DSO M&A 101

Top Tips, Timelines, and Red Flags for Dentists and DSO Executives

Chris McClure

ALIGNED DENTAL PARTNERS

Kevin Cumbus

TUSK PRACTICE SALES

Rondi Michaux

DSO OPERATIONS EXPERT

Samantha Strain

HEALTHSTREAM VENTURES

Brian Colao

DYKEMA

Duff Bourassa

E78 PARTNERS

planet DDS

Mergers & Acquisitions: Top Tips for Practice Owners

For many dentists, it's a scary statistic: 75% to 80% of dental practices will be affiliated with a dental support group within 10 years.

That's the prediction from Brian Colao, the Director of the Dykema DSO Industry Group, and the nation's foremost expert on mergers and acquisitions in the dental space.

The consolidation trend started in 2010 and quickly accelerated in 2015 when it was easy to get financing and investors were willing to pay 10X, 12X, and even higher multiples in their evaluations. That trend continued until about 2021 when higher interest rates started impacting the market, Colao says.

Even so, about **30% of the dental practice market is currently affiliated with a dental support organization (DSO).**

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M&A 101: Truth vs Fiction

One of the biggest fears of private practice owners is the concern they will have to give up their clinical autonomy. That's not what happens, said Duff Bourassa, a Managing Director in the healthcare division of E78 Partners, an accounting advisory firm.

Another myth is that the DSO wants the dentist to leave.

"Most DSOs want you to work for at least two years," said Bourassa. "The more time you commit to staying, the more likely you'll get a better offer from a potential buyer."

The number of deals closed in the first half of 2024 was lower than expected, mostly because of higher interest rates.

"DSOs are being more discerning than ever with their acquisition strategy," said Chris McClure, co-founder of Aligned Dental Partners, which provides M&A advisory and consulting services to group practices and DSOs. "They're seeking to affiliate with practices that have greater than 20% EBITDA, are willing to roll equity, and where the owner dentist will stay on for five to seven years."

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Chris McClure

Top Tips for Practice Owners Thinking about Selling to a DSO

Knowing how long you want to continue working will influence your transaction.

"If you're trying to get out within two years, then you may want to get a 100% buyout," explained Bourassa. "But if you're willing to work longer, then you want a deal that has more equity."

Rondi Michaux is the former Director of Corporate Development for two large DSOs, 42 North Dental, which is based in Boston, and Dental Care Alliance, which is based in Sarasota, FL. She also has years of experience in operations.

Rondi Michaux recommends asking these questions if you're considering selling your practice or group to a DSO:

What are the terms of the employment contract?

- How is the deal structured? Will it be a joint venture? Will you receive equity in the parent company?
- How long are you expected to work after the transaction?
- How will you be compensated?
- What is the DSO's management fee?
- How are lab expenses factored?
- How many hours are you expected to work and how will vacation / time off be handled?
- How will your lease or real estate investment be handled?
- Will the name of the practice change?
- Will you be compensated if there is a second equity event?

What will happen with your associates and team?

- If you have associates, what happens to the existing doctor contracts?
- What happens with employee benefits? Vacation time? Sick leave?
- When and how will the DSO team want to meet with the practice team?
- What needs to be planned for the transition, including payroll processing, technology changes, and culture

What will happen with your patients?

- How will they be told, especially if you are retiring / leaving the practice?

Deciding When Is the Right Time for Dentists to Start Talking to Potential Buyers

If you're planning to sell your practice or group to a dental support organization, you need to have a plan.

Once you have decided that you want to start the process, consider hiring an expert to guide you.

"You only get one chance to sell your life's work," said Kevin Cumbus, Founding Partner and President of TUSK Practice Sales. TUSK excels at working with owner-founded and debt-funded practices to prepare them for sale. It will then identify potential buyers that are a good match, handle the non-disclosure agreements, share the appropriate information to help drive up interest and enterprise value, and go through the sales opportunities with you.

Whether you choose to prepare your files yourself or hire a professional broker, you will need to provide financial and operational due diligence dating back at least a year. From "coffee to close," **the sale process can take anywhere from 60 to 90 days**, said Rondi Michaux, although some deals take up to six months.

Brian Colao recommends practice owners take these three steps:

1. Leverage all of the technologies available to you. These include adding artificial intelligence to aid in diagnostics, automation that can streamline and shorten the revenue cycle, procurement solutions that will cut costs and maximize the discounts available to you, and practice management systems that can increase efficiency and run reports that help you track EBITDA and key performance indicators in real time.

2. Evaluate your overhead to ensure it's as low as possible. Colao recommends reviewing and optimizing your payor mix and adding the appropriate infrastructure that will help you prepare for a future equity event.

3. Review your accounting practices and ensure you have properly prepared financials. Potential buyers are going to want to see them.

DSO M&A: Planning and Timelines for a Dental Practice Sale

Consolidation is the buzzword in the dental industry, and it's not just dentists who are planning for retirement.

The fastest growing segment right now is small group practices – three to five locations – that are being acquired by larger DSOs. Even so, about 30% of the dental practice market is currently affiliated with a DSO. There's also movement with large groups; several DSOs with **more than 70 practices are exploring mergers with even larger groups.**

"Groups that had variable rates on their debt have been squeezed recently leaving them in a bad position with their banks," said Chris McClure at Aligned Dental Partners. "Many have failed their bank covenants and don't have leverage to fund new acquisitions."

Private practice owners and DSO executives are eyeing the market to gauge when might be the best time to sell. Many strategic buyers postponed transactions in early 2024 because of high interest rates and the rising cost of capital.

"Same-store EBITDA growth is really important right now," said Kevin Cumbus at TUSK Practice Sales. "Buyers want to know: Is your business getting more or less profitable in today's market?"

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Kevin Cumbus

What Dentists and DSO Executives Should Do to Prepare for a Sale

Planning for a dental practice or group sale starts months, even years, before going to market.

As you're evaluating your practice from a buyer's point of view, consider:

- Auditing all vendors to see if there are any that overlap and can be consolidated.
- Analyzing how easy it is for patients to book appointments, receive treatment, and pay you
- Moving to a cloud-based practice management system to eliminate the need for servers and streamline workflows, training, and reporting
- Deploying technology that will increase case acceptance, such as artificial intelligence for X-ray analysis
- Negotiating and optimizing fee schedules with insurance carriers
- Knowing your numbers, including fixed costs, variable costs, and EBITDA (earnings before interest, taxes, depreciation, and amortization)

Advanced practice management systems such as Denticon now include online scheduling and digital forms, email and text message functionality, revenue cycle management automation, detailed reporting and analytics, and other tools that used to require third parties. Evaluating your tech stack regularly will ensure you're not paying for duplicate services and improve your EBITDA.

I recommend practices get evaluated at least annually so you can identify areas to improve and position yourself for the greatest success. **Anything that makes you more efficient, lets you do more with less, and increases your A/R will help make you more attractive to a buyer.**

Rondi Michaux

From Coffee to Close: What Happens Within 90 Days

The pace of the sale is set by the seller. From "coffee to close," a sale typically takes 60 to 90 days, although it can take longer, said Rondi Michaux.

Once both parties sign a non-disclosure agreement (NDA), the buyer will typically request:

- Up to three years of P&L (Profit & Loss) statements, balance sheets, new patient numbers, practice production and collection reports broken down by provider
- Real estate contracts and equipment expenses
- Associate contracts and staff W2s
- Any fees charged to the company, such as country club memberships or entertainment expenses
- Disclosures of malpractice claims, legal situations, and inter-office relationships

A traditional sale timeline may include:

- Gathering financials, operational details, employee matters, contracts, legal and regulatory information. Consider having your practice manager sign an NDA and possibly include a bonus for the manager's time, effort, and discretion.
- Having a lawyer review the NDA
- Conducting due diligence
- Understanding add-backs for any expenses or information not originally disclosed
- Determining the financial details and deal structure
- Reviewing the Letter of Intent (LOI) with a lawyer
- Conducting more due diligence
- Renegotiating the real estate lease/contract
- Potentially meeting the dentist's spouse and associates before the sale
- Meeting the dental team, which may happen either right before the transaction, or after the sale is final

Dental Brokers, Attorneys, and Letters of Intent

Many dentists and dental group executives prefer to hire an M&A advisory firm to help guide them through the process.

Our job is to protect our clients from tire-kickers. We can do all the financial and operational diligence on a trailing 12-month basis (TTM) in a few weeks, pull together a full analysis of the business and the adjusted EBITDA, and vet potential buyers – **all while keeping your identity a secret.**

Kevin Cumbus

In this scenario, potential buyers sign a non-disclosure agreement before they can meet with TUSK Practice Sales to walk through the seller's story and data.

Top Tips for Telling the Dental Team That You're Selling

Experts recommend having the buyer and the seller together tell the team about the sale. Often times, it helps to have someone from the buyer's human resources team on-site to answer questions.

"They're going to want to know how this affects them," said Rondi Michaux. **"They want to know how this will impact their job, their salary, their benefits, their vacation time."**

There are often operational questions, too, such as whether the name of the practice is changing, how long the original owner will work post-sale, and what they should tell patients.

In many cases, team members are not surprised. Currently, about **one-third of the dental industry is consolidated. That number is projected to jump to 75% or 80% within a decade.** That's why many dentists and DSO leaders are starting to prepare now, so they can make the best decision for their company in the future.

The team will follow the doctor's lead. If you're happy and excited, if the messaging is clear and concise, if you have answers to their questions, and if you explain why you couldn't share the news with them earlier, then the team will respond positively.

Rondi Michaux

DSO M&A:
Red Flags for Buyer and Seller

High interest rates combined with higher salaries, higher supply costs, and stagnant insurance reimbursement rates have many dental practices feeling squeezed.

That has many dental practice owners looking to sell to a DSO so they can consolidate costs around supplies, labs, marketing, technology, operations, and human resources.

What DSOs/Investors May Consider a Red Flag in a Dental Acquisition

Rondi Michaux shares this checklist of potential red flags:

- [ ] Family relationships and salaries that may not be market value
- [ ] Extramarital relationships between team members
- [ ] A high-producing dentist wants to leave post-sale
- [ ] High staff turnover
- [ ] Discrepancies between the P&L and tax returns
- [ ] Equipment loans and liens
- [ ] Malpractice claims, active lawsuits, dental license issues, and background check concerns
- [ ] Outstanding bills, invoices, and/or credit balances
- [ ] Personality conflicts
- [ ] Lack of empathy about what will happen with the team post-sale
- [ ] Out-of-date technology
- [ ] Poor website functionality

Duff Bourassa at E78 Partners says his firm may also see these as red flags:

- Lack of a developed hygiene program, with at least 30% of your revenue from hygiene
- Payor mix that doesn't match the buyer's preference, such as heavy Medicaid
- Small practices with fewer than three operatories and no room to expand
- Location where it's difficult to hire staff
- A real estate lease that is coming up for renewal
- Track key metrics and report on success

Red Flags Regarding Team Culture

“The analytical nature of most DSO M&A processes tends to focus on financial metrics and leave out some of those soft considerations that impact the transaction’s success when it matters most: post close,” said Samantha Strain, a Partner and Chief Development Officer with Healthstream Ventures, a firm that offers buy-side transaction advisory services and capital and formation services for private equity companies in the healthcare sector.

> **We highly recommend that the sellers truly vet the buyer/partner from a culture perspective.** The seller should ensure that their clinical and operational values align with the buyer. Overlooking operational and business integration capabilities has had devastating consequences for both sellers and buyers over the past few years.

Samantha Strain

Eye of the Beholder: Red Flags or Positive Indicators?

Some metrics can be viewed as a negative or as a positive.

If a DSO sees that your labs and supplies are higher than average, they know they will be able to **negotiate lower fees on your behalf, and that will save money**.

If you're referring out a lot of work to specialists, that can be a positive because the DSO can **bring specialists inside to grow that practice**.

Duff Bourassa

Red Flags for the Dental Practice Seller

There are red flags for the seller to consider, too. The dentist or dental entrepreneur also should make sure the sale will benefit the providers, the practice team, and the patients.

Workplace culture, employee benefits, training and staff development opportunities, and compensation are all important factors.

Another important consideration that we believe sellers should know is related to **transparency around any type of proposed equity value that could be conveyed to the seller as part of a transaction.** Equity rolls into the DSO's holding and has been a favorable part of many DSO offer structures over the past 3 to 5 years. This method of structure is meant to be mutually beneficial to both the DSO and the seller. It is meant to incentivize a dentist who is partnering with the DSO to have an ownership stake in the larger enterprise, and to provide a payoff whenever the platform goes through a capital event in the future.

However, over the past 12 to 18 months, we have observed many DSO holding companies or equity shares diminish in value. The high interest rate debt environment, coupled with uncertainty in the financial markets haven't helped this situation. Another major contributor to this issue is internal to the DSOs, in that many paid extraordinarily high multiples for practices that had operational inefficiencies surrounding same-store growth, resulting in significant issues, including tripping lending covenants with their debt providers.

Samantha Strain

Dental Mergers & Acquisitions Predictions

With high interest rates and compressed margins, many potential buyers are delaying mergers and acquisitions until the end of 2024.

That gives sellers time to gather all the information they'll need to go to market. It also gives them time to implement technology and staffing solutions that can increase efficiency and revenue, which will increase their EBITDA.

"Buyers are seeking to partner with practices that have greater than 20% EBITDA, are willing to roll equity, and where the owner dentist will stay on for five or more years," said Chris McClure at Aligned Dental Partners. "The main red flag that strategics look for is a seller's intention post-transaction. The industry has shifted from a traditional corporate model where the DSO owns 100% of the practice to a DPO (Dental Partnership Organization) model where the split may be 60/40. Buyers want to know that the seller will stay with the business long into the future and will operate as a partner to the business to ensure alignment."

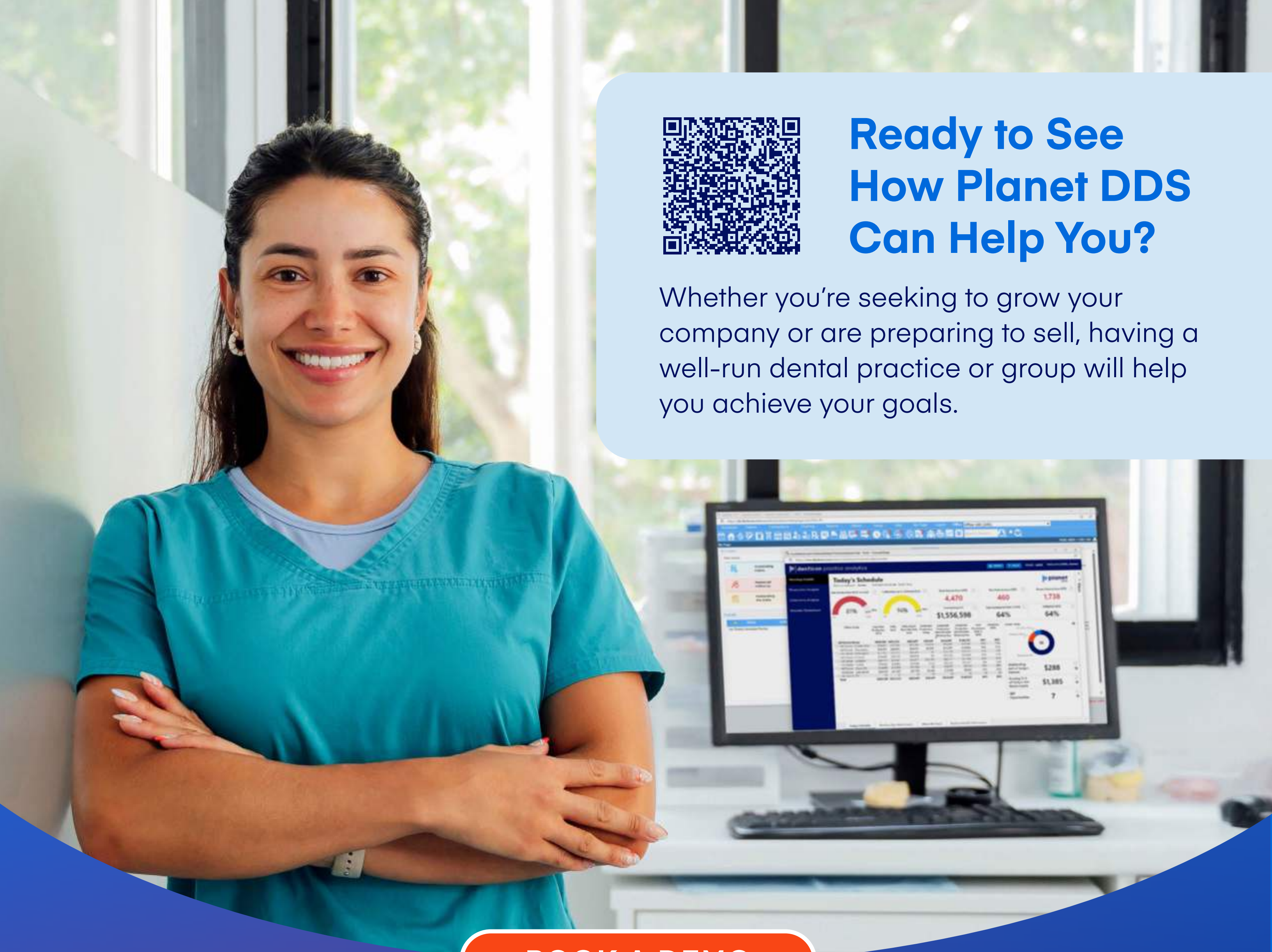
Despite the 2024 slowdown in M&A activity, Brian Colao, the Director of the Dykema DSO Industry Group, predicts the industry consolidation is still on track to increase from about 30% right now to **75 to 80% in the next 10 years.**

It's going to happen. So whether you're thinking about partnering with a group this year, next year, or a decade from now, you can **put yourself in the best possible position by preparing now**.

Brian Colao

Ready to See How Planet DDS Can Help You?

Whether you're seeking to grow your company or are preparing to sell, having a well-run dental practice or group will help you achieve your goals.



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