

The 100 per cent of Gross Myth



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Many practices sell for 100 per cent of the last year's gross revenue. That is an undeniable fact but it does not mean that all practices sell for 100 per cent of gross revenue and it does not mean that your practice or the practice you are looking at buying is worth 100 per cent of gross revenue. It may be worth more or it may be worth less than that. Sometimes much more or less.

We get asked regularly, by buyers, sellers and dentists that are just curious about what their practice might be worth to explain what their practice or the practice they are considering purchasing is worth and why. Regular readers of *The Professional Advisory* will remember that **Patients** and **Profit** create value. It is obvious that the higher your active patient count the more you will get for your practice but there is more to it than that. We use the example that a practice that generates \$1 million of gross revenue with 2,000 active patients is worth much more than a practice that generates \$1 million of gross revenue with 1,000 patients. Patient factors that buyers consider are; billings per patient, new patient flow, age demographic, socio-economic status, ethnicity, insurance coverage and dental I.Q. Practices that have all of these factors in balance will sell for a premium compared to those practices that have one or more of these factors out of balance. Similarly, practices that have higher profit margins will sell for a premium compared to less profitable practices. Using our sample \$1 million dollar grossing practice, a profit margin of \$200,000, after deducting an owner "salary" of forty per cent of professional billings will be worth much more than the same practice that generates \$100,000 of profit.

The other factors that contribute to value are;

1. **Staff.** Think about your staff as a buyer would. They are going to be an important link to your patients after you are gone. Are they all the best people you can find? Are they trained and motivated to do their best? Will they stay after you are gone? Do you have employment contracts with them? If you have the extra "floater" person, consider right-sizing before you sell. Associates and hygienists are also a factor and their impact on your practice will be examined in detail in a future article.

2. **The Premises Lease.** You should have at least seven years remaining between the existing term and renewal options. The rental amount should be at current market rates and the size of your suite should be appropriate for the size of your practice. It is acceptable to have a little extra room for future growth but not double the space you actually need. Your rent should equal about 6.5 per cent of your gross. If you own your own building, it should carry for about the same percentage.
3. **Physical Plant and Equipment.** Your practice is a reflection of you and buyers will draw conclusions about the practice from the state of the office and equipment. It does not have to be brand new or all high tech but it should be clean, functional and fresh. The combined market value of equipment and leasehold improvements should be 25 per cent of your billings. Many people fail to take this into consideration when thinking about what their practice is worth.
4. **Other factors.** Cost-share or partnership interests will sell for less than solo practices. Practices with strong hygiene programs will get a premium compared to those practices with weaker hygiene production or dentists that do their own hygiene. Invisible locations sell for less than main floor locations with good signage and visibility. Big city practices are in higher demand so they will get a premium to smaller town practices. Smaller practices will sell for less (relative to their gross) than larger practices. Dentists with multi-locations in the same area will receive less than single owner operated practices. Retiring dentists will get a premium to those who are serial buyer/sellers.

In summary, the 100 per cent myth is just that, a myth. You must consider all of the value drivers in a dental practice before you can determine the true value. If your practice or the practice you are considering purchasing is well balanced and the factors I have mentioned above are understood and analyzed, the myth may become reality.

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