Ep #38: Dr. Phelps' Lessons Learned from a Failed Practice Sale

Full Episode Transcript

With Your Hosts

Dr. David Phelps and Evan Harris

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You are listening to the *Dentist Freedom Blueprint* podcast, with David Phelps and Evan Harris. Navigating you through the uncharted waters of a turbulent economy with straight-forward advice to, transform your practice into a self-sufficient cash machine, compound your net worth assets, and multiply, multiply, multiply your passive cash flow streams.

David: Hey everyone, it's Dr. David Phelps from the Dentist Freedom Blueprint podcast. Today I'd like to let you be a listener in on an interview that Mr. John Warrillow of the Built to Sell radio podcast and also author of the same book, Built to Sell. John interviewed with me about my failed practice sale; how that occurred, what happened, how I turned it around. I think you'll find this very interesting. Please, enjoy.

Hi John, it's great to be here with you today.

John: Tell us a little bit about the Gentle Dental, first of all, I love the name.

David: Gentle Dental, well obviously a dentist, private practice. Got out of school back in 1983 and associated with for a few years with another dentist, I kind of learned my clinical skills, got up to speed and then opened up my own practice; The Gentle Dental back in about 1986. Almost 30 years ago, ran that private practice for about 20 years before some things happened in life that motivated me to sell the practice. I learned a lot along the way.

John: Just give us a sense, before we get in, to what motivated you to sell. The day to day life of the practice were you the dentist that was filling the fillings, cleaning the teeth, or did you have a staff of dentists you were overseeing? Just give us a sense of the overall structure.

David: Sure, well I started out as the dentist, the one that did all the work. That's typically what we do when we go through professional practice school, get the degrees, the license is really the practice in this case is about us. That's what our whole mindset is and when you're in professional practice you tend to think to increase my productivity, to increase my profit I have to become a better technician. That's what I was about because that was the mindset, but I quickly found that if I could bring in other dentists that would help. That was part of my entrepreneurial side, I always had that side about me, even though professional practice had kind of geared me towards being this clinician. I brought another dentist, within two years of opening my own practice, I had my first associate dentist. I was pretty good with associate dentists but there is a little bit of a revolving door because most decent or competent dentists' associates want to have their own practice, so they're not going to stay with you forever unless you allow a pathway for ownership. That is something that I would probably do differently today.

I had additional dentists, I had specialist oral surgeon that came in one day a week and I had several hygienists that of course did the cleanings. You could run a practice with multiple providers and take some of the load off of the actual owner/doctor/practitioner.

John: When you say you do that differently, specifically around giving people a pathway to ownership. Can you just describe what you'd do differently if you had to do it over again?

David: Yeah, if I went back today, I wouldn't be so fearful of giving up equity in a practice. I think there's a lot of fear because, I'll just say dentists, but I think it goes off the course for a lot of professionals, could be accountants, could be lawyers. We have this practice, this baby that we grew somehow, and mostly it's about us or the work we do. We're about control, there's just a mindset about having control and if we give up something we fear that we're giving too much away. What I found, and I'll tell you more about that in my story when I sold, what I found was giving up that control actually gave me more freedom. Until I got there it was this thing that I don't want to give up anything so I bring associates in.

Now, today I would set up a pathway to let the right doctor associate come into the practice. With the right formula, the right betting process of course, allow them a pathway to have a fraction of the ownership of the practice. Maybe, do that several times, it increases the value of the business and gives you, I think a lot more freedom and gives you a potential exit strategy, if you need it. Today I wouldn't be afraid of doing that with several practices, if I was in that mode. I think buying a practice that is undervalued, maybe under-managed would be a fun thing to do because I really enjoy that part of business. Maybe today more so today than I do the actual clinical procedures, which is actually what I learned to do while I was in school.

John: If you had to do it over again, how much equity would be willing to give up for the right partners?

David: I think you could do it in quarters, you could do it in thirds. Again, if it was the right partners and there was an opportunity for me to take all my equity off of the table, and go to something else, it could be another practice or something else altogether, today I would do that. Earlier on, again, I think when you've gone through a lot of school and training that you don't want to give that away so quickly. You have sort of a guilt complex about if I did something different, or if I'm not the actual doctor providing the treatment, what did I do all this training for? Having more of business ownership mindset today is something that I think is more fun. You can still practice and do treatment for patients if you'd like to, but I'm about freedom. I'm about saying if you want to do that then do it on your own terms. You see the patients that you want to see, you do the treatment that you want to do, do it based on the compensation you think is applicable for the type of procedures and the risks you're taking on to provide it. Don't let other outside influences like insurance companies or government dictate who are and make you a commodity.

John: Tell us about the life events that led to you wanting to sell.

David: I have one child, one daughter. She's 23 today, when she was 2 1/2 years old, this goes back to that 1995 she was diagnosed with high risk leukemia. That was a major, major setback for a person like me, who I'm the character and personality I described earlier, I'm not control. I'm all about control and planning and future planning and setting everything up and the work ethic. Everything I would do to have just the right practice, the right family, the security, and build all that the right way. Bam, out of the blue comes this health crisis that I was no where prepared for than the man on the moon. It was stressful, obviously, for our family. It was very difficult to see a young child go through all of the chemotherapy and everything that goes through with that. I still maintain this attitude that okay I've got to be the financial bread-winner. I've got to go on and be strong and in the end unfortunately, that ended up in a marriage that dissolved.

That was one set-back. Eight years later after Jen and my daughter survived her leukemia, she had to undergo a liver transplant. She was in end-stage liver failure at age 12. That was due in part to all the chemo she had for treating the leukemia, but she also had seizures. She had a lot of anti-seizure medication, all that medication combined caused her liver to go into failure. Now she's at the brink, again, of a life threatening crisis. At this time, John, when she was going through the liver transplant it's not going one week and come out the next and you're done. She had a lot of complications, she was in and out of the hospital for multiple times over the following year. During that time that I pulled myself out of the practice, I had associate doctors and hygienists, so it wasn't all about me. I pulled myself out and was with her and her mom, while she was recovering for sometimes weeks at a time. I found out that the practice could actually run without me and that was a real epiphany to see that happen. It had nothing to do with my ego, I was glad to see that happen.

At that point I was really ready to unshackle the chains that I felt were binding me to this schedule. This day in and day out schedule that gave me no freedom to be with the people who I really cared about. In this case, my daughter, who could be gone in a month, the next day. I realized that the time was slipping by and I wasn't living my life how I should be living it. The way the real dream was, when I decided to go into practice and have this so called business some 30 years ago.

John: Jenna was 12 when this happened, the liver transplant. It sounds like it was successful, although incredibly difficult for you and her. You came out of that, at that point was that when you decided that you wanted to sell the business?

David: Yeah, Jenna did survive, she's doing well today. Thanks for asking. Yes, it was during the time that I was with her and I just thought enough is enough. I need to go in and sell the practice, I had developed a real estate kind of side platform, if you will. On the side in the same years that I was in practice. I had other things going on that allowed me, financially to leave. It was really a matter of just giving myself permission to do it. Yeah, I decided while she was recovering that year that I was going to make that happen. I found a young doctor, very clinically gifted, had great communication skills, very motivated in the field of dentistry. Brought him in as an associate, within six months we had come to a letter of intent terms of a sale. I was ready to pull the trigger and let it happen.

John: When you found the associate, was it your intention to find an associate that would have the potential to buy the business in the future?

David: It was, at that time it was. Prior to that time, associates that I would bring in or find it was not my intent to sell. This time it was different, yes.

John: Got it. What was revenue of the practice, revenue and profit after you brought on that associate?

David: About 1.3 million gross.

John: Got it, got it and a profitable practice?

David: Yes, yeah. I think definitely in the upper tier for profitability.

John: Got it. Tell us about that negotiation. How do you value a dental practice and did this associate have family money that they brought to the table? What was that like?

David: Yeah, good questions. I did know from previous experience with the buying another practice and merging it into mine, I had some experience with what the process looks like. I knew that evaluation was critical, there are good independent brokers and evaluators that bring that credibility to the forefront. It's not that difficult to evaluate a practice, at least the size of my practice, not that difficult.

John: What's the formula?

David: The basic formula, today, it's about anywhere from 60-75% of gross or about 1.5 to maybe as high as 2 times net. Not really great multiples, because again, these practices are typically not real businesses. They are about the technicians, the doer. You can see the difference about what we deal with in the professional arena, versus real entrepreneurial businesses that are scaled up to a higher degree.

John: Got it, so that's the formula that you use. What did you end up selling the practice for?

David: Just a little under a million, just a little under seven figures. I got pretty close to what that formula would allow for. It was fair, it was a fair number.

John: How was that structured? Was it a hundred percent cash up front? Did you take a note?

David: Yeah, well okay, so this is where the boomerang sale comes into play John. I was motivated to sell, I really felt like this young doc ... he did, he had the skills, he had been at a practice and was producing great numbers. But he didn't have the credit, he had some credit issues and ... because I'd sold a lot of real estate over the years and I had carried notes and I knew how to do that and I was comfortable with that. I thought well, I'll carry the financing 100% in this case, I thought maybe a year would do it and he could refinance me out. The problem was, that this young doc, with all the skill in the world and future potential. There was some character flaws that I, frankly, overlooked and I know I overlooked them. Long story short it was like giving the keys to a Ferrari to a 16 year old. He kind of went crazy in certain respects and I had to take the practice back through litigation. It was messy, it was very frustrating, I was angry at him, I was angry at myself. I realized, in the end, I was the one that had made the mistake. I was the one that was responsible.

John: Take us through that, when you sell your business, one formula you can use is to basically finance the acquirer. Meaning, you say okay, you can buy my business for a million bucks, but instead of giving me a million dollars cash you're going to give me x amount of money over the period of ... how many years was it, in your case?

David: Yeah, I think it was set up on a seven year payout.

John: Got it, so you're going to give me a little bit of money every month for the next seven years.

David: Right.

John: In your case, how did you determine the interest rate?

David: Whenever I do any kind of structure like this I go back to real estate. It has to make sense from a cash flow basis. Knowing what the numbers of the practice are and backing the debt service to see what this young doc would be able to achieve. Again, knowing what his numbers were, it was pretty easy. There's a range that makes sense, and honestly this was seven years ago, on the first sale. Probably the interest rate was somewhere around seven, give or take.

John: Got it. Okay, it doesn't have to be ... just roughly. It's better than prime essentially.

David: Correct.

John: For folks listening and wondering how to structure some of these things because there's obviously enhanced debt or enhanced risk, which you found out, unfortunately the hard way. We'll get to that in a moment, but just on the structure again. You're looking at the cash flow of the business, you're saying every year we're making a million bucks on the top line we're putting to the bottom line a few hundred thousand so the business can throw off enough cash to finance this person who is getting the cash. Therefore, the owner, therefore they can send me a chunk of it every month. That's the theory, is that right?

David: Yeah, that's the theory. Whether you're financing the sale as the sale itself or that's the same thing a bank's going to look at, right? They're going to look at the same thing; is there enough cash flow at the end of the day to not only fund the overhead of the practice or the business, fund the debt service and leave enough for a reasonable amount for lifestyle overhead for this new buyer.

John: Got it.

David: Got to build that in.

John: The structure is again, getting into the mechanics here, the structure of these deals is that typically in the event of a default and the event that you don't get your monthly cash, essentially you take over ... you own the business again. Am I distilling it down in good basic components?

David: In theory that's what it is John. We have a society today that allows people to contest issues and go through a judicial process and that's what this young doc decided to do. It wasn't as easy as just saying hey you're defaulting, just give me the keys back and go on your way and it wasn't that easy ... yeah go ahead.

John: I want to get to that, but what was your first clue that you knew that something was wrong?

David: Oh, when one of the payments was not made on time. I think the first series of five, six payments came in as scheduled and then there was a payment that wasn't made. Typically, you think well something happened, maybe it got lost in the mail, whatever happened. Then the communication is not there, there's delays in communication and then all of a sudden your antena goes up and you say I need to dig deeper here. Something's going on and as I did so, that's where I found out that monies that should have been paid to myself and even other lenders wasn't happening.

John: Take us through the ligation process, what was that like?

David: That's never a pretty situation. People tend to lawyer up and unfortunately lawyers are there to provide a service but I think lawyers also are there to put food on their table. Oftentimes, they see opportunities and there's really never anybody on your side, as the way I come to see it. There's this equity, there's assets, there on the table and the lawyer is going to get in there and they're going to shuffle it around until somebody gives and says enough is enough let's get this thing settled. It just goes down a course of it could be weeks, it could be months. This took about eight months and during that time the practice is totally in shambles, mis-managed and shambles. Falling apart, the patients are leaving in droves, staff are leaving, some staff stayed because they knew I was, aggressively, trying to take the practice back. About half the staff stayed and the other half left, I can't blame them because they had to look out for their own well-being.

John: What ended up happening in the end? Did you get the keys back and what did that all cost and so forth?

David: Yeah, I got the keys back. Gosh, all in all it cost well over a $100,000, with litigation costs and just coming back in a revamping. There's always a lot of PR that has to be done to rebuild a reputation and name, it's just like the bad restaurant in town, all of a sudden they say under new management. Well, what's really changed? You really got to ... in a small community there's a lot of gossip that goes around and so there's a lot of negativity.

John: How did that impact your numbers? When you got the practice back, what kind of revenue was doing? That kind of stuff.

David: Yeah, the numbers were terrible. The revenues were down by almost 50%, I asked a practice appraiser, I said, this is more for litigation purposes and damages. I said what would the practice appraise for? He said I can't even put a number on it, because of the issues. So really, it wasn't even a sell-able practice. Maybe, just the assets, but goodwill was gone, reputation was obviously tarnished. It took a massive PR campaign and marketing. It does work, it does work. You can look at other companies in history; Tylenol, the problem they had back in the years. They proactively stepped up and took that on. You can do that, you can rebuild, even in a small community. It took a massive effort to do it.

John: Got it. Eventually, you got the practice back up to your standards that it was ... am I putting words in your mouth to say at or at a similar level to where it was before you handed over the reins the first time?

David: Here's what I had to do; I had really two choices. I could either just let it go and said I don't ever want to go back. Really, I couldn't in my heart do that. There were patients that relied on the succession of that practice that were still staff members there that ... I decided that I've got to build this back up. I didn't want to be the doc to go back in and do it. I had checked out, emotionally, from going back and being a dentist. I had to go back in for the first few months, but I aggressively, through multiple channels sought new associates as potential buyers. That was aggressive and so over about five months, I brought in not one, not two, but three associates. We expanded the hours of the practice, I went into major marketing mode.

It turned around, it probably took about 12 months to bring revenues back up to close to what they were prior to the sale. I say within 18 months we have surpassed our gross revenue prior to the sale. Within about another 12 months one of the three associates rose to the top, meaning they had the wherewithal, the leadership and they had the credit to go to the banks. This was in the depths of the recession, 2010 when bank financing was pretty much at a low and the stockbroker was able to go to the bank and get 100% financing based on his credit and the fact that he was one of the key producers in this practice and the fact that this practice was actually being run as a real business, without the owner, myself, being actively involved in it at that point.

John: What did you sell it for the second time?

David: The second time, a little bit higher than the first time. That part worked out but it would have been a lot easier if I had done it right the first time. A little bit more.

John: The second time when you sold it, did you get all your cash up front?

David: I did, I got it 100% up front so that was a much cleaner sale.

John: For folks listening and just to summarize; you had roughly a million bucks in your pocket and the risk has been transferred from you, in the original deal. In the second deal the bank that financed the new owner basically bore the risk of that debt. Is that correct?

David: That's correct.

John: Got it. You were not on the hook for any of the debt at all for the second sale?

David: Correct.

John: Wow, that's a bad story gone good. Good for you.

David: Really I look at everything in life ... and I didn't when I was early on in life. When things came up, like my daughter's health issue, or when this practice first failed John, I looked as that as why me? Life isn't fair. What's gone wrong? Every time I've gone through something like that, some kind of adversity, on the other side, as long as I preserve and take back and attitude of look something is going on here but if I just go in here and work this model something good will come out of it. The back end is that there have been so many good things that have come out of it. Besides the fact that I learned a lot about what one can really do in a professional practice to create more of a real business structure and not just be reliant on oneself to be the technician, the producer, the doer. Kind of going back to Michael Gruber's the e-myth. That's typically what most professional practices are. It's all about the owner and it doesn't have to be that way.

John: Absolutely. What has been the most surprising thing for you after the second sale? You've got this cash in the bank, has life kind of ruled out as you expected it would? Or has there been any surprises along the way since you took the check and said goodbye to your business?

David: You know, it's been all good surprises. I would say I was reticent about saying goodbye to the practice. Again, I put my blood, sweat and tears into becoming a dentist and practicing that to the highest degree I could for a number of years. I'm proud of that so it's like you're taking this hat off, it's like all of a sudden you're no longer the doctor but it was so important to me to have the freedom to spend time with my daughter. Then this freedom, besides spending time with my daughter, it allowed me to start doing things that I had given up. Previous to my life, just hobbies, other interests, other people.

John: Give me an example.

David: Yeah, I love to ski. I grew up in Colorado, even though I live in Texas. I grew up in Colorado so I love to ski. There were years where I didn't go back to ski because of just life and drained everything out of me. Working hard in the practice, my daughter's issues, the divorce, practice sales, all those things beat me down to where I just didn't feel like I had permission to go live my life. I love playing tennis, I played tennis all the way from grade school into college. I kind of quit doing those things and I got back and I started skiing, I started playing tennis again. Everything just started getting better once I was unchained to this practice schedule that dominated my life for all these years.

John: Fantastic. I got to ask, you get this big check, what's one thing, one trophy you bought yourself, one indulgence you allowed yourself to buy as a sort of success of the sale the second time around?

David: Probably not one main trophy but it goes back again to the freedom to do what didn't give myself permission to before. My father, who is currently 85 years old, so we're going back 10-11 years ago when I got that check. I said dad we need to take a trip together, I was single at the time. My mother passed away, some years prior and my dad being pretty healthy we always loved doing trips together when we were young. He helped me with Boy Scouts and we went camping together, we did white water rafting trips. I said dad we need go to do a trip. He's 75 years old but still in good shape so we took a trip to France and did a bicycling trip and it was just outstanding. In the lower valley and wine country. We had the best time, so I got to reconnect with my dad. You know, those are things we live life for and our business is really something that should serve us and our lifestyle. That's something I didn't get all those early years John. It was just about trying to create this fake wall of security that never really amounted to anything. That was really the real indulgence to create a memory and do something with my dad that now I have that forever.

John: Fantastic. What are you doing now? When you're not playing tennis, not skiing, not cycling around the Lower Valley? Are you fully retired or are you up to something new?

David: Well I'm fully retired from dentistry. I still keep my license in tact because I thought well, I could do mission trips and that's something I still want to do. Here's what happened, subsequent to getting out of the practice the second time. A lot of my friends, colleagues in both dentistry who didn't really know that I had this other side of real estate asked me, David how did you do it? How did you sell out of your practice back before you were 50? How are you making that happen? So I explained, at the same time I was in practice all these years, I was building up a separate platform through real estate. Well, tell me more about that and as I started to explain to some of my friends that this organically started to grow and today I have a lot of fun coaching consulting and I've created a master mind full of professional practice owners, primarily dentists. We've got some physicians and chiropractors, a veterinarian. That we come together four times a year and we deal with what I call the Freedom Blueprint.

That is number one, taking your practice, your business and optimizing that. Making it better, so that as long as you want to be in it, it's not solely dependent upon you. The second part is how do you build wealth outside of that business and real estate is the asset class that I love so much. I bring that together and we just have a great time, a great people in that group and it's just, to me, about changing lives and being around people that I love to be around.

John: Where do people find out about that if they're interested?

David: Yeah, John, that's it www.freedomfounders.com

John: David Phelps, thanks for your time.

You've been listening to another episode of the *Dentist Freedom Blueprint* podcast with David Phelps and Evan Harris. The place to be to create your freedom lifestyle with more time off, security and peace of mind. Please subscribe, download the podcast, and share it with others who want to create real freedom in their lives and practices.