

Purchasing a practice

GETTING A GREAT VALUE AT A REASONABLE PRICE ENSURES SUCCESS

By Timothy G. Giroux, DDS

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Is there a difference between price and value when purchasing a practice?

Emphatically, YES! Getting a practice at a great price does NOT ensure success, but getting a great value at a reasonable price does. Even the buyers who hire the best transition specialists in the industry confuse the interaction of these concepts. Let's define each of these terms and discuss how to best deal with the problem in the process.

Price

Price is the easier of the two concepts. Price, as with any commodity, is determined by the marketplace. Currently the national average for the price of a dental practice is approximately 65% of the past year's gross receipts. This rule of thumb value can range from 50% of gross in rural areas, to 100% of gross in desirable urban areas.

Essentially, the local prevailing market will dictate the price. Individual characteristics and specific neighborhoods within a region can produce a local price variance of 10%.

Therefore, price usually falls within a 10% range of variance in the local market. Is that price variance really a make it or break it issue for the buyer?

Quick note: Net profits arguably should be a greater factor than gross receipts. However, in pricing, net profit is generally secondary to the gross receipts multiple. I believe this is the case for two reasons.

First, the gross receipt number is easily apparent, while the true adjusted net profit is not. Second, an argument can be made that each buyer will manage the practice differently, resulting in different profits from the same starting gross receipts.

The percentage multiple has not changed much in the past several years, but the calculation has changed slightly in our current economic environment. Previously, depending on the local circumstances, the price could be based on the best year of the last two or three years.

As most practices have declined in this economy, the

market (essentially the banks and the buyers) dictates that the price is determined by the most recent year-end revenues (which have usually declined) rather than previous years' average. This reality is underscored because lenders may not even finance a practice if the revenues have dropped more than 15%.

Value

This is the most important aspect of the success of any dental transition. Unfortunately, it is totally subjective and virtually impossible for even the best and most well-intentioned brokers, accountants, and consultants to measure.

Case in point: A dentist in San Jose purchased a practice five years ago, where the local rule of thumb gross receipt multiple is approximately 75%. She paid 100% on a practice that was grossing \$300K a year. The three-op office was poorly designed with a lot of wasted space and had a very high rent, with equipment and leaseholds more than 20 years old.

Every accountant and advisor told her this was NOT a good transaction, but she purchased the practice anyway. Within four years, she was collecting nearly \$1 million and even moved into her own office building when her lease became due!

I could also give you an example of a practice that everybody, including me, thought was the greatest deal in the universe, only to have the practice struggle and the buyer do poorly. **My contention is that I could place 10 dentists in either of those situations and I would get results anywhere from bankruptcy to wild success in each practice.**

Price is not the issue. Every practice will ultimately sell at its market value if it is properly vested into the market. The price will usually be within 10% of the local average percentage, and yet the ultimate success of the practice usually has little to do with the 10% variance.

Success will ultimately be determined by the "value" of the particular opportunity in the specific hands of the buyer.

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Problem

Value is determined by the skill sets of each buyer relative to the skill sets of the selling doctor. Only the dentist is qualified to make that determination. Ultimately, the buyer needs to take charge and own the due diligence process to enable him or her to make the proper decision.

While I fully encourage the buying dentist to hire the best transition team, the dentist is the only person qualified to correctly analyze the pieces of the puzzle as it relates to his or her particular skill set.

Due diligence

It is impossible in a brief article to review the entire process of what is proper due diligence when purchasing a dental practice. I will try to give some guidance below on how a buyer can achieve the goal of assessing the value of a particular practice.

The ultimate question is, *What will I likely produce and collect with my skill sets and philosophy after I take over the practice?*

While I am pleased that most buyers are seeking the advice of good dental accountants, consultants, and attorneys, I am frustrated that many are missing the mark because they are not properly interpreting the counsel they receive as it relates to the real value of the opportunity.

The starting point is the evaluation of the basic financial reports, which include three years each of tax returns, profit and loss statements, and production/collection reports. A good dental advisor will be able to verify if an asking price is within the normal expected market price range for the area.

A good dental accountant can quickly point out issues that may be of concern from these basic financial documents. The buyer should eventually have a full understanding of any expense that is above or below the normal average for a dental practice; however, the buyer should remember that most accountants simply look at pieces of paper and not the entire picture.

Additional reports may be needed to help clarify issues out of the norm. However, asking for excessive reports on accounting minutia that do not help the buying dentist realize the value of the practice adds cost and time to the process. The dentist should be the person who directs advisors to answer the question, "What is the value of this practice in my particular hands?"

Skill sets: The determining factor

Once the buyer understands the basic financial reports on the practice, he or she should also review the many management reports generated from the practice software. My favorite report is the Procedure Code Analysis. This report generated for the last year will show exactly what procedures were done to get to the numbers that established the price. No two dentists' skill sets are alike.

The buyer will need to determine what skill sets he or she

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may lack as compared to the seller. This difference might be made up by procedures not currently performed in the office. For example, it might be safe to say that older doctors seem to do more crowns compared to other procedures.

In general, many young dentists likely attempt more molar endo, extractions, and ortho. Interestingly, none of this really affects the price in a true market, but it does affect the value for each particular buyer. A doctor's ability to present and close a difficult treatment plan can also make a huge difference in the success of a practice. Closely related to communication skills is philosophy of treatment.

We all have different opinions on how large a restoration should be before full coverage, whether an implant or a fixed/removable appliance is the desired treatment, or when to refer certain procedures to a specialist. An interview with the seller and a good chart audit to help determine who is more aggressive on treatment planning is essential.

Conclusion

Ultimately the doctor, not the consulting team, owns the decision because only the doctor can properly assess his or her clinical, communication, and managerial skills. Value is a big picture question. The small picture mentality needs to be placed in the backseat for this decision, but be allowed to take

over *after* the transition to successfully manage the practice.

While each buyer should hire his or her own trusted team to help evaluate any practice purchase, he or she needs to understand, control, and eventually answer the most important question — *Why do I think I will produce and collect similar numbers in my practice purchase?*

If value can be answered in a positive way and the price is within the normal local boundaries, then negotiation on price becomes more of a sport than a determining factor in the success of the transition. I believe this process should produce a gut feeling that may be the most important factor in determining whether the buyer should pull the trigger.

Getting a practice at a great price does NOT ensure success, but getting a great value at a reasonable price does! DE

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