

Dental Support Organizations

A SMART GROWTH INVESTMENT IN A FRAGMENTED MARKET

By Brian Buebel and James Nugent

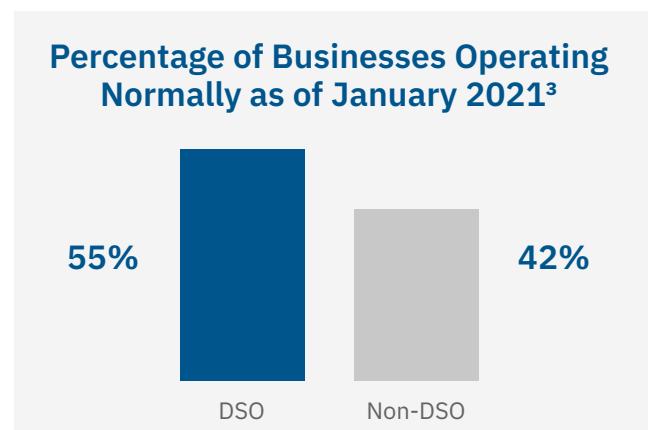
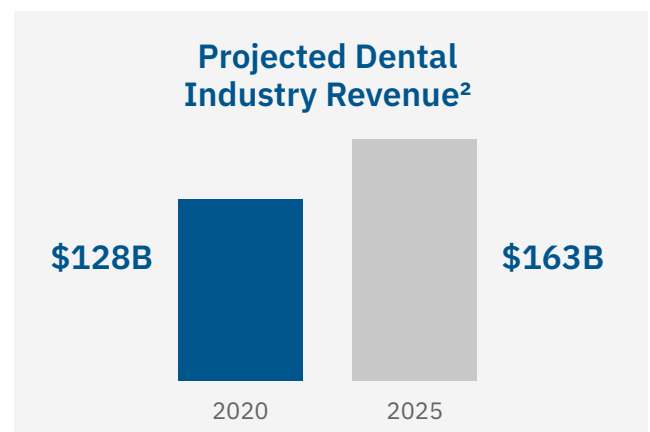
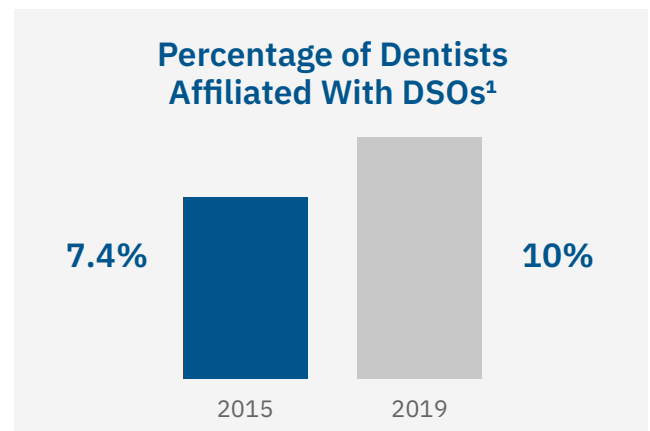
Dental support organizations (DSOs) offer potentially lucrative investment opportunities, but all transactions are not created equal. To strike a successful deal, investors must identify DSOs that have strong alignment with dentists, provide quality support services on a consistent basis, and have a clear and achievable growth strategy, whether driven organically and/or by acquisition.

DSOs by the Numbers

The DSO model is gaining traction in the market because it offers substantial benefits for patients, practitioners and investors. DSOs provide dentists with better access to capital and efficiencies of scale that allow them to leverage new technologies and best practices. This equates to less time spent on administrative responsibilities and more time spent seeing patients. For patients, that means better care, and for investors, enhanced profits.

DSO Defined

DSOs provide nonclinical support to dental practices, allowing dentists to focus on patient care.



Expert Interviews

Huron asked three industry experts to share their insights on the challenges and opportunities of DSO investments.



Doug Brown

Executive Committee Member and Former President, Association of Dental Support Organizations



Michael Lindley

CEO, D4C Dental Brands, LLC, a portfolio company of Cressey & Company



Eric Salzo

Partner, Waller Landsen Dortch & Davis, LLP

“The emergence of the DSO model came at the right time. They started gaining traction in the mid-1990s when dentists were graduating with hundreds of thousands of dollars of student debt, making it difficult to open a standalone practice. Over the last 20 years, the business of dentistry has become incredibly complex and highly competitive. To succeed alone, dentists must have financing and understand the nuances of marketing and reimbursement. If that’s not you, affiliating with a DSO may be your best option.”

— Doug Brown

“On its face, it’s an outsourcing model, but that’s not what makes DSOs tick. It’s more than just duct taping practices together. They bring professional management, operational efficiencies and capital to the dental industry.”

— Eric Scalzo

The DSO Model

Some of the services provided by DSOs may include:

LEGAL

- Risk Management
- Insurance
- Legal and Contracting
- Compliance

HUMAN RESOURCES

- Talent Management
- Recruitment
- Business Development Support
- Total Compensation Benchmarking Administration

FINANCE

- Payroll
- Accounting
- Billing and Collection
- Financing and Capital Management
- Budgeting
- Accounts Payable

OPERATIONS

- Marketing
- Information Technology
- Office Administration
- Centralized Call Center
- Equipment Management
- Vendor Management
- Scheduling
- Purchasing

CLINICAL CARE

- Clinical care, quality assurance and peer review are all managed by the dentist, not the DSO.

“DSOs are a great place to invest. But you have to be careful about the business you are investing in.”

— Doug Brown

Growth Opportunities for Investors

DSOs that are well capitalized by private equity (PE) sponsors with strong balance sheets are well prepared to acquire and integrate other entities, whether stand-alone practices or other DSOs.

OPPORTUNITY:

Acquiring Distressed DSOs to Sell Assets

“For lenders looking to turnaround a distressed DSO, there may be an opportunity to sell off assets to local players that fit into smaller networks. Individual practices may be worth more as one-offs in certain cases.”

— Michael Lindley

OPPORTUNITY:

Purchasing Individual Practices

“If practitioners are retiring early and not going down a DSO pathway, that allows existing DSOs to pick up market share.”

— Michael Lindley

OPPORTUNITY:

Merging Small DSOs

“Large DSOs will not be able to move the needle by continuing to purchase one-off practices. To really make an impact, they will need to start acquiring smaller DSOs.”

— Doug Brown

OPPORTUNITY:

Finding the Right Mix of Specialties

“I expect we will see continued diversification of DSOs into specialties (endodontists, oral surgery, etc.) and that larger DSOs will begin to backfill their general dentistry DSOs with more specialists.”

— Eric Scalzo

Questions for Investors Vetting Potential DSO Acquisitions

The decision to acquire or merge with a DSO is a serious one, and investors should seek the answers to these essential questions before cementing a partnership.

LEADERSHIP ALIGNMENT

- Are dentists aligned to the future vision for the organization?
- Is the governance model sustainable, flexible and mutually beneficial for both dentists and investors?
- Is there a model for quality control, training and peer review?

MODERN TECHNOLOGY

- What technology assets (equipment, dental lab, information, etc.) does the organization already own?
- What technology assets do they need to be competitive and provide the best care?
- What investments are required in the near term?

GEOGRAPHIC LOCATION

- Is the organization geographically positioned to do well in current and adjacent markets?
- Is the organization in the right place to get the right payor mix?
- Are there opportunities for growth in the organization's area?

GROWTH PROFILE

- Does the organization have a strong growth profile?
- Can the practice add services and grow market share by investing in new technology and expanding specialties?
- Does the organization have a plan for and pipeline of potential acquisitions (individual and group)?

FINANCIAL PERFORMANCE

- How has the organization performed financially over the last several years?
- How have dentists managed the financial performance of the organization including the compensation and capital structure?
- Are there service mix opportunities?

STAFFING CHALLENGES

- Is top talent available for key roles and positions in the market in which it operates?
- Does the organization have high turnover or other indications of staff dissatisfaction?

Potential Challenges for Investors

Despite ample opportunities in the DSO space, investors must strategically sidestep a few common challenges to ensure success.

CHALLENGE:

Contracting and Legal Concerns

“DSO investors have to make sure all contracts work for both parties because, in times of trouble, you often turn to documents that were signed in good times to find they were drafted without potential downsides in mind. This leads to conflict.”

— Eric Scalzo

CHALLENGE:

State Regulations

“Some states are welcoming DSOs and others are putting up roadblocks so as to minimize disruption in the dentistry space.”

— Doug Brown

CHALLENGE:

Lender Engagement

“Growth opportunities abound, but lender engagement may impair investors’ abilities to execute on growth.”

— Michael Lindley

CHALLENGE:

Dentist Collaboration

“You need to be sure you can trust the dentists to understand the DSO’s business model, deliver great care and have some sense of business acumen.”

— Eric Scalzo

CHALLENGE:

Market Saturation

“Some DSOs are building a system of 30 to 40 practices they can sell to a larger DSO, but that approach is not without risk. Those with the right management, however, may do very well.”

— Doug Brown

The Future of DSO Investments

The outlook for DSO investments is bright, but investors should carefully and strategically select their targets to ensure they initiate the right partnerships. As with any other investment, due diligence is critical to confirm alignment of values and goals before the deal is signed.

As with medical practices in the mainstream healthcare space, the dental industry is ripe for consolidation and most experts agree that the gap between the number of solo practitioners and DSO-affiliated dentists will continue to close over the coming decade.

“DSOs will continue to be an attractive opportunity for investments because they are essential to American healthcare. They provide another avenue for dentists to obtain access to capital and increase access to care.”

— Eric Scalzo

“There will be an explosion of emerging DSOs run by young, smart dentists or businesspeople over the next decade, and it will be very challenging for many solo dentists to compete with them.”

— Doug Brown

“The funnel for M&A within the DSO space keeps getting bigger. The recent environment has created better visibility to the value proposition for being part of a large and well capitalized DSO.”

— Michael Lindley

1. <https://www.ada.org/en/publications/ada-news/2017-archive/march/hpi-7-4-percent-of-us-dentists-are-affiliated-with-dental-service-organizations>
2. <https://www.ibisworld.com/united-states/market-research-reports/dentists-industry/>
3. <https://surveys.ada.org/reports/RC/public/>



huronconsultinggroup.com

© 2021 Huron Consulting Group Inc. and affiliates. Huron is a global consultancy and not a CPA firm, and does not provide attest services, audits, or other engagements in accordance with standards established by the AICPA or auditing standards promulgated by the Public Company Accounting Oversight Board (“PCAOB”). Huron is not a law firm; it does not offer, and is not authorized to provide, legal advice or counseling in any jurisdiction. Huron is the trading name of Pope Woodhead & Associates Ltd.

21-4004