



Western Practice Sales

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SCRATCH START VS BUYING A PRACTICE

WHAT THEY DIDN'T TEACH YOU IN DENTAL SCHOOL

Most of us graduated from Dental school with little or no training in basic business principles. Some of us may have taken a year or two of business classes (as I did) and others may have even graduated with a business degree. Even then, there was usually little practical training on how to evaluate the typical decisions all of us must make at various points in our dental careers. Perhaps our teachers knew that we would be too preoccupied with accumulating enough clinical procedures to graduate, than to attend classes on future possibilities. This is evidenced by the low attendance in some of the non-clinical classes I witnessed during my senior year! However, I feel that most Dental schools may be negligent in preparing their students adequately for the real business world we are thrust into.

When I graduated from Dental school, I followed in the footsteps of a few graduates that migrated to the Phoenix area. In fact, I replaced the associate position that my colleague vacated when he left to start up his own practice from scratch. In turn, I also left after 2-3 years and did my own scratch-start practice. At the time, I never even considered purchasing an existing practice. Even if I had, I possessed no knowledge on how to properly evaluate my options. This article will provide some basic concepts to help dentists begin to think more like accountants and businessmen.

The problem that most of us have is that we assume that just having a DDS after our name will ensure our success. For the most part, this is actually true! For example, I just ventured out, surveyed a new growth neighborhood and selected a highly visible, easily accessible corner to set up my practice. Eventually every-

thing worked out well and my practice became highly successful. However, an astute businessman would have "crunched the numbers" to ensure that he would get the best "return on his investment". *When all things are equal, without extraordinary growth, the economic gains of a practice purchase outpaces the gains of a new scratch start practice.* Price, rather than generating cash flow is often the major concern of most buyers. Some buyers will comment that a practice costs too much, without even knowing what the profit of the practice is! *Cash flow and return on the investment should be king!*

The following discussion will be a comparison of cash flow and profit

equipped with two operatories is \$300,000. The purchase price of an existing practices historically falls between 60 to 75 percent of gross receipts. In an effort to exaggerate our premise on practice purchases, we have used a multiple of 80% of the gross receipts to prove our conclusions even when paying higher than what market values would dictate. Therefore, the purchase price of our \$500,000 gross receipt practice and our \$1,000,000 gross receipt practice will be \$400,000 and \$800,000 respectively.

Most dental offices usually run at approximately 60 percent overhead expenses so we have used 40 percent as our bottom line cash flow before debt service. A reasonable fixed rate

Scratch Start vs. Buying A Practice							Illustration 1
	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7
SCRATCH START - \$300k Start Up Price							
Collections	\$250k	\$350k	\$475k	\$600k	\$700k	\$800k	\$900k
Cash Flow	100	140	190	240	280	320	360
Debt Service	55	55	55	55	55	55	55
PROFIT	\$45k	\$85k	\$135k	\$185k	\$225k	\$265k	\$305k
\$500k Practice - \$400k purchase price							
Collections	\$450k	\$550k	\$675k	\$775k	\$875k	\$975k	\$1075k
Cash Flow	180	220	270	310	350	390	430
Debt Service	73	73	73	73	73	73	73
PROFIT	\$107k	\$147k	\$197k	\$237k	\$277k	\$317k	\$357k
\$1 million Practice - \$800k purchase price							
Collections	\$900k	\$975k	\$1050k	\$1150k	\$1200k	\$1250k	\$1300k
Cash Flow	360	390	420	460	480	500	520
Debt Service	147	147	147	147	147	147	147
PROFIT	\$213k	\$243k	\$273k	\$313k	\$333k	\$353k	\$373k

between (a) scratch start practice (2 operatory set-up) (b) a moderate practice (3 - 4 operatories) and (c) a large practice (5 or more operatories). Several assumptions based on historical data are applied in the flow chart labeled Illustration 1. The industry average loan for a scratch start practice

loan in today's market is about 7.5 percent over seven years which is reflected in the debt service column corresponding to the start-up cost or the purchase price of the practice. The net profit (before taxes) is the cash flow minus the debt service. In addition, we will also assume some

PROFIT AFTER DEBT

fairly good start up numbers and good growth for our scratch start practice as compared to the existing practices.

Illustration 1 will then reveal the net profit before taxes for each of the seven years the practice is in debt. Also note that we did not make any additional debt service adjustments to reflect additional leasehold expenses and equipment purchases for the scratch start and moderate practices to actually produce the same numbers of the larger practice. It would cost well over \$100,000 to build out and equip the scratch start practice from 2 operatories to 6 operatories. **Therefore, we have given almost every advantage to the scratch start practice.** In fact, when I give this

Profit – After Debt Service			
	3yr Total	5yr Total	7yr Total
Scratch Start @ \$300k	\$265k	\$675k	\$1,245k
\$500k practice @ \$400k price	\$451k	\$965k	\$1,639k
\$1 million practice @ \$800k price	\$729k	\$1,375k	\$2,101k

Illustration 2

presentation to large groups, many dentists in their beginning years of a scratch-start practice will despondently ask if they are supposed to be doing as well as the projections on Illustration 1.

Many of you may be quick to point out the flaws in the assumptions of Illustration 1. That is not the point! Adjust the many variables to fit the complexities of your own situation. Perhaps you never want a million dollar practice or you feel that you can turn a thousand patients into two thousand relatively quickly. The point is to take this template and work up your own analysis for your particular situation.

Illustration 2 shows the Total Profits after debt service (before taxes) in this scenario at the 3, 5 and 7-year totals. As you can see, the difference in potential lost income for the scratch start practice is significant and increases year by year until

theoretically you reach your full potential in your own practice. Depending on the circumstances, you can see how the decision may cost you over \$1 million dollars over several years!

We need to touch upon another variable that further solidifies the case for buying an existing practice. The main reason for buying an existing practice is the patient base. Theoretically, the larger the patient base, the larger the gross receipts and the higher practice purchase price.

By experience, this has not always been the case and we will discuss this issue in subsequent articles.

Many dentists, including highly intelligent and seasoned ones, have a hard time paying “all that money for goodwill”. They may have established large practices from scratch and possess the vital skills and talent to do it again. However, the essential attributes to start a practice from scratch and develop it into a thriving practice are exponentially more beneficial for a practice with a healthy practice base. These attributes may include personality, communication and/or managerial skills along with a host of other attributes.

Therefore, if you possess the special “people skills” that result in quick growth and success, it is advantageous to be able to apply those skills to an existing patient base. If you do not possess those special skills that result in high growth, you definitely have a better chance for success if you buy an existing patient base.

In any event, do not just assume that you are making the best decision. Work out your model based on an honest evaluation of your own circumstances.

NETWORK MARKETING - SCRATCH START

Let us examine this principle by using the following example. Many of us are familiar with Network Marketing, which is based on the concept of “friends telling friends” about a service or product. The premise is that if one friend talks to two people, and those two talk to four, and those four talk to eight, which will result in exponential growth and success. The Dentist in a scratch start practice opens his

practice with relatively few patients and depending on marketing strategies, the practice will hopefully grow (See **Illustration 3**). Using this same application with an existing practice, one can apply the same marketing strategies

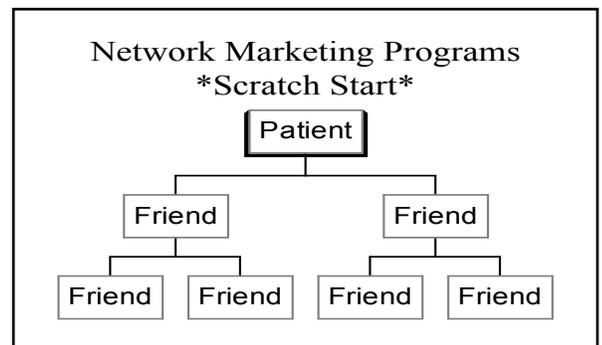


Illustration 3

NETWORK MARKETING— EXISTING PATIENT BASE

and techniques to a base of perhaps a thousand or more patients right off the start! (See **Illustration 4**). Obviously, a network marketing phenomenon in this case would produce very high growth. In reviewing the Profit Analysis, (Illustration 1) we had assumed very small growth for the large practice and that practice still showed the highest return on investment. Just imagine the differences in net profit between the scratch start practice

and the practice with the existing patient base that is properly marketed and managed! **In short, purchasing an existing practice historically produces quicker growth than a new start up practice.**

This is not to say that buying an existing practice is a guarantee of success. There are many factors that must be addressed and evaluated in a practice purchase as well as a

scratch start practice. In subsequent articles, we will discuss the attributes of dental practices and the importance of proper due diligence based on the needs, expectations, opportunity and personal qualities of the dentist. We will discuss essential issues on transitioning a practice as well as the sale of your practice at retirement. Until then, do what you do best!

-Timothy G. Giroux, DDS

“.....a practice purchase historically produces quicker growth than a new start up practice.”

Network Marketing-Existing Patient Base

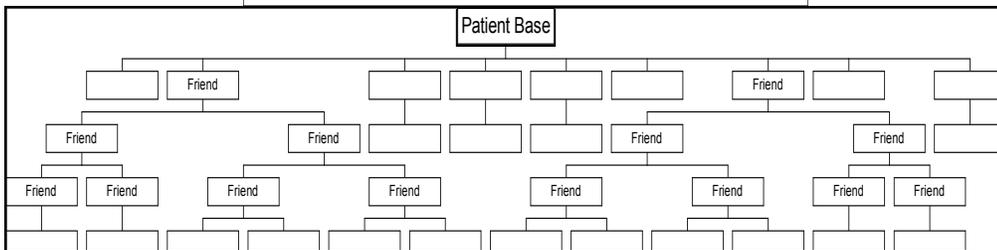


Illustration 4

If you have been considering selling your practice, there is no better time than **NOW!** Trust the best brokerage team!



Timothy G. Giroux, DDS
Broker

Dr. Tim Giroux established and sold a highly successful dental practice in Scottsdale, Arizona. His personal experience in dental associateships, sales and workback situations enhances Western Practice Sales' commitment to excellent service.



Jon B. Noble, MBA
Broker

Mr. Jon Noble received his MBA from California State University, Chico. Jon was one of the founders of WPS over 25 years ago and has been involved in over 300 practice sales. He adds a wealth of knowledge and experience to serve you during the transition of your practice.



Mona Chang, DDS
LLU 1984

After graduating from Loma Linda University in 1984, Dr. Mona Chang joined her husband's dental practice in Scottsdale. Teaming up again at Western Practice Sales, Dr. Chang brings a refreshing perspective as a female Asian dentist to serve and assist sellers and buyers during their transition.



John M. Cahill, MBA
Broker

John Cahill is nationally known as one the country's premier dental transition specialists. He brings knowledge, experience and integrity to the transition process with more than 35 years of experience in the industry.