Will Today’s New Dentist’s Debt Prevent Future Practice Ownership?
-- Gene Heller, DDS

As I have traveled across the United States recently meeting and speaking with hundreds of new dentists and dental students, most report they have been told (and unfortunately believe and accept) that because of today’s unprecedented levels of school debt, future practice ownership is no longer a possibility for them, even though most went into dentistry hoping to eventually own their own practice. These new dentists go on to report these debt levels are preventing banks from loaning them additional money. And finally, they believe that this debt, coupled with a changing dental industry infrastructure, will prevent them from future traditional dental practice ownership and will no longer be a reality for most new dentists. Let me begin this discussion by answering the titular question. The answer is NO – traditional ownership is still readily available despite the perceived barriers.

Changing Business Models
The dental industry delivery model and infrastructure is changing. There are three changes occurring concurrently. First is the business model change occurring as a result of the development of Dental Service Organizations (DSOs) and small, one (or several) owner, multiple-location, group practices. DSOs are typically defined as having more than 10 practice locations, while the smaller groups have 10 or fewer practices under individual or investor ownership and management.

Leaders and owners of these two group practice models have figured out different management systems to allow for the development of these “investment-type” business entities. These groups are typically buying high-end, highly productive practices and staffing them with new graduates. While these groups have been a great source of employment for new graduates, because they typically either target the high-end practices that require several years of experience to handle or are doing start-ups, the emergence of DSOs and small group practices are not preventing new dentists from becoming practice owners. In fact, many of these group practice models actually allow ownership in the various practice operational entities or provide the experience required for future solo practice ownership!

The second change in the delivery model for dentistry is within the dental insurance industry. Most new dental insurance plans sold today are primarily PPO (Preferred Provider Organizations) type plans, replacing the traditional indemnity type dental insurance plans. It is estimated that over the past couple of years, traditional indemnity plans represented less than 15 percent of new plans sold, and the number of indemnity plans sold has been dropping annually.

Technically, “dental insurance” is not “insurance.” Any insurance plan, by definition, basically says a group of insured people each pay a small amount of money to an insurance pool, and if one of the members of the group suffers an insurable event, the pool of everyone’s contributed money goes to that member who has suffered the loss.

Because almost everyone (95 percent) has varying levels of dental disease, the insurance definition does not work. If everyone needs treatment, then the insurance plan is really just an alternative reimbursement system for paying for dental services. The insurance companies providing policies have figured out how to package these programs, collect as much money as possible (the premium) and limit the pay-outs (through deductibles, co-insurance and annual limits), thereby making as much profit for the insurance company as possible.

Many years ago, the insurance companies determined another way to decrease their potential risk and increase their profits. If they could persuade dentists to cut their fees in return for being included on an exclusive, limited list of providers, the insurance companies could make even more profit on their plans. Through participation with a “PPO” plan, dentists agree to reduce their fees by 10-30 percent in return for being included on the insurance plan’s list of participating dentists, or preferred providers. This means if the patient has this plan and uses a PPO dentist, the patient is guaranteed a lower fee. While this definitely increases the insurance company
profits, it does so at the expense of the dentist’s bottom line profit, with the dentist seeing a dollar-for-dollar decrease on each dollar of fee decrease. However, this is not having an impact on a new dentist’s ability to become a practice owner.

The third major industry change is the entrance of the federal government through the Affordable Healthcare Act. There is no question inclusion and mandating of coverage for all children under the age of 21 coupled with the anticipated future inclusion of low income patients will have an impact on dentistry as a whole. However, this is not having an impact on a new dentist’s ability to become a practice owner.

**Dental School Debt**

Three arguments are being given as to why today’s dental school debt levels are preventing or will prevent future dental practice ownership. The first, and most significant falsehood, is that banks are not lending to today’s graduates because of their school debt levels. Most readers are well aware that the U.S. has recently gone through a banking crisis. During this crisis, banks were not lending money to small businesses, either for expansion, ongoing operational working capital, or for acquisition of new businesses. What has not been publicized is that the only group of future business owners not having any and/or having only minor trouble getting loans, either to start-up or to purchase an existing business, was new dentists.

Not all, but many lenders, are well aware of the documented lowest failure rate of all small businesses experienced by new dental practice owners. These lenders have aggressively sought new dentists (right through the recession) interested in purchasing an existing practice, and are willing to loan up to $1 million (or more) to these future practice owners at reasonable rates.

There are only three requirements for consideration for a practice acquisition loan. The first is a clean credit history. The second is that the purchase produces sufficient cash flow to meet both the businesses operating needs and the dentist purchaser’s personal financial needs. The third is that if this is the purchase of an existing practice, the buyer has the experience and can produce sufficient dentistry to cover all the expenses, both business and personal. Meet these three requirements, and banks are lending to new dentists every day. Banks are readily lending, and today’s high dental education cost and subsequent debt levels are not preventing new dentists from borrowing the money necessary to become practice owners.

An emphasis on the experience factor is one change the recent recession has caused within bank lending guidelines for the new dentist. One of the arguments given by those people saying that today’s new dentists will not be able to obtain loans to purchase practices at today’s debt levels is that the new graduate cannot produce enough dentistry to cover all their financial needs, i.e., business acquisition costs and operation, personal needs, and school debt retirement needs. This is why most lenders are requiring one-to-two years of experience prior to consideration for a practice acquisition loan.

What about the unprecedented levels of debt? The reader will note, this was not one of the above three conditions to obtain a loan, i.e., a “limited amount of school related debt. While all banks certainly look at the amount of debt, if the transaction cash flows, a large education related debt level will not prevent new dentists from becoming practice owners. What follows is a comparison of an average practice purchase and school debt repayment requirements today versus ten years ago.

**Cash Flow Comparisons**

For the following comparison please note:

1. Average practice receipts were approximately $500,000 in 2004 and $600,000 in 2013.
3. A 60 percent adjusted overhead level was used for columns designated 2004 and 2013.
4. Average school debt is assumed to have doubled from 2004 to 2013 for these calculations.
5. While practice purchase debt retirement was kept constant at 6 percent APR for both 2004 and 2013 and a seven year term was used, in 2013 it was more common for a ten year term, thereby increasing the net after debt cash flow to slightly more than the model shows.
6. A 15-year term was used for the school debt, although a 20-year term is frequently seen today, thereby again slightly increasing cash flow for the 2013 model.

7. The final line below shows what an associate would earn without ownership at each of the Practice Gross Receipt levels. It should be noted that the associate only earns 30 percent of the doctor-only collections, assumed to be 80 percent of the practice gross receipts (the associate does not get paid for hygiene production). Therefore, the associate does not share in the hygienist’s profit the same way the practice owner does. For 2004, if the dentist provider was an associate producing the same amount as they would have as an owner, the calculation is Total Practice Gross Receipts ($500,000) minus estimated Hygiene Receipts ($100,000) equals $400,000 Doctor only Receipts times 30 percent Compensation Rate equals $120,000.

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<thead>
<tr>
<th></th>
<th>2004</th>
<th>2013</th>
<th>2013+Add’l Buyer Receipts</th>
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<tbody>
<tr>
<td>Practice Purchase Price</td>
<td>$300,000</td>
<td>$390,000</td>
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<tr>
<td>School Related Debt</td>
<td>$175,000</td>
<td>$350,000</td>
<td>$350,000</td>
</tr>
<tr>
<td>Practice Gross Receipts</td>
<td>$500,000</td>
<td>$600,000</td>
<td>$700,000</td>
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<tr>
<td>Operating Expenses</td>
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<td>$360,000</td>
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<td>Pre-Debt/Pre-Tax Profit</td>
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<tr>
<td>Annual Practice Acquisition P&amp;I</td>
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<tr>
<td>Net Practice Taxable Income</td>
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<td>School Debt Annual P&amp;I</td>
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<td>$201,000</td>
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<td>If Dentistry Provided as Associate-Earned Comp = 30% of Receipts</td>
<td>$120,000</td>
<td>$144,000</td>
<td>$168,000</td>
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This comparison clearly demonstrates that while educational debt levels are higher, so are average sizes of practices purchased which generates a comparable post-operating expense/post-debt repayment bottom line today versus 10 years ago. A comparison of 2013 Net Pre-Tax/Post-Debt with 2004 shows a $3,500 annual increase in pre-tax cash flow for 2013, and that excludes any additional cash flow resulting from using a 10-year practice acquisition loan term and a 20-year educational loan repayment schedule.

2003 also demonstrates that if one compares the available ownership compensation after acquisition debt is paid, it is still slightly higher than if the individual was employed as an associate. And this does not take into account the equity being built. At $144,000 associate compensation, 2013 does show an associate position paying $18,000 more than an owner’s net ($126,000), but that excludes the approximately $60,000 in principle (and subsequent equity) the owner would enjoy over the associate.

Finally, it should be noted that the average practice purchaser sees a first-year increase in receipts of 10-20 percent. Any additional receipts only have lab fees and supplies as additional expense items, so the profit on the additional receipts is approximately 75 percent, compared to the 60-percent overhead seen by most offices. These highly profitable additional receipts subsequently decrease the overall office overhead percentage. The third column above demonstrates that this additional $100,000 in receipts over the 2013 cash flow model
results in $75,000 in additional available owner pre-tax compensation, and including the equity build-up, $135,000 more in the first year than being an associate producing the same amount of dentistry.

Summary
Today’s graduates face a new world of dental delivery options. However, as a practice owner, they will still earn 3-4 times the level of income over the course of their careers when compared with working for someone else and letting someone else take all the profit.

Today’s levels of dental school debt will not prevent new dentists from becoming future practice owners. Ownership is available and anticipated to remain available (short of an overall economic meltdown, more severe than the recent recession). That ownership can take the form of a partnership/co-ownership arrangement in a two- to three-owner group, a larger group, or some DSOs. It can also occur as either a start-up (although much more difficult to secure financing because of lack of initial cash flow), or an outright practice purchase. Banks are lending as long as the new dentist has clean credit, sufficient experience to handle the subject practice and the practice has previously demonstrated the ability to produce enough profit to support the business and the personal needs of the new dentist owner.

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