Corporatised dentistry 10 years on

A look at how dental corporates are travelling after a decade

By Genna Levitch, BDS

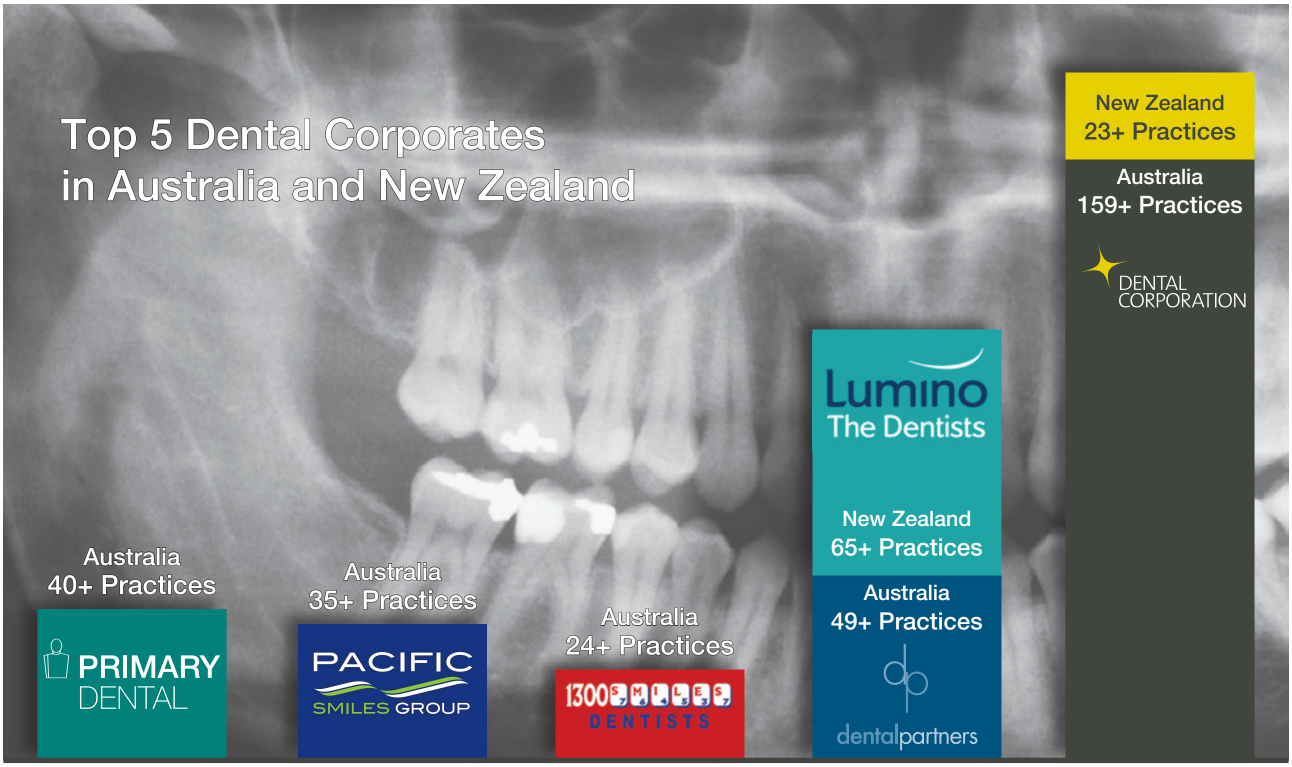
For most of the 20th century, dentistry was a relatively protected profession. Only dentists could own dental practices, the number of dentists graduating from the five dental schools in Australia barely covered the rate of attrition from retirement and there was a reasonable level of *quid pro quo* on the migration front. Dentists enjoyed a position of respect in the community, were granted the privileged title doctor and inevitably accumulated a reasonable level of personal wealth for all their hard work. New graduates aspired to own their own practice, were in demand with a selection of avenues for employment and expected to spend their entire career "on the tools".

Fast forward to 2012 however, and how times have changed… and changed fast!

The catalysts for change

In the space of a little over a decade, all the rules have changed and when you consider those rules have existed for as long as dentistry has been practised as a profession, it's quite significant.

One of the catalysts for the changes we're experiencing today happened right at the end of last century. Legislative change occurred and suddenly, non-dentists could own dental practices. There was by no means an initial run on practice sales to lay people, however there were, for example, entrepreneurial practice managers who suddenly became transition options for retiring principals. Despite being perfectly legitimate, you could always tell one of these "trailblazers" by their utter reluctance to reveal their status as non-dentist practice owners for fear of some retribution.



Over time however, the business world cast its eye over the many areas of healthcare that had become potential "opportunities" with a view to leveraging a buck from combining essentially small, bespoke enterprises, managing them more efficiently and then selling them on for substantial gain.

Dentistry, by its very nature, was not initially an attractive target for corporatisation - too capital intensive and reliant on a short supply of skilled labour. Even so, of the 6,000-odd dental practices in Australia today, some 400 are now operated by a "corporate" in some form, the majority by five main groups (See Table overleaf). 6% in the space of a little more than a decade is not insignificant; but given corporatisation is a relatively new phenomena, the question is whether this level of market share will continue to increase at the same rate (0.5% pa) and whether supplying dentistry in this manner proves to be a profitable, sustainable and scalable business in the long term.

Getting the model right

Pacific Smiles was the first dental corporate in Australia and probably the easiest to understand as it is run as one large practice. Pacific Smiles was founded by three dentists, the author included, who sold their practices into a company which then issued shares to them corresponding to the value of their individual practices.

Why did we do it? Well, we were sick of mortgaging the family home every time we bought another dental chair. We thought that having professional managers rather than dental nurses to run things might make a difference. And most importantly, our practices were *that* successful, they were too big to sell! So how were we ever going to get our money back or retire?

The problem keeping more corporate interest away from dentistry, the industry analysts will tell you, is that the right "model" has not yet come along. A business model is not simply putting up your shingle and doing good clinical work. That is your professional aim. Your business model, for example, dictates what type of practices you want to operate. In turn, this will subsequently govern whether you acquire existing practices, start completely new practices or a combination of both. Acquisition has been a common path to date which raises questions about which practices to buy, how much to pay for them, how you will integrate them into your network, how you renumerate your practitioners, the level of management "oversight" you will impose, how you ensure loyalty from your practitioners, how you replace retirees, how you incentivise practitioners to "perform", how you ensure clinical freedom yet to a high standard of quality, how much of the profit goes to the shareholders and how much is reinvested in new equipment? There are many options to choose from to address each of these areas and the resultant mix constitutes your business model.

It is evident that some of the corporates currently operating in Australia have allowed their model to develop organically, with some well-known "blunders" being made. Working to a plan and having a considered position that has an edge on the competition, however, is more likely to succeed.

Making it pay

Out of your business model grows a financial model. "Money men" love financial modelling. It implies that all those variables have been assessed, with only the soundest options finally chosen. It purports to minimize unknown factors, mitigate risk and generally paint the operator as simply visionary, heroic and unstoppable. It is all good and proper and filed away, never to be seen again, except in the dire circumstances that it all unravels.

Table 1. Dental Corporate Models

Name	Success Due to	Founded	Founder(s)	Ownership	CEO	Number of Practitioners	# Practices 2012	2012 Gross Fees	Av/Gross Site	2012 EBITDA	2012 EBITDA %
Dental Corp.	$200m investment by NAB. High prices for practice purchase. Recently purchased by Fortis Group (Singh Brothers). Substantial profits for NAB	2007	Ray Khoury, a dentist who worked for Primary Healthcare. Sold concept to NABHealth	Private company. Shareholders: NAB/Fortis Healthcare India	Mark Evans	530 Dentists 222 Hygenists	AU - 159 NZ - 23	$265m	$1.352m	$52,160m	19.7%
Lumino/ Dental Partners	Purchased by Abano Group. Investment funds from CBA	2003	Carl Boroughs of IDM and Mike Tomoney	Public Company: Abano Healthcare NZ	Mike Tomoney	Not stated in reports	AU - 49 NZ - 65	$143.5m	$1.226m	$17.4m	12.1%
Pacific Smiles Group	First consolidator. Owns and operates its own practices as well as 4 NIB practices. Mostly country & regional centres.	2001	Alex Abrahams, Genna Levitch, Alison Hughes - dentists who combined their practices	Private Company. Alex Abrahams major shareholder. Recently sold 20% to private equity	John Gibbs	144	AU - 35	$86m	$2.45	$10.5m	18.6%
1300 Smiles	Local Opportunity. Lean middle management	2003	Darryl Holmes dentist, owned several practices, listed to release value	Public Company. Darryl Holmes major shareholder	Darryl Holmes	75+	AU - 24	$45.9M	$1.48m	$6.559m	17.8%
Primary Healthcare	Dental inside large scale medical centres. $2b business	1994	Dr Ed Bateman	Public Company	Ed Batemen	40+	40 in Large Medical Centres	Primary does not does not separate dental figures from medical centre reports			

So why would a corporate bother to amalgamate, consolidate, corporatize or accumulate practices? For profit of course! Many dentists like practising dentistry to a high standard because of the self-satisfaction they derive from being successful at their work. That success often brings wealth, but as a consequence, not a goal. The successful heads of corporations similarly derive the same self-satisfaction from their work, but their principle aim is always to "increase shareholder value". This difference, correctly, will always be contentious in the delivery of healthcare services.

Consolidators of dental practices thus believe they can buy your practice and then on-sell it for a lot more than what they paid you. The actual mechanics of the delivery of the services of the resulting group, whilst even though in dentistry is particularly important, complex and heavily reliant on skilled labour, is essentially a side issue.

Corporates do take a fair amount of risk - a buyer will only pay them more if the group of practices are well run, more profitable and are of a commercial size i.e. show a group profit of $6 to $10m. *How much more will a buyer pay?* This is where it gets technical.

Dentistry is a service industry and EBITDA - Earnings Before Interest Tax Depreciation and Amortisation - is the tool of choice for service company valuations. An individual dental practice on its own, with nothing to spend on equipment or fitout, well-run and profitable, can be worth four times its EBITDA.

A well-run corporate healthcare service company, however, may be worth 6 times EBITDA i.e. 50% more than what the dentist was paid. Corporate service companies floated on the stock market have even been valued by the market (i.e. what investors are prepared to pay) at anything between 8 to 12 times EBITDA. i.e. 100-200% more than what the dentists were paid for their individual practices.

Current players

Setting up Pacific Smiles Group solved all of the problems I mentioned before, but it also created another one: middle management! Central Administration makes PSG function like one big practice spread over 35 locations but consumes 6% to 8% of revenue as a consequence.

> *"Consolidators of dental practices believe they can buy your practice and then on-sell it for a lot more than what they paid you. The actual mechanics of the delivery of the services of the resulting group, whilst even though in dentistry is particularly important, complex and heavily reliant on skilled labour, is essentially a side issue..."*

Alternatively, Dental Corporation, the biggest of the "big five" decided it would let their practices do what they had always been doing, just run themselves. With the principals of the practices they acquired knowing their practices inside out and as they were contracted for five-year minimums anyway, a "business as usual" approach sat well with everyone at many levels. And, given the initial goal was IPO, having a lean administrative structure also sat well with the financiers. Dental Corporation's central admin is less than 4%, so they should have excellent profits as a result.

In order to offset the risk associated with lack of control at the practice level, Dental Corporation attempts to structure its practice acquisitions such that the former principal dentist(s) are responsible for ongoing maintenance of the profitability for their contracted period which effectively repays the purchase price they were paid over that first 5 years. The NAB backed Dental Corporation financially with an initial view to recouping a healthy profit at IPO, however with the onset of the GFC and only the best and bravest organisations attempting to float, subsequently on-sold to the Fortis Group based in India, who operate hospitals and healthcare facilities in India and Africa. NAB and the dentists, who all received shares as part of the initial acquisition, did well by all accounts.

Dental Partners began with a similar operating model to Dental Corporation but have also now on-sold to the Abano Group based in New Zealand, who operate the "*Lumino the Dentists*" chain of practices across the ditch.

Pacific Smiles Group and Dental Corporation are privately held and as a result, have no obligation to publish financial data on their earnings or profitability. The Abano Group is listed in New Zealand, however Dental Partners is a relatively new acquisition and prior to that, was privately held.

The two remaining members of the "big five", Primary Dental and 1300SMILES are both publically listed. Primary Dental is part of Primary Health Care Ltd (ASX:PRY), which, in 2012 will turnover some $1.3 billion. However, they do not segment their reporting to isolate financial data for the dental arm of the business.

1300SMILES Ltd (ASX:ONT) has grown through careful acquisitions and now operates 24 practices in Queensland. It was set-up and floated on the ASX by Darryl Holmes in 2005. Dr Holmes, a dentist and the group's managing director, retains 62% of the business and also owns a significant part of the property and equipment and leases it back to the company. 1300SMILES reported a Net Profit After Tax of $6.2 million to June 30, 2012 (Up 20% on the previous year) whilst dividends were up 14.8% to 17.8 cents per share. Turnover was up 28.7% to $45.9 million. By all accounts 1300SMILES is a very successful operation.

"No one clear strategy for managing dental practices as corporations has yet presented as optimal and the long term viability of the corporatizing of practices remains uncertain..."

The future

The formation of corporations to consolidate and operate dental practices in Australia is a relatively new phenomenon. There are currently five main groups actively acquiring and/or establishing practices and all are operating under different business models. In some cases, these business models have changed significantly over the course of a few years and in addition, a majority shift in the shareholding of two of the groups has essentially signalled a change of ownership.

It is apparent that no one clear strategy for acquiring and managing dental practices as corporations has yet presented as optimal and the long term viability and expected profitability of the corporatizing of dental practices remains uncertain.

More and more, the future success of any business relies on its ability to capitalise on market opportunities and dentistry is no different. As an example, the rapid increase in the pool of skilled dental labour that is now available as a result of the commissioning of four new dental schools together with a more one-sided influx of practitioners from abroad will no doubt not be missed by the corporate world.

The attitudes and outlooks of new graduates, the so-called Generation Y, have also evolved and being an employee of a large corporation rather than a partner in a small practice will appear attractive for reasons the author is too old to comprehend.

A dental degree alone, however, doesn't make a practitioner a success. Owners of dental practices know that profitability comes from operating efficiently and to a high standard and that rarely comes without significant experience and guidance over time.

Current corporate groups acquiring practices have, generally, sought to lock-in the services of the outgoing principal for several years to ensure a smooth transition of goodwill and to underwrite ongoing profitability. However, the viability of corporatized dentistry can only be fairly gauged once the period of heavy acquisitions has slowed, first generation practice principals moved-on and the business has transitioned to a level of operational maturity.

To date, the success of corporate dental practices has largely been through the hard work and efforts of the skilled dental practitioners in their employ, based on a respectful level of remuneration equivalent to employment in private practice. Dentists were involved from the start in setting up all of the "big five" and rightly, knew the criticality the choice of labour force would make to overall success.

Longer term however, when current management of corporates has completely transitioned from the originators of the groups to professional administrators looking purely to increase shareholder value, the growing pool of young, inexperienced graduates who are struggling to find full time employment may be a tempting solution to cut costs.

As the owner of a large, successful practice, the advent of corporate dentistry allowed me to realise a healthy return on its sale well ahead of retirement and then provided me with employment until I decided the time was right to stop.

Many other practitioners are enjoying a similar path to transition and retirement that, a decade ago, wasn't even an option.

If you were in the position where you either wanted or needed to sell your practice, isn't that what you would be looking for too? An opportunity to get a high value for your practice and shares that would increase in value dramatically as the corporate increases in size, profitability and stability.

The key to successful practices of course, for all time, has been the skill, dedication and determination of the dentists delivering care. The ability of dental corporates to transition that essential element into a sustainable corporate culture will similarly be key to their future success.

About the author

Dr Genna Levitch is a regular contributor. He has had 25 years experience in private practice and 10 experience in practice set-up, and management, if you are considering selling your practice, he can be reached on (02) 9694-5700.