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Considerations for Practice Transition

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Introduction

When considering selling or purchasing a practice, there are a multitude of factors that weigh into the decision. The following articles from subject matter experts in the dentalcorp network, provide insight into some aspects that should be considered when researching and beginning the acquisition process.

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Dental Service Organizations: They're Not All the Same

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The dental industry in Canada is evolving. With over 24,000 dentists and 14,000 practices across the country, today's market is highly saturated and fragmented. The fragmentation, along with increased expectations of consumers, has given rise to a new business model: Dental Service Organizations (DSOs). DSOs can be thought of as independent business support centers that contract with dental practices to facilitate further growth and success.

While there are many benefits to joining a DSO, it is important to note that not all DSOs are alike. A number of very diverse models exist in the industry, and it is necessary to do your research when evaluating potential opportunities. The following are useful questions to consider as you weigh your options.

Will you maintain your clinical autonomy and professional independence?

By removing the administrative burden that comes with running a business, a DSO should allow you the freedom to focus entirely on delivering exceptional patient care. The DSO's involvement should be limited to the business side of things while the clinical decision-making is left to the clinicians. You should have complete autonomy to practice dentistry the way you always have, while leveraging the resources and knowledge of the DSO to remain competitive and successful.

Will you have access to a supportive and expansive infrastructure?

A DSO should have a robust infrastructure in place to support practice optimization and future growth. To understand the true scale of the infrastructure, enquire about the different resources available, as well as the size and background of the teams. Along with the essential administrative functions, understand what strategic tools and resources are available to you to support your ambitions and your practice's success.

Can you diversify and de-risk your wealth?

Different DSOs afford varying degrees of financial growth. The ideal opportunity should include a 100% sale of your practice, allowing you to extract the full value of your practice and the freedom to invest more money elsewhere, today. You should also be provided with opportunities to become a true shareholder in the organization and benefit from its overall success. When evaluating shareholder opportunities, ensure you have a good understanding of the stability of the shares and past liquidity events to shareholders.

Will your legacy be secured?

Your years of hard work building your practice should not be undone upon joining a DSO. The legacy of your business should be secured while you continue to practice dentistry. It is essential to find a DSO that will allow you to remain the leader of your practice, while maintaining your practice's brand name and culture.

What is the reputation of the DSO and its affiliates?

Taking into account the reputation and history of the DSO, its affiliated partners and private equity investors can help to gauge credibility. A DSO should be home to a network of highly successful, reputable practices. Valuable insights can be gained from looking at the investor's history of success, the number of years it has been in business, as well as the nature and timing of historical investments made. Ideally, a prospective DSO would have strong financial backing by established investors with a proven track record of success.

What are your growth ambitions? Will partnership enable you to achieve your goals?

A strategic DSO should be poised to enable your continuous growth through multi-clinic ownership opportunities, if that is your goal. An ideal partnership further provides you and your team with opportunities for mentorship, continuing education and training, in addition to access to leading-edge technology and equipment to stay ahead of the curve. The truly strategic DSO recognizes the value of its partners and leverages their knowledge and experience to achieve shared growth and success.

Is it a true partnership?

Prospective partners should take the time and effort to understand your unique practice and situation, and subsequently customize a partnership deal that will meet your needs. True partnership is mutually beneficial and should ultimately serve to support the success of both your practice and the broader organization.

The decision to partner with a DSO is much more than a financial transaction. Among other factors, your autonomy, reputation, and potential for continued growth and development should be considered when determining what's right for you. To help you make an educated decision, actively seek further information and guidance from experienced peers, and ask the tough questions – your legacy depends on it.

The Antiquated Approach: Rethinking the Role of a Broker

Sarah Osman, Vice President of Legal, dentalcorp
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Prior to joining the dental industry, I acted as counsel to one of Canada's largest IIROC-regulated brokerage firms – a hyper regulated space in the financial industry where regulators and business stakeholders shared one ultimate goal: the protection of investors and their investments. Regulators monitored broker activities, conflicts, and investor-facing communication, holding brokers to high ethical and professional standards, and enforcing strict disciplinary actions if their rules or standards were broken. After transitioning into the dental industry, it became alarmingly apparent that even though dental practice brokers are arguably involved in a dentist's most valuable investment (their dental practice), they are regulated to a far lesser degree and held to a much lower standard.

There was a time when brokers played a role in facilitating the sale of a dental practice by listing the property and sourcing potential buyers – essentially acting as the middleman. With the emergence of more sophisticated market players in recent years, however, brokers are increasingly finding themselves on the sidelines of dental practice sales, leading many practice owners to question whether they need the services of a broker at all.

Generally speaking, dentists retain brokers because they assume they have no choice. They are not aware that there are expert advisors better suited and more qualified to not only prepare sellers for the sale of their practice, but also drive more successful sale outcomes. If a practice owner is still considering engaging a broker—whatever the reason may be—there are key considerations to take into account before doing so.

Brokers can be costly.

It's useful to understand the compensation structure of your service providers, and in the case of brokers, they are almost always paid on commission. Brokers routinely charge commission fees ranging from 7-10% of the sale price of a practice. Considering that Canada's average practice sells for $750,000 - $1.5 million, that's no small figure – and it almost always comes out of the seller's pocket.

Not all brokers are reputable.

Sale transactions can be financially and legally complicated. Unfortunately, most brokers in dentistry do not have any formal business certification, professional designation or true financial acumen. If you are looking to sell your practice with a broker, it is important to retain licensed professionals with Chartered Financial Analyst (CFA), Chartered Professional Accountant (CPA), and/or Chartered Business Valuator (CBV) designations, who have the necessary knowledge and experience to guide you through the financial and legal terms of the transaction.

Brokers may be prone to conflicts of interest.

In contrast to other industries—the finance industry in particular—brokers within the dental space are minimally regulated, and thus expose clients to the conflicts of interest inherent in the role they play. In other highly regulated and more transparent industries, brokers must disclose the potential for a conflict of interest. However, dental practice brokers manage to fly under the radar in this regard.

As dental practice brokers are compensated based on the sale price of a practice, they are entirely incentivized to get any deal done regardless of the outcome. For dentists who care about the future of the practice they built, and the staff and patients they are leaving behind, fit and value go hand-in-hand. There needs to be trust that a good deal is not just any deal, but the right deal; and so, it is important that advisors' interests are aligned with the seller's – not the opposite.

OPTIONS BEYOND A DENTAL PRACTICE BROKER

The dental industry's fragmentation and complexity, along with increased expectations of consumers, has led to the emergence of sophisticated buyers like Dental Service Organizations (DSOs) – which can be readily found by sellers today.

DSOs have become an increasingly popular option for dentists looking to sell their practices, due to the supportive infrastructure, economies of scale and opportunities for growth they can provide. Dentists are also drawn to DSOs as they provide the unique ability to continue practicing dentistry, while protecting the well-being of their practice team and patients, thus securing the legacy the dentist has worked hard to build.

With qualified advisors and the support of sophisticated buyers, practice owners now have more opportunities than ever to optimize their sale outcomes without involving a broker.

From origination to negotiation, DSOs have robust sales processes of their own.

The success of a DSO relies on their ability to source, evaluate and close deals, and the successful ones have spent a considerable amount of time investing in the resources and personnel to do this. From the onset of a conversation with a seller, a DSO is focused on achieving alignment between their values and goals, and those of the seller. Following the agreement between the two parties, the DSO will start their due diligence process, regardless of whether a valuation has already been conducted by a broker.

It is crucial to note, however, that a number of very diverse DSO models exist. As such, it is increasingly important to understand the differences between DSOs when evaluating potential buyers. Among other factors, a dentist's autonomy, reputation, and potential for continued growth and development should also be considered when joining a DSO.

Leveraging the services of experienced professionals can save you money.

Regardless of whether you choose to engage with a broker or not, in order to sell your practice, you will require a lawyer, accountant, and other service professionals and will be subject to their various fees. An experienced transactional or corporate lawyer and accountant can help walk you through the sale process and prioritize your interest, ultimately saving you the money you would have paid a broker.

Looking beyond a dental practice broker and leveraging necessary professional services can ensure both your qualitative and quantitative goals are achieved, and ultimately keep more of the purchase price in your pocket.

Due Diligence When Purchasing a Dental Practice: A Risk and Compliance Perspective

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Purchasing a dental practice can have a lasting impact on a dentist's career and is one of—if not the—largest investments of a lifetime. Acquiring the right practice can provide a dentist with meaning and satisfaction for years to come; however, buying the wrong one can leave a dentist worse off than owning no practice at all. Such an important decision requires careful deliberation, attention to detail and due diligence.

Due diligence is the process through which buyers determine whether a practice—taking into account its potential perils—matches their present and future needs. While there are a number of important factors to consider at the outset, one of the biggest areas often overlooked or superficially addressed is the costs and risks associated with regulatory compliance. And yet this component can greatly impact the short and long-term success of a practice. With today's dentists under pressure to meet increasingly complex regulatory requirements, it is vital to ensure the clinic is compliant prior to purchase; and if not, one must fully understand the investment needed in order to make it compliant.

In an article published in Oral Health in 2018, John Hardie, BDS, MSc, PhD, noted that "Implementing all of the [RCDSO's IPAC] Standard's recommendations will necessitate immediate and long-term capital and labour expenses." Depending on the extent of renovations needed to provide a dedicated sterilization area with one-way flow, or the equipment required to handle the volume of patients seen by the practice, the cost of compliance can easily exceed $100,000 (excluding downtime for renovations, training and/or hiring of staff, etc.). In the past three years, several provinces in addition to Ontario have overhauled their IPAC standards, meaning the cost of acquiring and operating a practice has increased significantly. The remaining provinces are expected to follow suit in the coming years. Let the buyer beware.

Infection Prevention and Control (IPAC): What to know before you buy

For those looking to purchase a practice, most sterilization areas are out of date—both in design and equipment—and do not comply with today's more rigorous standards. While some clinics have recently invested in this area, many have not. Dentists on the verge of retirement often make a calculated decision to forego such an investment (and the significant dollars required to make it). While that calculated decision works for someone at the end of his or her career; buying a practice with a deficient steri-centre represents a significant legal, financial and reputational risk for the purchaser.

Continuing to operate such a clinic without making the appropriate upgrades is, in today's world, professional Russian Roulette. According to a recent study, **public health complaints in Ontario rose** 470% between 2015 and 2018, with a meaningful amount originating from staff at the clinic itself. Anecdotally, IPAC related complaints are up across Canada, as are practice closures and the damaging media attention they attract.

Purchasers of dental practices must take into consideration the cost of compliance when deciding:

1. Whether to buy the practice;
2. How much to pay for it;
3. If significant improvements will be required; and

If so, who is responsible for the cost of those expenses.

The regulatory landscape and other related risks

As demonstrated, healthcare is heavily regulated. Indeed, after aviation, it is the most heavily regulated industry. Although quantifying the regulatory risk posed by the clinic you are considering purchasing is a tall order, the task must be attempted. Failing to ensure the practice holds the appropriate sedation and radiation licenses, for example, can result in business disruption, not to mention a logistical nightmare.

The same can be said of overlooking the importance of the practice's privacy and data security systems. As you read this, somewhere in Canada, a practice is experiencing a ransomware attack—or worse—having their data stolen surreptitiously. When a new dentist is getting acquainted with a practice's patients and staff, demonstrating confidence and competence is essential. Having to explain to patients that their data was stolen or encrypted is the last thing a new owner needs.

Fortunately, the risk of facing these scenarios can be greatly reduced if you approach buying a practice intelligently and systematically. As is often said, knowledge is power, but you must know which questions to ask and how to make sense of the information you receive. As most dentists only buy one practice in their lifetime, getting it right the first time is a must.

The nuts and bolts of legal and regulatory due diligence

Before buying a practice, dentists should find out whether there have been any recent lawsuits, disciplinary proceedings, investigations or regulatory complaints that may impact the practice's value. If after the buyer has reviewed the information, and they still have a strong interest in acquiring the clinic, the next step is visiting the practice to evaluate the location, facility and equipment. During this visit, the buyer should:

1. Take pictures of the equipment;
2. Verify that the practice has a preventative maintenance regime in place;
3. Examine recent reports generated during routine servicing and repair of equipment; and
4. Ensure any issues identified in the reports have been resolved.

Using a sedation monitor, NO/O2 delivery system, or CBCT machine that is malfunctioning presents both safety and liability issues. Therefore, the buyer or a trusted dental equipment representative should inspect all critical equipment to ensure it remains in good working order prior to the sale, and that the expected remaining life of the equipment is adequate. At the same time, the interested buyer should insist on receiving a room-by-room equipment asset list to ensure they receive everything agreed on once the practice is purchased.

Once all the above information is collected, the buyer will know whether, e.g., IT systems need to be upgraded or whether sedation units need to be replaced—or worse—a new sterilization area needs to be built. Taken together, these legally necessary improvements often comprise a significant investment of money and other resources. Having all of the relevant information is the only way for a buyer to know whether the price they are paying is fair.

A dentist's mind should be on caring for patients' health and supporting team members in a safe environment. Approaching the due diligence process in a focused manner and knowing how to identify legal and regulatory risks, will allow the dentist to make a wise purchasing decision: one that will set them on a new and rewarding professional path, while ensuring safe and effective care for their patients.

COVID-19 Brings Additional Considerations When Selling Your Practice

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While no one can predict the long-term social and economic impact of the COVID-19 pandemic, we have already seen significant job losses and economic turmoil. Dentistry, like most industries, has not been spared.

Amidst these challenges, many practice owners are asking themselves if it is still a good time to sell. The answer to that question has—and always will be—based on personal circumstances and needs, many of which have changed drastically by this crisis. If selling today is an answer worth exploring, it's important to ask the right questions.

The first question you should always ask is how your personal and professional growth ambitions align with the group or purchaser you are considering selling to or partnering with. Beyond that, this pandemic has raised unique considerations that should be taken into account today and well after things return to normal (whatever normal may look like). That is, can you successfully sell your practice, and if so, what will that look like?

While dentistry has historically been recession-resilient, it will not be immune to the catastrophic effects this pandemic is wreaking on global economies. In this economic environment, banks, particularly Canadian banks, are increasingly risk-averse and are approaching their lending activity with a much higher level of caution and scrutiny. In the dental world, this means buyers are finding it more difficult to secure purchase financing. If you are in discussions with a purchaser, it is vital to understand what they are doing to ensure they have the financial means to close the transaction. Before spending any time, money or effort on selling in the middle of or after a crisis, it is useful to know the financial wherewithal, sophistication and track record of the potential buyer.

I encourage practice owners and advisors alike to consider the below factors before engaging in a discussion about selling a practice.

1. Compensation if a buyer can't or won't close

Obtain a sizeable deposit with a signed Letter of Intent (LOI). Taking this step at the outset will provide owners with compensation for the time, effort and expenses incurred during the sale process. By insisting on a deposit, practice owners can force a purchaser to demonstrate their financial strength and commitment to completing the transaction.

2. No financing conditions

If a purchaser is unable to secure capital from its lenders or investors, financing conditions provide purchasers with an easy exit to walk away from the transaction. Sellers will have no certainty that a closing can take place until conditions have been waived. The absence of a financing condition provides peace of mind that the buyer has the funds to fulfill their commitments.

3. Flexibility with deal structure and liquidity opportunities

It is crucial to understand whether the seller's preferred structure can be accommodated and what restrictions, if any, the buyer has. If a seller is required to retain an interest in their practice, it is worth knowing the parameters of the retained interest and how and when it can be sold. How is the value of the retained interest calculated in the future? Is there a guarantee that it can be sold, and if so, at what value and under what timeline? If you are required to find your own buyer, what is the marketability of the retained interest and do you have a right to choose the buyer?

Similarly, if the seller receives shares as part of the deal, it is important to understand what those shares represent in actual value. What has the historical performance been? Have there been opportunities to sell? If so, how many and did all shareholders get to participate?

Finally, selling your practice should be more than a paycheque. It should be a personal and professional transition to be proud of and benefit from. During crisis, an individual or organization's leadership is pushed to the forefront and seeing how they respond tells you a lot about their culture, strengths and, most importantly, values. Before starting a discussion about selling your practice, it is essential to understand the leadership style and capabilities of the buyer and the support they offer in a time of crisis. How has the potential buyer delivered value to their dentists and practice(s)? How are they ensuring that their staff are financially supported? Are they providing resources to support the mental health of their staff? Are they going above and beyond to ensure their teams are supported with up to date resources? How are they sharing their knowledge and expertise with the industry?

So, what is the key takeaway here? Times have certainly changed, and if it looks too good to be true, it probably is. The above considerations can help practice owners in understanding a potential buyer's leadership and character, as well as their financial strength.

Learn more about opportunities for partnership at **dentalcorp.ca/partnership** or connect with the Partnership Development team.

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