

Appraising a dental practice before buying



Buying a dental practice is most likely one of the most critical financial decisions a dentist will make. An informed and thorough decision can lead to a successful career and financial stability. A misinformed or hasty decision can cause financial distress and a career with unnecessary emotional stress and struggles. It is no longer an assurance of success in the dental industry to graduate with exemplary clinical skills. A dentist must also focus on the business operations and be prepared to make good management decisions.

As a certified public accountant and a certified valuation analyst dealing exclusively with the dental industry for 20 years, I have advised hundreds of dentists in the critical decision of whether or not to buy a particular practice. It is an important decision that requires a thorough analysis. It is my opinion that a dentist should hire a professional advisor who deals with these types of transactions consistently to help with the decision-making process.

I developed three categories of data to be requested and reviewed. I list specific reports or data that the selling practice should be able to provide any interested buyer and the reason for the request. If a selling practice cannot or is unwilling to provide a reasonable amount of the information, this is a possible "red flag." They may lack the management or computer capabilities to provide the information or they may have inaccurate or no data to provide. With today's dental software and fairly simple accounting packages, most of the items should be readily available by any dental practice owner.

Nine important pieces of financial information

Three to four years of tax returns — These will provide the financial data needed to measure the historical financial performance of the practice. By gathering several years of data, trends can be monitored and stability can be analyzed.

Practice valuation — Hopefully the seller has had a formal practice valuation prepared by a qualified party. As a certified valuation analyst, I believe any seller should make this investment if they are serious about selling their practice. A buyer should examine the report's thoroughness and

the credentials of the preparer. Practice valuation should consider several methodologies and the revenue and profitability in these calculations.

Cash flow model — This is one of the most important tools to analyze whether the practice is a viable option or not. The cash flow model should be a projection of the next five to 10 years after the acquisition. The model should consider growth rates, variable and fixed operating expenses, the debt service needed to finance the purchase of the practice, and the compensation needed by the buyer to support his or her lifestyle and personal financial needs.

Aged accounts receivables — This report will illustrate the competence of the collections policies in the practice.

Lease agreement for the facility or real estate appraisal — Another important facet of the practice acquisition is securing the facility for operation of the dental practice. Find out if the space is available for purchase or if it is a lease arrangement. Buying the real estate in another critical investment decision, and a certified appraisal is needed to establish the value. If the buyer is leasing the space, there may be an opportunity to purchase it in the future. If the facility is being leased, it is important to be able to obtain a suitable lease. This will require either an assignment of the seller's current lease or renegotiating a new lease with the landlord. Key components are the buyer's financial strength, the term of the lease (many lenders require the lease term to equal their loan term), the renewal options, the escalation amount each year, and any other costs expected to be paid by the tenant.

Production/collection reports by provider and procedure — Potential buyers will want to see what each provider is actually producing and collecting. This includes the seller, associates and hygienists. As a buyer analyzes the practice, it is important to determine which providers will remain after the transition and at what level the buyer will need to produce to maintain practice revenue. The procedure report should identify what treatments are performed at the practice and what they contribute to the overall revenue.

Appraising a dental practice before buying

Associate agreements — If there are associates in the practice, it is important to find out if they have contracts and to receive copies. If there are no contracts with associates, it becomes risky to purchase the practice. The associates will be able to leave the practice and solicit patients. If there are agreements, identify the restrictive covenant mileage, the time frame of the agreement, and the non-solicitation of the patients and staff.

Employee list with salaries and benefits — Buyers should obtain a detailed list of the current staff and their pay rates and benefits. Potential buyers need to understand each employee's function and try to get a sense if they will remain after the sale. There is usually no legal format to guarantee the employee base will remain, as most staff members are not under contract. Many times the staff does not know about the practice sale until immediately after the settlement or just before the transition. This expense category is critical in maintaining reasonable overhead in the practice. An industry average is 23 to 27 percent for this category, which does not include the associate doctor wages.

Financing ability — Your analysis will need to include your ability to finance the acquisition of the practice. Two major factors are reviewed by a lender/bank — the buyer's credit and financial worthiness and the practice's capability to produce adequate cash flow and debt coverage. The buyer will need to borrow or provide \$50,000 to \$100,000 of working capital to get started in the practice.

What you need to know about the facility

Site visit — It is generally advantageous to have the seller provide a tour of the facility.

Equipment and leasehold improvements — Establish the age of the equipment and improvements. Determine the working order of all equipment.

Ability to expand — Make sure the facility will be adequate for at least five to 10 years. Find out if there are expansion capabilities in the existing space or adjacent space.

Type of building — Identify that the facility is suitable for a dental practice location and is consistent with the buyer's vision of patient demographics and advertising/marketing plans.

Ten critical patient and practice characteristics

Number of active patients — Determine the number of patients that have had appointments in the last 12 to 18 months.



Number of insurance patients — Determine the number of patients who participate in the insurance plans of the practice.

Patient demographics — Most dental software packages can provide the number of patients in each age group and zip code area.

Number of new patients — This will give the buyer the new patient flow into the practice.

Hygiene — Request the number of hygiene appointments each month and the average monthly revenue generated by hygiene.

Doctor and hygiene schedules — Request a copy of the schedule for several weeks.

Fee schedule — Review the fee schedule to analyze the fees relative to the industry, competition and insurance reimbursements.

Insurance adjustments — A buyer will want to see how much of the normal procedure fees are being adjusted for insurance reimbursement.

Office hours/days worked — Review the current hours of operation and the number of days worked by the owner.

Reason for sale — It is important to know why the practice is being sold. Reasons may include retirement, relocation, sale of second location, financial distress, dental licensing problems of the seller, illness/disability, or death of the owner.

Conclusion

This information allows a buyer and his or her advisors to make a thorough and educated analysis of a dental practice. If you cannot obtain every piece of data, it does not mean the practice is not a viable option. Some practices just don't maintain all of this management data. However, if a majority of the information is not available, it will be difficult to make an informed decision.

As stated earlier, this analysis and decision is of great importance to a successful career. If a buyer does not have the financial and management background to perform these analyses, it is critical to obtain professional advice. Owning and operating a dental practice can be a rewarding financial and career achievement. This information can help buyers begin on the right track. **DE**

Karen Norris is an owner of the McNor Group, a dental brokerage, valuation, and consulting firm. She is a certified public accountant and a certified valuation analyst, as well as a member of American Dental Sales. She can be reached at (888) 273-1014, karenn@mcnorgroup.com, or by writing 1301 York Road, Suite 800, Baltimore, MD 21093.