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WHAT IS HAPPENING TO DENTISTRY -
The changing face of the dental profession

I wish I knew exactly where the industry is going, and I imagine many of you do, too.

Our best chance of picking the key trends for the future lies in having a full understanding of the state of the industry now. It may be more complex than many of you realise.

I think many dentists lump the players in our industry into just two or three categories. The way I look at it, there are five main categories, and if we understand what these players are up to we might be able to form a view of where the industry is headed.

1. SOLO OPERATORS AND SMALL PARTNERSHIPS

Despite the growth of various corporate entities operating in dentistry, the majority of Australian dentists still work alone, in small partnerships, or in small groups sharing facilities but operating as separate businesses.

The latest figure I can find suggests that about 60-70% of all dentists work in the solo and small sector; maybe someone at the conference today has a more precise figure to share with us. In any case we can be confident that most dentists still work within small- or micro-business structures.

Small practices have been around for a long time and seem unlikely to disappear overnight. They are, however, particularly vulnerable to the growing oversupply of newly-graduated dentists on the one hand and uniquely growth-constrained on the other.

To add an extra dentist to a one or two dentist practice and keep the new dentist busy requires a huge percentage increase in patient flow at that practice. Adding an extra dentist to an operation encompassing a hundred dentists, on the other hand, requires only a slight increase in total turnover.

2. STATE-OWNED DENTAL SERVICES

The state-owned operations are fundamentally different to all others because they don't seek to increase the number of patients they treat or their turnover. Quite the opposite: from the point of view of a state dental clinic, every new patient is an additional expense increment.

As much as we'd all like to believe that the managers of these facilities are rewarded for delivering the maximum dental benefit at the lowest cost, we all know that the truth is that the managers' main job is to work within each year's budget.

Another key thing which differentiates the state facilities is that they tend to have entirely adequate capital budgets--sound facilities, enough chairs and equipment--but insufficient operating budgets. This often adds up to big, multi-chair facilities with more chairs than dentists and a waiting list which just keeps on growing.

At 1300SMILES we've had some success cooperating with one state dental service, treating state patients within our private facilities. This has delivered wins all around: revenue for us and our dentists, treatment for patients who really need it, and greatly reduced waiting lists. I remain aware that there's always a business risk in relying too heavily on any state agency for business.

3. LOW-TOUCH AGGREGATORS

There may not be any of these operating at the moment, but a few years ago they were by far the most aggressive buyers in the market, snapping up practices at prices which were--in my personal view--far above market value.

These aggregators did not seem to want any involvement in the operations of the dental businesses they acquired. There was no common branding or marketing. This is the classic "roll-up" model of aggregation: gather up a number of practices and roll them together to make them look like a coherent business.

From what I could see, these companies were simply buying cash flow, apparently in the hope that they could flick the aggregated businesses for a quick capital gain.

Under a typical purchase contract from a low-touch aggregator a dentist would be offered four to five times annual net income, mostly in cash, up front. In return, that dentist had to deliver that agreed net income to the aggregator each year for five years. If the dentist failed to do so, the company retained the right to claw back any shortfall.

By any reasonable standard, this offer was simply too good to be true. That's exactly what I told dentist friends of mine who were offered such deals: if someone offers you your next five years income in cash, today, take it, especially as the contract leaves you free to walk away at the end of the five years.

It seems to me that both the aggregators and the dentists who sold to them were indulging in a cynical dance. The aggregators hoped to bundle up enough dentists and sell their companies for big capital gains BEFORE they ever had to prove that they could manage and grow these businesses profitably.

The dentists, for their part, looked at the too-good-to-be-true offers and figured that at the end of their contracts they could simply walk away and set up new practices elsewhere.

But the plans of both the aggregators and their dentists were knocked off the rails completely by not just one but two major events.

First was the Global Financial Crisis. Before the GFC, it might have been easy to flick a recently-assembled collection of dental practices at a high price. No longer, so the aggregators had to come up with new plans.

Second was the end of CDDS on 30 November 2012. The cancellation of that program had the effect of shrinking the entire Australian dental industry by about 20%, overnight. Those dentists who had been planning to move on from their aggregator parents quickly realised that spending the best part of a million dollars to set up a nice new practice wasn't nearly as attractive as they had previously imagined.

So the aggregators were stuck with a lot of dental practices, and the dentists were stuck with the aggregators.

So where did they go? Dental Corp, as you know, was first sold to the Indian private equity firm Fortis Global Health. Two years later it was acquired by BUPA, a major UK-based health fund.

Meanwhile, the founders and promoters of Dental Partners sold their interest to Abano Healthcare, a New Zealand-based conglomerate with an established history of buying and selling businesses in the health care industry.

Just by the way, I'll add here that during the period in which the low-touch aggregators were gleefully overpaying for dental practices, 1300SMILES pulled back and made few acquisitions, as we'd rather not buy at all than pay a silly price.

4. HEALTH FUND CAPTIVES

Dental operations within or heavily dependent upon the health funds face a different dynamic with lots of in-built tension.

The funds promise an adequate supply of patients with dental cover (obviously) and care requirements, so a dentist in one of these is likely to have enough patients to stay busy. The health funds, however, exert pressure to keep the cost of service delivery down, so dentists working within these structures face barriers to maximising their hourly or monthly income.

The health fund/dental market is extremely concentrated, with BUPA and Medibank each controlling 30-40% and the rest divided amongst the rats and mice in the industry. How is this all going to work out? There are certainly lots of questions.

First of all, a practice strongly associated with BUPA or Medibank would seem to exclude a great swathe of the market for potential patients. Only 40-50% of Australians have health care with dental benefits, so a practice which limits itself to just 30% of only about half of the population now sees only about one Australian in seven as a potential customer.

I'm sure there are lots of different ways to look at this, but for my money I'd be nervous about handing so much influence over my professional life to the sort of company which has absolute discretion to make changes which might be very much to my detriment.

5. HIGH-TOUCH MANAGER/BUILDERS

I think this category has just two significant players. There's Pacific Smiles Group, run by Alex Abrahams, and my company, 1300SMILES Ltd.

From the outside, our companies appear similar in many ways. We're similar in that we're both focused, long-term dental practice builders. Our practices generally operate under a common brand, and our marketing and administrative functions are centralised. We've both been operating in our present forms for well over twenty years.

Both of our companies also trade on the Australian Stock Exchange. 1300SMILES has been listed for more than ten years now, while Pacific Smiles listed just over a year ago.

The similarities between our two companies could cause you to overlook two important differences.

The first difference is that Pacific Smiles has adopted a roll-out model. The company does not acquire existing dental practices but rather pursues a plan to open several large new greenfield sites each year. The company recently confirmed its plan to complete eight to ten new centres in the 2016 financial year.

In contrast, 1300SMILES takes the view that it can add value both by acquiring existing practices and by establishing new ones where suitable opportunities exist. While we would always like to do more of both, we are absolutely committed to ensuring that every single addition to our network meets the strictest financial hurdles. We'll always walk away before we'll lower our standards.

As if to demonstrate the dangers of dealing with the health funds, Pacific Smiles recently reported that "...two of the three centres acquired from Medibank failed to meet expectations..." It's certainly not up to me to explain what's going on within Pacific Smiles, and you can of course invite Alex to explain what he's up to at another gathering.

The second major distinction between Pacific Smiles and 1300SMILES lies in the sharp difference in the emphasis the two companies place on preferred provider relationships with the health funds.

As many of you would know, 1300SMILES allows dentists great latitude to manage their own careers as they see fit. If some of our dentists quite like the idea of health fund work, we certainly won't stand in their way. Dentists within 1300SMILES are free to choose the degree to which they take health fund dental work. The rate ranges from 0% for some of our dentists up to rates as high as 50% for others.

While we don't do anything to make it difficult for our dentists to take health fund work, we're careful at a practice and at a corporate level to avoid the important potential conflicts which can and will arise between health fund operators and dental practitioners of any scale.

In stark contrast to our approach, the roll-out approach pursued by Pacific Smiles seems to lean heavily on the company's preferred provider status with health insurance providers. While I can understand how the flow of patients from a health fund would seem to reduce the risk of major greenfield expansion, I suppose I would place more weight on the potential risk which would seem to come along with this dependence.

THE FUTURE OF OUR INDUSTRY

A few years ago no one would have predicted either the Global Financial Crisis or the end of CDDS, yet these two events proved to have more impact on our industry over the past few years than any other factor.

As we look ahead, we have to try to figure out where the big changes, the surprises, and the volatility will come from.

At the top of my list is the fact that the relationship between the big health funds and the dental industry is still evolving and could deliver some startling changes. We have to remember that the health funds are far, far larger than their dental operations and we could well see major shifts in policy which are inexplicable from a dental point of view but which might make sense at a corporate level.

Any such surprise change will have to be absorbed by an industry which is already under significant pressure. We're already dealing with an oversupply of new graduate dentists and the long-lingering effect of the end of CDDS three years ago.

My key insight to the future is that we're more than likely facing a period of increased volatility. Government at the state and commonwealth levels still seem to have no idea how dentistry fits in with the health care system. I don't expect any important policy initiatives from any level of government, but we've all been surprised before.

The health funds aren't finished with us yet. Remember that just a few years ago the health funds were keen to sign you up as a preferred provider. Since then they've become far more picky and demanding, and confer preferred provider status much less often. Plus they've moved on to dominate many dental practices, either operating their own clinics or effectively controlling facilities which are closely tied to a single health fund brand. They've gone from needing our services to competing with us.

Health fund behaviour will be driven by events in other industries and other countries. Their policies and actions will sometimes make no sense to Australian dentists. We all just have to be prepared for a world which might not make sense.

At 1300SMILES we have experience dealing with industry shocks and I think we've proven that our exceptionally strong core business helps us deal with surprises as they arise. From where I sit, there are other players in our industry who would seem to be considerably more vulnerable to industry volatility.

Dr Daryl Holmes BDSc (Hons)
Managing Director

ABOUT 1300SMILES LTD

OVERVIEW OF THE COMPANY'S BUSINESS

1300SMILES Ltd owns and operates full-service dental facilities at its sites in New South Wales, South Australia, and in the ten major population centres in Queensland. The company continually seeks to expand its presence into other geographical areas throughout Australia. It does so both by establishing its own new operations and by acquiring existing dental practices. The administrative and corporate offices are in Townsville.

1300SMILES enables the delivery of services to patients by providing the use of dental surgeries, practice management and other services to self employed dentists who carry on their own dental practices. The services provided by the company allow the dentists to focus on the delivery of dental services rather than on the administrative aspects of carrying on their businesses. The dentists pay fees to the company for the provision of these services under a Dental Service Agreement with the company. In some circumstances the company also employs qualified dentists.

The dentists who use the company's services range from new graduates to experienced dental professionals. Several dentists who use the company's services have special interests and experience in such areas as endodontics, oral surgery, implants and periodontics and cross-refer work to other dentists who use the company's services.

The company provides comprehensive services in the areas of marketing, administration, billing and collections, and facilities certification and licensing to all participating dentists. The company also provides all support staff, equipment and facilities, and sources all consumable goods using the buying power which derives from such a large group of dental businesses.

FUTURE DEVELOPMENTS

The company's core objective is to continue to increase profits and shareholder returns while providing a rewarding environment for our staff and the dentists using our facilities.

The company aims to achieve a combination of organic growth in its existing locations and the addition of new practice management facilities.

The key drivers for future growth of the company are:

- Increasing profits by attracting more dentists to our existing facilities and expanding those facilities which are already at full capacity;
- Assisting dentists who already practice within the 1300SMILES system to increase their turnover and income through benchmarking, training, and mentoring;
- Establishing new practices in existing and new regions (greenfield sites);
- Acquiring substantial existing practices where we can do so on favourable terms; and
- Managing dental facilities owned by others.

DENTIST ENQUIRIES

Owners of dental practices who are interested in unlocking the goodwill value of their businesses (or freeing themselves from all the management hassles) are invited to contact Dr. Daryl Holmes, Managing Director, on +61 (7) 4720 1300 or **md@1300SMILES.com.au**.

Qualified dentists who wish to know more about joining one of our established facilities are encouraged to contact Dr. Holmes directly or email **dentalcareers@1300smiles.com.au** or visit our website **www.dentalcareersaustralia.com.au**.