Industry Perspective: U.S. Dental Practices
Industry overview

The U.S. Dental Practice industry has proven to be quite resilient throughout the economic recession, having registered positive revenue growth each year from 2002 to 2010.

In 2010, U.S. dental practices recorded a collective $107.6 billion in revenue, up 1.8 percent from the prior year, driven primarily by continued favorable demographic trends, improvements in technology, and heightened consumer awareness of the importance of oral hygiene to overall health.

Industry revenue is forecast to reach $130.0 billion by 2016, representing a compound annual growth rate (CAGR) of 3.2 percent from 2010 to 2016. Growth should be fostered in large part by the increase in the number of individuals who will have access to health insurance beginning in 2014 under the Patient Protection and Affordable Care Act.

The industry is highly fragmented, with an estimated 154,000 practices in the U.S. in 2011; however, the increasing cost to outfit practices with the latest technology, coupled with the soaring cost of dental education, has deterred many dentists from owning and operating their own practices.

As a result, the number of practices owned and operated by dental management practice companies (DMPCs) is projected to rise, as DMPCs help to spread capital and operating costs across multiple operations.

Industry Revenue

<table>
<thead>
<tr>
<th>Year</th>
<th>Revenue ($ in Billions)</th>
<th>YoY Change (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2002</td>
<td>$89.3</td>
<td></td>
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<tr>
<td>2003</td>
<td>$90.3</td>
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<tr>
<td>2004</td>
<td>$94.4</td>
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<tr>
<td>2005</td>
<td>$96.8</td>
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<tr>
<td>2006</td>
<td>$98.4</td>
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<tr>
<td>2007</td>
<td>$102.4</td>
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<tr>
<td>2008</td>
<td>$104.7</td>
<td></td>
</tr>
<tr>
<td>2009</td>
<td>$107.6</td>
<td>3.2% CAGR</td>
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<tr>
<td>2010</td>
<td>$109.9</td>
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<tr>
<td>2011F</td>
<td>$111.8</td>
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<tr>
<td>2012F</td>
<td>$116.6</td>
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<tr>
<td>2013F</td>
<td>$121.8</td>
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<tr>
<td>2014F</td>
<td>$125.9</td>
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<tr>
<td>2015F</td>
<td>$130.0</td>
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<tr>
<td>2016F</td>
<td>$130.0</td>
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</tbody>
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2011F Revenue composition

- Examinations: 20.0%
- Radiographs: 20.0%
- Caries treatment: 18.0%
- Cleanings: 18.0%
- Oral surgery: 8.5%
- Fluoride/sealant application: 8.0%
- Periodontal disease treatment: 4.5%
- Prosthodontics/orthodontics treatments: 3.0%

Source: IBISWorld
U.S. Dental Practice Industry

Key Industry Drivers

Number of people with private health insurance

- Private health insurance coverage lowers the out-of-pocket costs to individuals for health and dental services.
- While lower costs tend to drive demand for dental services, the fees collected from dental insurance carriers are often less than those charged to other customers.
- The number of people with private health insurance is forecast to increase during the five years to 2016, particularly in 2014, when a health insurance exchange will be initiated as part of the Protection and Affordable Care Act (PPACA).
- The exchange will create a more organized and competitive market for health insurance by offering a choice of plans, establishing common rules regarding the offering and pricing of insurance, and providing information to help consumers better understand the options available to them.

Per capita disposable income

- Although health insurance pays a portion of the cost of certain dental services, a majority of the overall expense remains the responsibility of the consumer, particularly in the case of elective procedures such as tooth whitening and cosmetic orthodontia.
- After declining for the first time in 17 years in 2009, per capita disposable income rose a modest 0.45 percent to $33,025 in 2010.
- Disposable income is forecast to grow at a 1.6 percent annualized pace through 2016 (compared to the 2.0 percent annual pace from 2001 to 2006) as the economy continues to recover from the recession.

Source: IBISWorld, Bureau of Economic Analysis
Key Industry Drivers (cont’d)

Number of adults aged 65 and older

- As individuals age, their need for dental implants, cosmetic procedures, and general dental maintenance increases.
- Between 2010 and 2020, the number of Americans aged 65 and older is expected to rise 35 percent compared to just a ten percent increase in the overall population.
- Increasing clinical awareness of the connection between oral and overall health is expanding the role of dental practitioners in patients’ overall healthcare.
  - However, seniors’ spending on dental care is more sensitive to income than their younger counterparts, as Medicare does not include dental benefits.

Price of nonferrous metals

- Nonferrous metals such as gold, silver, palladium, and platinum are key components in crowns, bridges, dentures, and dental implants.
- Over the course of the past twelve months, the prices of these metals have risen between 138 percent and 225 percent, as investors have flocked to metals as a hedge against global inflation and currency volatility.
- Over the next two years, global prices for nonferrous metals are expected to rise 12 to 14 percent annually, as construction activity in India and China is forecast to drive demand for these materials.

Source: IBISWorld, Bureau of Economic Analysis, Kitco
Healthcare reform includes provisions to improve the nation’s oral health, particularly that of children.

- On March 23, 2010, President Obama signed the Patient Protection and Affordable Care Act into law.
- Reform measures implemented in 2010 that had the greatest impact on the healthcare sector included increased Medicaid rebates and expansion of the 340B pricing program.
- In 2011, industry experts believe the most important development to watch regarding PPACA will be how states challenge the constitutionality of PPACA’s coverage mandate.
  - Given the historic magnitude and impact of the health reform law, the final judgment will likely come from the Supreme Court.
- Nevertheless, reform measures that will take effect and impact healthcare companies in 2011 include the implementation of a minimum medical loss ratio, the pharmaceutical tax and Medicare drug coverage cap, establishment of the Center for Medicare and Medicaid Innovation and Medicare Independent Advisory Board, and increased payment for primary care.
- There are a host of additional reform changes that will take effect in 2012 and beyond. The changes include:
  - Individual mandate requiring U.S. citizens and legal residents to have qualifying healthcare insurance coverage beginning January 2014;
  - Expanded Medicaid coverage for incomes up to 133 percent of the federal poverty level beginning January 2014; and,
  - A MedTech tax of 2.3 percent imposed on the sale of taxable medical devices beginning in January 2013.

Source: Deutsche Bank (December 2010), U.S. Census Bureau, American Dental Association
Healthcare providers continue to prepare for Version 5010 implementation deadline

- A December 2010 survey of healthcare providers showed that, while progress has been made since the May 2010 survey, many providers have not begun to prepare for the January 1, 2012 deadline for Version 5010 implementation.

- In 2008, the U.S. Department of Health and Human Services proposed the adoption of an updated standard format for electronic claims and related transactions in the healthcare industry.

- Known as Version 5010, the new standard format is required to facilitate the mandatory adoption of ICD-10 on January 1, 2013.
  - ICD-10 is a diagnostic coding system used to document procedures and diagnoses in the hospital setting while also serving as the backbone of the financial claims process.

- In the May 2010 survey, only 38 percent of respondents had a plan in preparation for Version 5010; by December, that number had increased substantially to 63 percent.
  - While this improvement is positive, the December results showed that 37 percent of respondents still have no plan at all.
    - This is troubling to experts because the initial timeline called for providers to have a defined process in place by Jan 1, 2011, allowing for a full year of testing with trading partners.

- December’s results suggest that some providers will, at best, not have sufficient time to adequately test their systems, and, at worst, not have a functional system in place when Version 5010 goes into effect.

- As it stands, after the transition to Version 5010, entities like Medicare and Medicaid will no longer accept data that does not conform to the new standards.
  - This means some healthcare providers could end up with no way to submit claims and receive compensation for their work.

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1 From the December 2010 Healthcare Information and Management Systems Society (HIMSS) semi-annual survey of 256 healthcare providers (hospitals, clinics, practices, long-term care, etc.) regarding 5010/ICD-10 readiness
Source: HIMSS, American Academy of Professional Coders, Health Data Management - 1/2011
Challenges

- Americans’ teeth are much healthier than they were 30 years ago, and this has reduced demand for traditional dental services.
- Industry growth may be limited by the growth of the U.S. population – about one percent a year – so dentists must look to other services such as preventative and cosmetic procedures to provide revenue expansion.
- According to the ADA, the average age of a practicing dentist in 2007 was 49 years.
- An aging dentist population combined with fewer incoming dentists than in prior years may lead to regional shortages of dentists.
- The industry may need to look to dental practitioners (similar to nurse practitioners) to treat patients in underserved areas.
- About 75 percent of dentists participate in preferred provider networks.
- Dentists who participate in these plans are required to accept the fees dictated by the insurer, and these fees are often lower than those charged to other customers.
- As these plans become more prevalent, dentists will be forced to contain operating costs in order to maintain profitability.

Trends

- The U.S. Environmental Protection Agency announced plans in September 2010 to begin regulating dental offices in order to prevent the discharge of mercury from old fillings into the environment.
- Expected to go into effect in 2014, the new EPA regulations would require dentists to implement mercury separating technology into their practices.
- As a result of the continued decline in the number of practicing dentists, some states are now allowing dental hygienists to perform certain dental procedures so that dentists may spend more time on more complex procedures.
- The U.S. Census Bureau forecasts a 30 percent increase in the number of dental assistants between 2006 and 2016.
- There is a small but increasing trend toward the sale of private dental practices to DMPCs, particularly those practices with specialized services.
- Practices typically sell at a value of 60 to 70 percent of one year’s revenue, although valuations are currently declining.

Opportunities

- As the U.S. population continues to age, there will be increasing demand for dental implants.
- However, this opportunity could be muted in the near term, as baby boomers may be reticent to spend on dental care given recent economic setbacks in the housing and stock markets.
- The ADA reports that Americans spend approximately $1 billion on tooth whitening each year.
- Cosmetic dentistry has risen in importance in many dental practices; more than 80 percent of dental practices offer cosmetic procedures.
- The link between gum disease and heart disease has prompted the ADA to recommend periodontal exams along with regular checkups.
- Researchers are currently studying the success of nonsurgical treatment vs. surgical treatment, which could provide new treatment options for dentists to offer.

Source: First Research, IBISWorld, American Dental Association