



Successful Dental Partnerships A Step-by-Step Process to Practice Transitions

Kentucky Dental Association

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The Deal

“Good”

Money

Cash Up Front — Accelerate Time to 3:1

Means of Transitioning Your Patients

Significance

Selling Doctor Guarantees the Buying Doctor's Note

Buyer receives tax deduction - Tax Leveraged Buy-Out

The Deal

“Bad”

I Didn't Get Enough Money for the Practice

I Paid Too Much for the Practice

Loss of Control

Loss of Relationship

Working Harder

I Have to Guarantee Note — I'm at Risk

Splitting the Money Sometimes Seems Unfair

I'll Receive No Hygiene Profit While At-Risk

The Deal

“Ugly”

Borrowing
At Risk Buyer <—> Seller
Paying the Tax
Buyer Has No Cash \$
Break the Basic Rules, Incur Penalty
Stress = Change

**Understanding The
Numbers of Your
Business**

Economics of a Dental Practice

- Break-Even Analysis
- Direct Cost
- Fixed Costs
- Profit Margin

Break-Even Calculation Associate Example

Profit Margin = 100% - Direct Cost %

Profit Margin = 100% - 30% = 70%

Associate Salary Package \$150,000

Break-Even = $\frac{\text{Associate Cost}}{\text{Profit Margin \%}}$ = $\frac{\$150,000}{70\%}$ = **\$215,000**

Associateship Phase

- Established Dr. produces \$1,000,000
- Associate Dr. produces \$500,000

Established Dr.

Profit
\$400,000
Direct Costs
\$400,000
Fixed Costs
\$200,000

Associate Dr.

Profit
\$300,000
Direct Costs
\$200,000

Associateship Phase

What happens to the increased profit?

- First, it must be understood that without the Associate Dr. there is no increased profit.

Therefore, a decision needs to be made:

- Does the Established Dr. want to make more money on a monthly basis with the hope that the Associate continues to show up?

or

- Does the Established Dr. allow the Associate Dr. to buy into the practice, share some of the costs and receive a lump-sum up money up-front?

Associateship Phase

The extra money is used to increase the Established Dr.'s profit:

Established Dr.	Associate Dr.
Profit \$400,000	Discretionary Profit \$150,000
Direct Costs \$400,000	Associate Dr. Salary \$150,000
Fixed Costs \$200,000	Direct Costs \$200,000
	Money Left To Fund the Buy-In \$0

Associateship Phase

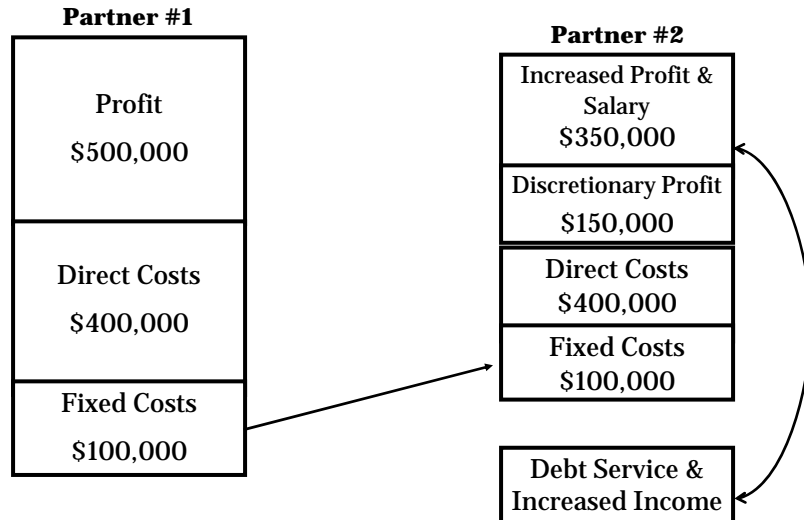
The decision is made to use the extra money to allow a buy-in:

Established Dr.	Associate Dr.
Profit \$400,000	Hygiene Profit \$67,000
Direct Costs \$400,000	Discretionary Profit \$150,000
Fixed Costs \$133,000	New Partner's Profit \$150,000
	Direct Costs \$200,000
	Fixed Costs \$67,000
	Debt Service & Increased Income

Partnership Phase

As the new partner develops, the business grows.

Both partners are now producing \$1 million:



Partnership Phase

Ultimately, the methodology allows for practice transition.

Partner #1 reduces production to \$500,000, Partner #2 maintains production at \$1,000,000, and an Associate Dr. is added to the practice.

Partner #1	Partner #2	Associate Dr.
Profit \$250,000	Profit \$450,000	Discretionary Profit \$150,000
Direct Costs \$200,000	Direct Costs \$400,000	Associate Dr. Salary \$150,000
Fixed Costs \$50,000	Fixed Costs \$150,000	Direct Costs \$200,000

Advantage to Established Dr.

Cain, Watters Methodology

Sale of 1/3 \$250,000

YEAR 1

Sale of 1/6 \$125,000

YEAR 10

Sale of 1/3 \$300,000

YEAR 15

Sale of 1/6 \$150,000

Retirement
Year 20

\$1,850,000

*Value of
Proceeds

Practice Sale at Retirement

Walk Away Sale \$400,000

\$400,000

* Assumes sale proceeds grow tax-deferred at 7% annually. Values are shown net of tax.

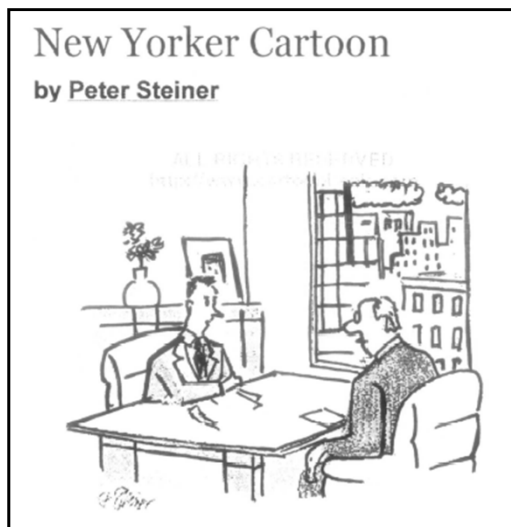
**Selection Process &
Understanding Personality Differences**

Who will you welcome
into your practice?



New Yorker Cartoon

by Peter Steiner



**"I will have someone from
my generation get in touch
with someone from your
generation."**

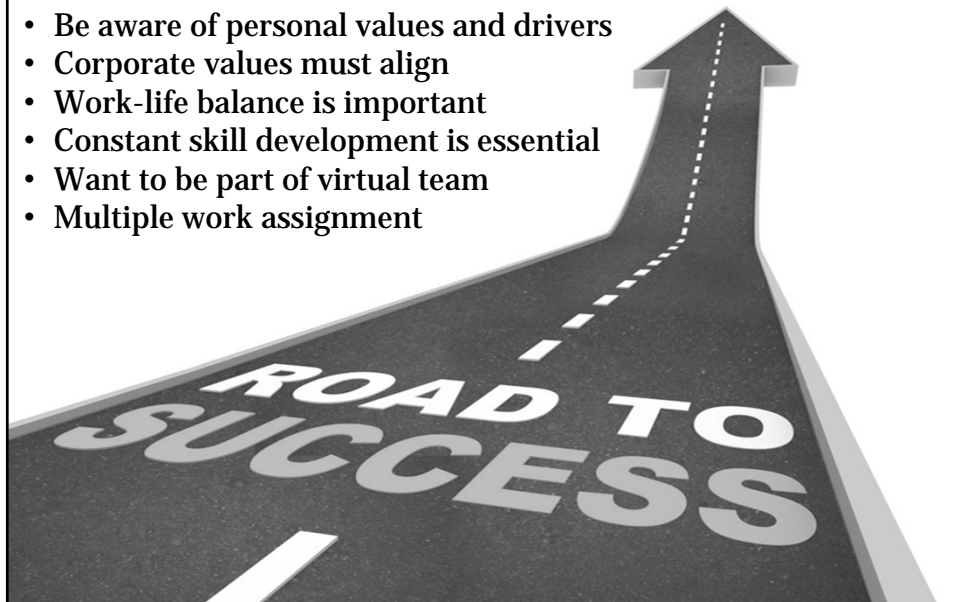
GENERATION



MILLENNIAL DEMOGRAPHICS

- 70 Million (26% of U.S. Population)
- Ethnically Diverse (1/3 not Caucasian)
- 1/4 Live in Single Parent Home
- 3/4 Have a Working Mom
- Prefer Directness over Subtlety
- Heavily Influenced by Branding and Peer Groups
- Family is Important; Money Takes a Back Seat

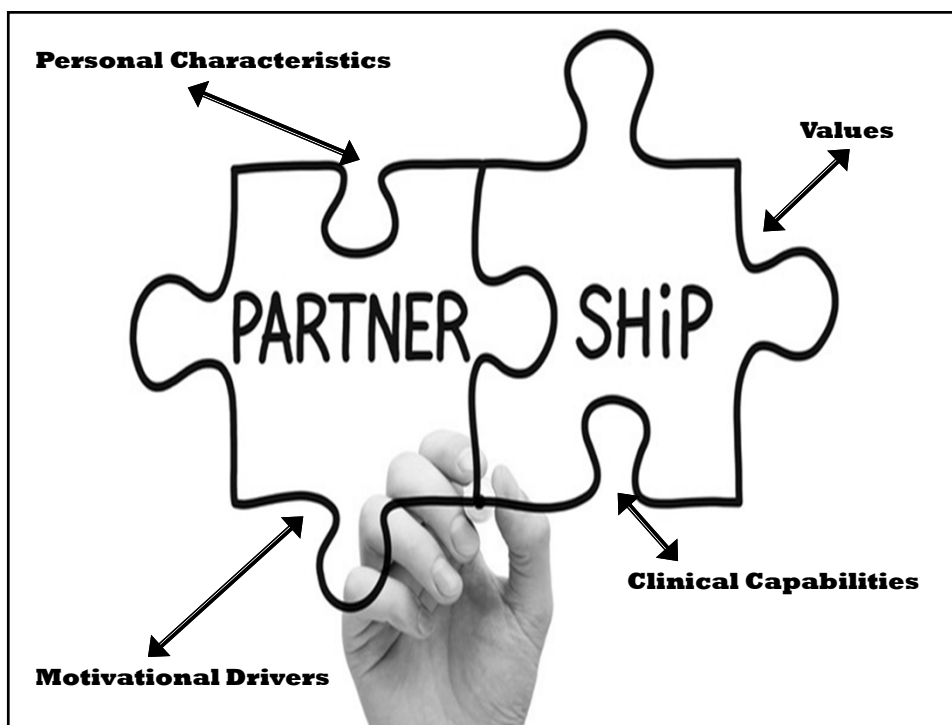
- Be aware of personal values and drivers
- Corporate values must align
- Work-life balance is important
- Constant skill development is essential
- Want to be part of virtual team
- Multiple work assignment



MANAGING MILLENNIALS



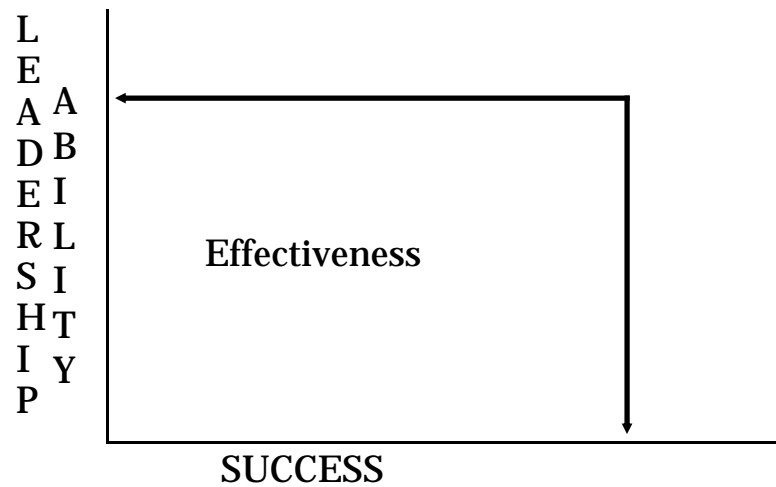
- You be the leader
- Challenge me
- Let's have fun
- Respect me
- Be flexible
- Let me work with friends



Success Without Leadership

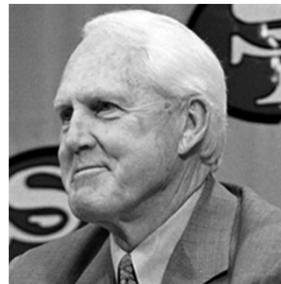


Success with Leadership



Law of Reproduction Survey Says:

85% of Leaders say the reason they are a
Leader is due to the Influence of Another Leader



**Employee
&
At Risk Phase**

Employment Phase

- Compensation
- Non-Compete
- How Long?
- Responsibilities

At-Risk Phase

- Independent Contractor
- Expectations
- How Long?
- Compensation

At-Risk Compensation

Production Ratios

Dr/Dr/Hygiene Ratio		Dr/Dr Ratio	
Dr. S \$65,000 Prod Ratio	43.33%	Dr. S Production Ratio	65.00%
Dr. B \$35,000 Prod Ratio	23.33%	Dr. B Production Ratio	35.00%
Hygiene \$50,000 Prod Ratio	33.33%	Total	<u>100 %</u>
Total	<u>100 %</u>		

Cost Sharing Methodology

Expense Category	Doctor Only	Hygiene Only	Dr/Dr Production Percentage	Dr/Dr Hygiene Percentage	Dr/Dr Ownership Percentage
<i>Direct Costs:</i>					
Dental Supplies				X	
Laboratory Fees	X				
Office Supplies				X	
Hygiene Salaries		X			
Staff Payroll Tax				X	
Office Manager Salary				X	
Front Desk Salary				X	
Assistant Salary			X		

At-Risk Compensation

Associate Dr's Share of Net Collections (Dr/Dr/Hygiene Ratio)

	\$150,000 X 23.33 %	\$ <u>35,000.00</u>
Less: 1) 30% to Dr. Seller		(<u>10,500.00</u>)
2) 100% of Doctors' Lab Bill		(<u>3,600.00</u>)
3) Staff Payroll Taxes (Dr/Dr/Hygiene Ratio)		
\$2,000.00 X 23.33%		(<u>467.00</u>)
4) Dental Supplies (Dr/Dr/Hygiene Ratio)		
\$9,000.00 X 23.33%		(<u>2,100.00</u>)
5) Office Supplies (Dr/Dr/Hygiene Ratio)		
\$2,250.00 X 23.33%		(<u>525.00</u>)
6) Front Desk Salaries (Dr/Dr/Hygiene Ratio)		
\$9,000.00 X 23.33%		(<u>2,100.00</u>)
7) Chairsides Salaries (Dr/Dr Ratio)		
\$10,500.00 X 35.00 %		(<u>3,675.00</u>)
Associate's Share of "At-Risk" Profit in Dollars		\$ <u>12,033.00</u>

Valuation & Partnership Phase

Profit & Loss

- Must be organized and consistent
- Compare to Industry Ratios
- Look for Variances
- Sellers & Buyers need to learn how to read

The Financial Statement

“A Must to Manage Overhead”

	Month	Percent	Year	Percent
Revenue				
Collections	101,000	101.0%	1,212,000	101.0%
Refunds	(1,000)	-1.0%	(12,000)	-1.0%
Net Revenue	100,000	100.0%	1,200,000	100.0%
Direct Expenses				
Staff Salaries	22,000	22.0%	264,000	22.0%
Payroll Taxes	1,500	1.5%	18,000	1.5%
Lab	9,000	9.0%	108,000	9.0%
Dental Supplies	6,000	6.0%	72,000	6.0%
Office Supplies	1,500	1.5%	18,000	1.5%
Total Direct Expenses	40,000	40.0%	480,000	40.0%
Fixed Expenses				
Accounting	1,000	1.0%	12,000	1.0%
Advertising	3,000	3.0%	36,000	3.0%
Rent	5,000	5.0%	60,000	5.0%
Utilities	500	0.5%	6,000	0.5%
Etc.	10,500	10.5%	126,000	10.5%
Total Fixed Expenses	20,000	20.0%	240,000	20.0%
Net Practice Income	40,000	40.0%	480,000	40.0%
Professional Expenses				
Dr Salary	21,250	21.3%	255,000	21.3%
Dr Payroll Taxes	900	0.9%	10,800	0.9%
Auto	500	0.5%	6,000	0.5%
Continuing Ed	500	0.5%	6,000	0.5%
Travel	500	0.5%	6,000	0.5%
Total Professional Expenses	23,650	23.7%	283,800	23.7%
Non-Operating Costs				
Amortization	400	0.4%	4,800	0.4%
Depreciation	2,000	2.0%	24,000	2.0%
Interest	500	0.5%	6,000	0.5%
Total Non-Operating Costs	2,900	2.9%	34,800	2.9%
Net Taxable Income	13,450	13.5%	161,400	13.5%

Philosophy of Splitting the Money

- Portion of profit should be based on ownership
- Majority should be based on production
- Partner who receives the benefit (cash) pays the expense
- It will cause problems allocating expenses to a partner that does not have the money to pay for the expense
- Four Basic Ways to share:
 - Direct Allocation
 - Based on Ownership
 - Between the Doctors Production
 - Between the Doctors & Hygiene

Philosophy of Splitting the Money

Direct Allocation

- Lab Fees
- Dues
- Subscriptions
- Perks
- Staff Pensions

Ownership

- Fixed Assets

Doctor's & Hygiene Production

- Front Desk Salaries
- Dental Supplies
- Office Supplies

Doctor's Only Production

- Everything Else

Normalization

The Goal is to Clean Up the P&L to Arrive at True Net Cash Flow

Remove Perks or Add Future Expenses:

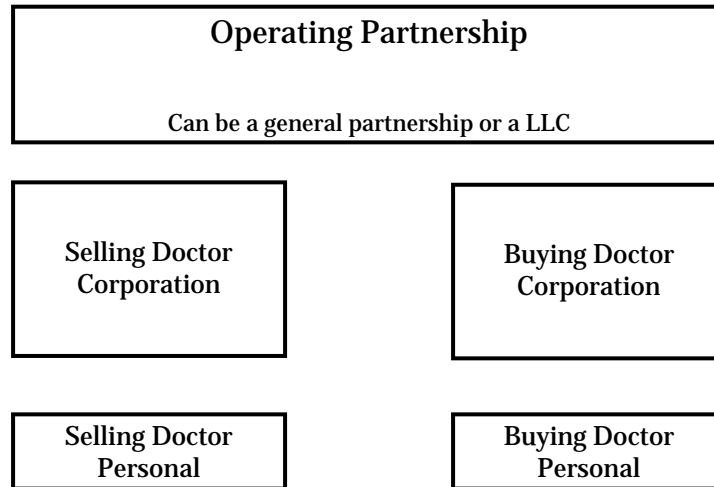
- Non-Working Spouse
- Dental Supplies
- Office Supplies
- Personal Taxes
- Personal Perks
- Underpaid Working Spouse
- Contingency Costs
- New Staff Pension Funding
- FMV Building Rent

Arrive at Net Income Before Pension, Perks, and Dr. Compensation

Valuation Process

Net Cash Flow Before Pension Funding and Doctor's Compensation/Perks	750,000
Imputed Doctor Salary (25% of Normal Collections)	(375,000)
	<u>375,000</u>
Assumed Tax Rate	35%
After-Tax Net Cash Flow Before Pension Funding/Doc Perks	<u>243,750</u>
Capitalization Rate	
Risk Free Rate (Long Term Gov't Bond Rate)	4.60%
Equity Risk Premium	7.10%
Risk Premium For Size (Small Stocks Risk Premium)	6.36%
Subjective Risk Factors Specific to Practice	3.60%
Capitalization Rate	<u>21.66%</u>
 Rounded Value of Practice	 <u>\$1,125,000</u>

Tax & Entity Structure



Questions...



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