

Dental Corporatisation: is it right for you?

By Garry Pammer, CA. B.Ec. LL.B

I recently have had the opportunity to discuss some of the pros and cons, risks and opportunities that dental corporatisation presents. Due to this exposure I was invited by Dr Shane Fryer, Vice President of ADA Inc. and President of the Australian Society of Orthodontists, to contribute to the debate occurring within the dental profession as he had received feedback that I presented a balanced view. I pointed out that feedback can be subjective in itself. However, as I have advised some of my own clients that corporatisation was right for them and yet others that it was not, I do believe, that I have objectively showed that I always endeavour to maintain a balanced view.

Notwithstanding that many confess to not appreciating all the financial issues, one of the major matters which will ultimately determine whether the dental corporate model will succeed or not, is ongoing maintenance of the current high standards of quality within the profession.

I have attempted to illustrate this point in the past by outlining the measurement of defects within the airline industry, which has high sigma targets for plane safety and low sigma targets for lost luggage. Both have different "sigmas" yet defect variances in both areas can lose airline customers – fast!

In statistical terms, reaching "Six Sigma" in a specialist dental practice for example, means that your procedure or product will perform with only 3.4 defects per million. I am uncertain as to exactly how high a "sigma" you should achieve regarding all patient - related procedures and products but consider it would be very close to almost no defects. If corporates diverged too far from the "sigma" of current private practice, for example, then corporates would lose patients – fast!

Rather than write yet another article (and many have been written – sensationalist and balanced) I thought it would be more helpful to have you test your own personal perspectives on what I see as the key issues.

What follows is a checklist of questions and the associated critical factors to consider in formulating your response. Ultimately you have to be comfortable with the resolution of these types of issues when exploring whether one of the corporate offerings will suit you and your practice.

Remember, every practitioner is different so ultimately, as has been the case with many of my clients, corporatisation may or may not be right for you at this point in time.

Checklist

Do you think your practice is worth more than one-and-a-half-times practice Earnings Before Interest and Taxes (EBIT)?

Is your practice successful and profitable enough to support a value of up to four- and-a-half times EBIT? Note: EBIT is a term that investors often focus on because it measures net operating income after excluding interest expenses and income tax expenses (i.e. strips out lending and tax costs which vary widely amongst practices).

- The range of valuations and prices paid by sole practitioners and amongst the corporates vary significantly
- Do not forget that the EBIT multiple calculation is after subtracting your own dental service drawings
- What is the nature and location of your practice?
- How secure is your existing patient book and your referral base?

Could you commit to delivering your current turnover and profitability over the next three to five years?

- Some corporates have you underwrite your own profit performance against future service payments
- Other corporates defer payment or claw back part of the purchase price based on performance components.

Do you have plans to improve the turnover and profitability of the practice in the short-medium term?

- If you do, you want to receive additional incentives to improve practice profits
- Some corporates pay levels of commission/retained income on current as well as improved annual profits
- Perhaps you could negotiate a larger up front multiple
- Such plans provide a safety net for underwriting your own future performance
- Should you lock in your current employee dentist(s) to achieve future forecasts?



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What is the after tax profit on sale?

- Your net of tax or take home proceeds is the significant profit number
- Carefully consider what you are selling and how to allocate consideration
- Did you commence your practice prior to September 1985 or after?
- Are you selling pre-capital gains tax (CGT) or post-CGT assets and goodwill?
- What CGT concessions and sale price allocations could apply to reduce your tax on sale?

Is it important to your personal wealth creation plans that the entirety of your practice sale proceeds be cash?

- Many corporates require you to take share scrip
- What lifestyle improvements do you want to enjoy now?
- Consider both the private and practice debt you will need to pay down
- What proportions of the proceeds need to be earmarked for your wealth creation or retirement plans?

Is capital growth on share scrip critical to you or can it be seen as a windfall bonus?

If profit on future sale of scrip is important then the eventual list price, ongoing buoyant profitability and resultant growth in share price of the corporate will be important. These factors will be influenced by:

- Ongoing growth in the \$4 billion-plus annual revenue within the Australian dental industry
- Overall quality and performance of dental services under the corporate group you join

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DISCLAIMER: This article is designed to provide generic information only and should not be viewed as a recommendation to act. Individuals should seek advice from a qualified advisor to ensure their actions are commensurate with their financial needs and requirements.

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- The current and forecast size of the corporate you are dealing with.
- The business development model they are implementing (e.g. organic/acquisitive growth model, cost cutting for profitability etc.).
- How and by whom your corporate is funded (e.g. what equity and loan facilities have been secured)?
- The timeframe to get to an IPO (Initial Public Offering).
- The caliber of the senior management team within the corporate.
- Average age of dental practitioners.
- Vintages of enlisted practitioners' service periods.
- Head practitioner succession policies.

Do you think incorporated practices are at risk of failing if the original practitioners leave?

- Determine the career opportunities and diversity of roles within the corporate group (e.g. will they attract, train and retain employee dentists for the future).
- Assess the employee dentist training, mentoring, recruitment, management and development programs.
- What are the current employee dentist incentive plans (e.g. current employee dentists taking over original profit share arrangements, scrip options etc)? Sufficiently high returns and incentives mean employee dentists may continue within the corporate model as they would not need to incur large debt to set up or buy out existing practitioners.
- Find out about employed staff retention and turnover (i.e. are staff happy within the corporate, continuity builds patient relationships and patient book etc.).

Is this a medium term or long-term commitment to the manner in which you personally wish to practice in the future?

- Length and terms of restraints of trade imposed on you.
- Rights to extend tenure and whether they will be on improved remunerative terms and incentives.
- When do you plan to retire?

Are you the type of person that simply must "run your own show"?

- What are the terms of the facility/service contracts?
- How much control of day-to-day management do you retain over purchasing, fee schedules, hours of work, staff selection, pay rates etc?
- What is the management style of the amalgamated dental businesses?
- Will your own motivation and productivity suffer if you are not the boss?

Do you find management of the administrative aspects of your practice (payroll, accounting practices, purchasing etc.) a chore or do you take them in your stride?

- Assess your own management skills realistically.
- What software support are you running now?
- What staff support do you currently have?
- How many staff do you have on payroll (reception, assistants, administrators, second and third employee dentists)?
- Determine the nature and background of the professional staff in the corporate head office support team.

- How much will you benefit from centralised procurement procedures in respect of supplies, insurances, telecommunications etc?
- How important is availability to access and maintain technological equipment like 3D imaging, digital radiology etc.?

Is the corporate you are dealing with signing up the types of practitioners you see as your peers or your betters?

- Nature of and locations of practices
- Highly experienced
- Leaders in field
- Well regarded
- Specialist categories
- Networking opportunities
- Cross referral opportunities
- Shared synergies and best practice ideas.

Whilst not an exhaustive list I trust that the above has been helpful in developing your understanding of the true pros and cons in the context of your own particular circumstances. Making decisions based on newspaper and magazine articles and dinner party conversations (unless with practitioners speaking of their own corporate experience) is not how you should make informed decisions.

- A checklist for Members considering talking to a dental corporate will be in the next issue.

Beware misleading dental budget figures

Don't be fooled by the political spin-doctors. The Government's media release on the 2009-10 dental budget is headed "\$52.8 Million To Boost Victoria's Dental Services And Prevention Programs". The fact is that the \$52.8 million boost is split between dental services, breast cancer screening technology and various prevention programs.

The Minister for Health, Mr Daniel Andrews, claims that the Government is "taking action on public dental waiting lists, with a \$21.1 million investment to provide more dental clinics and chairs and increase the number of patients seen".

When you look at the detailed budget however, you discover that:

- A mere 9700 extra public dental patients will be treated – an increase of 3%

- The expected expenditure is \$148.9 million – an increase of only \$8.5 million or 5.7%
- Only about half of the increase in recurrent spending will be assigned to additional treatment, with the rest absorbed by increased costs of service delivery
- The ratio of emergency to general care is expected to deteriorate, with over 50% of public patients needing emergency care.

ADAVB is disappointed that the budget has not provided for much needed dental services to residents in nursing homes. Although the Commonwealth Government intends to train carers at nursing homes to help residents with basic oral health, the State Government should provide dentists to serve these senior Victorians – many of whom require more than knowing how to

clean their teeth and dentures.

The ADAVB appreciates the extra capital spending commitments of the State Government, because additional and upgraded public clinics were sorely needed.

The ADAVB also appreciates an increase in treatment funding by an amount greater than inflation, because the dental services budget is still well short of the figure required to provide the community with appropriate access to basic dental care. In our view the amount being allocated at present is less than half the amount required.

The budget has not taken into account that many more Victorians are entitled to public dental treatment, nor has the Government made any allowance for the waiting lists to grow because of growing unemployment. There is still much to be done. **GLP.**