



Practice Appraisers & Brokers

Advisors, Value, Investment - Timothy A. Brown & John Wilson

Be careful of advice! Purchasers, you may miss out on a wonderful opportunity. Many buyers, especially ones that rely on a single advisor, have lost out on a practice ideally suited to their needs. The problem arises when recommendations from these advisors are based on non-market based evaluations. One of the most common errors is to base the value of a practice on a 5 year payback, meaning, if you can't pay the practice loan off in 5 years, it's over-valued. Wouldn't this be great, when buying houses! Try buying anything that way! This method completely ignores the market. I wonder if these same accountants recommend this method for determining what you charge for dentistry. A patient comes in and says "I'll pay \$100 for that bridge as that's all I can pay off in 6 months!!" I just know there are a lot of dentists wanting to do business this way. Wrong! And it's also wrong for determining the value of your practice. A 7-8 year repayment is now the Canadian standard.

One of our competitors recently told one of their clients this week that a patient chart is worth \$100. The office in question is located in the Greater Toronto Area - one of the highest demand areas in Canada. **NONSENSE I say!** We just sold a practice in a major city (one that had to be moved out of the house) and we got exactly \$400 per file, 800 files in total, \$320,000 sale price! No hold backs, no fancy formulas based upon patients showing up, income staying the same - NOTHING! Cash on closing!

The same value should hold true for all major cities with a surplus of dentists - there are no major market differences between provinces, with some exceptions. I submit that Vancouver, Calgary, Edmonton, and all the GTA centers, plus Ottawa and to some extent Halifax, are very similar in supply and demand of dental manpower, thus the value of a patient would be similar. We hear from people all across the country who want to argue differently, but we will defend our opinions to the very end! Why will all five major banks (especially Scotiabank and RBC) offer any dentist, anywhere in Canada 100% based upon the ROI appraisal? They have confidence in our market values because they have confidence in dentists! They know they can service the debts, so the appraisal must be accurate!

What is a patient really worth? If a patient appoints just 2 times per year for a cleaning and a 1, 2 or 3 surface filling - the dentist will bill about \$500 in one year. Over 10 years (estimated patient loyalty term) they gross \$5,000! From an income related to investment approach, that is a return of 10% if you paid \$500 for the chart - and the dentist still owns the chart after ten years and can probably sell it for \$500 - all things remaining equal.

I recently had dinner with a Investor Dentist (i-dentist™) this week who is absolutely salivating to get his hands on as many practices as he can. He wants to put in as many associates as he can hire and does not plan to work in any of them. Why? Because he knows he easily achieve a return on investment of 10 to 20% just for managing. He told me that when he pays back the bank in 7 to 10 years, his ROI goes up to almost 30%! Where can you get that kind of ROI? Nowhere! I have looked at many business systems, none of which produce this ROI - consistently and with so little risk!

Recently one of our associates in Ontario had 19 appointments booked to view a practice, all in one day in Cambridge, Ontario. He already had two (2) signed offers for this practice and if you can believe-neither of the buyers had even seen the office yet!. One of the offers was for \$125,000 above the asking price of \$1.3 million. By the end of the day he had 4 signed offers. This is happening every week in Ontario within 1 hour of the GTA!

Recently we were called in to reappraise a practice here in Vancouver. The dentist was upset at the low value determined by one of our competitors. We valued his practice at a substantial margin above that and he had 13 buyers interested and ending up selling it above our appraised value. We had under appraised it too!!

Don't be fooled by appraisers and accountants who under appraise to get a quick sale. You have spent many years building your business, putting in countless unpaid hours of time to get it where it is - you deserve to sell with DIGNITY, and to be respected by today's young purchasers.

The New Patient Obsession — Anne Wright, RDH, MBA

One of the first things a prospective dental practice buyer wants to know is the number of new patients who enroll in the practice each month. Purchasers are obsessed with this figure, but how relevant is this statistic? Many buyers have preconceived ideas as to how many new patients constitute a healthy practice. Whether their information is derived from a practice management seminar or from conversations with their professional advisors or other colleagues, they are often under the mistaken impression that unless a practice has large numbers of new patients, then it is a questionable investment. One of the major factors in deciding to purchase an existing practice is the value and revenue stream generated from the *existing* patient base. The current patients represent the range of dental treatment being provided and the efficacy of the hygiene recall program. The decision to purchase an existing practice or to construct a new one is complicated. Most advisors suggest that a practice purchase should generate an immediate cash flow sufficient to cover the overhead and to pay down debt. Therefore, if purchasing an existing practice is attractive, then the patients who currently attend the practice are the most valuable statistic upon which to focus. Selling dentists typically do very little in the way of advertising or marketing their practices. These vendors established practices at a time when the demand for dental services was very high and a dentist didn't have to advertise to attract new patients. This generation of dentists is uncomfortable with anything more pro-active than listing the practice in the Yellow Pages. They are now in their mid- to late-careers and generally satisfied with a steady income. They want to practise fewer hours and provide treatment for patients who are receptive to their treatment plans. Their patients are well-educated, don't miss regular recall appointments, are familiar with the office policies, like the staff, pay their bills on time and have absolute trust in their dentist. Moreover, these practitioners are not motivated to expand the practice in terms of services or numbers of patients. They want to treat patients who have become friends over the years. This is completely opposite to the rationale for starting a brand new practice. A young dentist will correctly look at location and the area demographics before building a new practice. We all agree that competition for dental services in the urban areas is high and dentist/population ratios have increased. Practice visibility and new patient numbers are critical if the practice is to get off the ground.

However, many may forget that it is not the volume of new patients who walk in the door that is important, but the number of these patients who return to the practice over time. A high return rate is not an easy goal to achieve and practice management consultants may command hefty fees to assist practices in developing patient management programs. Can you imagine how much easier it is to promote regular recall visits in an established practice with a committed patient base? Established dentists do not have to resort to promotional gimmicks such as free tooth whitening, electric toothbrushes, coupons, hockey tickets or discount exams as a marketing tool.

Purchasing an existing practice is quite different, with an entirely different set of factors to consider. If the practice to be purchased has a healthy cash flow, then the main consideration should be to devote time and attention to the needs of the existing patient base. In the first couple of years, all of a new dentist's focus and energy should be on developing relationships with these loyal patients. As brokers we know that patients will continue to return to a practice, even after the death of the dentist! A sensitive purchaser will spend his or her efforts developing trust with the existing patient base. If the patients are not urged to adapt to huge changes in philosophy, procedures or décor they will be immensely receptive to the new dentist's treatment. Why does this occur? Because, these patients have placed so much trust in their previous dentist and are eager to give his or her successor the opportunity to continue to provide their dental care. There is little reason to focus so much attention on the number of new patients. The educated purchaser knows that new patients are generated by referral.

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The Private Sale—Who Benefits? - Timothy A. Brown

On occasion, and after we have completed an appraisal, some clients tell us that they are going to attempt to sell their practice to their Associate, or to a colleague that they have formed a relationship with. While a broker would prefer to act as an agent, thus earning the commission, we do not insist that our appraisal clients' also use our brokerage services. This is known as 'tied selling' and most regulators, including my own, frown upon it.

What are the benefits of the "private" or "Limited Market Exposure" (LME) sale? Are there any pitfalls?

The first perceived benefit, held by the seller, is that he will save the usual and customary commission paid to the broker. Sellers then conclude that this will increase the net proceeds of the sale. While this is entirely possible, my informal research on the topic reveals it is not actually the case. The primary reason the net proceeds of the sale are not as high as anticipated, when compared to the brokered sale, is that buyers are quick to suggest that the lack of a commission should entitle them to a reduced sale price. I asked several leading and reputable bankers, accountants, and lawyers who are active in the dental market what their client's were actually saving when a private sale transpires. The answer may surprise you - most of these market experts readily admit that the sale price was notably lower, when compared to similar 'brokered sales' and that their client's anticipated savings rarely materialize.

Another concern for the private seller is the accidental withholding of valuable information. Buyers are afraid to insult the owner by asking some of the more difficult questions about financial matters or clinical philosophy. Buyers rarely have this same reservation when working with brokers. I have often heard a buyer say "I wish I had known that before buying this practice" and I reply with "why didn't you ask?" The answer is invariably this "I did not want to insult him." Sellers I speak with, who have sold their practice privately, tell me they wish they knew more about the buyer before the sale was completed, but they remark "I didn't want to discourage her, so I never mentioned some of the aspects of my practice."

For the buyer, the obvious benefit is that they do not have to compete with the multitude of other buyers in the market place. This affords the buyer more time to perform their investigations and reduces the pressure on increasing prices. The major shortcoming for the buyer is that they may not know all the facts before proceeding, due to the desire to save professional relations. Difficult questions must be asked when buying a practice, questions that can insult a colleague if not phrased correctly.

Professional relations are important to dentists, they genuinely want to trust each other, and in the large majority of sales, trust is earned, rightfully so. However, in today's ever-changing market, generational, gender and ethnic variables have come to play a large role in the buyer and seller interaction process.

I believe that dentists, who try to buy a practice privately, will offer a lower sale price in the absence of the broker. And further, if they know that they are the only 'option' being explored by the seller, they will secretly feel that they have a distinct advantage – perhaps to the extent whereby they try to gain at the seller's expense.

Buyers have told me, in no uncertain terms, they think private sellers are one of two things: "cheap or naive." Is that how you would want to be perceived by the buyer of your practice?

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Multiple Offers — Timothy A. Brown

In today's active market, many practices for sale are attracting multiple offers from multiple buyers. Why is this phenomenon happening and what should buyers do when 'competing' with other dentists who wish to purchase the same practice?

To understand the competition for practices, the first and the most influential issue to consider is the ever-increasing surplus of young and ambitious general dentists in our urban centres. In one recent sale, our firm appointed with 34 dentists - each of whom arrived to view the practice for sale - and all in one day! This was unheard of in the past and only serves to prove the huge number of buyers seeking an established practice in these urban areas. As a result of this one-day "open house" numerous offers were submitted within the following week, affording the seller the 'luxury' of choice. In the end, only one offer can be accepted and the remaining buyers are now seeking other opportunities.

Buyers often ask us what they can do in these situations and what steps they can take to improve their chances of being the successful candidate. My first suggestion is that speed is the buyer's best tactic. The process of deciding what price to offer and working with a lawyer, accountant and banker to structure the offer is very important. Some buyers wait too long, thus decreasing their chances. Much like the housing market, if you see something you want, it is imperative to move with expediency and with decisive communications to the seller, and their broker (if the seller is using the services of a broker). Buyers should also know that the market has developed into a 'sealed

bid' process. In other words, only the seller knows the price and terms of the various offers. If a broker informs one buyer of another buyer's price or terms, he then creates a 'Dutch Auction' whereby all buyers are entitled to know the price offered by all the other offers. While the "Dutch Auction" is common in some markets, it is not the preferred technique for selling professional practices. Even buyers tell me they do not want others to know what they have offered the seller. As well, buyers do not wish to be subjected to an increasing price simply by allowing the seller (or their broker) to create this open knowledge auction. Invariably, the price will escalate even higher, if the competition becomes an open auction process.

Another strategy for today's buyer is to carefully examine the tax structure of the sale in advance of submitting their offer. Many sellers are forming Professional Corporations prior to sale so that they will benefit from the substantial tax savings afforded by the capital gains exemption. Buyers traditionally were not inclined to buy the shares of corporations, as it does not afford them the same tax reduction as sellers. However, as the market continues to evolve, the incorporated practice is fast becoming the norm and buyers are advised to prepare for the impact of buying such practices. Your accountant is the best advisor to consult with on this matter before you commit to submitting an offer.

The buyer should also seek advice from their bank before entering a competition for a practice to be sure they are well prepared for the possibility of a counter-offer (also known as a 'sign-back') from a seller who is seeking a higher price. It should be noted that in many recent sales, the final selling prices are often higher than appraised values.

I am empathetic to buyers who are ready willing and able to take over an established practice only to find that they are being eliminated from transactions due to the over-whelming number of competing buyers. The market must change, as all markets do over time, but as I have predicted in the past, I do not foresee the surplus of dentists in the GTA or Metro Vancouver reducing in number any time soon. In fact, one discussion I had with some regulators and senior dental administrators last month, more or less confirms that more buyers entering these markets may prove to increase prices even higher. Great news for sellers - not so great for buyers.