Practice Sale Options and Liquidity Events - What You Need to Know - Bob Winder: Ep #409

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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: Good day everyone, this is Dr. David Phelps of the Freedom Founders Mastermind community and the Dentist Freedom Blueprint Podcast. Today, I'm looking forward to a conversation with Mr. Bob Winder.

Bob is the president and founder of Logan Growth Advisors, a mergers and acquisitions advisory firm that specializes in healthcare.

He began his career in growth strategy consulting for Fortune 500 companies. And later worked as a private equity investor and raised his own fund and purchased a group of dental practices, which he ran and sold.

His extensive experience on all sides of M&A, mergers and acquisition transactions, Bob founded Logan with an emphasis on partnering with founders to build and maximize value through M&A. Bob majored in finance at Brigham Young University and earned an MBA from Northwestern University.

Bob is also an adjunct professor at Brigham Young University and Utah State University, teaching private equity investment banking. He's also an avid CrossFitter, proud father of five children.

Bob, it's great to have you here today.

Bob Winder: Great to be here, David. Thanks for having me.

David Phelps: Let's jump right in. The evolution of private equity backed dental models; this was not a thing really at all when I was practicing.

Now, I date myself a little bit because I left practice back in the early 2000s and there really wasn't much on the scene there. But things have changed in the last two decades immensely. And private equity is all over the place today. What caused these model to evolve?

Bob Winder: That's a great question, and it has evolved a lot over the last two decades. When I was in private equity a decade ago, we were really, really excited about investing in dental because it was more recession-resistant.

Coming out of the last recession, we thought, “Well, we need to find places to park our money that can still grow at a steady clip, but that's really safe.” So, this flight to quality, moving away from more volatile investments to safer, more stable investments in healthcare and dental.

So, a lot of money pursued those more safe kind of flight to quality investments. Dental had been consolidating for a long time before that, but I feel like coming out of the last recession is really when it became invoked for Wall Street.

There's a lot of ways to win here, there's a lot of aging doctors that are looking to retire and have a path to retirement. So, there's the way … the biggest piece of how this model works for private equity, it's called multiple arbitrage.

So, that's a key term that I love to teach my students. I challenge them to use that term in their circles over the weekend and we'll come back to it.

David Phelps: Yeah, regular conversation. Bring it up wherever you can.

Bob Winder: Yeah just bring it up. Multiple arbitrage. You're going to sound amazing. I love this term. So, from a private equity standpoint, the concept is let's buy, let's invest in a platform, a bigger group of dental practices that has a management team, that has systems and processes that we feel I can quickly scale.

It's a true company, so you might have to pay a double-digit EBITDA multiple. So, EBITDA is kind of a proxy for cash flow. All these get valued based on multiple EBITDA. So, call it a 10x.

Back when I was in private equity, a 10x multiple was kind of the big benchmark multiple. Wow, this is a 10x deal. You'd have to pay up to get in the game and pay to play to get in the game.

But then you could go and you can buy these onesies and twosies single doc practices for like three or four times. And that's where this multiple arbitrage comes in.

Because you might buy $500,000 of EBITDA or pretax cash flow, and now, you merge that in with your bigger platform, and immediately, that same EBITDA went from being worth three times, it's now worth 10 times. So, immediately you get a 3x gain just by making an acquisition. It's financial engineering.

So, in private equity, we love that concept because there's so many opportunities to acquire and merge in and growth through acquisition that we felt like there's a lot of runway here. That was 10 years ago and I felt like maybe we had a five-year window before the market became too picked over. But it's just as prevalent today if not even more prevalent.

David Phelps: So, this is your area and my area of finance is much lower level more in real estate. But multiple arbitrage, does that not always require another buyer at some point? I mean, we go with the stack. And I guess eventually, is it a public offering, an IPO? Is that the ultimate exit?

Bob Winder: Most likely. So, we have a big DSO in Canada that's public, but we don't have any in the U.S., but a lot are talking about it. So, what's happened is you have the small private equity funds invest, and then they grow the platform up and they sell it to the next private equity. And then the next and the next.

There's multiple layers, there're tiers of private equity until ultimately, you get with their big boys, the KKRs, the Blackstones, the Apollos and there's nothing bigger than that. I mean, maybe some sovereign wealth funds that want to hold onto something for a long time.

But apart from those really wealthy families or sovereign wealth funds, it's really going public. So, we have quite a few dental groups, big DSOs that are kind of flirting with that concept now. I anticipate over the next five years, we'll probably have at least one if not multiple big DSOs that have gone public in the U.S.

David Phelps: And it's also worked as you go up the chain to sovereign wealth families, KKRs, Apollo, that they have so much capital that they are looking for a smaller but obviously, predictable, call it safe or less risky return on capital. Is that what makes that work?

Bob Winder: Yes, exactly. So, bigger is better generally speaking, and bigger seems to be less risky. So, the more offices that you can aggregate together through the law of large numbers, kind of like insurance. You feel like if you have a bigger pool of policyholders, any one of them can have an issue.

But if there's a big enough pool, it's going to reduce the risk of the overall group. Same thing in healthcare, same thing in dental. The more you can aggregate — one or two offices might get sick or might have an issue or might have doctor turnover, or something, but as a whole, you're okay.

Whereas, if you just have concentration to a few offices and some key big producers, if one of those individuals gets sick or something, now, the whole thing can go south. And I had that experience when I owned my handful of offices with a dentist partner.

We had a key doctor leave, and we were in a world of hurt. So, the whole idea is this bigger is better aggregation, which I don't always agree with the bigger is better, but that's generally what the Wall Street world believes.

David Phelps: Yeah. With the economic and capital market volatility we have today globally, interest rates going up, how do you see that or how has it, in your opinion, in your work, Bob, changing the dynamics of the multiples or the structure of the deals being made? Can you give a little insight of what we're seeing there? What the trends are right now?

Bob Winder: Folks are somewhat on our heels right now. We don't really know what the future holds. Everyone's crystal ball is pointing in a different direction. And so, we've seen the mega deals, the really, really big healthcare and even non-healthcare deals. That market has started to dry up the mega deals.

Because that's largely dependent on getting a lot of leverage in addition to the equity investment leverage buyout. So, leverage meaning debt. So, with the debt market's getting squeezed, that's squeezing that whole market.

We haven't really seen much of a slowdown in appetite for the mid-market or even the lower middle-market deals, especially add-on acquisitions. So, 20 years ago, 15, 10 years ago, there was a plethora of these add-on acquisitions buying for three or four times.

Well, now, the market's been more picked over and there's more savvy dentists that know that they can get more for their practice so they're holding out to get bigger multiples, better terms. You've seen multiple evolutions. DSO 1.0 was, “Hey everyone's an associate and there's only a couple owners, and private equity kind of runs the show.”

And then DSO 2.0 came along and said, “Well, let's let all of our key doctors have ownership, and they can ride this wave together and participate in some of that arbitrage.”

And then you see DSO 3.0 come more recently where, “Hey, let's let some of the doctors have ownership in their specific individual practices or a sub DS0 model, and like a joint venture where they can still get distributions on what they own. And when we go trade to the next private equity, now they can sell some more of their shares at the local level at the much higher multiple. So, they get a lot more of that upside.”

So, we're seeing folks get a lot more creative to compete to get the best talent, to get the best doctor talent. So, all of this is happening at the same time with all the economic headwinds and the rates, and it's just creating a lot of confusion.

Because you have so many folks that are still really aggressive, they want to grow, they want to partner, but now, the debt market's really squeezing everybody and not really knowing where that's going to go in the future.

So, I haven't seen much of a slowdown per se specific at our lower middle market size range due to the rates more than anything I've seen a slowdown because of the squeeze from inflation.

So, a lot of doctors, their margins have been squeezed because of inflation or not being able to staff. And so, just not being able to see as many patients as before, and so their EBITDA hasn't grown or maybe even has contracted this year.

And more from a doctor's standpoint, they say, “Hey, this isn't a good year for me. It's a down year,” and the rates haven't come up as fast as inflation has. So, almost the whole market's getting squeezed to some point.

David Phelps: Interesting you bring that up because you're right, is the squeeze with inflation and the high labor cost if you could even get the labor today.

So, when doctors are at the point where they really would like to hang up a hand piece and exit, but they have had a year where their EBITDA is falling short of what their target would be based on the potential multiples they might exit with today, what's your advice?

I mean, I know it's going to depend on different situations and, I guess, the motivation for why they would want to be leaving. If it's a health situation or something else, then obviously, there's a stronger push. But just somebody that's like, I'd like to kind of hit the timing of the best exit, but right now, I feel like there's a squeeze.

Would you tell somebody well, just then ride it out a little bit longer and mean I don't know what's going to happen. You don't either. With cost and labor, I mean, we hope it gets better, but right now, it is what it is.

Bob Winder: I'm never one to tell someone that they should try to time the market. My ability to time the market is not very good and I don't anticipate that many people are much better at timing the market.

So, my advice is let's look at your lifestyle and what you want to accomplish. If you are enjoying what you're doing, practicing dentistry, owning your practice, you feel like you don't have too much administrative burden, then just keep doing what you're doing, and you're always going to have great opportunities.

There's always going to be folks that are eager and willing to purchase your practice or purchase a part of your practice or have some type of merger. It really needs to be on your terms. A lot of folks that come to me, and they say if you can accomplish three things, then a transaction makes all the sense in the world.

Number one is if you feel like you have most of your net worth tied up in this illiquid asset, your business or your practice or group of practices, and you feel like, geez, at any point something can go wrong, I could get sick, et cetera, and I'm losing sleep because of that, I sure would like to diversify my net worth a little bit. Yep, makes a ton of sense.

Number two, but I still want to have upsides. I still want to participate, I still want to be a leader here, and I want to have upsides. But I don't want to take all the chips off the table, I still have fire in the belly and some more runway, I'm not ready to retire. So, is there a way I can structure a deal or a partnership such that I can take some chips off the table but still have a ton of upside in the future?

And then number three, remove some of the administrative burden off my shoulders. I'm wearing so many hats, I'm chairside, I'm producing, I'm managing other doctors. I have to deal with all the administrative issues and business things.

It sure would be nice if I could have partnerships that could alleviate me from some of those burdens and I can focus on the things that I like that I'm good at and that add the most value.

So, those are the three things that folks usually come to us trying to solve. And there's a lot of ways to solve it and there's a lot of groups and potential transactions that can solve those three.

So, I'm less-concerned with specific timing of the market and more concerned with let's have it your personal timing, when does it make sense for you when you feel like your business is in a good position, and hopefully, you're more in control of that.

If you feel like your business is in good position, you're growing, you have a good EBITDA, you have a good organization. It's going to show well to investors, figure out a way to thread the needle to accomplish those three things.

David Phelps: And I would think Bob, if you partner with the "right" (and that's the key word) buyer that even if your practice is not hitting the numbers that you would ideal like to hit right now, but you find the right partner, then the different types of structured buyouts can be …

So, as you said earlier, you can still have a joint venture where you still have equity in your practice. You could have stock ownership in the parent company. You could still ride this and still take some of the burden of management and HR off your plate.

And if you're still viable and you still enjoy the ride, then making the right move at the right time with the right person, the right buyer could make a lot of sense.

Bob Winder: That's a really good point. Yeah, you don't necessarily need to maximize every single dollar today if you feel like you're in a good partnership, then you have upside. And there's two ways that upside is structured.

One is through an earn-out. So, you could say, “Hey, this is a down year because of inflation, but I really believe that next year is going to be better. How about you give me X percentage of the purchase today, and then hold the rest for next year, maybe over the next 24 months, and I'll prove to you that I can get back up to kind of pre-pandemic levels, and then it's this contingent earn out piece.”

And those, I've seen that a lot, and it's a great way to kind of skip the price that you want but have to work for it and kind of earn it and prove it, and a little more in your control.

The other way I see is through that rolled equity component of, “Hey, I still own a meaningful stake in this, so I'm not selling at a hundred percent, and I believe in the partners that I'm working with, they're going to help me grow.”

“They have access to capital that I can't access on my own to do acquisitions or de novo practices or add more operatories or other growth initiatives. And potentially they have other networks help me recruit doctors," which is so difficult to do today. And then just by removing some of that administrative burden, I can focus more on the things that add the most value and we can all win together.

So, that's a really good point. Sure, you want to maximize value today to the extent possible, but you still … there's a lot of meat on the bone in these partnerships. Virtually nobody's doing full buyouts and you can just walk away. Or if they do, it's a really low multiple.

Bigger multiples come from this partnership approach where you're tied in, you're going to continue to work and invest and really have a partner for 3, 5, 7, 10 years. And so, thinking through this, not when you're 65 but maybe 50 or 55 — hey maybe it's time to start thinking about more of a two or three step sequence to retirement to maximize your multiple and your output by planning ahead.

David Phelps: So, if you find who you think is a good strategic buyer and you're looking at that longer game because you can together create more cash flow, more EBITDA, more value for down the road, but what happens typically, Bob, when your buyer consolidates and sells to somebody else.

Am I the seller that's staying on the practice? Am I going to be susceptible to cultural change that was good when I first sold but now, it's changed? What's my risk there?

Bob Winder: That's a real risk. Absolutely. So, you may partner with a smaller DSO that has a lot of the same DNA, same chemistry and really feel like hey these are good partners, I love to work with these guys.

But ultimately, who has a majority control equity position of that DSO that you partner with? Most likely private equity and they've got a three-to seven-year hold period that as soon as you grow to a certain threshold, they're in the business of flipping businesses and making money on business investments based on growth.

And so, there are some family offices or longer-term hold investors, but the vast majority of private equity is kind of a five-year hold period and then sell it.

And so, a lot of times they'll sell it to a bigger private equity and the culture probably won't change a whole lot because these are financial investors that aren't super involved in the operations.

But to the extent, they sell it to another strategic, another bigger DSO, it's an acquisition, they're going to acquire the smaller DSO, and they're going to implement a lot of their systems. And so, the culture could absolutely change it at that point, and you don't have a lot of control over who it's sold to in the future.

David Phelps: What are some of the attributes that would make my practice more viable, more attractive to a potential investor buyer?

Bob Winder: There's a few key things. First is size. How much revenue, how much EBITDA? These are folks with their Excel spreadsheets and their calculators that are looking at numbers. And so, the numbers are the biggest thing they look at, EBITDA is number one.

Number two is payer mix. Folks are afraid of customer concentration. In this case, it's payer concentration or the government, and they can change things quickly. We call it stroke of the pen risk.

So, there's a lot of pediatric Medicaid groups that we work with that do really well and they serve a huge need and I love what they do, and there's a lot of benefits for pediatric Medicaid, but a lot of investors view a lot of risks associated with pediatric Medicaid.

I doubt there's going to be a politician that's going to commit political suicide and do away with children's dental benefits. They worry about that. They have this parade of horrors and conjure up these horrible scenarios.

I don't think that's realistic, but they can make your life difficult; more pre-authorizations and changing the fees and different groups are included or they're not.

There's just a lot of administrative complexity and burden associated with Medicaid. So, there's a subset of investors that just won't touch Medicaid, and that will bring your value down just because it's not as frothy and active of a buyer market.

The third is the doctor. So, we're working with an oral surgery group and the doctor has hired associates and is no longer practicing and is overseas and the associates have some equity, but they have a long runway, they're younger. That's fantastic.

Because there's not this big transition risk where if it's a 65-year-old who is the main producer, what's going to happen after he now owns 30% of the practice versus a 100%, probably doesn't have a ton of runway left.

So, maybe we're not going to have as much value there. Versus if you've kind of thought through a transition and now you've got associates around you, you're no longer kind of the main producing most of the production.

You have other folks surrounding you — that kind of reduces the risk, that transition risk. So, that can help a lot as you kind of think through how to maximize the value of your practice.

David Phelps: So, today, Bob, what are some of the key considerations that a potential seller needs to be aware of in a mergers and acquisition transaction like we're talking about today?

Bob Winder: There's a lot of structures that are really confusing and not easy to identify when you partner with a strategic or even a private equity. So, cash is king, it's really easy to understand how much cash you're getting at close.

But the deferred component, whether it's an earn out or it's reinvested equity that you're hoping to realize an investment on the next sale or the next exit or the next bite of the apple.

There's just a lot of nuance there that it poses some significant risk to doctors and I don't want to say that the equity guys are looking to take advantage of, but you need to have someone looking over your shoulder to make sure that those are structured.

So, a couple pitfalls examples. One, if you're working with an equity group, if they put their equity in a preferred class that's preferred over your reinvested equity, then they get all their reinvestment paid out first before you get anything.

And sometimes, they do what's called a “participating preferred” which is kind of this trick that they like to play where they get all their money paid back and then it gets double counted, and they still own that percentage of the common equity even though they've already been paid back.

So, they're essentially double counting their equity. They like to play those kind of tricks. It's just the nuance of the wording. They won't tell you this, and they'll say, “Oh this is the market, this is really common.” But no, it's not. There's ways to be pari-passu common, we're all in this together.

Strategics, what they love to say is, “Hey, partner with us, we're trading for 15 times, sure we're going to buy you for five but imagine what you're going to be worth when you're trading with us at 15 times. Isn't that great?” And they'll make it sound really good.

But then if you think about it, you say, “Okay, well, 30% of my proceeds I'm going to reinvest with you guys at this 15 time-multiple. So, you're buying me out at 5 and I'm taking a portion of my proceeds and I'm buying it at 15, so I'm immediately diluting myself 66%.” That's crazy.

So, that's why this DSO 3.0 concept of keeping your equity down at the local level, reinvesting at the same price that they're purchasing with, and then you can trade up and get that arbitrage versus getting diluted. There's just a lot of nuance like that that you got to be careful of.

David Phelps: I think the bottom line is then, is that there are a lot of opportunities for the right person, right place. There's a lot of pitfalls if you don't know what you're doing. And that's certainly why I a hundred percent agree you need to have somebody in your corner that can help walk you through this and look at the nuances. Because it's a world that no doctor or dentist has entered except maybe one time in their life and that's the time you've got to get it right.

So, how does Logan work with docs that are just interested in even considering am I at a place, is my practice something that could be offered to the marketplace? What's the starting point? How does that work?

Bob Winder: We start with a lot of education. This doesn't need to be a black box. I'm a professor, I love to educate. So, let's just walk you through the different frameworks, the different concepts, how these deal structures typically work.

And then, if that sounds interesting, let's do an upfront financial analysis. We call it a phase one. Let's just look at your financials. Let's look at your financials through the lens of private equity.

And I say private equity because they're the guys making the decisions, whether it's a private equity buyer or bigger DSO. At the end of the day, it's the private equity guys doing the numbers.

So, we put on our private equity goggles, let's look at your practice through their lines. Let's look at the numbers, let's do that analysis, and then we'll tell you what we see. And a lot of times, it's, wow this is really fantastic. They're going to love this.

I don't want to say we do a full valuation per se, but we'll tell you kind of this is likely what the market will yield if we took this to market and shopped it to hundreds of different buyers creating an auction process where you have a lot of the leverage.

Or we might say, "You know what, there's a few things that we identified that you could probably tweak to make improvements." It might make sense to really focus on that right now in XYZ practice.

The collection ratio is 82% and the other ones is 97%, the average is 95%. You've only looked at the average. Whereas in this one practice, the collections are way down because we just weren't looking at it on a practice-by-practice basis.

Let's work on that specific practice, get it up, and then we can pro forma the difference and get you a $500,000 EBITDA add back or increase. We don't have to wait for a full year to dramatically increase your output.

So, it's just good to do that analysis and just look at your business through that lens, which you probably haven't had the opportunity to look at it that way, just have third party experts come and do that analysis and really help you see your business through that lens.

There may be a lot of opportunities to improve or maybe you're running your business fantastically, but either way, just understanding kind of where you stand and what your options are is really, really helpful.

David Phelps: I'm sure like anything Bob, with the timeframe to get something done, of course, there's again a lot of variables, there're things you need to do or should do to optimize areas in the practice that could be optimized or sometimes could be leases or just lots of things of things that you'd have to look at.

But range of time. I mean are we not talking about a year today, over a year? I mean, what's kind of a … if you had to ballpark, this is a process that it's not going to happen in three months typically unless everything was just aligned, everything was … probably that's too short. I mean, it just takes time.

Bob Winder: Yeah, it takes time. And we've come into situations where a funder says, “Hey, I really need to transact quickly.” And we'll say “Okay, we do the quick work, take you to market in a month or two. Do the quality of earnings, the light financial audit, put together a really robust PitchBook and CIM (Confidential Information Memorandum). And then go pitch it to hundreds and hundreds of investors and we can get a deal done in six months. We hustle.

But it is really nice, like you're saying, just to have a little more time, be more thoughtful and deliberate; let's get all of the contracts in really good order. Let's take a hard look at our expenses.

Is there anything that we're spending on that we really don't need to. Maybe this year, I don't want to be Scrooge. But maybe this year we don't throw a really huge elaborate Christmas party.

Because that might cost you one times in the actual event and then 10 times when we go to market. So, you might be paying for that Christmas party 11 times.

David Phelps: Do it in January.

Bob Winder: Exactly, right. But it's just being thoughtful and careful. A lot of folks come to me and they say, “Hey, I've heard that private equity, they want me to have a call center and they want me to have an in-house biller. So, I've spent the last year just banging my head against the wall trying to build all this corporate infrastructure. Now, my EBITDA tanked because I spent all this money."

Yeah, it's kind of a sad story. Like don't run your business because you think that's what private equity wants. Run your business to produce cash flow and to do really good work for patients. And private equity, they're going to love that. Why? Because they love EBITDA.

So, don't conjure up in your mind that you need to change your business because that's what someone else wants. Just run your business how you know how to run your business and do a great job.

Be compliant. Don't take shortcuts. Don't pay patients' Medicaid to come to your practice. Don't do dumb stuff that isn't sustainable. But other than that, don't get too caught up in, "Hey, I need to put lipstick on this, I need to hire the guy from Harvard because the private equity guys went to Harvard, and they're going to love this."

No, just run your business how you know how to run your business. And that's what they want. They want you to have conviction. They want you to have a successful business with your brand on it, the way you run it.

David Phelps: So, I'm thinking from my perspective, I don't have a practice anymore. I've been there, done that, sold mine a number of years ago. But if I were in practice today, I would, even if I thought it might be 5, 10 years before I was going to sell, I think it would be wise — and I hope I'm not setting you up for more calls than you want.

But I would want to contact you and just have you look at things. Well, you never know what you might learn that could be done. The optionality of knowing what you could do, I think would be worth it.

So, I'm just kind of setting things up, like reach out, get help. Get advice. Get some insights. Get some education. Even if you don't think you're going to be selling for some time. Because just being prepared is better than sitting back and waiting until the time when you feel like you need to do something.

Bob Winder: Absolutely. Just knowing the playbook; here are my options. Here's what's important. More time to think through that and kind of craft and build towards a better outcome, that's just smart business.

So, whether it's today or in 10 years, really understanding what your options are, what the market is doing and what's important to them. That's a really valuable lesson to learn as quickly as you can.

David Phelps: Bob Winder, Logan Growth Advisors, I really appreciate the time today. I enjoyed the conversation. You are a wealth of information and I learn something every time I get to talk to somebody who's smart like you. So, I know our listeners achieve and obtain the same thing. Thanks for your time.

Bob Winder: Been great. Thanks David.

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