

To loan or to lease?

by Brian Choate and Jon Voeller

Because the popularity of cosmetic dentistry is increasing at a breakneck pace, plenty of financial institutions are now eager to provide dentists with the funding needed to obtain the latest in "extreme makeover"-enabling technology such as tooth whitening machines, chairside CAD/CAM systems, digital radiography equipment, and laser surgery systems.

But before you leap at the first offer, it pays to understand the ins and outs of capital equipment financing. Some critical questions to consider include:

- Should I lease or loan?
- What are the tax and depreciation implications?
- How will it affect the balance sheet?
- What do lenders look for?
- How do I choose the financing company that is right for me?

Leasing advantages

In equipment financing, there are two primary choices — leases and loans. Leases generally have lower monthly payments and, with less money diverted to payments, dental professionals can improve their cash flow, matching revenues with expenses. Moreover, most leases don't appear on the balance sheet as debt. Thus, they don't adversely affect ratio analyses such as debt-to-capitalization, which can be critical for dental practices that are being prepared for sale, for instance. In essence, lessees are paying for the use of the equipment rather than the ownership.

Generally, leasing terms offer greater flexibility and can be written to wrap in upgrades and services, such as maintenance. Leases can also help guard against equipment obsolescence. By leasing your equipment, you may be in a better position to step up to the very latest in technological advances as they become available. Moreover, at the end of the lease, the borrower can purchase, renew, or return the equipment, providing lessees the opportunity to maintain state-of-the-art equipment in a cost-effective manner. Leasing allows you to have the use of the equipment that makes you productive, while preserving your savings and working capital. Overextending your finances by purchasing costly equipment may deplete your cash reserves.

A loan to own

If cash flow and equipment obsolescence aren't an issue, financing may be a better option. When you finance your equipment, you will own outright whatever you purchase with the borrowed capital. Loans offer a predictable, though higher, payment schedule, often ranging between three years for information technology equipment to five years for capital equipment.

Ownership can have immediate tax advantages for you and your practice. Under IRS Section 179, up to \$105,000 of the cost of an asset can be expensed for tax years beginning in 2005. The remaining cost can then be depreciated over the remaining years depending on equipment type. This business expensing deduction will reduce your tax liability by increasing your tax deductions, thus reducing your taxable income.

To contrast, with a lease, the lessor, not the lessee, keeps the income tax benefits, including the right to depreciate the equipment's cost — although most lessors indirectly pass these tax benefits back to the lessee in their pricing. With loans, the borrower keeps the tax benefits, which includes deducting the interest expense and depreciation.

What do lenders want?

For dental practices, financing companies will evaluate credit score and debt management. When lenders start reviewing the credit worthiness of

an applicant, they begin by looking at the credit score. Credit scores are the measuring stick lenders use to evaluate the risk of the customer. The credit score is a mathematical formula developed by the credit reporting agencies to determine the likelihood of the borrower to repay the loan. Simply put, the better your credit score, the less risk there is to the lender and the better your chance that your loan request will be approved.

There are a variety of factors that affect your credit score. The amount of debt you are carrying is something to which you should pay attention. Though it does not always affect your score negatively, it is important to monitor how much debt you are carrying, what type of debt you are carrying, and most importantly, what your history is with repaying on the debt you are carrying. Another factor to consider is the length of your credit history. A longer history gives a more complete picture of your credit worthiness. Finally, each time an entity makes an inquiry on your credit score, it gets reported. Multiple inquiries give the impression that you are looking to open up new lines of credit and possibly over-extending yourself financially.

In addition to monitoring your debt, you should also have a plan to effectively manage it. It is important to review your credit report periodically to ensure that it is accurate. Always pay your bills on time to maintain an exemplary payment history. Finally, whenever possible, try to reduce credit card balances and pay off debt rather than moving it around.

Choosing a lender

When seeking dental equipment financing, one place to start is the dealer/manufacturer. All of the major companies offer financing, and many provide favorable pricing and financing. Unfortunately, most vendor financing groups only finance their own equipment, so borrowers/lessees might have to seek separate financing for their other equipment. All of them, however, have third-party funding sources that can handle more than just equipment.

Independent lenders offer both equipment loans and leases. Some may specialize in a market, such as healthcare, or a geographic region. Industry expertise gives lenders greater insight into issues specifically affecting healthcare customers and, based on this industry expertise, they frequently offer better terms and flexibility.

Ideally, the lender you choose will have industry expertise, offer a wide range of financing packages, and be committed to the healthcare industry long-term.

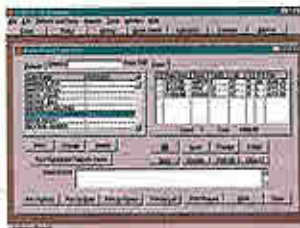


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