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the dental management specialists

## **What's the deal with the Corporates?**

*By Dr Phillip Palmer BDS*

The hottest topic for conversation around Australia's dentists in the last 6 months has been the corporate entities buying dental practices around Australia.

The questions that most people want to have answered are-

1. Who are they?
2. What are they offering selling dentists?
3. How do the corporate companies hope to make money?
4. What will happen in the long-term?

Let's deal with these various questions separately.

### **Who are they?**

There are basically 3 established companies that have been running their practices for a number of years already.

1. There is one company (Pacific Smiles) that started by restricting itself to practices in non metropolitan areas, and had a great deal of success for many years with this model. It built largish new practices – (mainly 5-8 treatment rooms) with obvious economies of scale in front desk operation, and other areas. It has managed to also successfully run some Health Fund Dental Clinics. They have bought some inner city practices in Sydney and Melbourne and the jury is out as to their success with this formula.
2. 1300 smiles is another company that that has successfully bought and run many practices in geographically specific areas. 1300 smiles practices are mostly located in far north Queensland but the company has of late bought some practices in other areas of Queensland. As a company it is already listed on the stock exchange (with some success but very little trading. It is reported that there is little diversity of ownership).
3. Primary Healthcare owns many dental practices that are attached to medical centres that Primary also own and run.

There are also two main companies that have been formed relatively recently, and are basically almost in competition with each other in buying up practices. They do not have long established histories of running and managing practices, however they each have executives or directors who have been involved with dentistry over a considerable amount of time.

4. There is one company called Dental Corporation which has bought some 40 plus practices of late.
5. There is another company Dental Partners, which has a smaller list of purchased practices at the time of going to print.

### **What are they offering selling dentists?**

Until now, when a general dental practice has gone on to the market, the sales/purchase price has usually amounted to an average of one to one and a half times the net profit (EBIT-Earnings Before Interest and Tax) of the practice. While many sellers have felt they weren't getting enough, and many buyers thought they were paying too much, there was a fair degree of stability in the market.

The recent buy-up of practices by Dental Corporation and Dental Partners has involved sales/purchase prices of four to four and a half times net profit of a practice, with the proviso that the selling dentist stays on for 5 years, and maintains the EBIT at the original level at least. Usually at least 20% of this purchase price is to be paid to the seller in shares of the buying corporate company. There is usually a clause in the agreement that states that the selling dentists will not be allowed to sell their shares in the company for a time after the listing.

Two things that are often under-emphasised that should be accounted for by any dentist thinking of selling:

1. After sale of a practice, many items that used to be tax deductible expenses of a selling dentist will need to be paid by the dentist themselves. These expenses include: all accountancy fees, insurances, loans, motor vehicle, continuing education (CE), travel associated with CE, super, etc. This means that the take home pay of the selling dentist will be reduced from what it was when they were the owner.
2. The shares in the company will often be presented to the seller with their expected value at time of listing. This value is of course hypothetical.

### **How do the corporate companies hope to make money?**

They aim to make money in two main ways.

1. Firstly they will make money through the profitable running of the practice. Basically these entities believe they can run practices at a good profit after they have paid all expenses including paying the dentist a commission (usually averaging 40% after lab fees have been deducted).

According to some sources, the first two companies (Pacific Smiles and 1300 Smiles) are making considerable reported operating profits of up to 20% and above, on every dollar that they collect. It has been reported in the popular press (the Australian Oct 23) by one of the companies (Dental Corporation) that the average operating profit of the practices being bought was in the order of 23% after paying the dentist's commission.

The profitable running of the practices is somewhat assured, and delivered in the first few years by the selling dentists running of the practice in the same way that they did before the purchase. It should also be noted that with the day to day management of the practices being handled by the selling dentist, the companies will have very lean head offices.

2. The other way that the companies expect to make profit is on listing on the stock exchange. While they are paying 4-4.5 times earnings to purchase, I have heard that they anticipate the stock market valuing the practice aggregation at 12 -16 times earnings. This should deliver a windfall profit to the promoters if it occurs as expected. However it must be recognized that this is by no means assured and that there are significant risks involved.

### **What will happen in the long-term?**

This is the 64 million dollar question. Will this be a repeat of IPO of the Pearl dental lab aggregation or the accountancy consolidators into Stockford (both unsuccessful) of a few year ago? Or will this be more like the corporatisation of ABC childcare centres or the Radiology practice buyups into DCA (both successful)?

I believe the answer to “what will happen in the long term” will depend on a number of factors:

- The ability of the companies to maintain profit. This may be somewhat predictable during the contracted years where the practice is run by the often well established, high-profile, high-grossing, selling dentist. However what about after this period? What happens when those dentists contract period is up and they retire? Will there be an effective transfer of goodwill? Will there be dentists available to take their place that can maintain similar figures?
- The ability of the corporate companies to manage the practices and keep dentists happy.
- The desire of the buy up companies to continue their management role if they manage a successful listing on the market. Do they have a long-term desire to manage these practices they have bought, or will they head for the door as soon as they can get their money out, by selling their shares. If they do sell their shares, will the controlling interests of the company continue to understand the nuances and subtleties of dentistry and how to run practices? Will the quality of work and patient experience be allowed to continue as is? Or will a potential new Chief Financial Officer (CFO) try to cut costs where they can?
- What will happen to the buy up companies once the dentists and the corporate owners are able to sell their shares. Will there be a flood of shares hitting the market simultaneously.

Some may claim to know the answers to these questions, but nobody truly knows. The only thing certain is that a lot of people will be affected by what transpires.

I believe the corporate interest in dental practices will make the next years very interesting indeed for the dental industry. It is hard to believe that in 5-10 years from now there will be 4 or 5 companies running dental practices on the stock market. It is almost certain that there will be a shakeout if and when a rationalisation occurs. If we feel we are living in interesting times now...that rationalisation period will prove to be even more so.

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