Ep #378: Practice Transition Panel (Part 1)

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Dr. David Phelps

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Welcome to the Dentist Freedom Blueprint, a podcast about freedom—freedom from expectations of society and the traditional path to success that has been ingrained in us from our early years, I'm joined by mavericks, renegades, and non-conformers to discuss an anti-traditional path to financial freedom, freedom of time, relationships, health, and ultimately freedom of purpose. My name is Dr. David Phelps. Let's get started.

David Phelps: Hi, David here. On the next three weeks of the Dentist Freedom Blueprint podcast, I'm going to take you behind the scenes into a conversation that I was fortunate to host with a panel of experts on the title of practice transitions. Now who's this for? If you're involved in the practice of dentistry at any level, you're going to find great benefit from these conversations. You may be young in career. You may not own a practice yet. You may not even want to own a practice. That's fine. You'll get a lot out of this.

If you're mid-career and you have a practice, considering your practice, considering your options for what's next for you, this will be very relevant. If you are toward the end of your career, you're looking at how to exit from practice, again, this will be very timely for you.

On this panel, I have the pleasure of hosting, Dr. Mike Abernathy, Mr. Brandon Moncrief, Mr. Jared Duckett, Mr. Bill Ladd, and Mr. Alastair McDonald. Each week for the next two to three weeks, I'll have a segment of this podcast for you to dive deep into these conversations. Stay tuned and enjoy the first one right now.

Everybody, glad to have you here with us. I have curated a top shelf group of people. Many of you who know them, but if you don't, we'll get some introductions. The premise for today's conversation is about the marketplace and where we are in practice transitions, the buying and selling of dental practices in the marketplace today. Who is this for? I think this is for anybody who is active in any regard in the dental space, the dental industry.

You could be young in practice right now or just getting out of school and trying to figure out what's your runway. How are you looking forward? You may be mid mid-career and figuring out what's my exit going to be, even though it might be five, six, or seven or 10 years out. Well, what's that going to look like? You may be on the last stages of your career, trying to figure out right now, "Do I take an opportunity to exit? Which way do I go? What's involved?"

But just realizing that all of these transitions, all these stages in one's career, wherever you are in your stage, requires participation. It requires some level of collaboration and some knowledge about what you actually want in your life. Not to follow a model just because someone else followed a model, but what do you want? There's a lot of players here and a lot of buyers. We'll define those as we go through here to know who the players are, and then give you some pros and cons, some caveats, for those of you who are figuring out your pathway from where you are today to what your ultimate exit may be, whenever they may might be.

So on my screen right now, I have Mr. Brandon Moncrief. Brandon is the principal with McLerran & Associates out of Austin, Texas. Brandon, just give us a little synopsis again, of your experience, your history, and how you're involved today in our industry.

Brannon Moncrief: Yeah, absolutely. Thanks for having me, David. McLerran & Associates had been around for 35 years. I've been in the dental industry for 20, 10 as a banker and 10 as a practice broker. We specialize in doing practice sales, practice brokerage appraisals, and sell side representation on DSO transactions. We do about 60 transactions a year. Most of the doctor to doctor transactions we do are in Texas, and we do DSO transactions nationwide.

David Phelps: Beautiful. Dr. Mike Abernathy, the wisdom in the room right here. Your CV is so long, sir, but give us the short shrift of it, if you would. If you don't tell me the truth, I'm going to add to it. So go ahead.

Mike Abernathy: I was born and raised in McKinney, Texas, and I've owned 43 practices. I've been retired for a few years. I write and talk. As David says, I interrupt people's lives.

David Phelps: Yes. Yeah, you interfere in people's lives, but-

Mike Abernathy: That's what I do.

David Phelps: ... always in a positive way. Well, at least I see it as positive. They may not see it that way, but you're always good medicine for the soul. So I love having you here. Thank you, Mike. Mr. Jared Duckett of Duckett Ladd, again, same thing. Your background, what you're doing today in the industry.

Jared Duckett: Yeah. So Duckett Ladd, CPAs and advisors. We work specifically with dentists and also real estate as well. But really where we're seeing in the dental industry is just a lot of M&A. Right? A lot of people looking to sell a lot of DSOs, looking to buy a lot of practices. So just really work with a lot of clients as they get along the journey to make that exit, if that makes sense.

David Phelps: Beautiful. And Bill, your side.

Bill Ladd: Yeah. Jared covered it well. We like working with dentists that are on an entrepreneurial journey and every journey has a beginning and an ending point. I think the beginning point and the ending point are relevant to this conversation, David. So appreciate the opportunity to be on here.

David Phelps: Great. My friend Alastair McDonald, you, sir.

Alastair Macdonald: My story is one of different industries. Five different industries. I've had five different businesses in five different industries, landing in dentistry about six or seven years ago. So I'm probably the newbie to the industry. But had the privilege of working with some really high performing docs that brought me more into practice ownership. I've owned, bought, grown and sold a veterinary hospital amongst other businesses and was one of the founders and previously the chairman of the Dental Success Network, a group of about 1,000 docs with practices all over the world, actually. So that's what I do. I have a private client group of docs that I work with and some select individuals that keep me sharp and keep me paying attention.

David Phelps: Beautiful. Gentlemen, I'd like to start first with, how did we get to where we are now today? When I was practicing a decade or more previously, didn't have all the options for potential exit we have today. How did we get here? Where did all of the money come from? Why is private equity so interested in our space? I'll just go back to the top. Brandon, you've been around the block for a long time in banking as well. How did we get here?

Brannon Moncrief: DSOs have obviously been around for quite some time, but I would say about 10 years ago, there was a shift in the marketplace from the DSO mentality, to where they looked at providers as being extremely valuable, rather than just W2 employees. They started to give them the opportunity to participate in partnership alongside the DSO and private equities investment. Then about five years ago is when that trend started to accelerate.

So there's been a tremendous amount of money flow in to private equity over the past 10 years as the rich have gotten richer. As the stock market has continued to rise to properly balance portfolios, you've got to shift some money into private equity. So we've seen a massive amount of cash flow into private equity, and dentistry has proven to be recession proof, pandemic proof. It's a very fragmented and highly profitable industry. Industries like that gain the attention of private equity.

So with DSOs evolving in their approach to dentistry and how they support doctors, combined with a massive influx of cash, it's caused a bit of a fever pitch as far as the acceleration of growth of DSOs fueled through private equity, and then cheap bank money with interest rates being so low. We've only seen that accelerate over the past few years.

David Phelps: Yeah. Well said, well said. Mike Abernathy, you've been in the industry for many years. Certainly a leader in your own right and one who looked outside your own in practice at an early age and started finding other models. Since you've exited your practice some years ago, you're still extremely relevant, helping so many docs navigate what their options are. Give us your overriding picture of how we got to where we are.

Mike Abernathy: DSOs have been around since 1975, and there were some tax advantages that made it. But the thing that really has driven DSOs is that after about 2003, prior to 2000, it was like 98% of the graduates from dental school became owners. Now with women being around 51% of the graduates, only 32% of the females and only 67% of the males are becoming owners now. So it's less than 50% of the graduates from dental school, 6,800, last year are becoming owners.

We've never been in a situation where we had unlimited number of employed dentists. That's fueled corporate practices. They can find doctors to work there. Now with that, you have winners, you have losers. As we're filming this, we had skipped any type of financial recession for almost 12 years and that wasn't driven just by the pandemic. It was overdue. We're seeing money come in internationally from countries where banking is crashing and these people are going, "If I even get 30, 40, 50% of my money out of this, I'm willing to pay really high dollars for this." Especially in Canada. I've seen a lot of Chinese money come in, stuff like that.

So it's an interesting deal, but I think, too, not to be a Debbie Downer, but I think it's a musical chair. Music plays, music stops. One chair is removed. Some of these corporations will fail. It's a greater fool theory. Equity money comes in when there is a better than average return on their money. When you look at large, large, largest DSOs in the United States, we're seeing debt to income ratios of 8% or 9%. So I don't think that's sustainable.

So I'm not against DSOs. I think it's an incredibly good for doctors that are near their "used before" date. I really can't tell you because there's not a long enough track record on happy people on the younger doctors doing this, but we probably have maybe three a week that are going with DSOs that I'm familiar with every week. So anyway.

David Phelps: No, that's great. That's great. Hi, Dr. David Phelps here. I started my real estate investing portfolio back in 1980. Inflation was running at 14.8% and the federal funds rate was at a high of 20%. This after a decade of hyperinflation, along with a very anemic economy called stagflation. Now look where we are today. We have hyperinflation again, interest rates going up, possibly triggering a recession. Could be back to the 80s. I know how to navigate these times. I've done it. I've built my whole portfolio during times of a lot of volatility.

I'm proud to announce the release of my newest book, Inflation: The Silent Retirement Killer. I packed it full of information about how fiat currency can undermine the hard work and the wealth that you've tried to create. You've got to do things differently to protect that wealth, going forward, and the wealth generation you hope to pass onto your heirs. You can download a digital copy of my book for free at inflationbook.com. That's inflationbook.com.

Author Venita VanCaspel once wrote, "Inflation takes from the ignorant and gives to the well-informed." You want to be well-informed in this case. This is what I call a great wealth transfer. Be sure you're on the receiving side, not the giving side. Download a free copy of my book at inflationbook.com.

Bill and Jared, Mike, brought up the point with the number of female dentists that there are more employees available. Maybe also let's bring in the debt side, the debt side of students coming out and graduating as young dentists. That's also adding to the higher number that are employable. But anything else you want to. I just want to bring that piece out as well.

Jared Duckett: I think that's a great point. You guys both nailed it on the head. I'll take a little bit of what you said, Mike, is the mindset of new dentists coming out of dental school maybe not wanting to be owners. But maybe it's because of that reason, David, is they're going to look for a consistent income stream immediately to start repaying that debt because that debt load has just increased substantially.

It's not uncommon for us and, Bill, I think you'll agree, to talk to prospective clients that are looking to buy a practice and they've got $500,000 worth of student loan debt. Their thought is, "How am I going to repay that?" It's so easy to go work for a DSO and get paid X consistent rather than scrape buy and create something of your own. So I think it's a lot of that is where the DSOs have really come in. But also, Brandon, which you've said, I think private equity and big, big money have seen dentistry as that stable, profitable industry that maybe, and maybe you guys might disagree, but has been undervalued in the past. Because a lot of these PE groups look at buying other businesses at multiples of EBITDA, etc, and I think they're realizing that dentistry is very profitable, very stable and there's money to be made.

I think the opportunity, the money's there. They want the yield, but also the opportunities there because dentists, older dentists, doctors are burned out and they just want to sell. They want to get rid of it. So I think the opportunity's there with the money. It' just the perfect storm.

Bill Ladd: Yeah. I'll jump in, Jared. I agree. I'll piggyback off that last comment. I think that there is some supply there, and I think through the COVID pandemic, I think that supply has got even higher because people are tired and burned out and sick of dealing with it. It was a fever pitch in 2020. As we move into 2021, 2022, it's still conversations we're having with dentists where they're still dealing with the lingering after effects of the frustration and the staffing and some state regulations and things. They're just pushing people to exit.

It's not just Baby Boomers. These are people who are 40s, 50s that are looking at exiting. Some of them are willing to look at DSOs and stick on for a while. But most of them are wanting to move on and try to do something different. So I think that again, Brandon, Mike, Jared, and I know Alastair will bring a great perspective, too, but everything they've covered is everything that we're seeing.

I will say that we are getting a lot of people calling, looking at acquisitions, but that's a small minority to the people coming out. I think they know that going to corporate is a little bit more of a steady paycheck. At that point, that's going to be hard for them to leave that relationship even if they have an entrepreneurial bent, because they're going to have a debt load here and they're going to be looking at potentially another major debt load to get a practice. So it is something that I think that there is supply there, but the individual buyers just aren't there at this point.

David Phelps: Alastair, I'm going to give you a lot of leeway here to take what's been stated so far, which has been right on point, and take it where you want to. I will just start with a little bit going back to how we got to here. You and I have had discussions over quite a bit of period of time that we've had 42 years of declining interest rates, which is, again, is a lot of the reason already brought up here on this panel as to why there's this seeking of yield for a lot of money.

That's driven a lot of this, so I want to get your take, but also a little bit of your forecast on start looking at what could shift this. The opportunity that we have today is today. That's great for people who are ready to exit and want to do it on these terms, whatever terms they are. But I also want to give a little forecast to people that aren't quite there yet and how things could shift as they make their plans forward. So let me let you sow into this conversation, sir.

Alastair Macdonald: Yeah, thanks. There's already a lot of insight being shared. I think if we look, there's two different is going on. One is the formation and expansion and growth of DSOs, as both Brandon and Mike have pointed out. There's really only ever been two reasons for a DSO to be formed. The first was back in the day, tax benefits. The second is just simple economies of scale. We can start haggling on prices. We can get better margins, etc, etc. So there's the existence of DSOs, the preexistence, the same version inside the vet spaces, a burgeoning industry.

But there's a whole other factor entirely, which is valuations. So we've got a premise that makes sense, the economies of scale, etc, interest of tax rates, not quite as beneficial as they would've been back in the day. But none of the ease really speak to the critical piece today, which is valuations. I am of the philosophy, and I think Mike is as well, that we are very much inside of a very large hot money cycle that has poured through multiple industries.

Having witnessed this as young as a kid in third world economies watching what hot money does, one of the most endearing characteristics of hot money is it convinces the recipient that they are God's gift to capitalism, that it's because they are remarkable, their industry. You never quite understand and you get all of the attended narratives. Everybody's moving here for the lifestyle, for a local real estate boom. No one's making any more land. Mortgages never go bust. You fill in the blank. This is the narrative, the siren song of late cycle hot money. I've seen it in mining companies' execs convinced that they're special. I've seen it now in the vet space. I sold my vet practice for about 15 times EBITDA about six or seven months ago. Just preposterous valuations.

Where is this coming from, the global hunt for yield? An army of Baby Boomers who have undersaved and overspent and desperately looking for income. 10,000 of them a day turning 65 until what is it? 2038 or something. These are huge, huge headwinds to overcome. As organizations like CalPERS and all the rest of these companies and pension plans and so forth are looking for yield, they increasingly move out onto to the margins of credulity there.

So inside of all of these assumptions, including the ongoing extrapolation that DSOs will continue to be trading at preposterous multiples, is a very deeply embedded, insidious trend that, as you alluded to, David, has been there for 41 years. Because of large trends, they become insidious. They're just baked into our assumptions. No one's paying attention to trend changes. It was back in August of 2020 that David, you and I and Mike all got to be the crusty old guys in The Muppets up on the balcony, sitting there saying, "Hey, this is likely to end. What we're all paying attention to there is interest rates."

I am convinced as I was at the time, increasingly convinced, that the July 2020 lows in interest rates represent the end of a then 41-year cycle or 40-year cycle of declining interest rates. Interest rates falling, asset that are leveraged off of them, of course, increase in the same sort of teeter-totter fashion that you would expect. One goes down. The other goes up. With it, with the rise in asset, price goes a rise in expectations of future yield, future value. You know, "Ah, multiples have gone from X to Y. Therefore they'll go to Z." This is happening constantly.

It was in March of 2018 that I was at a large dental event, about 600 or 700 docs. I was making the case that we're very late in the cycle of these ridiculous multiples. At the time, there were 15 or 16 times EBITDA. I was using examples of hot money in different sectors. Those that were choosing to listen chose to hear that this is late in the cycle in the equity market. That's not where dentists have to worry about. They have to worry about their practice valuation, especially if it's a large part of the nut that they're going to use to fund their future income needs. At the time, that was the high water mark. One individual I know did a deal at 17 times. This is astounding. Those people were buying losses amazingly.

Now fast forward to today, and we're seeing five, six times for those same practices. What's changed? You would think that suddenly there's 2/3 less teeth in a human skull. Well, that's not the case. You would think that suddenly there's been a 160% increase in the number of practices or dentists. Well, that's not true. What could possibly justify it is the departure of hot money. I think that those July 2020 interest rate lows are crucial for us to anticipate the future valuations.

All valuations are a relative trade. Everything is a relative trade. This hot money is saying, if we could get 10% in a profitable practice, give back 3% as a management fee. We're taking the 7% yield. When rates are, excuse me, when corporate bonds are 3% or 4%, that's a good trade. But when those interest rates get to six or seven, why would we want to deal with dental practices and OSHA and legal oversight and click sell? This is what worries me. I think it's still out in the future, but it concerns me.

David Phelps: Yeah, well said. So let's take currently today what the market's giving us, and those who are on the precipice of, in a position where they want to sell, they can sell if they get a certain valuation and a certain after tax date on equity.

David here. I'm sure you found a lot of key takeaways from this first segment. Next week, we'll jump into segment number two of this conversation with these experts, really focusing on taking chips off the table. Partnerships, pros and cons, DSOs, private buyers, and what to do with the money, the capital gain that you take off the table. Where do you put it? A lot of considerations here in looking at next week's episode. Jump back in and we'll take it from there.

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