



The impact of inflation and higher interest rates on practice values

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WHEN SPEAKING WITH SOME 200 DOCTORS OF ALL SPECIALTIES EVERY MONTH,

I informally survey them about their costs and fee schedules. The survey results so far in 2022 have been simple: costs are universally rising, especially with labor, supplies, and equipment. Very few doctors have received increases in reimbursement rates and/or increased their fees. The simple term for this is margin compression. Practice operating profit as a percentage of collections is declining in many practices.

While most dental practices that we review financials for in our valuation process have achieved growing revenues in the last 12 months, their growth rate is decelerating. The recent record five-year low in the University of Michigan Consumer Sentiment Index (below mid-COVID-era levels) is a harbinger of potentially lower collections in the near future. This is not a positive for practice values.

One of the key metrics in determining practice values is operating profit, or

earnings before interest, taxes, depreciation, and amortization and after doctor compensation (EBITDA). Collections growth rates are also a crucial driver of practice values. If a practice is valued at seven times EBITDA on today's growing \$500,000 in EBITDA for the past 12 months, its value is \$3,500,000. If EBITDA were to drop to \$400,000, its value declines by \$700,000 (seven times \$100,000), or probably more due to declining, not increasing, profitability.

FORTUNATELY, THE "BUYER" UNIVERSE IS STILL GROWING

There are hundreds of invisible dental support organizations (IDSOs) in all 50 states that are eager to quietly partner with general or specialty practices. IDSOs invest in great practices by purchasing 51% to 90% of a practice for cash up front. The dentists remain as owners in the balance and continue to lead their practices with their brand, team, and strategy for years or decades. They benefit from the resources of a larger, silent partner to grow bigger, better, and faster and increase the value of both partners' ownership over time; some equity values have increased by three times, five times, and even 10 times or more over time.

PRACTICE VALUE MAY CHANGE, BUT OPTIONS IN IDSO PARTNERSHIPS ARE GROWING

Today, any quality practice of any specialty with \$1.5 million or more in collections will have at least five qualified bidders, and some will have 10 or more. IDSOs have been active for more than 30 years, and dozens of new IDSOs have been formed already in 2022. Some are better than others, and unfortunately a few IDSOs will fail. You must choose your partner wisely.

Dental practice consolidation over the last three decades has proved to be a very lucrative investment for private equity groups, family offices, and even sovereign wealth funds. In 2021, investors in IDSOs and the doctors who partnered with them in the preceding five years harvested billions of dollars in profits from the ultimate sale of their practice equity last year. And there will be more investor and doctor exits in 2022 than there were in 2021.

THE IMPACT OF HIGHER INTEREST RATES

Your practice EBITDA, by definition, is not impacted by interest expense or principal payments on loans, so rising interest rates will not directly affect your practice's theoretical value. However, virtually all DSOs and IDSOs finance their acquisitions or partnerships with debt. As interest rates rise, their costs increase. Higher rates will potentially impact the record values we have been able to achieve for clients in the last two years. Low interest rates enabled higher values for doctors.

EXIT LIQUIDITY FOR INVESTORS/DOCTORS

In Q1 of 2022, private equity investors' exit transactions decreased by 57% versus Q4 of 2021. In addition, the initial public offering (IPO) markets have effectively shut down, with the average 2021 IPO share price down by over 40% as of June 1, 2022.

Completed IPOs in Q1 2022 were down by 72% in the number of transactions, and the net proceeds from IPOs decreased by 95% versus Q1 2021.

Fortunately, dental consolidation is still in its early stages and is a very lucrative endeavor. Due to the sheer number of eager bidders for great practices, current values are still 20% or more above 2019 levels. But now may be a good time to understand the value of your practice in an IDSO transaction before the looming storm arrives on your shoreline. **DE**



Chip Fichtner is the founder of Large Practice Sales, which specializes in invisible DSO transactions for large practices of all specialties. The company has completed more than \$500 million in

transactions in the last 12 months. Learn more at largepracticesales.com.