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# Dental Practice Values

Is there a bubble?

You have heard the mantra for years: "Practice values are much higher than ever before. This is a bubble that has to burst soon. All those baby boomer dentists will ultimately sell their practices and, combined with an inevitable rise in interest rates, 'pop!' the bubble will burst and prices will come tumbling down." We hear it from owners rushing to sell. We hear it from buyers waiting to buy. And we hear it from those who profit when dentists decide to sell.

We would like to propose another hypothesis and provide some data to support it. We suggest that the recent reduction of barriers to entry in the profession, combined with the arrival of serious capital investment funds will increase demand more than enough to, at a minimum, offset any increase in supply from the eventual retirement of the baby boomer dentists shown in Figure 1. These capital investments, as further explained below, represent investors who wish to

use their own capital or money that they manage to buy dental practices.

While both the long-term implications of increasing the number of new dentists entering the profession and the expanding role of capital give many of us pause for concern, they are now undeniable facts. For people engaged in the valuation and sale of dental practices, and for buyers and sellers of dental practices, these are realities that cannot be ignored.

## Reduced Barriers to Entry

For many years, the entry of new dentists into the profession was largely limited by the number of positions available at North American dental schools, based on the educational reciprocity agreements between the CDA and ADA. These reciprocity agreements extended mutual recognition of the quality of the academic programs in both countries and allowed for a different examination and licensure process for Canadian and American dental school graduates. Conversely, with a few exceptions for some Commonwealth dental programs, if you were trained outside of North America, you had to be accepted into one of the limited spots in one of the Canadian university qualifying programs before getting licensed. Even with that barrier to entry in place, new entrants to the profession have significantly exceeded those exiting the profession in each of the last 10 years, as shown in

Distribution of Ontario Dentists by Age Group

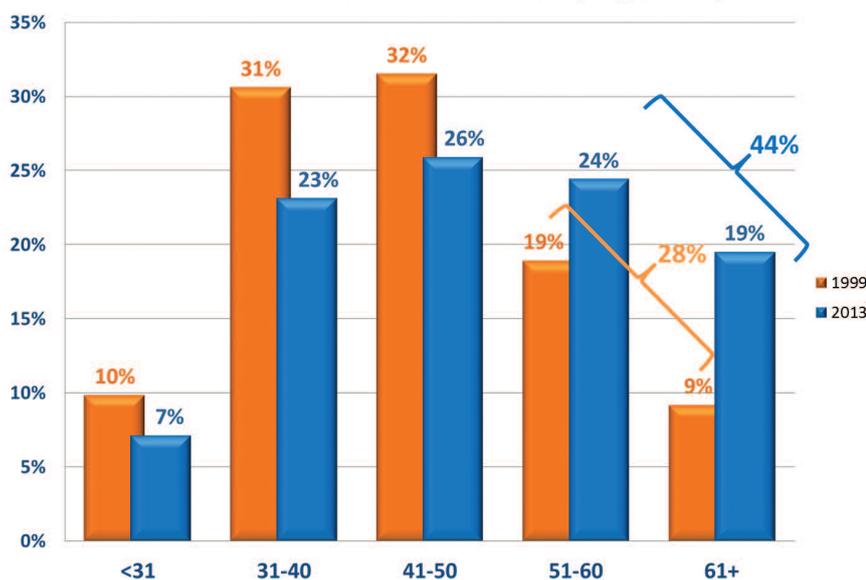


Figure 1

Source: RCDSO Annual Report

Figure 2. Indeed, over that 10-year period, there was a net increase of 1,890 dentists in Ontario — which was a 26 percent increase at a time when Ontario’s population grew by only 13 percent. In other words, the profession has been growing at twice the rate of the population.

In 2012, the requirement to attend an accredited school’s qualifying program was eliminated, and we are already seeing the impact. Figure 3 shows the increased number of internationally trained dentists who were newly licensed in 2013 alone. And this process is just getting started. U of T is increasing its class sizes by 20 students per year. Private training groups are also making a business out of preparing internationally trained dentists who want to challenge the board exams.

**Capital Investment Funds**

There is another, potentially bigger, factor at work — investment capital. The days when virtually every practice was owner-operated are gone. The role of dental practices as investment vehicles is growing in two important ways, both driven by the fact that dental practices are fantastic investments. Even at the increasingly high prices paid for a practice in southern Ontario, it generally yields an apparent 15 percent to 25 percent annual return on investment. Even after rolling in conservative costs for capital reinvestment and management costs, returns still exceed 10 percent and often exceed 15 percent, with more stable, predictable earnings than many other industries such as consumer goods, durable goods, communications, technology, real estate, infrastructure, auto, etc., which individuals or investment types of funds can invest in. For dentists, there is no better investment than owning their own dental practice.

For many years, individual dentists have realized that, having paid off their first practice, they could make a

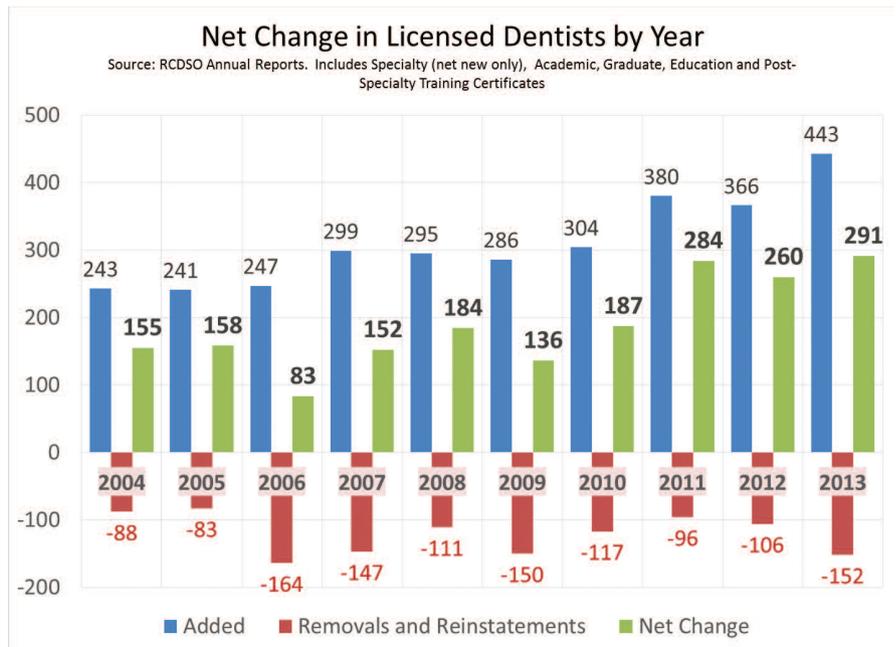


Figure 2

Source: RCDSO Annual reports

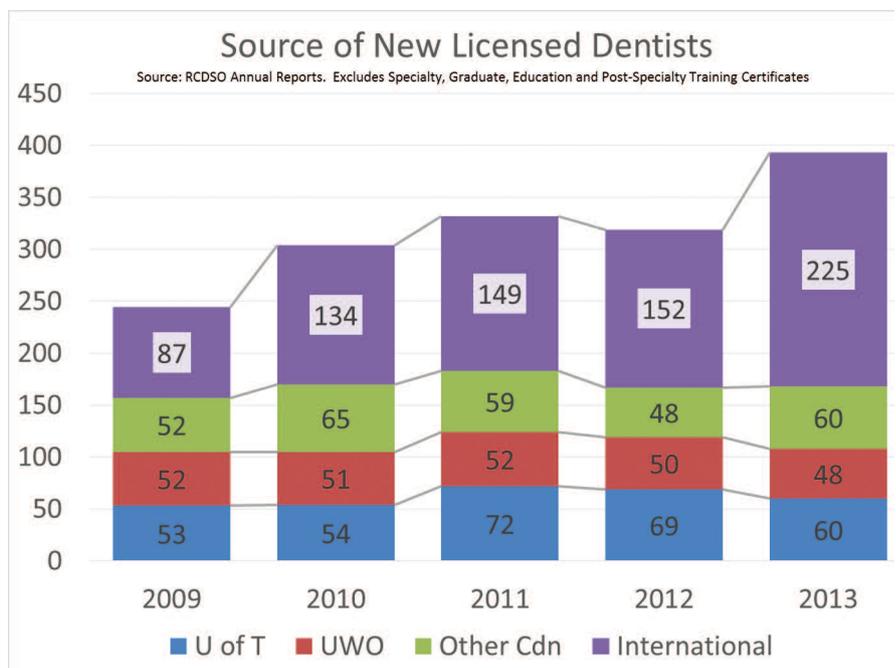


Figure 3

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better return with less volatility by buying another dental practice, rather than investing their capital in the stock market. If that first investment practice proves successful, they often move on to a third and fourth. Indeed, of all the practices we sold in the past 15 months, 61 percent were sold to someone who already owns one or more practices.

Beyond the individual dentist who invests in multiple practices, there is another much more powerful influence — formal capital investment funds. When an industry has the kind of predictable returns that dentistry enjoys, investment funds are a lot like water surrounding a basement: try as you might, to keep them out, eventually the funds are going to find a way in. And they have.

In the U.S., the multiple-ownership segment of the total number of dental practices has doubled every five years for the last 20 years. According to the ADA News, April 9, 2012, 69 percent of U.S. dental practitioners were in solo practice compared to 76 percent in 2006, and there is reason to believe that number has fallen further since then. There are those who believe that this type of trend tends to cross the border, with Canada lagging behind the U.S. by a few years. Several of the groups buying up dental practices have serious private equity backing. After selling the Toronto Maple Leafs, the Ontario Teacher's Pension Plan paid a reported 11 times the earnings for U.S.-based Heartland Dental.

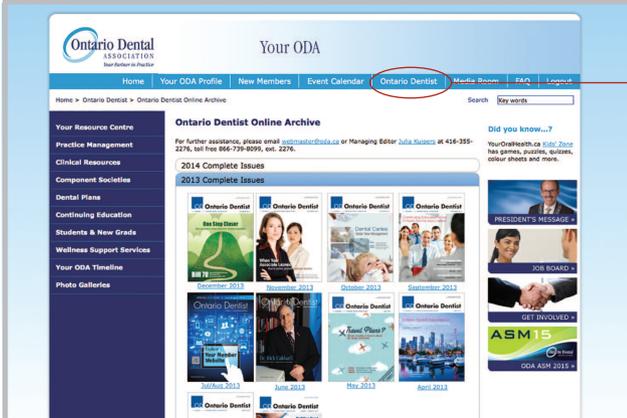
At the time, many scoffed and said that was the U.S. and it would be much harder to do here. While there is some validity to that, like the water around a basement, group funding has now found its way into Canada: another large public-sector pension fund, the Ontario Public Service Employees Union (OPSEU), recently made a sizeable investment in Dental Corporation of Canada through one of their investment firms, OPTrust. This means that one of the country's largest investment funds now has an ownership stake in Ontario dental practices — and it would be naïve to think this is an isolated incident.

Some of the medium-sized Canadian dental chains have switched from bank financing to private equity backing. With the kind of economic returns dental practices yield, the supply of funds is virtually unlimited, so more and more investment managers are working on ways to own dental practices. Often when dentists become aware of this situation, the first question asked is, how can a non-licensed dentist own or participate in the profits of a dental practice? The answer is complicated and beyond the scope of this article, but the reality is that it is happening and it is happening within the existing regulations.

The reduction of barriers to entry to the profession, combined with the gravitational attraction of still-excellent dental practice returns for capital — both individual and large-scale — are exceptionally powerful forces that we argue could impact the demand for dental practices well into the future. Given these factors, we believe the real increase in supply is going to have very little, if any, impact on practice values. This isn't a bubble that will burst. It is the new normal. 

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The screenshot shows the Ontario Dental Association website. The top navigation bar includes 'Home', 'Your ODA Profile', 'New Members', 'Event Calendar', 'Ontario Dentist', 'Media Room', 'ADA', and 'Logout'. The 'Ontario Dentist' link is circled in red. Below the navigation bar, the 'Ontario Dentist Online Archive' section is visible, featuring a grid of issue covers for 2014 and 2013. The 2014 section shows 'Complete Issues' for January, February, March, April, May, and June. The 2013 section shows 'Complete Issues' for July, August, September, October, November, and December. A search bar is located to the right of the archive grid.

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