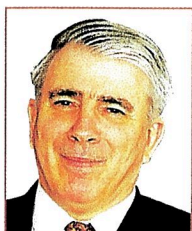


# Multi-tiered Dentistry 2019

By Graham Middleton, BA, MBA



*"The professional practice rollup market is now on the nose... The widespread corporate troubles in professional practices are reminiscent of the failure of the accounting rollups..."*

**D**uring the past year, a number of changes and trends became pronounced and it's not all bad business news for dentists in private practice.

## **Corporate dentistry - a bubble bursting!**

**C**orporate dentistry is showing signs that the take up of practices was far from easy. National Dental Care had to pull its proposed October 2018 initial public offering and stockmarket listing "amid market uncertainty". Having pulled the IPO and listing, it may be another year before it makes an attempt.

**The stockmarket is warning that the good days for dental and veterinary corporate roll ups may be over**

**S**mile Inclusive had its IPO in April 2018 and listing with initial acquisition of 52 practices. It announced to brokers and fund managers that those practices contained 61 totally unused chairs which it expected to be able to fill with patients. Discerning observers realised that these chairs once had patients and the current absence might be a

pointer to the type of practices that Smile Inclusive was purchasing. When it released its first quarter of 2019 cash flow statement, the market sold down its shares. Subsequently when the *Australian Financial Review* ran a story about its dispute with the co-owner of its school mobile dental facilities, the share price fell lower. Its share price, which had a high of \$1.18, hit a low of 26.5¢ cents on 27 December 2018; ouch!

Peter Hughes, formerly associated with Ekera Medical Ltd, was in the market for dental practices in his company Kikada Lane Pty Ltd. He may have found that there were slim pickings in the market.

Would-be corporates often run around trying to get enough practices interested without actually paying any money out because it needs a critical mass to be able to obtain finance from banking backers. The difficulty is that sometimes the practices that have been herded into "the pen" wander out again while the would-be entrepreneur is searching for more practices to round up. We expressed serious doubts about the Kikada Lane Pty Ltd proposal being put to dentists of a partial buyout with dentists maintaining some equity. It seems to us that when it comes to the eventual sell out of the remainder by the dentist, there is only one buyer and as a result, that buyer can set the price.

### Corporate penetration

The number of practices controlled by the corporates is nowhere near what was anticipated ten years ago. Indeed, the first mover 1300 Smiles Ltd's acquisitions have slowed, probably because of others in the market and a desire to stay profitable rather than be drawn into the vortex of paying too much for underperformed practices. Corporate dentistry in Australia is unlikely to reach a level of some overseas countries. Too many Australians have an independent mind and many dentists take pride in the fact that they are running a good practice without corporate or health fund interference and at distance from government schemes. The old adage that it's best not to have third parties involved in your practice is as true as ever.

### Rollup market on the nose

The professional practice rollup market is now on the nose with further significant examples in the veterinary profession also. For example, Greencross Ltd is only down

9.9% for the year to 10 December 2018 but had been much lower (12 month low of \$3.58 compared to a high of \$6.56) until it was rescued by two separate private equity suitors offering to take it over. Synstrat has

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regularly received reports from a variety of competing vets on the poor condition of many of the Greencross practices and it's likely that a private equity buyer will separate out its Petbarn business and attempt to sell off its freestanding veterinary practices.

Many of those practices are nowhere near as good as they were when originally purchased. The impact of withdrawing a generation of experienced practice owning vets in a short time and leaving practices to be run by inexperienced and part-time vets without the leadership of an experienced veterinarian or experienced partners is proving destructive. National Veterinary Care Ltd's share price was down by 25.22% in the year to 10 December 2018 so there's not much solace there and we also note in passing that Apiam Animal Health was down 43.67% in the same period.

The widespread corporate troubles in professional practices are reminiscent of the failure of the accounting rollups of Harts Australasia Ltd, Stockford Accounting Ltd and Knights Insolvency Ltd about 20 years ago, each of which ended in liquidation. 50 to 100 suburban accounting practices rolled into a group don't substitute for an international accounting group type practice which in reality is a different type of business doing the audits of major listed companies and providing an array of consultancy services.

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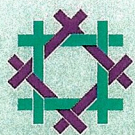
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Dental laboratory business Pearl Healthcare Ltd never traded at its IPO price and had a dismal time as a sharemarket listed company before it eventually disappeared into liquidation. Its IPO subscription was 25 cents per share and at the end of day one on the stockmarket, it was worth 19 cents per share and never traded at that height again before eventually falling into liquidation.

A collection of small businesses don't make a big business. Hundreds or more of small miners and prospectors don't add up to the massive operation of Rio Tinto or BHP Billiton in the Pilbara.

The same can be said for the medical world. For example, I am aware of a rollup of high fee earning orthopaedic surgeons which was intended to get to the market but fell apart as unforeseen difficulties caused the surgeons to become disillusioned and warn their colleagues not to join.

There was also the sad case of Foundation Healthcare Ltd and there are numerous other medical examples.

### The lesson

**J**oining together a substantial number of a particular type of professional practice or a collection of small businesses often does not provide a viable large business.

Further examples occur in the franchising industry where a huge number of franchise outlets are part of a sea of trouble of struggling overworked franchisees and underpaid staff.

### The second lesson

**O**nce individual practices are removed from the direct control and influence of experienced owner operators of the profession concerned, they can deteriorate rapidly.

### High risk

**C**orporate rollups of professional practices have proven to be high risk and any stockbrokers or corporate advisory groups thinking otherwise need to concern themselves with the risk that they will inflict on their clients if they propose that they invest in them. Obviously, these thoughts will be

uppermost in the minds of those who might be contemplating an IPO or listing for the Vet Partners business or other dental rollups. In the latter case, potential investors would look at the trajectory of Smiles Inclusive Ltd's share price since its IPO, being the most recently listed dental corporate.

The rollups have removed a generation of veterinary and dental practice owners from a large number of practices in a relatively short period and it is extremely difficult to pick up the pieces with far less experienced practitioners who are not practice owners involved in running the practices.

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### Corporatised professional practices - high risk investments

**H**uge numbers of failures and mediocre performances among the corporate rollups of the accounting, medical, dental, dental laboratory and veterinary practices are far too many to ignore and point to the repeated failures of corporate managements to achieve the same level of practice performance as which formerly existed in a multitude of practices under private ownership.

Corporate advisers, sharebrokers, analysts and investors have been subjected to many losses and must consider further corporate rollups as being high risk investments.

### Private health insurance funds

**H**ealth funds continue to receive adverse publicity on a regular basis and there were signs of a gradual awakening of a wider group of dentists to the dangers of becoming impaled on preferred provider agreements with Medibank Private and AHM (a business of Medibank Private) being the latest to announce that they were cutting payments for dental services despite making a large margin on extras cover.

Over in the West, HBF announced a new scheme for dentists which in reality was a preferred provider scheme dressed up in new clothing.

### Hints of trouble with corporates

**T**here are reports of dentists dissatisfied with the actions of corporate dentistry groups. The talk in the profession is of vendor dentists who had vital practice support removed by corporate owners, or who had a stream of preferred provider patients substituted for much of the work that they formerly did, leading to extreme difficulties in achieving their earn out payments. These dentists are aggrieved at the corporates who have not met the other side of the bargain.

There were hints of legal action and in a particular case, where a corporate commenced legal action against vendor dentists, the legal response pointing to breaches by the corporate effectively nullified the matter.

It's likely that corporate dentistry groups will be more careful about bullying vendor dentists who have taken on the obligation of lead dentists on an earn out basis.

Dentists are becoming aware that the contracts with the corporates imply, whether implicitly or explicitly, obligations on the corporates to provide a similar level of support as existed in the practice prior to sale.

Corporate representatives blaming the deals on previous directors/managers don't wash. An agreement signed on behalf of a corporate cannot be dissolved by a change of corporate management. The agreement is binding on the corporate regardless.



## Dental numbers

The number of dentists, dental specialists and registered dental auxiliaries continue to grow at twice the rate of growth of the Australian population and this produced some sad failures at the bottom of the profession. For example, immigrant dentists starting up new practices having bought premises and paid for fitout, then found that they were unable to attract sufficient dental work to pay their financing cost resulting in the practices quickly closing down or being closed down. While success is visible, failure occurs quietly with practices which cannot attract enough patients to pay their way disappearing without trace. Some of these practices have been in shopping complexes and some in strip shopping centres. The huge sample of dental clinicians may be alleviated to a modest degree by an increasing number of dentists choosing to work part time due to family responsibilities.

## Lesson three

The hard lesson for dentists is that buying a practice with a reasonable fee base and the potential for a steady build up is overwhelmingly a less risky strategy than starting from scratch. The true gold inside dental practices is the established patient referral base. On day one, a new start up has a zero patient referral base and their local marketing is of limited success compared to having sufficient existing patients who will provide a predictable level of referrals of their friends, relatives and neighbours. However, a proper handover is a critical element of the practice acquisition process with the departing owner being prepared to work on a declining availability basis for a reasonable period of time for the buyer.

## Premises ownership

Having long term ownership control over premises enables dentists to get good value out of the embedded dental fitout including all that wiring, plumbing, cabinetry, etc, a good deal of which cannot be moved to new premises. That's a good reason why dentists buy a combination of dental practice and premises when the numbers stack up to proper analysis.

## Private vs corporate sale

Some practice vendors wrongly argue that the value of their practice in a simple dentist to dentist sale should be the same as the value that a corporate might pay but with the corporate offer being conditional on the vendor signing an agreement to defer 20% of the purchase price to be paid out over three years and subject to meeting onerous earn out targets.

The economic reality is that the more buyer conditions on the sale, the higher the sale price. Corporate buyers have lots of conditions on the sale whereas by contrast, a simple dentist to dentist sale

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with limited employment handover and no obligation to meet targets suits most vendors and hence the price is lower.

## Forcing employed dentists to sign corporate contracts!

While practice vendors will sign an employment agreement under vendor dentist earn out requirements to get a higher price, the situation facing other dentists employed by the vendor differs. While they may agree to employment by the corporate, they are not obliged to and we note a number of situations where dentists have refused to sign corporate contracts, particularly where such contracts impose restrictions on them which didn't exist before their employer

sold the practice, and in some cases, dentists have chosen to either join other practices or start practices on their own.

We note situations where a corporate buyer has made a purchase offer for a practice conditional on the existing experienced assistant dentist signing a contract but the assistant dentist quite rightly has said... *"No way, I'm not giving up my rights to practice elsewhere in the town or city of the practice, or my right to start up a practice; indeed why should I do so so that you can get a higher price for your practice!"*

No business adviser would advise the employed dentist to give up rights without compensation so that their existing employer could get a higher price unless of course the employer offered them financial incentive to sign. Every case will be a little different. In this respect, I point to private equity buyouts of significant businesses where the private equity buyers, knowing little of the business or industry concerned, know that the success of the buyout will be heavily dependent upon key managers being retained in the business to operate it under new ownership. In such situations, it is normal for those key employees to be provided with generous incentives to sign contracts with the private equity buyer of the business.

## A silly corporate purchase

In another situation, an extremely high performing dentist who did 80% of the fees in a practice, representing all the high-end work, and employed an assistant dentist who did 20%, being the routine work that the high-end principal didn't wish to do, sold to a corporate. The corporate was buying the practice for a substantial sum but during the due diligence phase, an accountant from a large accounting firm queried that the assistant dentist had resigned and suggested it was a business risk. We pointed out that with the huge pool of unemployed/underemployed dentists, employing another dentist capable of doing about \$500,000 of fees per annum was not difficult at all and the deal proceeded. The corporate's real risk lay with the huge difficulty it would have in replacing the vendor dentist at the end of his contracted employment period since the very few dentists capable of replicating his work were inevitably running their own successful practices.



## Lesson four

**C**orporates which aren't selective about choosing practices to buy can get badly burned as a result. Accountants from the big end of town often don't understand professional practices and the professions concerned.

### Legal dispute resolution

**W**hether it's for property settlement associated with divorce or disputes between co-owners of a practice, legal disputation is an extremely costly business once it approaches the courts. Arguing the value of a dental practice in front of a judge with two barristers, two solicitors and several accountants and practice valuers in attendance is like setting fire to a sizeable stack of \$100 notes.

Sometimes, the case gets postponed several times for procedural reasons with the cast of barristers and experts turning up on each occasion only to be told after a couple of hours of milling around in conference that the judge won't hear the case on that particular day. Furthermore, the dollar figure which a judge accepts as the practice value or as a settlement figure may end up being significantly different to what either party expected. The one thing that is certain is that lawyers cost a lot and generate huge expenses requesting multiple expert reports. There can be huge delays in getting a matter into a court and once there, the result is far from predictable.

Unfortunately, sometimes one or both parties pursue an outcome regardless as to the amount of joint wealth which is being destroyed in the process.

Fortunately the vast majority of valuations we do as jointly appointed practice valuers end up in settlement without being further litigated in court. However, on rare occasions, we watch the parties destroying hundreds of thousands of dollars worth of hard earned assets chasing a pyrrhic victory. In the end, it's often the case that both parties are the losers.

## Lesson five

**P**artnership/associateship agreements should avoid having dispute resolution mechanisms written into them by lawyers. The supposed fast track to a legal mediation process is rarely fast and never cheap. Whenever we are requested to assist dentists in writing an associateship agreement, the conflict resolution process has many simple steps before invoking the help of a lawyer. Inevitably, this means that most disputes are resolved without getting lawyers involved. Lawyers have a habit of writing letters to the other party which cause the other party to consult a lawyer and once that process starts, the dispute takes a deep dive into a large pool of money. Lawyers tend to inflame disputes. In fact, lawyers almost never solve disputes between two associated dentists or two dental partners and in a number of cases, I've resolved disputes through a logical approach and advising lawyers to take a backward step.

### Dentists v time

**W**hile younger entrants to the profession have a tendency toward a belief that they have an unlimited dental career, the reality is that they have at most about 40 years between graduation and retirement of which about 14 years will be years of peak performance and profitability. For many dentists, females in particular, there will be a significant period in which they work part time due to family responsibilities. Dentists need to be well situated and profitable, own practices by age 38 and often experience a tailing off of practice performance from about age 52. Naturally, there are early bloomers as well as late developers, but a general observation is that practice owning dentists have about 14 years of peak performance. You cannot afford to waste those years if you intend to enter retirement debt free and own substantial assets.

## About the author

*Graham Middleton personally has been advising dentists on strategic, practice management, valuation and conflict resolution processes for 31 years, the last 24 as a founding partner and director of Synstrat Management Pty Ltd and Synstrat Accounting Pty Ltd. He was once a regular army officer, and later Director Human Resources Management, of the Attorney General's Department of Victoria. He is considered an expert on dental practice valuation and practice performance benchmarking. He has spent many years advising dentists in respect of their business and financial strategy and measuring their practice and financial performance. He is the author of Synstrat Dental Stories, the Synstrat Guide to Practice Management, 50 Rules for Success as a Dentist and Buying & Selling General & Specialist Dental Practices. He is a long-term contributor to the Australasian Dental Practice magazine. The Synstrat Group is an independent data-based organisation providing management, benchmarking, valuation, financial and accounting services to the dental profession. Synstrat Management Pty Ltd is a Licensed financial services company. Both Synstrat companies are owned by the same directors who work within the Synstrat Group. Call Tel: (03) 9843-7777 Fax: (03) 9843-7799 visit [www.synstrat.com.au](http://www.synstrat.com.au) or email [dental@synstrat.com.au](mailto:dental@synstrat.com.au).*

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