

DENTAL PRACTICE \$ALES: GET THE MOST WHEN YOU \$ELL

For the last few years, it's been a seller's market when it comes to dental practice sales, due to too many buyers, not enough sellers, low interest rates, 100% bank financing and dental service organizations scooping up practices.

These conditions have triggered bidding wars for certain highly sought-after practices. For example:

In 2016, the best practice we sold was a 1,500-square-foot, 4-op in Burlington, On. It was grossing around \$1.25-million, with 25% hygiene, and 2,800 active patients. The selling dentist was taking home over \$600k in cash earnings per year. The practice sold for \$2.2-million.

In 2017, the best practice we sold was a 1,500-square-foot, 4-op in Mississauga, On. It was grossing around \$1-million with 38% hygiene, and 1,600 active patients. The selling dentist was taking home over \$450k in cash earnings per year. **The practice sold for \$1.75-million.**

In 2018, the best practice we sold was a large 3,000-square-foot, 7-op practice in Ottawa. It was grossing around \$2.5-million with 50% hygiene, 3,000 active patients. The selling dentist was taking home over \$875k in cash earnings (after all dentists were paid). **The practice sold for \$4.5-million.**

In 2019, the best practice we sold was an 800-square-foot, 4-op practice in Mississauga. It was grossing around \$1.25-million with 30% hygiene, and 1,800 active patients. The selling dentist was taking home over \$800k in cash earnings. **The practice sold for \$2.15-million.**

And in 2020, the best practice we sold was a 2,500-square-foot, 6-op practice in Ottawa. It was grossing around \$2.35-million with 30% hygiene, and 3,500 active patients. The selling dentist was taking home \$650k in cash earnings (after all dentists

were paid). **The practice sold for \$4.1-million.**

When we ran the open houses for these particular practices, we had many prospective buyers attend. These practices experienced bidding wars and ultimately sold to single owner-operator dentists or more sophisticated practice owners.

So what made these the most attractive practice to buyers? It was a combination of these factors:

- Great location (most of these were ground floor)
- Excellent metrics (billings, collections, earnings, active patients, solid hygiene program)
- Experienced team on proper contracts (that limit termination costs)
- Strong brand
- Room for growth (stay open later or on more days, keep referrals in house, market the practice, etc.)
- Good leases (no demolition clauses)
- Staff on proper contract
- Incorporated to take advantage of the capital gains exemption
- Experienced team of professionals (lawyer, accountant, etc.)

Location

Purchasers want ground floor of a strip plaza on a busy intersection in a big city. Easy-access. Free parking. Great signage.

Professional medical buildings are a close second to strip plazas.

Mall practices have historically done well (the walk-by advertising and traffic makes up for the high rent) and should be coming back after COVID-19.

Practices that are high up and buried back in tower buildings are getting hit the hardest now



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because of COVID-19 but they'll come back too.

Purchasers will also want to know if there are residential developments happening nearby that they can target.



Lease

Purchasers generally prefer to buy the building along with the practice. This way, they don't have to deal with landlords and all of their shenanigans.

Granted, landlords are always demanding rent increases. But they're also constantly trying to put value-destroying clauses – like demolition or relocation clauses – into leases and renewal documents. A demolition clause, for example, is a tiny little clause that allows the landlord to terminate the lease and kick the dentist out (without compensation) simply by providing a minimum amount of notice (e.g. 6 to 12 months) should the landlord decide they want to tear the building down to redevelop (think: condo).

We've even seen these types of clauses inserted in brand new strip plaza leases. These clauses simply decimate the value of the practice when the time comes to sell. For example: we helped a dentist purchase a \$1-million practice for only \$550k solely because of a demolition clause; in that particular case, the plaza was old and falling apart, vacancy rates were high, and new condos were popping up all around. The practice was eventually moved.

Sometimes, landlords simply won't give renewal terms to the dentist to keep their options open until the last possible minute. This is bad news if you're looking to sell because most buyers (unless they have a practice close by) and their banks will need at least ten (10) years left on a lease in order to finance the deal.

Also, be mindful of assignment clauses – in other words, how the lease gets transferred in the context of a sale. The worst clauses are the ones where the landlord can be unreasonable in granting consent to transfer a lease. Or they ask for some absurd amount of compensation – like five percent of the purchase price – in order to grant the requested consent. Or even worse: they have the full-out right to terminate the lease if you even ask for their consent to a transfer. Please, please, please: double check your lease right now. If you have a nasty clause or two, you might have to bribe your landlord before

a sale or, in the worst case scenario, sell to a neighbouring dentist at a discount.

By the way, the very best leases include: low fixed rent for a long term (e.g. 10 years), lots of 5-year renewal options in favour of the tenant, no demolition or relocation clauses (and no ability for the landlord to insert / request them on renewal), and no personal indemnifier / guarantor of the lease. They also allow for the dentist to easily transfer the lease to an incoming dentist tenant who is also buying their practice (landlord's consent is automatic) and remove any existing tenant or indemnifier / guarantor from the lease.

Physical Space

Physical space within a dental practice is just as important as the location itself. A good size for a 3-op practice is anywhere from 800-1,000 square feet; for a 4-op practice, it's 1,200–1,500 square feet; for a 5-op practice, it's closer to 2,000–2,200 square feet.

The physical space is important because buyers want to figure out if there's room to grow. Is all the physical space being put to use? Can another op be added and/or equipped? Can the practice go paperless and a chart room or area be converted into a pan or supplies area? Is the practice open at all hours and days to accommodate patients?

Financials

Financials play perhaps the biggest role in practice sales. The numbers tell us how good the dentist/practice is at scaling up production while managing expenses. Here's what buyers are looking for:



- Steadily increasing production
- Very little difference between production and collections
- Healthy hygiene program (comprising ~40% of collections)
- Low rent (~5% of production) for a long, long time
- Controlled staff wages and benefits (~22–25% of collections)
- Controlled supplies expenses (~6% of collections)
- Healthy number of active patients (those who attended for any procedure in the last year and who have a tendency to return – particularly for hygiene)
- New flow of patients (20–30 a month being ideal) without many leaving

Forget everything you've heard or read about practices selling for a certain percent of billings or collections because it doesn't hold water: would you pay the same for two practices that each collected \$1-million but one had better cash earnings? I didn't think so.

- High percent of non-assignment patients
- Low percent of social welfare patients
- Consistent expenses
- High cash earnings (discussed below)

The financials can tell us a lot. Given the level of patients, is it over or under-producing? Is it paying too much in rent for the size and location? Is it over or under-staffed? Does it have enough patients coming in for hygiene appointments? Is it paying too much for advertising to acquire new patients or not investing in marketing at all? Is it spending too much on supplies (buying and storing in bulk)? Does it have a co-pay issue (perhaps not collecting to the fullest, or at all?). Were repairs and maintenance expenses very high one year when they shouldn't have been – perhaps because the dentist wanted to write off their new equipment (chairs, cabinets, sterilization area, etc.)?

Perhaps most important, the bottom line cash earnings available to the selling dentist will help a buyer determine whether they can offer a winning purchase price and still be able to repay the bank and have a comfortable living for the next few years. Note: banks typically amortize loans over a 10 year period, but smart dentists tend to pay off the loans quicker. The best we've seen is 4 years; the average is 7 years.

Sophisticated buyers will zero in on the cash earnings (also called “adjusted cash flow” or “adjusted net income” or “earnings before interest, taxes, depreciation, and amortization” or EBITDA for short) available to them and use a multiple of that figure to propose a purchase price. Forget everything you've heard or read about practices selling for a certain percent of billings or collections because it doesn't hold water: would you pay the same for two practices that each collected \$1-million but one had better cash earnings? I didn't think so.

Now you'll need to appreciate that there's generally two ways to calculate cash earnings. And keep in mind that these figures are average and don't factor in everything else discussed herein – all of which can drive a purchase price higher or lower.

Owner-Operator: 3.5x Cash Earnings

At one extreme is the situation where the buyer is an owner-operator dentist that will largely take over the principal dentist's presence. So here, the cash earnings amount to collections minus business related cash expenses. The average multiple that tends to be used to come up with a purchase price here is 3.5x cash earnings. At the height of 2019, the multiple used to be around 4x. During COVID-19, the multiple dropped to 3x. So let's look at a typical general dental practice that collects \$1-million and has \$400k in cash earnings after business-related expenses (so this number is before the principal dentist pays themselves, a bank loan, taxes, or write offs for depreciation or amortization expenses on equipment). Based on a multiple of 3.5x \$400k, a buyer will offer the seller \$1.4-million.

Absentee-Owner: 6x Cash Earnings

At the other extreme is the situation where the buyer is an absentee-owner (like a dentist with multiple practices or a dental service organization) that will solely use associates to run the practice. Here, the cash earnings amount to collections minus business related cash expenses, minus associate fees. The average multiple that tends to be used to come up with a purchase price here is 6x cash earnings. At the height of 2019, the multiple used to be around 7x to 7.5x. During COVID-19, the multiple dropped to 5x. So again let's look at a typical general dental practice that collects \$1-million and has \$200k in cash earnings after business-related expenses and after paying all associates (and also before the absent-owner pays themselves, a bank loan, taxes or write-offs for depreciation or amortization). Based on a multiple of 6x \$200, an absentee-owner will offer \$1.2-million.

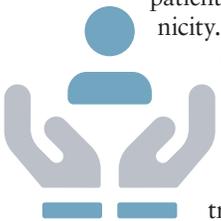
Specialty Practices: 1x Cash Earnings – 1x Collections

Specialty practices that don't have hygiene programs and which are solely referral based sell for lower

amounts than general dental practices. There is a viable market for endo and ortho practices – especially with dental service organizations getting into the game. We’ve been selling certain specialty practices for anywhere between 1x cash earnings on the low end, all the way up to 1x collections on the high end. Again, it largely depends on the other factors discussed in this article.

Patients

New and existing patients are the lifeblood of any dental practice. Buyers will want to see a diverse patient demographic in terms of age and ethnicity. How many new patients are coming to the practice is just as important as how many are leaving. Obviously, non-assignment patients are worth more to a practice than assignment patients as the practice won’t have to deal with trying to collect the co-payment.



Treatments

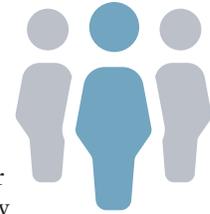
What kind of practice is it? At one extreme, a primarily preventative (40–50% hygiene) and restorative practice will have the most interest from buyers who can add value by doing complex surgeries, extractions, and specialties (root canals, ortho/Invisalign™ and implant placement). At another extreme, a practice that refers nothing out will have less interest and a lower purchase price because there’s not much room to improve the cash earnings. Some of the quickest ways to boost production include: doing complete oral exams more regularly in accordance with RCDSO guidelines and keeping referrals in house.

Team

Your team is your best asset but also your biggest liability. They’re friendly up until the point that you stop paying them. Keep those two nuggets of gold in mind at all times. Maybe I’m jaded (it comes with being a dental lawyer who’s seen a lot of nice people do bad things). But you need to protect yourself at all times. We’ve seen team members turn against the selling dentist after a sale because they didn’t “know” about the sale (confidentiality be damned!), or “pick” the buyer, or didn’t get “their” raise or payout.

You can have your own friends outside of the practice. But in the practice, keep things

professional and courteous. When you leave your house and family in the morning, it’s not to socialize and be with your friends. It’s to make a buck so you can pay your bills and live your life.



Buyers tend not to know a selling dentist’s team members and will want the selling dentist to limit their liability in the event they need to terminate someone. This is done by putting the team members on proper contracts. This in itself must be handled by lawyers very carefully. Sellers won’t want their team members to find out about the sale. But if they do nothing, then they risk taking a reduction on the purchase price or having to share in employee termination costs after the closing (e.g. the seller will contribute 50% of total termination costs if the buyer terminates within 6 months, etc.).

To avoid all of this, it’s best for the seller to introduce team contracts that limit their and any buyer of the dental practice’s liability well in advance of a sale. Think 2 to 5 years, although we have done it in the context of an immediate sale without anyone suspecting a sale.

If you have a solid practice that hits all the marks above, you’re on the right path to a great sale. It’s still a seller’s market and there are lots of motivated buyers; COVID-19 has simply delayed sales.

The next step is to prepare your practice for sale and have it marketed (confidentially at first) so that you can get a great offer from a serious buyer that you can get along with.

We’ve found that having buyers and sellers interview one another as part of the sale process is also very useful. This way, each person can gauge the other’s personality types, dental skill set / philosophy and strategy going forward. Everyone should also be happy with who they’re buying / selling from.

The final thing to keep in mind is that selling a practice is an emotional rollercoaster for most dentists. They’ve never done it. They have one chance to do it right. So use an experienced team of professionals – lawyers, appraisers and accountants – to do it properly. There are also important tax ramifications that only lawyers and accountants can guide you through. And find a team of professionals that will charge you fixed fees (not commissions) so that, when you do sell, you can keep more of what you’ve worked for all these years. ✨