

Rita Li
CFA MBA CFP

Purchasing Your First Dental Practice

From speaking with dentists, I know there is significant desire yet anxiety around purchasing a first dental practice. After battling to repay sizeable student loans, the notion of taking on more debt to run a practice can be very daunting.

As well, since the spread of COVID-19, the economy has faced some unprecedented challenges, causing many to put any purchasing plans on hold. But however severe, the impact of the pandemic is expected to be transient. Using China as a reference point, quarantines were implemented in late January for approximately two months, reducing new cases. By analyzing real-time data gathered and tracked by the *Financial Times*, you can see that China's economy is on its way to recovery (1). See Table 1.

Industry growth, spending by segmentation, and sector versus industry costs

Before you do anything, it's important to do your homework. A recent industry report published by IBISWorld indicates the dental industry is still in a growth phase, with projected growth to outpace the overall growth of the Canadian economy (2). While most dental visits are not fully covered by insurance, dentistry is the second largest category in health-care expenditures by Canadian households. The higher growth areas are in geriatric and cosmetic dentistry. After profit, most of the industry expenses are in personnel, with relatively low overhead. See Tables 2 and 3.

Table 1.

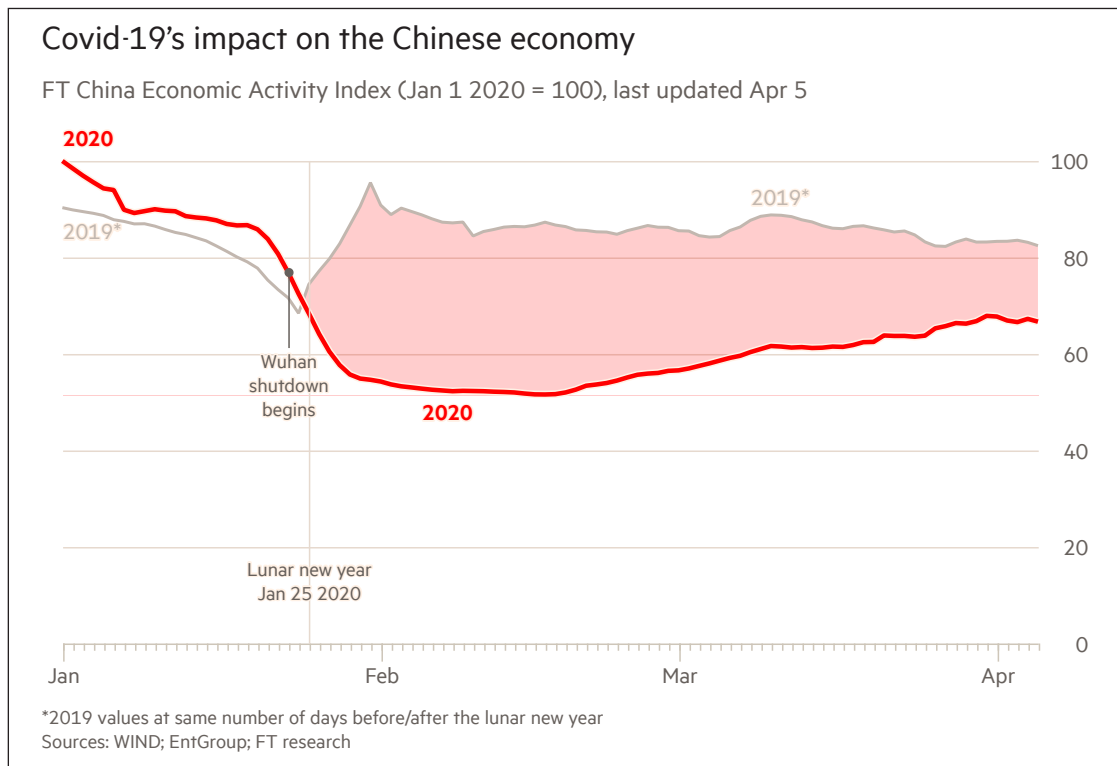
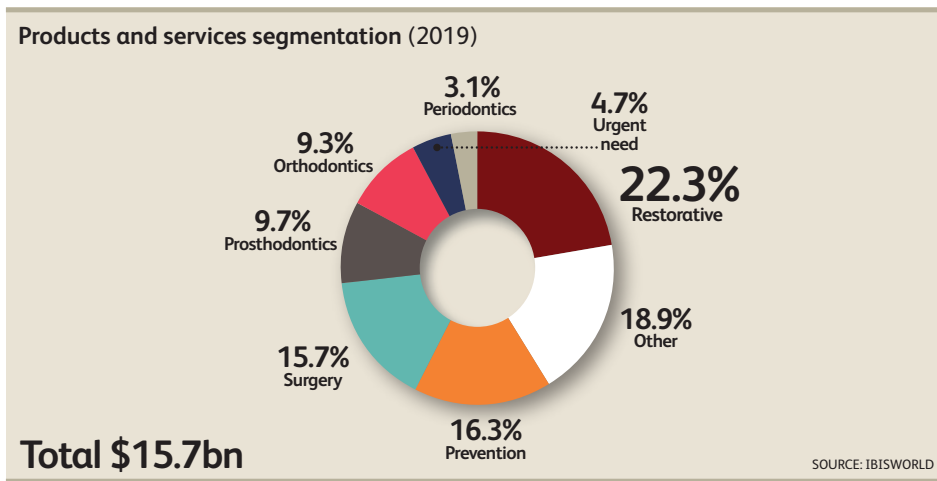
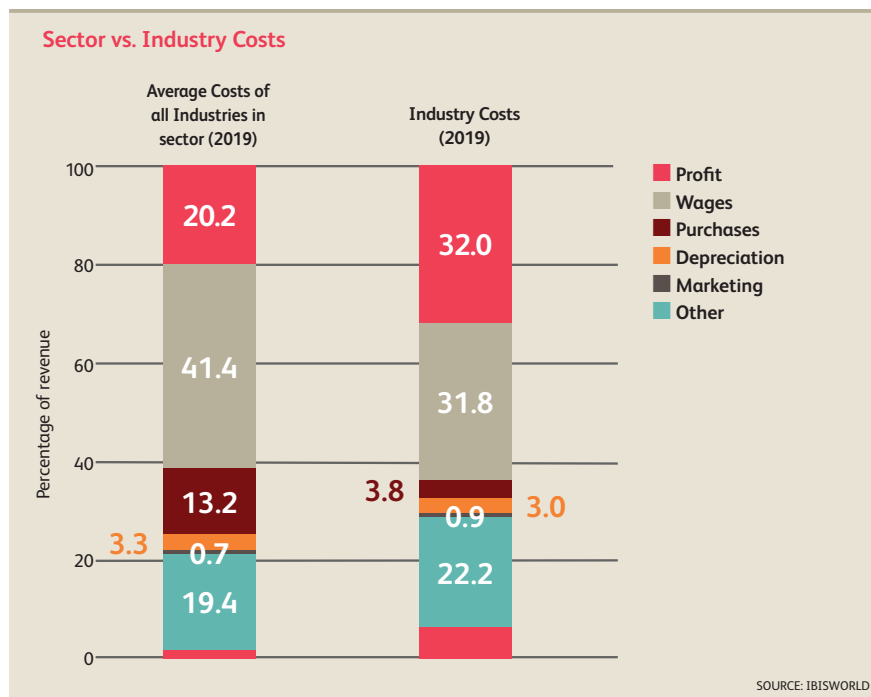


Table 2.



This shows a segmentation of products and services last year, depicting demand for dental services; the industry generated \$15.7bn in combined revenue. The annual growth rate between 2019 and 2024 is projected to be 2.1 per cent. The key external drivers for growth are: number of adults aged 65 and older; total health expenditure; per capita disposable income; per capita soft drink consumption.

Table 3.



The cost structure of dentistry

Last year profits — measured as earnings before interest and taxes — account for 32 per cent of revenue, down from 33.2 per cent in 2014. This compares favourably to the profit margins of many industries in Canada. The main costs are: wages, which account for 31.8 per cent of revenue; purchases, such as dental impressions, account for 3.8 per cent; depreciation accounts for 3.0 per cent; marketing accounts for 0.9 per cent; rent accounts for 1.4 per cent; utilities account for 4.9 per cent. Other costs include insurance, maintenance and professional fees.

When you are ready to buy: have a number in mind, and be willing to walk away

Picture that a confident, young dentist has identified an ideal practice to purchase. There's considerable alignment in personalities, dental philosophy and competencies with the practice owner. You are reasonably confident that client retention will be high after the transition and you have already identified a few areas for improvement to enhance growth and profitability, such as renovation of the reception area, and localized advertising.

Still, it is unwise for young professionals or anyone to take on a large amount of debt without an executable plan for repayment. After all, you are taking on business risks with inherent liabilities.

While the payback period is not the most sophisticated analysis, it serves as a simple illustration. The payback period is calculated as the cost of the investment divided by the annual cash flow. Assume you are paying yourself a salary that meets your lifestyle needs, and you are able to obtain full financing for the purchase.

Let's assume there are two practices for sale

One practice is in a relatively remote area, the listing price is \$400k, approximate annual cash flow is \$100k as measured by EBITDA — earnings before interest, tax, depreciation and amortization, often used in practice valuation as an approximation for cash flow. The practice is valued at four times EBITDA with an approximate four- to five-year payback period.

The other practice is in the Toronto downtown core, with an asking price of \$1.2 million. EBITDA is \$150k, therefore the practice is valued at eight times EBITDA with an approximate eight- to nine-year payback period.

Which is the right one to choose? Notwithstanding there are other factors to consider, such as where you prefer to live, time to commute, etc., this illustrates how the purchasing price paid will have a direct impact on overall financial burden, real or perceived, and how long it will take for you to pay back the investment.

The importance of having a business and financial plan

I hope the illustration above shows it's important to have financial discipline. Not only is it good to have, it is imperative to have in order to obtain lending — financial institutions want to ensure you are able to pay back on the loan. The first few years may be about hard work and disciplined savings. You may need to maintain an associateship to enhance cash flow. However, is there anything more rewarding than being your own boss?

Financial institutions lend to dentists because historically, their default rates are very low. However, given the rise in valuation in recent years, banks have also enhanced the due diligence they conduct in the underwriting process.

Lenders want to see a solid understanding of the financial undertaking as well as a plan for repayment. The dental practice itself is important: its growth, profitability, cash flow, etc. Your personal and professional history is also crucial in obtaining the financing you want. What banks want to see is a competent professional with relevant work experience and a history of financial discipline.

While there is no “pre-approval” in the current environment, some banks can lend up to 100 per cent of the purchase price with an amortization term of 10 to 12 years.

Consider having a niche

Do you have a natural niche; specializations that offer differentiation? I had the pleasure of meeting a dentist who told her story of working with clients who have phobias. While they can be considered difficult clients by some, she has no problem in empathizing with them. As result, she was able to build a thriving and differentiated practice with many incoming referrals and a loyal client base.

What about marketing?

Do dentists have to be business people, too? I am afraid so. If you operate in a competitive market with other dental practices within a 10-minute driving distance, client retention becomes really important. As we move towards an experience economy, whereby the experiences that companies create will significantly matter, offering a consistent, high-quality service combined with personalized advice can enhance consumer loyalty.

Building a brand and reputation has long-term significance. As shopping moves to digital platforms, client testimonials and consumer reviews serve to attract more first-time customers.

Having paid for an undergraduate degree and then an MBA, I can empathize with many of the financial challenges a dentist might have. I can also empathize with the challenge of building one's own business and professional practice. While I covered some of the considerations for a first-time purchaser in this article, there are many nuances that only a team of professionals can address. Make sure to seek professional advice when making this important decision.

REFERENCES

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Rita Li is a Chartered Financial Analyst CFA® and Certified Financial Planner CFP®. Rita obtained her MBA from Richard Ivey School of Business. Rita works with dentists to advise on investments, retirement, succession and estate planning. For a complimentary review of your current financial plan, contact Rita by email at: rita.li@rbc.com or phone: 416-974-3794.

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Tier Three Brokerage