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The Dental Transition

NEWSLETTER

In this issue

A Three Part Plan for a Successful Dental Practice Transition

We have all heard the old saying, "Fail to plan, plan to fail." This saying never rang more true than in a dental practice transition. A dental practice owner spends years building a loyal patient base, well trained staff, and profitable business. A dental practice buyer spends years paying off the purchase price and building upon the foundation poured by the previous owner. Both parties deserve the best possible outcome for their efforts.

Every practice transition has the potential to be a win-win proposition if handled properly. When the sale of a dental practice is imminent and a buyer emerges, it is essential for the buyer and the seller to create a plan that details how a smooth transition of ownership will be accomplished. In general, to have a successful change of ownership, there are three main areas of the practice transition that require planning: (1) Doctors; (2) Patients; and (3) Staff.

Transition of the Doctors

The transition of goodwill is an essential element discussed in each practice sale contract. Usually, a substantial portion of the sales price is directly allocated to the purchase of goodwill. If a seller agrees to transition goodwill, what does that really mean? The best way to avoid confusion and post-sale disagreements is for the buyer and the seller to discuss their expectations in regards to the transfer of goodwill in prior to closing. Here are some questions and advice the buyer and seller should consider:

1. What is the time frame for the transition?
2. Will the seller continue seeing patients following the sale? If so, the parties need to discuss the post-closing work schedule for each doctor and include an employment agreement for the seller within the Asset Purchase Agreement. If not, how will the seller finish up any cases which are in-progress as of the closing date? Will the seller be available for phone consultation post-closing to answer questions regarding patient treatment plans and the business aspects of the practice?
3. How will the patients be notified about the sale?
4. Is the seller expected to personally introduce the buyer to patients?
5. Following closing, will the seller's name be available for approved marketing purposes?
6. The Asset Purchase Agreement should include a restrictive covenant for the seller with a reasonable distance/duration and a non-solicitation of staff and patients.
7. Are the accounts receivable being sold with the practice? If so, the Asset Purchase Agreement should detail the terms of the A/R purchase. If not, how will the collection of the seller's A/R be handled post-closing?
8. The health of the relationship between the buyer and seller at closing typically has a substantial impact on the transition of goodwill. Therefore, in the interest of preserving the relationship and goodwill between the parties, we encourage doctors to employ the services of experienced, dental specific advisors and to take a calm and fair approach to negotiations. If there are disagreements along the way, try to understand the other side's perspective and make concessions when reasonable so that both parties feel that they were involved in a win-win transaction.

Transition of the Patients

A careful transition of the patient base is paramount to a successful practice sale. Practice growth cannot occur without a plan to retain existing patients and attract new patients. We suggest that the buyer implement a branded, integrated marketing strategy that includes:

- A well-crafted, succinct transition letter from the seller (approved by the buyer) should be mailed and emailed to

Continued on Page 2

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Continued from page 1

all patients seen within the past 2-3 years immediately prior to OR immediately following the closing date. This is imperative both from a legal and a marketing perspective. The letter should be designed to announce the seller's decision to transition the practice to a new doctor and introduce and endorse the buyer. The seller's show of support and confidence in the new doctor will go a long way to promote patient retention. We recommend for the buyer to send another letter to the active patient base a couple of weeks following closing to introduce themselves in a more personal manner (include a family picture), welcome the patients back to the office, assure the patients that it will be "business as usual" (same staff, insurances, etc.), and highlight any positive enhancements that are being made to the office (i.e. expanded services, expanded hours, new technology, etc.).

- Place a framed copy of the transition letter and/or personal bio. for the buyer in the reception area for patients to review during their first visit to the office following the sale.
- If the selling doctor will not continue seeing patients following the sale, call all patients who are scheduled the first two weeks following closing to inform them of the transition (so they aren't surprised when they arrive to their appointment), endorse the buyer, and convey that the new doctor is looking forward to meeting them at their appointment.
- Provide the staff with a copy of the transition letter and make sure the team is prepared to explain the transition and answer questions from patients with confidence.

One of the best ways to ensure a smooth transition is to create a script for the staff to use when answering patient questions about the change in ownership. The buyer and seller should make their wishes clear about how they want the staff to explain the change in ownership to patients. If the new owner does not tell the staff what they should say to patients about the sale, the result will be idle gossip and extrapolation that will waste time and squander an opportunity to secure patient loyalty. Here is a post-sale sample script for your consideration:

Patient: What happened to Dr. Seller?

Staff: We were so fortunate to have Dr. Seller for so many years. We will miss him/her! We are also excited about the new doctor, Dr. Buyer. Dr. Buyer comes highly recommended, and other patients who have seen Dr. Buyer have been really pleased with the care they received. Can I offer you some information about Dr. Buyer's education and training?

- Develop/update a customized, mobile-friendly practice website reflecting the buyer's information.
- Develop/update customized pages on social media reflecting the buyer's information.
- Develop a system for enhancing the online reputation of the practice via obtaining positive online reviews from existing and new patients.
- If possible, have the new doctor greet each patient in the reception area and walk them to the chair for the first 6 months following closing.
- Schedule longer appointments to allow the new owner to develop a personal relationship with each patient during their initial visit.
- The buyer should also develop and implement marketing initiatives that will stimulate new patient growth to keep the practice moving forward.

Transition of the Staff

Staff retention and contentment plays a key role in the transition of goodwill from the seller to the buyer, especially in a sale where the seller is exiting the practice immediately following the closing. If the transition of the staff is handled properly, the staff will rally around the buyer and convey their trust and confidence in the buyer to patients, leading to maximum patient retention. If the transition of staff is handled poorly, key staff members could leave the office shortly following the sale, potentially damaging the transfer of goodwill and leading to increased patient attrition.

The best way to retain key staff after a practice sale is to consider the perspective of the staff as you prepare for your transition. The staff is typically unaware of the sale until 5-10 days prior to closing. They didn't ask for the change or the extra work that will be required of them to facilitate the transition of ownership (without additional pay). More importantly, it can be stressful for the staff to prove themselves as competent and necessary to the new owner after successfully holding their position under the selling doctor for years (possibly decades).

The best strategy to stabilize and retain a supportive, engaged staff is for the buyer to be well prepared on the first day of ownership. The new owner should be prepared to answer questions about how the transition will impact the individual staff members. The staff will expect the new owner to answer job related questions, such as:

1. Will my salary/hourly salary change? Benefits? Vacation?
2. How and when do I get paid?
3. Will I work the same schedule?
4. Can I work more hours?
5. Will my job description and responsibilities stay the same?
6. Are you retaining all of the current staff members? If not, why? Are any new employees joining the team?
7. Can I still take my planned vacation?
8. Can I still go to my scheduled continuing education seminar?

During the first days of ownership, the buyer should schedule a meeting with the entire team along with individual meetings with each staff member to get to know each of them on a more personal level, address any questions/concerns, and discuss the buyer's vision and future plans for the office. The buyer should address their expectations in regards to how they would like the staff to handle the administrative and clinical aspects of the practice. We recommend that the buyer also discuss their professional background, treatment philosophy, procedures they perform, procedures they refer out, and address any other clinical-related topics that are important to the staff. During the individual meetings, ask the staff to share information about themselves, their experience in the dental industry, and why they chose dentistry. The new owner may also want to ask the staff if there were any new skills that they wanted to learn or contribute to the practice.

A successful practice transition requires a coordinated effort from the buyer and the seller. Following a detailed transition plan for the doctors, patients, and staff will lead to smooth transition and win-win transaction for all parties involved.

How Private Equity Firms Are Generating Exponential Returns in the Dental Industry

Over the past few years, our team at McLerran & Associates has become experts in assisting successful dental practice owners with unlocking the equity in their practices and obtaining better work/life balance by selling to or partnering with DSO/Private Equity buyers. Oftentimes, our clients ask us how these DSO/PE buyers can afford to pay the high prices (compared to private buyers) we have been able to negotiate for their practices. The following article is designed to explain how private equity firms are generating exponential returns in the dental industry despite paying a premium for practices.

Successful PE Firms operating in the dental industry typically build the foundation of their dental enterprise by funding their platform investments with 100% equity. This equity typically consists of a combination of cash from investors and rollover equity from the sellers of the practices that were initially acquired (often referred to as platform investments or anchor partners). In our example, we'll assume that a PE firm funds their initial round of practice acquisitions over the course of 18 months with $20 Million in equity.

Once a PE firm has constructed a dental enterprise with substantial EBITDA (Earnings Before Interest, Taxes, Depreciation and Amortization) of $3-$5 Million, they will "leverage" the business by obtaining bank financing at favorable terms to fund additional growth. In this case, we'll assume that, after the initial $20 Million equity investment, the PE firm funds all future transactions with 90% leverage (debt) and 10% equity.

Over the course of the next 3.5 years, the PE firm constructs a dental enterprise with total revenue of $100 Million and EBITDA of $20 Million (20% EBITDA margin). At that point, the PE firm looks to sell the investment to another financial institution (most likely a larger PE firm). Let's assume that the PE firm has paid an average of 5 X EBITDA for their practice acquisitions. While the original acquisition cost may have been higher than 5 X EBITDA, we assume that the average cost of these acquisitions has been reduced over the life of the investment as a result of the PE firm increasing the total EBITDA of the enterprise by centralizing infrastructure and leveraging the size of the company to negotiate more favorable reimbursements rates from PPO plans and more attractive pricing with supply/equipment/lab vendors. Additionally, we'll also credit the ongoing EBITDA of the enterprise over the life of the investment towards the total cost of the acquisitions, further reducing the average costs of the acquisitions.

For this example, the math shakes out as follows:

- $20 million in EBITDA at a cost average of 5 X EBITDA = Total Investment of $100 Million
- The Total Investment is comprised of:
  - $28 Million in Equity = Original Investment of $20 Million + $8 Million in additional equity thereafter (10% of the next $80 million)
  - $72 Million in Debt – We'll assume the ongoing EBITDA of the enterprise covers the interest on the debt.
- Assuming the Sales Price of the Enterprise is 12 X EBITDA or $240 Million ($20 Million X 12), the Net Gain on the Investment is as follows:
  - $240 Million Sales Price minus $72 Million in Debt = **Net Gain of $168 Million**
  - Net Gain of $168 Million / $28 Million Equity Investment = **ROI of 600%**

600% ROI Over 5 Years = Annual Return of 120%!

As you can see from the above example, despite the fact that PE firms are paying a premium for practice acquisitions, they are generating tremendous returns on their investments in the dental industry by utilizing leverage to fuel growth, taking advantage of economies of scale to increase EBITDA, and selling their investments at high EBITDA multiples upon their exit. To learn more about DSO/PE buyers and how to potentially maximize the value of your practice, we encourage you to contact McLerran & Associates TODAY!

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Thinking About Selling Your Practice to a DSO? Don't Go At It Alone.

If you are considering selling your practice to a DSO, you need to explore and understand your options. McLerran & Associates is here to help. Here are several factors to consider when selling to a DSO:

- Competition is a good thing … you need to shop your practice to multiple DSO/Private Equity buyers in order to receive the highest price and best terms. If you entertain an offer from only one buyer, you may be leaving money on the table.

- While DSO buyers may pay a premium price for your practice, there are numerous other deal points that will have a significant impact on your net sales proceeds, post-closing compensation, and overall satisfaction with the transaction.

- Not all DSO/Private Equity Buyers are created equal. You need to vet potential buyers to ensure they have the capital to complete the purchase and the right culture, practice philosophy, and infrastructure to support you and your practice post-closing.

When selling to a sophisticated buyer like a DSO, you need an experienced advisor who will represent your best interest, negotiate the details, and guide you through the process. McLerran & Associates has spent years vetting DSO/Private Equity buyers in order to provide our clients with the best possible options and terms available in the marketplace. Call us today for a free consultation.

Contact us TODAY to schedule a free, confidential consultation!

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