sellers.

From the sellers' perspective, knowing when is the right time to sell is often the first question. There is no single correct answer. Understanding your personal and financial goals will help you determine when to start the process. However, the emotional process of selling a doctor's life work often plays a more significant role than any of the financial ramifications.

Knowing the fair market value of your practice is an important first step in understanding when the time is right for you to sell. Practice values are dependent on profitability, your patient base—including demographic information, specific practice characteristics, the age and condition of your equipment, the local dental market, and of course, the location of your practice.

Unless a seller has done this before, prior to embarking on a practice transition, engaging the help of a professional practice broker is in their best interest. Though there is a cost involved, brokers are skilled in helping sellers make financially sound decisions, from obtaining proper valuation of the practice to making the most beneficial allocations for the sale price for tax purposes. Brokers are invaluable in keeping a transaction moving forward, as they often stall at various stages of the process without one.

As a seller, if you are ***considering bringing in an associate***

Frequent Questions in a Practice Transition

Continued from page 2

to whom you will ultimately transition the practice, there is much to think about beforehand. Unless your practice has 1800-2000 active patients and is generating $800-$1M in annual revenue, it is not economically feasible to bring in an associate. The office footprint and size must also be able to accommodate two doctors and, ultimately, the additional staff required to allow both doctors to meet their patient needs.

When considering a transition, it is important to consider ***the cost-benefit of office updates*** and additional equipment acquisitions. Though these upgrades will likely increase your practice's desirability, they may not make financial sense. A fresh coat of paint and updates to flooring go a long way in perceived value. Adding a 3-D cone beam may not be in your best interest but replacing or repairing broken equipment will likely be a requirement to complete the transaction. A seller who owns the building should know that, typically, buyers also want to own the property. It usually makes more financial sense than leasing the space. However, knowing the building's fair market value as well as its fair rental value is important in determining the timing of the doctor owned building sale.

The ***average amount of time it takes to sell a practice*** depends on several factors. Most of the aspects considered in the valuation process include: profitability, appearance, equipment age, productivity, and location, which all determinate the time it takes to sell a practice in today's market. On average, 6-12 months is typical, however it can happen in as quickly as one month or as long as several years.

What will happen to a sellers' staff after the sale? Most buyers want the staff to stay in place to assist in the practice going forward. Once the staff is informed of the pending transition situation, a seller should make every effort to encourage them to stay. The staff is a vital part of the practice and are invaluable in retaining the patient base. When employed by the buyer, their pay and hours usually remain the same. Buyers need your staff in order to be successful. As a general rule, it is best to inform them of the imminent transition once the buyer and seller have created a well-thought-out plan.

Are buyers able to obtain financing in the current market? Absolutely! Many lenders will finance 100% of the practice purchase price, plus additional working capital. Lenders consider the practice value, the ability to cash flow the practice to include a reasonable salary to the buyer and the ability to meet the annual debt service, a buyer's income to debt ratio, and, more recently, school loan debt. They may also require some liquidity on the part of the buyer. A seller is rarely required to take back a part of the note or support a portion of the financing.

From a buyers' perspective, they may wonder, ***"How hard it is to obtain financing under the current inflated interest rates?"*** In most cases, as long as their income to loan ratios are moderate and the practice is fairly valued, obtaining financing is pretty easy. Most brokers have relationships with dental specific lenders, who are able to get the financing done fairly easily. Loan terms and rates are very competitive, so buyers should form relationships and seek financing from more than one lender in order to find the one that meets their specific needs. Not all lenders are the same, even if their rates are the same.

Buyers are often worried about ***purchasing a practice with older equipment*** in place. However, most lenders and equipment companies are able to assist in the purchase of necessary newer items required by a buyer. Buyers should keep in mind that the seller has been operating with the older equipment and has been able to produce an income with it, though it is understandable that buyers will want to add pieces of equipment that will allow them to perform treatments the seller hasn't been performing.

At times buyers question whether they should ***purchase an existing practice rather than build one from scratch.***

Obviously, a "startup" starts with brand new equipment and usually an updated office space, which usually comes with a hefty price tag in itself. A downside of purchasing the existing practice is having to use older equipment and update the equipment as you go. However, purchasing an existing practice gives them a patient base with an immediate stream of income. Often buyers will discover that the existing patient base needs services that have been "referred out or watched" by sellers, which gives them the opportunity to increase patient revenue from the start. On the flip side, a startup means you must obtain patients one at a time, which can take a considerable amount of time to build up to a full schedule. That means more time before they can realize a fair salary and the ability to meet debt requirements.

Buyers wonder ***if buying a seller's building makes more sense than leasing.*** Usually, it does, unless the building is too large for the practice to support. Sellers, however, are not always ready to sell their building at the same time that they sell the practice. Consequently, a buyer will often request a first right of refusal to purchase or perhaps define

Practice Impact

5071 Forest Drive • Suite A • New Albany, Ohio 43054

A Member of

NAPB
National Association
of Practice Brokers

ARTICLES INSIDE:

WWW.PRACTICEIMPACT.COM

PRACTICE SALES + APPRAISALS + TRANSITION CONSULTING + ASSOCIATE PLACEMENT

Frequent Questions in a Practice Transition

Continued from page 3

a specific time for purchase in the future when the seller is ready to sell.

Leases in non-seller owned spaces require some understanding and negotiation. Most lenders will require that buyers have a lease in place that covers the life of the loan. This ensures that the buyer has a place to practice until the debt is paid off. Landlords can make this process difficult but should consider the fact that dentists are very solid tenants that don't move their offices frequently due to the extensive leasehold improvement costs of such a move.

Must a buyer be willing to purchase the seller's accounts receivable? Not usually; however, most will collect the seller's receivables for a 3–6-month period, and pay them over to the seller, while charging the seller a small management fee for doing so. When purchasing the receivables outright, they are discounted to account for insurance reimbursements and the time and staff involvement necessary to collect on them as well as the age associated with each of the receivables.

Lastly, both buyers and sellers often question whether they can get a better price by conducting the transition on their own and the simple answer is 'no'. As mentioned above, working with an experienced professional practice broker will save you time, money and potential errors in the transition process. We encourage you to reach out to us TODAY to discuss a free practice consultation to decide when is the ***RIGHT TIME FOR YOU*** to begin planning for your transition.

Contact us TODAY to schedule a free consultation!
