



BUYING A DENTAL PRACTICE

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EXECUTIVE

SUMMARY

So you are going to buy a dental practice. That is awesome. America needs more people just like you. Smart, college educated, licensed professional with the entrepreneurial spirit.

Before we get too far I would like to suggest that you spend a few hours and read *The E-Myth*, by Michael Gerber. It's a quick read that does an excellent job of highlighting the differences between being an associate doctor and being an owner of a dental practice.

HERE IS MY SHORT LIST OF 6 KEY POINTS EVERY BUYER OF A DENTAL PRACTICE MUST KNOW. THIS LIST IS BY NO MEANS COMPLETE BUT IT IS A GREAT EXERCISE TO GET YOU THINKING LIKE AN EDUCATED BUYER.

- 1. What does a dental broker do?*
- 2. What should I do to buy a dental practice?*
- 3. How do I pay for the dental practice?*
- 4. What are all these dental practice ratios and statistics?*
- 5. What happens in the real world when you buy a dental practice?*

On to the important stuff. We have seen good deals and bad deals. We have listened to mind blowing conversations with attorneys, brokers, buyers and sellers that left you scratching your head.

Battles can be waged over anthills and the keys to the castle are all but given away for the sake of one or two perceived deal killers. My point is when the human element is introduced every deal becomes unique. With that said there are still many common elements that you must be aware of and plan accordingly.



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WHAT IS THE ROLE OF A DENTAL BROKER?

“Okay, I found the practice online and it’s in the right city, it is all fee for service, it’s the right production size, but the asking price is 75% of collections, so I think it’s overpriced”.

Sound familiar?

There are many things wrong with this line of thinking but let’s focus on the brokers role here.

First, what does the dental broker do?

Well actually quite a bit, but one of their primary objectives is to set the price of the dental practice. Now this is by no means a science but more of an art. What do I mean?

Well, the broker will have many conversations with the seller to understand what they want and why they want to sell and what they hope to accomplish. The dental broker will then collect documents and data to prepare financials and cash flow reports.

The dental broker will attempt to “Normalize” the reports with adjustments and then apply a capitalization rate to determine a fair market value for the practice.

The dental broker then needs to convey that price to the selling doctor and sometimes convince them that their practice is not worth what they thought it was. Then the dental brokers take this calculation to market and try to find a buyer.

They do all of this in the hopes of reaching a deal between their clients (the selling doctor) and you (the buying doctor). If they can accomplish all of this then they get a commission usually between 8 and 10% from the selling doctor’s proceeds.

Roughly 50% of all deals that are agreed to between buyer and seller, never get to closing, without a broker.



WHAT THEY WANT YOU TO THINK

“So that’s great, the broker has already done all the calculations and determined the fair market value, right?”

In fact, the broker was very vocal about all the work they have done and how many deals they have prepared and that their price is in fact the real value of the practice so I just have to make an offer and be done with it.

What is the big deal?”.

Please remember that the dental broker prepares their analysis to determine a fair market price that the selling doctor agrees to that they then offer out to the world.

They only need one person to say yes. You on the other hand are looking to see if this practice is what YOU want, that fits YOUR style of dentistry, that fits YOUR cash flow needs (more on that later) which is a HUGE difference.

THEY’RE NOT ON YOUR TEAM

Brokers work for the selling doctor period end of statement.

Don’t believe me?

All you have to do is follow the money, who pays their fee? You? No, the selling doctor. The broker has spent hours and hours with the selling doctor reviewing their practice, getting to know what they want, agreeing on a price and promising to deliver.

Does the broker want you to buy the practice and reach a deal?

Absolutely, but remember they have been working with the seller long before you came along and promised them to deliver a price, less their 8-10% commission.

We have other articles on this topic and we will end with “the brokers are not the bad guys.”

They are very good at preparing the seller to sell their dental practice. They are very good at determining an overall fair market price. They are very good at finding potential buyers. They are very good at working through the transition cycle.

But please, if you take nothing else from this **DO YOUR OWN DUE DILEGENCE.**



WHAT SHOULD I DO TO BUY A DENTAL PRACTICE?

“So I found a practice I like online and called the broker. I signed a confidentiality agreement and they sent me a bunch of data.

Now what?”

Okay good question.

As we have read above we know we must DO YOUR OWN DUE DILEGENCE, but how? Here is a short list of the next steps to get you started.



STEPS TO GET STARTED

- Assemble your transition team
- Go visit the practice
- Collect the data
- Layout and review the data
- Normalize the data
- Calculate YOUR practice cash flow
- Determine YOUR asking price
- Fight or Flight
- Begin the negotiation process

ASSEMBLE YOUR TRANSITION TEAM

It is very important to work with people that understand your industry. We believe in Malcom Gladwell's theory of 10,000 hours to achieve mastery in a field. Why would you trust one of your biggest decisions with someone that only dabbles in dental transactions?

At a minimum you should have both a dental attorney and dental CPA that are familiar with transitions and lease negotiations. You might also add equipment appraisers, an insurance counselor and a practice management expert.

GO VISIT THE PRACTICE

Pick a day with the selling doctor and broker to go look at the practice. Is this the city you want to live in? Can you picture yourself working in this office? Are there enough operatory rooms? Did you get a good feeling from the selling doctor? Do you think you could work well with his style, remember his patients can relate to him. Will you need different equipment?

Drive around the office and town, where are the schools, neighborhoods, social events that are important to you, remember you will be living here for some time. Review their active charts, we have heard 10% audit rate is normal. If there are 1,000 active charts than pull 100 random and review for treatment plans, activity and accuracy. Do these charts look like patients you would like to have?

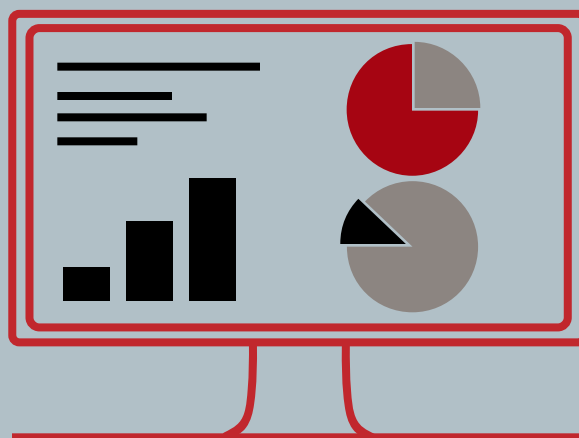
There is a post on Dental Town that recommends taking another person with you and having them use a video recorder to walk through the practice. This is a great idea and lets you look again at the practice through another person's eyes at a later date.

COLLECT THE DATA

Now that you have your dental transition team and some broker data, you will need to request additional data to DO YOUR OWN DUE DILIGENCE. Here are some documents to think about. These are all the moving parts under the hood of a complex machine.

Your Dental CPA will help explain how they work and what they mean. You will use all these documents to determine what the practice looks like and what is it worth to YOU, not to anyone else, but to YOU.

- 3 years company tax returns
- 3 years of CPA prepared financials
- 3 years company W2s
- 3 years payroll reports (names, department, rates, days worked, years of service, benefits)
- 3 years Practice Management Collection Reports
- 3 years coded procedure by provider reports
- Practice statistics (patients by zip code, age)
- Seller valuation
- Last filed company personal property tax return, if state required

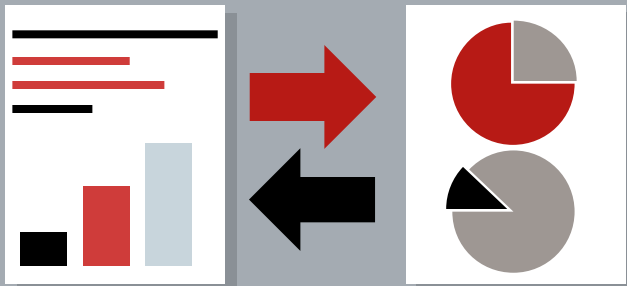


LAYOUT AND REVIEW THE DATA

This is where your Dental CPA goes into the telephone booth and changes from Clark Kent into Superman. Or something like that.

Your Dental CPA will review all the documents and creates their own financials and cash flow statements.

They will look for missing items and amounts that do not appear normal. They will look for what kind of work the selling dentist performs and if it matches the buying doctors style. They will look for outliers and trends in the data. They will verify the brokers calculations and share with you what they think the practice looks like.



NORMALIZE THE DATA

Now that the data has been reviewed for potential errors and omissions, your superhero Dental CPA will then apply benchmark data to “Normalize” certain amounts and line items.

Doctors often run perks through the business that a buying doctor may not. Selling doctors may have family members on the payroll that the buying doctor may not. There could be large profit sharing distributions to subtract. These are generic adjustments to get the practice cash flow to what we call “Normal”.

CALCULATE YOUR PRACTICE CASH FLOW

Once your amazing Dental CPA has calculated “Normal” cash flow reports, then he or she must take into consideration your needs. This is where we customize the asking price to YOUR needs. For example, what might have been fine equipment for the selling doctor may be out of date for the buying doctor and thus capital expenditures need to be added?

Maybe the doctor owned the building but you are going to lease it from him so there would be rent expense that needs to be added.

Maybe the doctor is outsourcing procedures that you would like to keep in house, so you may put some goodwill to that. Maybe the might have to be reflected in your asking price. You get the idea.

DETERMINE YOUR ASKING PRICE

We are getting closer and closer. We have spent a fair amount of time and energy getting to know this dental practice and now have a pretty clear vision of what we feel it is worth for YOU. There are two conflicting strategies that are both very true and you should remember.

First, let me ask you a question. How many people in the world would like to have \$600,000 cash right now? How many people in the world would like to have Dr Selling’s 4 operatory, general practice in Port Orange, Florida for \$600,000? Now I understand that the buying process is an emotional exercise and a great deal of intangibles go into every transaction. But there are so many options for the buyer, different practice, different city, purchase or start up. Every selling doctor wants one thing, your money.

My point is cash is king. It always has been and always will be, period. He or she who has the cash generally has the power, remember that and you will be better served.

The other conflicting point is that there are many noncash factors that go into the price calculation. Is this the city you really have your heart set on? Is this the office building you have to have? Is this the overall practice you will be heartbroken if you lose out?

The buying process is very emotional and intangibles play a big role in the transition. There is defiantly something to be said for paying a premium on something you really want. At the end of the day what is an additional \$50,000 spread over a lifetime to live in the city you want and own the practice you want doing the dentistry you want?

Sometimes we get hung up on all the numbers on what we perceive is the right price when in actuality it's okay to pay a little more and get what you really want. You have worked hard to get to this position, your lifestyle is worth a premium.

FIGHT OR FLIGHT

The moment of truth. You have found a practice, assembled your team, done your own due diligence and have calculated what you will be willing to pay for the practice. What do you think? First let's take a big deep breath, hold it in, and now slowly exhale. Everything will be okay. It seems overwhelming, I know, but really, everything will be fine. Now is when you decide if this is the practice you have been looking for or is this one better for someone else. If you're ready to dive in then it's time to sign the Letter of Intent (LOI) and let your dental attorney throw his or her hat into the ring and begin the negotiating process.

If you decide that after all your research and best intentions this is still not the right deal for you, please remember the wise words of Donald Trump "Sometimes your best investments are the ones you don't make." How true it is.

BEGIN THE NEGOTIATION PROCESS

Congratulations, you have done your due diligence and decided to sign the letter of intent and begin the wonderful world of negotiations. Don't worry, if the very word negotiate fills your stomach with dread its okay. This is why you have a dental attorney to help you navigate through the contract process. It can be a nerve racking experience for some buyers. What appears to be a straight forward contract can be filled (or omitted) with many crucial elements.

It is imperative that you the buyer go slow through this process, the devil is in the details and while fear of losing the deal can set in along the way, it is important that you stay the course and hammer out a solid contract for both you and the seller.



WHAT SHOULD I DO TO PAY FOR A DENTAL PRACTICE?

IF YOU'RE STILL IN SCHOOL

Before we begin let me first talk to the dental students who are still accumulating student loans. Please be frugal. Just because the banks are lending you money doesn't mean you should be using it for anything but what you absolutely need. The banks are prying on our youth.

In 2014, National student loans now total one trillion dollars, the same as our national credit card debt.

Your credit score and total debt are very important and will benefit you or hurt you when you graduate. You will want to keep your credit score above 680, we will touch on this in greater detail in a moment.



AIM HIGH

The banks will write \$300k-\$400k loans all day long without blinking an eye. They will write \$500k - \$700k loans for you qualified buyers if everything lines up nicely. When you start asking for \$800k and up the banks want to really dig into the details for a young new buyer.

Here's the delima.

Most students are graduating with over \$300k in student debt. Why on earth would you buy a \$300 - \$400k practice? They don't cash flow. It doesn't make fiscal sense.

You should buy as much as you can produce. This is why it's important for you to work 1 or 2 years in industry to get a gauge for your production. Here's what I mean. If you are producing \$600k right now you should be looking for a practice doing close to \$800k. Why so high?

The rule of 3s.

Hygiene should be 1/3 of doctor production ($600/3=200$ added to yours = 800).

So aim as high as you can fly.



THE BANKS LOVE YOU, BUT...

There is a reason all the big boys have special medical underwriting departments and that they all have booths at your trade shows.

Historically, dental loans have had a 1% default rate and this is not a secret. The banks will try do everything they can to write your loan at 100% plus working capital. Here's the caveat. You need to do your part too.

- Keep your credit score above 680.
- Work with a dental lender (more on that below).
- Work 1 to 2 years and produce as much as you possibly can.

All of these steps are important but your production really matters. The banks want to see that you can take your schooling and apply it in practice. They also want to know that you can handle the work load for the practice you are buying. The banks also look at your global cash flow.

They will project the net cash flow from the practice and account for your acquisition loan, working capital loan, your student loans, mortgage, credit card debt, etc. this is another reason to live frugal during college and keep your credit score up.

As Stephen covey said in the 7 habits of highly effective people, "**Begin with the end in mind**".

WHAT BANK SHOULD I CALL?

The main reason you should work with a dental lender is that they have account managers that only write medical or physicians loans. They also have an underwriting department that understands the dental industry.

Can you use your local bank?

Sure you can, but I would first prefer to work with someone that handles dental transition loans every day. You don't want surprises.

The buying process has many twists and turns and is an emotional roller coaster. I don't want to have to worry about my rates changing, or terms changing or last minute document requests that could push back the closing or any other "oh by the way".

When you deal with a dental lender they know how to write the loan, they give you a term sheet up front and then have a standard conditions of acceptance checklist for you to follow, no surprises.

So who are the big players?

Bank of America is huge, they are everywhere and we have had good deals with them so far. PNC is a big player in Florida, we have had some good deals and some bad deals with them (I can not recommend them on the west side of Florida). We have heard good things about US Bank however we have not worked with them yet. CitiBank has a dental division that is big in south Florida. TD Bank is all along the eastern United States and are taking dental loans.

HOW LONG DOES ALL THIS TAKE?

When you work with a dental lender, one that knows the value of a practice and has its own medical underwriting department, they can typically get a deal done in 4 weeks.

That means from the time you give them all the supporting documents for their review that we outlined in Chapter 2 under Collect the Data. We have seen them get a deal put together in as little as 2 weeks but 4 weeks is what you should plan for. If there is real estate involved you should add 2 weeks for a total of 6 weeks.

Real estate has its own set of conditions of acceptance and additional steps. Usually you will work with an account manager that specializes in medical loans and they will be able to review all the data and give you what is called a term sheet.

This document will make several assumptions, including your credit score of above 680 (if it's lower you will want to let the banker know in advance). Because you're dealing with a dental banker this term sheet should be pretty solid for you to make your decision on which bank to choose. After you choose your bank the manager will send everything to underwriting to finalize the deal.



WHAT HAPPENS IN THE REAL WORLD WHEN YOU BUY A DENTAL PRACTICE?

YES THIS HAPPENED. “BUT THE BROKER SAID SO”

Representing the buyer we had the privilege of listening to the selling broker yell at us on why we were being so difficult about the covenant not to compete. The selling broker told us that under Florida statute that there was no way a judge would agree to anything more than two years and 15 miles when reviewing a covenant not to compete.

The selling broker went on to say that they were a National Broker and their legal department had written the contracts and even the listing broker had his law degree and it was preposterous for us to be so difficult on this point.

Florida statute 542.335(1)(d)(3)

3. In the case of a restrictive covenant sought to be enforced against the seller of all or a part of:

- a. The assets of a business or professional practice, or
- b. The shares of a corporation, or
- c. A partnership interest, or
- d. A limited liability company membership, or
- e. An equity interest, of any other type, in a business or professional practice,

a court shall presume reasonable in time any restraint 3 years or less in duration and shall presume unreasonable in time any restraint more than 7 years in duration.

Too which we said “Um, selling broker, have you actually read the Florida statute?” Silence. “No. But I can assure you we have this covered.” To which we said “Ok, how about I send you Florida statute 542.335(1)(d)(3) and you can read it and have your attorney call us to talk more on this.” We later settled on 5 year 100 miles bundling it in with other give and takes.

What is the moral of the story? Just because they are a National Broker that blows hard and tells you that your wrong doesn't mean a damn thing. Do your due diligence and have a Dental team of Trusted Business Advisors on your side. The seller does.



NOT ALL BANKS ARE THE SAME

So you've heard us talk about why you should deal with a Dental Lender. The account manager knows the industry and can “prequalify” the doctor based on limited documentation and then work with a special underwriting department that just deals with doctor loans. Well in theory that's great, but it doesn't always work that way.

Having worked with a national bank and Dental Lender on a deal that went poorly on the real estate end, we talked at length with the new account manager on how we want this next deal to please go smoothly. “oh don't you worry I have 25 years experience in these loans and been in the industry for, blah, blah, blah.

So we get a term sheet from Wells Fargo, PNC and Bank of America. Two of them were at 6% for 10 years and one was at 4.5%, pretty sweet deal, so we thought.

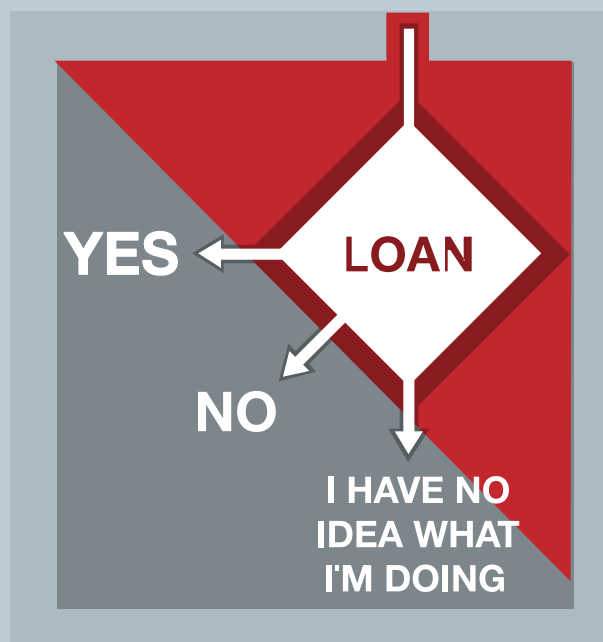
One of the banks (HQ in Pittsburgh) told us they'll send it in to get approved and will let us know if they can do this special rate. We were later informed by email that we were all set to move forward. We tell the other two lenders were sorry but this is just too good a rate to pass up.

Two weeks later we get an email from her boss telling us the buying doctor does not qualify for the special rate and, with only 7 business days to close, he tells us we should just go with one of the other banks!

Are you kidding me?

What is the moral of the story? Even when dealing with a Dental Lender it is important that you're sure the account manager knows what they are doing.

they are not all the same.





WHAT? WE'RE DONE?

Every deal is like its own little snowflake, in that no two are exactly the same. We prepared a doctor buy out for an existing associate. There were many moving parts to this \$2 million dollar practice. The selling doctor wanted to lock in the price but remain on staff as an associate for several years.

We knew the most important item to him was the purchase price. Production issues, how salary would be determined, years of employment, associate expense issues, days worked issues, staff issues, covenant issues, accrued expenses, accounts receivable, goodwill and many other items all still had to be addressed.

The existing associate put together a buying team consisting of him, a dental attorney and us, a dental CPA. I remember the numerous meetings discussing what if scenarios, what items were very important to him to ask for, how much to push on a specific item versus another.

We crafted all the documents heavily favoring the buyer and just waiting for a battle over at least a dozen big ticket items. About a day after the documents were sent the associate got an email "Looks good, lets sign them."

What is the moral of the story? Sellers may get hung up on their hot buttons and give you many items they are not focused on. If you don't ask, you don't get. Be prepared to ask for what you want and don't be afraid to negotiate what you want.



CONCLUSION

1. **This is a big deal. Don't take the brokers word as the final answer.**
2. **People make the difference, be sure you have a good team.**
3. **This is your chance to get what you want. Be prepared and diligent.**