



Coronavirus Update #3 (3.22.20) *The Short Window of Value*

We will not bore you with CV statistics updates as the media has that well covered. However, as the dental practice value world changes, we have distilled some important points to consider below.

Operationally, we are in uncharted waters. The ADA has never recommended a national shut down of dental practices. In the value world, we believe transactions will resume once the shutdown is complete and that 2020 will end up being the last time, for a long time, to achieve practice liquidity at rational values.

The world has changed and those who monetize in 2020 will be almost as happy as our grateful clients who completed transactions in 2019 and as recently as March 16, 2020. We have a window and it will only be open for a short time. Transactions will resume shortly after the shutdown and you will want to be one of them. Diversification and liquidity will be very valuable in 2021 and beyond.

Operational Suggestions

- 1) Track your CV related expenses in a separate line item on your P&Ls. These may include employee support payments, direct costs related to shut down, etc.
- 2) Keep answering the PHONE – Reschedule appointments to the first week you are expecting to open. Get the schedule full – even work overtime (5 days not 4 or 3). Worst case if you don't open you can reschedule. This will also provide for Emergency Care. If you are not there to treat emergencies you may lose that patient forever.
- 3) Treat Emergency Patients – Production, Good patient relations.
- 4) Teledentistry – Numerous platforms can provide this and now more than ever is generally accepted.
- 5) Email – Messaging at this time is important to your patients. Send an email to your patients letting them know what you are doing and how your practice can still be reached.
- 6) Lower Your Overhead – non-essential personnel – if you can afford to keep them at 100% do so, if not, some is better than none and they will thank you forever. Take a hard look at your expenses and rethink the money you may be wasting on things that are not working.
- 7) Facebook/Instagram – Post a COVID update for your patients – tell them your available for emergencies – your office will be calling to reschedule non-essential appointments.
- 8) Employee Communication – If your office is not open or operating with a skeleton crew, get on a conference call every couple of days – keep the team together. It costs nothing FREECONFERENCECALL.COM.
- 9) Use this time to update your financial reporting so that if you decide to pursue a monetization strategy, you will be prepared.

Future Practice Value

We have talked to dozens of IDSOs this past week about their plans for transactions currently under a Letter of Intent (LOI), meaning on the path to closing, and about their post crisis interest levels. (LPS has over \$200,000,000 of transactions in this phase at the moment.) The larger, legacy IDSOs with hundreds of practices are focusing on triage at their primarily shut down practices. The smaller IDSOs and the eager new entrants into the industry have less current carnage and are thus more focused on what happens next in the acquisition world.

Virtually all transactions in process as of March 16 will be postponed until after practices reopen. Many already negotiated transactions will be restructured to include an earn out component to accomplish two things:

- 1) Achieve the agreed to initial value of the transaction, but provide protection to buyers that practice performance rebounds to pre-crisis levels in the year subsequent to a transaction.
Example: Transaction occurs now at originally agreed value based upon Trailing Twelve Month EBITDA, with a portion of the value paid at closing and another portion deferred until one year after closing based upon achieving pre-crisis levels. In other words, clients will get the agreed upon Xx EBITDA, but it will be based upon future EBITDA, not the crushed EBITDA inclusive of the shut down period.

The reasons for no price renegotiation are illustrative of the quality and long-term view of the right IDSO partners: *“We are trying to create a long-term partnership. We do not think it begins a relationship off on a good note if it starts with us trying to squeeze doctors for a lower price. We would rather keep the overall value the same, but tune the structure to protect us from excessive risk. Not adjust the price, the structure. We believe this builds immeasurable goodwill with our new partner doctors.”*

- 2) Many doctors will take the position that they will revisit a monetization event after the impact of the shutdown has washed through their Trailing Twelve Month (TTM) earnings, and thus revisit a monetization in 2021 or 2022. THIS IS A MISTAKE.

By providing 2019 values, albeit with different structures, buyers can still attract great doctors with 2019 values well into 2020. By 2021, we expect a return to traditional structures, but at lower values due to fewer buyers and general economic conditions. Fortunately, dental will still be an attractive area for investment, there will just be fewer buyers and far more sellers.

Now Not Later

Upon reopening, we expect many of the IDSOs to resume the completion of transactions with structures that are tied to performance rebounds measured AFTER closing. Given the pent-up patient demand, for a while, this will be good for doctors.

We strongly believe that the emotional, “return to normal” expectation by buyers and doctors will make 2020 the best year for values for many years into the future. The risks of a new administration with higher tax rates in 2021 will result in 20% lower net, after tax proceeds.

The potential for long-term economic damage from the shut down and the bailout will potentially reduce values for two or more years. The remainder of 2020 is the nine-month window to achieve the highest practice values for years and perhaps decades.

In addition, the number of practices available will increase dramatically in late 2020 and 2021. The doctors who declined to monetize in 18, 19 and 20 have now suddenly realized that diversification of assets is important and that predictable practice income is not guaranteed. Doctors will also grasp that an IDSO transaction can provide not only diversification with cash in the bank, but also a partner with which to weather future storms.

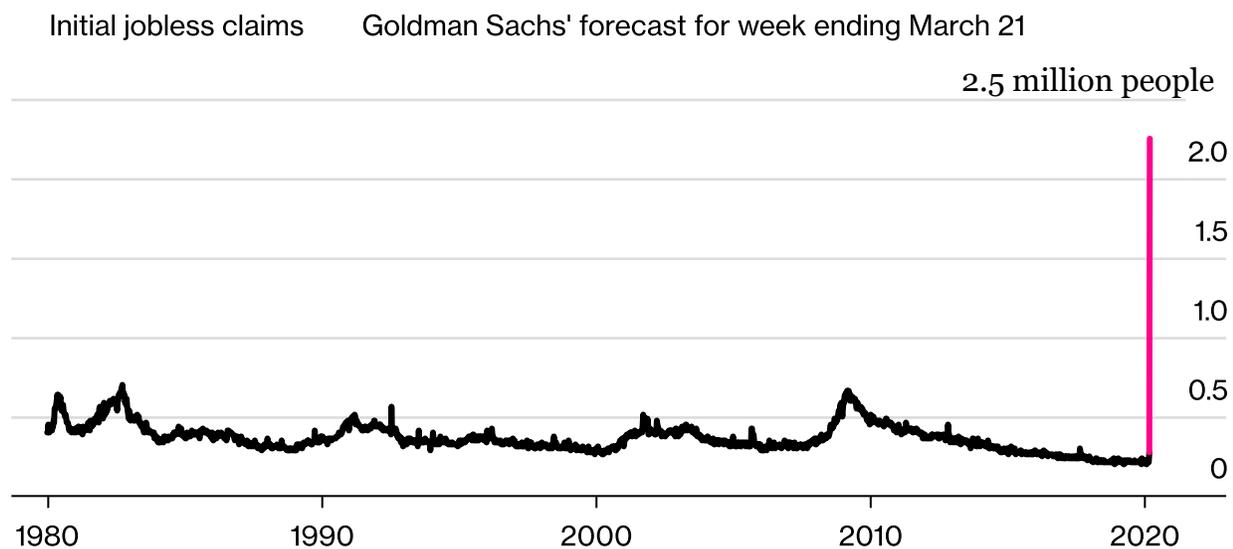
The former doctor's response to the LPS value estimate of: "THAT IS NOT A HIGH ENOUGH VALUE, I WILL JUST WORK ANOTHER 7 YEARS AND GET THE SAME AMOUNT OF MONEY" is no longer true. The world has changed. Liquidity will be king.

In the future, practices may be illiquid as they were in 2008 to 2012 with few exceptions. The 2020 crisis is far larger than 2008 as it will abruptly DEPRESS GDP and unemployed millions of U.S. workers in a matter of weeks, not years.

A week ago, Goldman Sachs predicted Q2 GDP at a 14% decline. By Friday it was a 24% decline. J.P. Morgan is now forecasting a depression starting in Q2. They optimistically forecast a short duration due to the resumption of normalcy in Q3. But just using the D word is unprecedented. We think they are optimists...But we have a window for great practices through the end of 2020.

Unprecedented Wave of Layoffs

Coronavirus effects expected to throw millions out of work



Source: Labor Department, Goldman Sachs