Luke Moore discusses understanding the value of your practice

Like it or not, the dental sector is consolidating and fast. A sector formerly run by clinicians is increasingly now a sector run by entrepreneurs and accountants with a stronger emphasis on underlying profitability.

As a result of these changes the business of dental practice valuation is becoming less of an art and more of science and the banks, burnt by overly ambitious practitioners, look for lending opportunities with good profits or business plans with substantial marketing budgets.

I first joined the sector when dental practices changed hands for as little as 20-50 per cent of Gross Fees, a figure that would see a buyer laughed out of town these days with the latest NASDA statistics stating averages of 84 per cent of gross fees.

However, I am not alone in finding this expression of valuation a complete lunacy. As someone with an accountancy background I simply cannot comprehend how businesses with identical turnovers can be regarded as the same when the rent and utility bills are frequently £15,000 different. Similarly, EBITDA (Earnings before Interest, Tax, Depreciation & Amortisation) is often used as the more mathematical method of valuing dental practices but business risk and likely cost savings are often ignored.

It is worthwhile remembering that whilst all of the dental corporates use EBITDA as a method of valuing what the business is worth to them, their EBITDA calculation will often be substantially different.

As with any investor they will look at cost savings within the business; the most obvious and potentially largest saving being associate fees.

However, they will also consider whether your practice awards them any ‘marriage value’ ie not only can they save £10,000 on your staff costs by asking the practice manager to look after another site down the road, but this could also increase the EBITDA of the practice down the road they already own. Similarly, each group buyer will have different ideas on average associate fees, lab fees and staff costs in any given area. Whilst as standalone figures, these numbers may be fractions of percentages and collectively they can equate up to £5,000 of EBITDA, which could be a purchase price differential of £50,000. It sounds obvious but many forget they also have to consider whether your practice can equate up to £5,000 of EBITDA, which could be a purchase price differential of £50,000.

Remember that group buyers always be dictated by their multiple of EBITDA and not a percentage of turnover calculation. In my experience, when group buyers start talking in terms of percentages of gross it is normally because they see a good deal coming their way! It is important to work out which group buyer assumes which risks and who can benefit from other local branches.

However, this is not the be all end all as some buyers have different strategies than others and you never know what other local practices are currently up for sale. Therefore the actual multiple at which practices change hands is largely irrelevant as one buyer’s 4.6 is more than another’s 5.4. In a recent case I had £182,500 different!

It is worthwhile remembering that the bigger the risk the lower the multiple. You can look to mitigate against this risk before sale in order to increase this multiple.

For instance, a principal performing more than £250,000 per annum worth of treatment, be that private or NHS, would instantly be deemed high risk and the outgoing vendor will have three options:

1. Stay on for a period beyond completion, in an ideal world this would cover the purchaser’s payback period of five years.
2 Make changes within the practice in the years leading up to sale so that the outgoing principals’ personal gross is less

3 Accept that you are going to have to accept a slightly lower price for the practice to find a very confident purchaser.

To counteract this principals are advised to consider when they are going to sell the practice well ahead of the time they intend to hang up their hand-piece. Principals often make the mistake of running down the practice before they sell it on which makes it less desirable and less valuable to any future purchaser. So:

1 Don’t reduce your NHS contract value unless you are replacing this turnover elsewhere; get an associate!

2 If you drop a session, don’t let the overall practice gross drop. There are options such as a dental therapist and associates who can do remedial work.

3 Don’t re-equip all the surgeries with brand new state-of-the-art equipment in the three years leading up to sale. You will not get your money back.

4 Do move the practice goodwill away from your name, i.e. if you are Dr Gregory & Associates become Cornwall Dental Centre.

5 Lock in your patients somehow. If you are not a plan or NHS practice consider looking at membership clubs and encourage some loyalty to the practice and associated brand.

The key is always in planning; the better an exit is planned the more fruitful it is likely to be. Similarly it is worthwhile considering the value of additional funding and additional turnover in the practice as your approach sale.

If your fixed cost base is covered (rent, nurses, light & heat etc) your typical gross margin as a dentist is 40.5 per cent, hygienists’ typical gross margin is 59 per cent. For every £1 in increased turnover from a dentist you will add 40.5p to the profit of the practice. If you later sell for a multiple of 4.8 x EBITDA this would equate to an increase in value of £1.96 per pound of turnover generated. In an NHS environment if the increased capacity can be met by existing associates at £10 per UDA an additional 1,000 recurrent UDA’s at £22 equates to an increase in value of £47,568 when based on multiples of EBITDA. This turnover is commonly referred to as exponential turnover.

Naturally, geography and the type of treatments you are performing does have an impact on this multiple and also the volume of marketing activity required to achieve this turnover. Put simply, routine family dentistry is valued at a higher multiple than that of dentistry, which relies heavily on referrals and big-ticket treatments; e.g. implants and full smile makeovers.

Of course some practices do not generate enough EBITDA to come to a value sensible for an acquisition by a group buyer and naturally fall into the arena of a practice suitable only for an owner occupier and are better valued using an alternative method practiced for owner-occupier sales. There are some practices, normally with turnovers between £300,000 and £500,000 who depend on their cost bases sit between these two models and it is worthwhile considering both buyer markets. This is especially relevant for principals with NHS contracts within these two boundaries who believe they will get the best deal from a dental corporate when often they will not.

About the author

Luke Moore Director – Dental Elite
Dental Elite are a Practice Sales & Recruitment Agency with a nationwide remit. We offer all principal dentists a complimentary on-site practice health-check with no strings. The health-check includes a valuation of the practice and a report detailing the basis for this valuation and some suggestions how this could be improved.

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