On The Legal Side

Navigating Transactions with DSOs in the Current Market

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In today's evolving dental practice landscape, Dental Service Organizations (DSOs) are reshaping the market for mergers and acquisitions (M&A) and practice expansions. While traditional doctor-to-doctor sales remain common, DSOs are increasingly involved in transactions, bringing a new level of complexity requiring attention to legal, financial, regulatory, and operational factors.

Understanding DSOs and Their Offerings

DSOs focus on providing non-clinical support to dental practices, thus allowing dentists to focus on patient care while leveraging DSO resources for greater operational efficiency. Typical services offered by DSOs include:

- HR and personnel management
- Financial oversight (billing, payroll, collections)
- Marketing and business development
- Purchasing and capital expenditures
- Real estate and lease management
- Legal and compliance support

This range of services can attract practice owners seeking growth or an exit strategy, particularly for larger practices.

Key Considerations in Dental M&A Transactions

When selling to a DSO, completing a traditional doctor-to-doctor sale, or partnering with another practitioner, planning each transaction step carefully is essential. Here are some core aspects to consider:

1. Due Diligence: Preparing for a Sale

Regardless of the type of deal, proper organization and preparation are crucial. Buyers will scrutinize finances, patient demographics, regulatory compliance, leases, and employment and billing law adherence. For sellers, thorough preparation can ease the process. DSO transactions, however, demand even more intensive due diligence, as DSOs are often represented by national law and accounting firms with stringent review processes. When representing a buyer, we stress the importance of a comprehensive due diligence process, ensuring knowledgeable professionals support clients to minimize liability post-sale.

2. Valuation and Deal Structure: Maximizing Value

The methods of valuing a dental practice differ significantly between traditional doctor-to-doctor transactions and DSO deals. Doctor-to-doctor valuations often use gross receipts with weighted averages, while DSO valuations typically apply EBITDA (Earnings Before Interest, Taxes, Depreciation, and Amortization) multiples. DSOs tend to offer higher valuations, supported by private equity capital, but these offers come with certain trade-offs.

Traditional doctor-to-doctor transactions usually involve full cash payment at closing. DSOs, however, often use a mix of cash and equity, with a portion of the payment tied to future performance (earn-outs) and continued seller involvement, generally requiring a five-year commitment post-closing. For those seeking a faster exit, a traditional sale may be preferable.

3. Legal Agreements: Protecting Interests

Legal agreements form the backbone of any M&A transaction, covering the essential terms and protecting both parties. Key documents typically include:

- Purchase Agreement: outlines transaction terms and obligations.
- Real Estate Contracts: includes leases, lease assignments or real estate purchase agreements.

- Employment Agreements: These agreements specify compensation, schedule, termination rights, and non-compete clauses for dentists staying employed post-sale.
- Equity Agreements: DSO deals may involve detailed agreements for any equity the seller receives.

A thorough Letter of Intent (LOI) addressing these details can prevent issues later. DSOs often present complex, detailed agreements (up to 90 pages) designed to protect their interests, requiring sellers to both understand and negotiate effectively.

Challenges in DSO Transactions

While DSOs offer resources, potential financial advantages, and reduced administrative burdens, they also come with unique challenges. Cultural misalignment is common when transitioning from independent ownership to a corporate setting, with DSOs typically enforcing specific policies, HR protocols, technology standards, and vendor requirements that may feel restrictive to long-time practice owners.

Moreover, the employment commitment—often five years or more—required by many DSOs can be a sticking point for those nearing retirement or seeking shorter commitments.

The Strategic Appeal of DSOs

Despite these potential drawbacks, DSOs remain an appealing option for various types of practitioners. For retiring dentists willing to stay on temporarily, DSOs provide a structured exit strategy with potentially lucrative returns. For owners of large practices, DSOs offer the financial resources to make purchases unaffordable for individual doctors. Growth-minded practitioners may find DSOs' resources, capital, and expert personnel beneficial for scaling their practices beyond what most individuals can achieve alone.

Preparing for a Successful Transition

Whether considering a DSO partnership or a traditional sale, preparing early, understanding market dynamics, and securing expert legal and financial guidance are essential to a successful transition. Each route—DSO or individual buyer—has unique benefits and challenges. My advice: start early, plan, stay informed, and consult with experienced professionals to make the best decision for your future.