

## *How to Determine the Value of a Practice*

There are many factors that go into determining the value of a dental practice. Generally there are the non-financial factors and the financial factors. Most people are only looking at the numbers, but many times the non-financial factors are as or more important.

**Non-Financial Factors:** First, we look at the location of the practice. Is it in a high or low median income area? Is the area growing? Are new homes being built? Next we look at the number of dentists in the community. For example, there are approximately 3.5 million people living in Orange County and approximately 1,600 dentists which indicates one dentist for just under 2,000 people. I looked at a practice of a dentist looking to sell recently in a community of about 50,000 people and in this community there are only 15 dentists meaning one dentist for every 3,300 people. The fewer dentist and higher patient to dentist ratio, the better.

Next is equipment and furnishings. Is the office new or old? Is the buyer going to have to invest money to refurbish the chairs, along with re-carpeting and painting? Does the office have digital x-ray and/or lasers and CAD CAM technology? Newer equipment and a modern looking office enhance the value.

How about the staff? Have they been with the practice for a long time or are they all new? Now let's get under the hood from a management perspective. Practices that have strong hygiene programs where at least 25-35% of the total office production is from hygiene indicates a strong base for doing restorative dentistry and also indicates that the practice has a strong non-surgical periodontal maintenance program. Now look at the mix of production done by the dentist in the practice. Does the dentist do many single units or is he or she doing quadrants of restorative dentistry. Is the dentist doing a lot of fillings which means the diagnosis philosophy is conservative or is there a strong crown and bridge component of the practice? We often times see practices we call "watch factories where the doctor is watching more than treating. This if handled properly and over time with good communication with patients can greatly increase production. Have your management consultant looking at the charts pull an uncompleted treatment plan report to see how much treatment has been diagnosed but not done. A large number here could indicate a need for improved case presentation and follow through by the office. An office with conservative diagnosis where a large amount of work remains can be what we call a practice waiting to happen.

How many new patients does the office get each month? A healthy practice with good marketing should get 12-18 new patients per month. Does the office ask for referrals from existing patients? We see a surprising number of offices that do not ask for referrals. What type

of marketing is done? Is there a strong internet presence with good search engine optimization? Does the office utilize social networking such as FaceBook and LinkedIn? Or are they still advertising in the Yellow Pages.

Practices that get a good number of patient referrals but do not do a lot of treatment are ripe for the picking. Look at the production per new patient. Offices that are averaging \$1,000 or less per new patient could have issues with doctor case presentation so a buyer with good case presentation skills can raise that to the desired average of \$1,500-\$2,000,

Financial Factors: A buyer must look at the net profit of the practice to determine how much he or she is going to earn after the purchase. First, we want to look at the trends of collections and production. An upward trend over the last two to three years is good, however be aware that the majority of dental offices are down 5-10% or more due to the recent economic downturn. An office that is even or up the past few years shows it is probably well managed and is worth more.

Look at the overhead of the practice. Are staff salaries over the recommended 18-20% of office production? This by the way does not include hygiene salaries which are measured as a percentage of hygiene production and should be 33-40% of total hygiene production. If the lab percentage is lower than 6-8% it means that the office is not doing enough crown and bridge work which could be good for the buyer. Dental supply expense should run 5-6% and rent 5%

Then you need to do a true net profit calculation. This takes the net profit shown on the tax returns and adjusts it for both non-reoccurring items such as depreciation and interest but also adjusts for both owner fringe benefits such as health insurance, auto, travel and pension to name a few and other expenses that might be more personal in nature. The seller is going to need to disclose this as he or she wants to show the buyer the true net profit of the practice and the bank will want to see this also.

If the true net profit of the practice is 30% of the gross receipts or less, this indicates a practice that is worth less as the buyer is not going to enjoy a net profit upon purchase that is in the industry standard of 20-40%. On the other hand, if the profit is 35-40% or more, this indicates a very well run practice which is worth more.

Now here comes what you have been waiting for. How do we come up with a value? I personally use two factors-one is by taking 2.0-3.0 times the true net profit for the last two years averaged as one factor. For example, if true net of a practice producing and collecting say \$1,000,000 is \$350,000, then we are looking a price of this factor producing a price of between \$700,000 and \$1,050,000.

The second gauge is a percentage of production averaged for the past two years. So my million dollar producing practice in say Newport Beach or Irvine would bring 85-90% or between \$850,000-900,000. Very few practices are valued at over 90% but all factors need to be taken into account.

As you can see, there is a lot involved in the valuation of a dental practice. It is very important that you do your homework, hire a good dental CPA and management consultant to review the books and records and charts if you are a buyer, and if you are a seller, make sure the office is up to date, the books and records are in good order and make sure your systems in the office are also good.