

Dental Market Update - 2019

When you read this, we will have finished celebrating the holiday season with family and friends. The beginning of a New Year is often a time of reflection. We look back on our accomplishments of the previous year while we look ahead and set goals for what we hope to achieve in the coming year.

I consider it a privilege to be a veteran in the dental business and am grateful for all the friends, clients, co-workers and colleagues that I have the good fortune to work with in this industry. On a personal note, I would like to take this opportunity to wish all in the dental community a happy, healthy and prosperous 2019.

The start of the New Year is a good time to take stock of what has happened in the practice sales market over the past year. I would suggest that the period of “irrational exuberance” is now well behind us. I say this despite the fact that one of Canada’s biggest dental practice aggregators was acquired in 2018 at historic valuation multiples. The transaction was more a reflection of the appetite of the private equity market for strong sustainable cash flows, than it was a reflection of the value of a single (or a few) dental practice(s). It spurred some individuals and smaller groups to consider their options. Some even tested the market, only to learn that the market differentiates based on the scale of the offering, and that no matter how you package things, it always comes down to numbers, particularly cash flow. Nobody will pay for something that doesn’t give them an adequate return. This is true for 1 practice, 100 practices or for General Motors. While the market is still very strong, buyers, supported by their advisors, are being careful to choose the right practice and pay the right price.

This measured approach is also being reinforced by the banks active in dentistry. Interest rates have increased. At the beginning of 2018, the prime rate was 3.2% and, as of this writing, it currently stands at 3.95%. On a \$1 million practice acquisition loan, that 0.75% rate increase would add \$625 monthly to a buyer’s borrowing costs. Stated in another way, the rate increase would mean the buyer could only afford to pay \$965,000 for the same \$1M practice without negatively impacting the cash flow. We can’t predict with certainty what will happen to interest rates in the future. In October, the government stated that the “interest rate will need to rise to a neutral stance to achieve the inflation target”. While there are many factors that influence the rates, it does not appear that they will be falling anytime soon.

Does this mean that the market has peaked and sellers need to act quickly or they’ll miss out? Or, does it mean buyers should wait until prices start dropping so they don’t overpay? No, absolutely not in either case! It simply means the market, which is very efficient, is now in a period of steady strength. There are still far more buyers than sellers. However, the buyers are well-educated, know what they want and equally important, know what they do not want.

This type of market rewards sellers that take the necessary time to prepare their practices for a smooth sale and an orderly transition of the goodwill. The distinction of time here is important because there are two types of sellers presently. One seller makes (or is forced to make) a quick decision that the time to sell for some reason is now. The practice then goes on the market, with little or no preparation, potentially in a state of flux, and without fine-tuning the operations of the practice. It is also likely that this vendor will either not want to stay after the sale, or will only

stay for a very short time. This is the equivalent of buying a boat “as is” in January when you can’t be sure it floats! Obviously, the seller will not receive maximum value for this practice.

The second type of seller has planned for the eventual sale and orderly transition of his/her practice for many years. It runs efficiently with a good, committed and engaged team. This seller will want to stay for at least 6 months or a year after the sale because he/she is passionate about finding the right buyer to carry on the legacy and care for patients. These vendors will receive maximum value for the practice, and will really enjoy “passing the baton” to the new owner, while helping to ensure an orderly transfer of the goodwill.

For buyers, this market offers great opportunities to acquire well-managed practices that may need some tweaking but not fixing. Pick one that “feels right”, where the numbers make sense, and where the value is based on what the vendor has done, not on what you might do in the future.

Here’s to a great 2019 for all!

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