

Is Smart Money Stupid?

BY TIMOTHY A. BROWN

I read an interesting item the other day from my friend Dr. Milan Somborac, who is the owner and founder of the Monday Morning Millionaire. He related how the Chinese government continues to release positive economic news, but there are a number of statistical references that suggest otherwise. One was a satellite map showing industrial activity. In recent years, the industrial activity via the satellite proved to be substantially more vibrant than the most recent picture. To say industrial output is increasing (when satellite imagery suggests it is not) could be a misunderstanding or it could be misinformation or it could be a lie.

There are a raft of leading indicators that the Chinese government rely on internally to gauge economic sentiment. One of these bellwether metrics is the number of people that return to work after a national holiday. Leading commentators on the subject have questioned the official press releases disseminated by the Communist party and stated that these numbers are down, significantly down. It suggests that the government may be releasing numbers pertaining to the economy that are not true. Would you believe that a communist government could do that? I certainly do.

Now let's jump back to Canada and look at our unique situation in the Canadian dental industry. Can the numbers tell a different story, depending on who releases them?

Recently, I read an article from one of my competitors that suggests the average dental practice will trade for between 6 and 7 times it's normalized (purified) earnings. I do not disagree with that finding. However, the writer went on to suggest that when 10 or 20 practices agree to combine that the same ratio of earnings will no longer apply and that those practices when combined could sell for 12 to 14 times their earnings. My question is this: Do you think that big money with sophisticated advisory circles is willing to pay twice the value as compared to an independent, hands-on owner/operator dentist?

If big money is so smart, why are they prepared to pay twice the earnings just because the practices have already been

bundled up to 10 or 20 in total?

I understand that transacting in medical practices can be laborious and expensive work. I should know, this is what we do. Everyday! This said, I would credit corporate accumulators with more fiscal responsibility than may have been suggested in the aforementioned article. It seems to me that this bucks the trend of sound economic theory. Normally we get a discount for buying in bulk and benefit from economies of scale? Corporate responsibility is something that a board and its executive obligate to their shareholders. Is this not

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what a sophisticated team of analysts and corporate development executives wield, prior to and during an acquisition?

Whoever has the numbers at their disposal can use them to fit their agenda. In a true arm's length open market scenario the "invisible hand" will always do its work. Adam Smith, observed this force on demand and supply and it is no less relevant today than it was almost 250 years ago. Brokers, such as our firm, are always championing the highest multiple that the market will bear under a number of circumstances, including the free flow of capital be it private equity or bank debt. The number of qualified purchasers is arguably what is most significant. It is the emotional interplay that only this exposure allows that can yield a black swan event and further push the range.

At present, Canada has an oversupply of purchasers and an under supply of vendors, which is proving to be one of the longest running, seller's market in history. This market phenomenon usually ends badly and when competing buyers pay foolish premiums, doubtless a leading indicator of a bubble that will burst.

Yes, 6 to 7, and maybe even 8 times earnings in some instances is normal,



rational and probably where the market is and should be at this particular time, given all other economic influences in the market as we see it.

With a large private placement comes a mandate to spend and a desire from your

investors to see the needle move. Private equity is certainly not without its checks and balances and if the purse strings appear to be loose at this time, believe me, if there is any arbitrary expenditures, accountability will be swift and unflinching. Real practice values are something that are organic and earned through the hard graft and sacrifice of individual practice owners. It is not something that can be contrived in the nonchalance of a quick merger and some creative corporate structuring. With the proliferation of private money looking to benefit from the medical practice market it should be interpreted as the precluding actions to a market correction. The eventual balance of supply and demand will cause both a drop in prices and a decline in profits. You don't need to take my word for it, trust in the eternally relevant writings of Adam Smith. He is yet to be proven wrong.



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