

Why a career in orthodontics is still a smart choice

Chris Bentson and Doug Copple, AVA, discuss the statistics that drive orthodontic opportunities

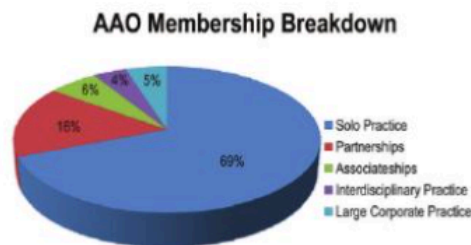
If you spend much time speaking to either very young or very, shall we say, mature orthodontists, you can get the feeling that the luster of the profession is somehow less bright now than it once was. For those in the middle years of practice life, the reviews are mixed on whether orthodontics still has the sheen of yesteryear. Our observation is that a career in orthodontics is indeed changing but offers doctors more choices of how to practice today than ever before with financial and lifestyle opportunities that are still the envy of dentistry and medicine.

It is true that complaints of increased competition, price wars, and rising technology costs are often coffee break fodder at alumni meetings. Lectures on new topics like marketing, social media, and why and how to blog and Twitter fill the lecture halls at meetings. On the clinical side, a myriad of new treatment modalities typically centered around more esthetic appliances or aligners, shorter treatment times, and touting more perceived value to orthodontic consumers are finding a foothold in "standard orthodontic care." The business and clinical options of the profession are indeed evolving. However, amidst this cacophony of new information requiring new skills from orthodontists, the financial rewards of practice ownership or employment have placed the profession in very rarified air at the top of income earners (America's Best-Paying Jobs, *Forbes Magazine*, July 12, 2010)—a position which shows no signs of materially abating.

This article will take a look at the current opportunities for young orthodontists and how the numbers work for the newly minted orthodontic graduate as he/she enters into the profession. Perhaps you will agree, orthodontics still offers the allure and rewards both in lifestyle and income of years past.

There is a meeting of residents across the U. S. that occurs each summer; it's called the Graduate Orthodontic Resident Program, commonly referred to as GORP. GORP rocked out of the cradle at the University of Michigan program as the brainchild of Dr. Jim McNamara and then resident Dr. Gary Starr. The idea was to bring residents together from across the country once per year to hear a top-tier slate of lecturers and to have some fun. Several years ago, Dr. Robert Scholz presented a lecture at GORP titled: "Do You Want a Job When You Graduate?" It's no secret that the recession that began in December of 2007 and ended in May of 2009 caused many practicing orthodontists to reevaluate their planned retirement date. Since late 2007, the job market for young orthodontists seeking to purchase a practice has been fiercely competitive. The current market has roughly three candidates vying for each practice available for sale. Additionally, the profession is aging. The

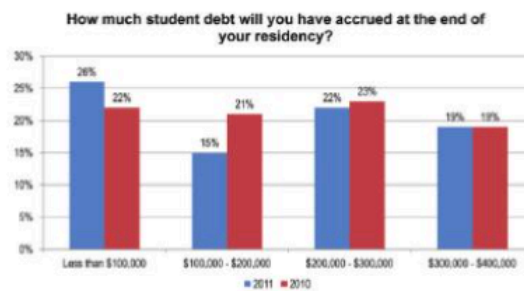
Chart 1



Source: ICA News, AAO Explains Growth of Large Group Practices April 6, 2012

AAO Membership

Chart 2



Source: Bentson-Clark & Copple, LLC Resident Survey, 2011 & 2010

2011 Orthodontic Resident Survey

most recent *Journal of Clinical Orthodontics* (JCO) biannual Orthodontic Practice Study (2011) reports the mean age of orthodontists in the U.S. is 54 years, and he/she has been practicing for 23 years (2011 JCO Orthodontic Practice Study, *Journal of Clinical Orthodontics*, Vol. XLV, No. 10).

In his GORP lecture, Dr. Scholz outlined nine possible landing zones for orthodontic residents to consider after graduation. They are, in no particular order:

- Startup
- Associateship
- Associateship, leading to buy-out
- Associateship, leading to partnership
- Solo group practice (space sharing with other dental professionals)
- Employee of corporate entity

Practice development

Chart 3

Potential Buy-Out of Seller's Practice by Buyer

100% Asset Sale

Dr. Buyer

	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9	Year 10
Projected Annual Growth		1.5%	1.5%	1.5%	1.5%	1.5%	1.5%	1.5%	1.5%	1.5%
Annual Collections	\$ 950,000	\$ 964,250	\$ 978,714	\$ 993,394	\$ 1,008,295	\$ 1,023,420	\$ 1,038,771	\$ 1,054,353	\$ 1,070,168	\$ 1,086,220
Operating Expenses 59.0%	(560,500)	(568,908)	(577,441)	(586,103)	(594,894)	(603,816)	(612,875)	(622,068)	(631,399)	(640,870)
Capital expenditures 1.8%	(17,100)	(17,357)	(17,617)	(17,881)	(18,149)	(18,422)	(18,698)	(18,978)	(19,263)	(19,552)
Buyer's benefits & personal expenses	(20,000)	(20,600)	(21,218)	(21,855)	(22,510)	(23,185)	(23,881)	(24,597)	(25,335)	(26,095)
Dr. Seller's post-closing compensation	(80,000)	-	-	-	-	-	-	-	-	-
Practice Income	272,400	357,386	362,438	367,596	372,742	377,995	383,317	388,709	394,170	399,703
Less Expenses / Payments Relating to Purchase:										
Purchase Interest	(56,990)	(50,077)	(42,591)	(34,483)	(25,703)	(16,193)	(5,894)	-	-	-
Supplies & A/R	(48,000)	-	-	-	-	-	-	-	-	-
FF&E Depreciation	(23,571)	(23,571)	(23,571)	(23,571)	(23,571)	(23,571)	(23,571)	(23,571)	(23,571)	(23,571)
Amortization - Intangibles	(37,267)	(37,267)	(37,267)	(37,267)	(37,267)	(37,267)	(37,267)	(37,267)	(37,267)	(37,267)
Income Before Income Taxes:	106,572	246,470	259,009	272,235	286,201	300,964	316,585	351,442	356,904	362,436
Estimated Taxes	(29,534)	(73,487)	(78,167)	(83,105)	(88,318)	(93,829)	(99,661)	(112,673)	(114,712)	(116,777)
Estimated Tax Rate	27.7%	29.8%	30.2%	30.5%	30.9%	31.2%	31.5%	32.1%	32.1%	32.2%
Income After Taxes	77,038	172,984	180,842	189,130	197,883	207,135	216,924	238,769	242,192	245,659
Adjustments to Arrive at After-Tax Cash Flows:										
Purchase Principal Payments	(83,286)	(90,198)	(97,685)	(105,793)	(114,572)	(124,083)	(134,382)	-	-	-
Amortization and depreciation above	106,838	90,838	80,838	80,838	80,838	80,838	80,838	37,267	37,267	37,267
Educational debt (principal & interest)	(24,500)	(24,500)	(24,500)	(24,500)	(24,500)	(24,500)	(24,500)	(24,500)	(24,500)	(24,500)
After Tax Annual Cash Flow	\$ 78,090	\$ 119,123	\$ 119,495	\$ 119,676	\$ 119,647	\$ 119,390	\$ 118,880	\$ 251,536	\$ 254,958	\$ 258,425
Equivalent Pre-Tax Salary (assuming 32% tax rate)	\$ 114,838	\$ 175,182	\$ 175,727	\$ 175,993	\$ 175,952	\$ 175,573	\$ 174,824	\$ 369,905	\$ 374,939	\$ 380,037

Assumed Purchase Price & Asset Allocation:

Supplies	36,000
Accounts Receivable	12,000
Fixed Assets	165,000
Patient Records & Contracts	20,000
Personal Goodwill & Covenant	489,000
Total Purchase Price	722,000

Comments & Explanations

- 1 Collections in year one are set at a projected level of \$950,000 (average per the JCO 2011 survey).
- 2 Operating expenses are set at 59.0% (average per the JCO survey).
- 3 This represents an annual allowance for capital expenditures, which is set at 1.8% of annual collections.
- 4 This represents the Buyer's deductible discretionary or personal business expenses, such as retirement contributions, health insurance, car allowance, or other deductible expenses that are personal in nature. They are assumed to increase at 3% each year.
- 5 It is assumed that Seller provides services to Buyer after the transaction. It is assumed that he is paid a daily rate of \$1,000 per day and works 3 days per week for 16 weeks and then 2 days per week for an additional 16 weeks.
- 6 The interest on the loan to purchase the practice is a deductible expenditure. The loans are assumed to be repaid over a 7 year period at 7.00%, although many buyers actually finance the loan over 10 years to provide additional cash flows.
- 7 These assets are deducted in the year of acquisition.
- 8 It is assumed that the fixed assets are depreciated over a 7 year period. Actual write-off periods will vary.
- 9 Goodwill and other intangibles are amortized over a 15 year period.
- 10 The principal repayments on the loan to purchase the practice are not tax deductible expenditures but must be paid with after-tax dollars (tax deductibility of the purchase price is recognized through the depreciation/amortization of the assets purchased - see comments 7 - 9).
- 11 Non-cash write-offs are added back to arrive at net cash flow.
- 12 Educational debt is assumed to be \$230,000, amortized over a 15 year period at 6.8% interest. Although the interest may be deductible, we have assumed that both the principal and interest is repaid with after-tax earnings.

For Illustrative and Training Purposes Only

- The pediatric dentist's orthodontist
 - The general dentist's orthodontist
 - Gypsy orthodontist—an employee for several practices
- We would add two more options to Dr. Scholz's list:
- Academics
 - Military

For those practicing over 20 years, it is fair to say that three of the 11 choices either did not exist or were very rare as you exited your resident program. Employee of corporate entity, the pediatric dentist's orthodontist, and the general dentist's orthodontist are relatively new phenomena for graduating orthodontists. However, the market responds to supply and demand, and these three options have offered hundreds of young orthodontists a place to land in these competitive times.

Recently, an article in the April 9, 2012 edition of the ADA News titled, "ADA Explores Growth of Large Group Practices," (ADA News, April 9, 2012) another relatively growing phenomenon, shared information from the executive director of the AAO, Chris Vranas, who reported the current AAO membership breakdown by practice

style. The results are shown in Chart No. 1 and reveal that 69% of AAO members are solo practitioners, 16% are in partnerships, 6% in associateships, 4% in interdisciplinary practices, and 5% in large group practices. While we have no previous data for comparison against this breakdown, observers of the profession over the last 30 years would likely conclude that the number of employee orthodontists is increasing, and therefore, a trend to watch.

Four major factors seem to be driving the trend to hire orthodontists as employees: (1) an increase in educational debt of current and recently graduated residents (see Chart No. 2); (2) fewer number of practices for sale in recent years; (3) proliferation of corporate, general dental, and pediatric practices that want to deliver orthodontic care, and (4) the increase in larger group practices that desire to expand their brand and footprint in a certain market, and are hiring orthodontists without ownership opportunities in order to grow.

All this boils down to more choices for young orthodontic graduates than seen in prior years. Each year, Benton Clark & Copple conduct an annual resident survey,

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and for the last 2 years, the number of residents who desire to work as employees as they exit their residency was reported at 26% in 2010 and 25% in 2011. Residents desiring to start a practice from scratch have remained constant at 11% in our surveys of the last 2 years. However, the majority of residents in our 2010 and 2011 surveys responded that they wanted to purchase a practice—51% in our 2010 survey and 54% in our 2011 survey. To analyze the cash flow opportunity for residents wanting to purchase a practice, Chart No. 3 provides a cash flow pro forma representing the mean practice opportunity available to potential purchasers. This cash flow model makes the following assumptions:

- Mean practice collections of \$950,000 (reported in the 2011 JCO Orthodontic Practice Study)
- Mean practice overhead of 59% (reported in the 2011 JCO Orthodontic Practice Study)
- A practice sales price of 76% of mean collections or \$722,000 for the mean practice described above (76% is the average price of practices analyzed by Bentson Clark & Copple in 2011 (*Bentson Clark reSource*, Vol. VII, Issue II))
- A conservative asset allocation on the purchase price (70% intangible and 30% tangible)
- Purchaser borrows 100% of the purchase price and finances the purchase for 7 years at 7% interest with the lender (Bentson Clark & Copple's experience indicates this is a common interest rate and that 7 years is a reasonable repayment period, although purchasers may finance the loan over a longer period)
- Educational debt of \$230,000 (average educational debt per the Bentson Clark & Copple 2010 and 2011 Annual Resident Survey)
- An interest rate of 6.8% on educational debt amortized over 15 years (current unsubsidized Stafford loan interest rate is 6.8%), [Stafford Loan Interest Rates, *StaffordLoan.com*]
- A work back of the selling doctor after the sale of the practice for 32 weeks, 3 days a week for 16 weeks, and 2 days a week for another 16 weeks, with a per diem fee of \$1,000 paid to the selling doctor for clinical service after the sale
- Long-term annual practice growth rate of 1.5% per year

The cash flow pro forma in Chart No. 3 reveals that after debt service for the practice purchase loan, educational debt repayments, allowing 1.8% annually for capital expenditures and a reasonable allowance for benefits and deductible discretionary or personal business expenses (\$20,000 in year one and increasing 3% a year), the buyer, under these assumptions, will have a pre-tax gross income of approximately \$115,000 in year one while still paying the senior doctor, and \$175,000 in years 2 through 7. After the seventh year, the buyer will be earning a pre-tax equivalent of approximately \$369,000 per year. Remember, this cash flow pro forma has a conservative long-term growth rate of only 1.5% per year.

The cash flow illustration given shows that young orthodontists can purchase the mean-sized orthodontic practice in the country, cover the debt service obligations on both the practice purchase and educational debt while maintaining a lifestyle that still places them near the top of income earners in any profession.

Has the luster or sheen of the profession diminished? Our opinion is there are more opportunities for employment for orthodontists than ever before, and there are lenders willing to partner with young orthodontists for practice startups or purchases. Without regard to the personal satisfaction of rendering orthodontic care, the profession continues to offer a lifestyle that is attractive with regards to earning potential and personal time off. The future of the profession is bright, even with the need for analysis and continued learning as a constant in these times—just as in times before. Young doctors can choose many directions in which to practice, all of which make a career in orthodontics still one of the most coveted and smartest choices in all of dentistry. ■



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