Deciding Whether to Sell—and How to Sell - Perrin DesPortes: Ep #486

Full Episode Transcript

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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: Good day, everyone. This is Dr. David Phelps with the Freedom Founders Mastermind community and the Dennis Freedom Blueprint podcast, here today to talk a lot about the opportunities and options and the risk factors with practice exit transitions. The market has changed immensely in just the last 18 months.

What you don't know will probably hurt you. What you need to know can really help you. And today you'll be pleased to interview with me, my guest, Mr. Perrin DeSportes. Well, ladies and gentlemen, this is a fun thing for me to get to do because I've been able to bring some of my greatest mentors and peer group thought leaders to our group here for the next several weeks and doing some of these recordings with them, it's really my privilege and really privileged to have someone of the means, the tenor, the experience that our friend here today, Mr. Perrin DeSportes has. Perrin, thank you so much for giving your time to the cause here today.

Perrin DesPortes: David, it's my pleasure. I always enjoy spending time with you. Anytime that the David Phelps phone rings, I'm one to answer it. So looking forward to today's discussion for sure.

David Phelps: Well, I appreciate that. And like some of the other people that I've brought to the forefront here, you bring your own unique but very deep experience in really all things dentistry and we can give a little bit of that

background because I think it helps for people to know, well, where did you come from?

Did you just like jump into dentistry because dentistry has had all these great multiples in the last couple of years? And I know that's not the case at all. Well, first of all, let's just talk about the company as it exists today, Polaris Healthcare Partners. And let's give us just a broader review of what you and your partner Diwakar set out to kind of what your mandate is, and then a little bit of your history, and then we'll dig into the conversation today.

Perrin DesPortes: Yeah. Happy to do it. And I'll try to keep it brief. So Diwakar Sinha and I are the two co-founders of Polaris Healthcare Partners. And Polaris is a multifaceted firm. We have what I call the consulting side of the business where we help entrepreneurial dentists and healthcare professionals build group practices.

We also help them devise ways to bring associates and executives into the ownership structures of those businesses. All of our clients are what we call doctor-founded and debt-funded. And that's a fancy way of saying that these are entrepreneurs who happen to be healthcare providers who want to build a multi-location group and they want to use bank funds to do it.

So all of our clients that are in the growth side of our business are looking for banking solutions to continue to buy or build locations and obviously bringing associates into the ownership structure of those businesses is critically important because it creates stability and a continuity of care and also creates continuity of cash flow.

At some point, most people, most clients will say, “Hey, Parris, I think it's time for me to take some chips off the table. I've built a really valuable business. I'd like to maybe exit outright or do a partial exit. I'd like to bring on a capital partner from an equity standpoint.” And so we represent those clients as a sell-side advisor in a private equity-based transaction. Could be a majority

sale, could be a minority sale, could be a lot of different structures involved with it.

But we have the two sides of the business: the consulting side and the sell side advisory side of the business.

David Phelps: And so as I, well, let's also give you your background ‘cause I don't want to miss that. You come from a family business that was involved in dentistry generation prior, give us that a little bit of history. It's interesting. And how that merged with Patterson and then why you didn't stay with Patterson. It's all part of the story.

Perrin DesPortes: Sure. Sure. So you could say that I was born into the business almost. My family owned a dental distribution company called Thompson Dental Company that was headquartered out of Columbia, South Carolina.

And the business was started in 1899, believe it or not, by my great-grandfather, James Perrin Thompson in Charleston, South Carolina. I was fourth generation in the business. When I came to work for the family company back in 1995, my father was president and CEO, and my grandfather was chairman of the board.

it was a business that had, I think, 14 sales offices from Baltimore through Orlando, was on a run rate to do about a hundred million in sales, 100 billion in revenue, the year that we elected to sell the business to Patterson, that was in 2002. And we elected to sell the business, not for what I would call operational reasons.

And candidly, not really for financial reasons, but due to poor equity transition planning on behalf of my grandfather. My father has two sisters, and my grandfather's estate on his ultimate demise was going to be share and share alike. So David, I'm not a math major and I'm really not that bright, but I can kind of do the math when two people who don't work in the business, neither

do their husbands or any of their children want to get their money out of the business. It was a valuable enough company that there wasn't going to be a way for my father to buy them out. And so really the only course of action was to find an acquirer for the business and the two logical choices would be Patterson or Shine, the two publicly traded companies in the space.

And it ended up being that Patterson was a better fit both geographically, philosophically, and from a background. We knew a lot of the people at Patterson, and it ended up being a great transition for the vast majority of the employees. I ended up having, I think, a pretty decent career.

I stayed with Patterson for 15 years and I ran three different businesses for them. And I always tell people that I wish I'd had a little bit longer to work for my father versus the seven years that I did. And I didn't miss out on too much, but I just would have liked a little bit more time maybe.

But at the same time, I probably wouldn't have learned all the things that I did at an enterprise level, running those businesses for Patterson. They gave me a lot of responsibility early on at 31 years old. I had full P&L responsibility. I turned around a couple of branches in the last branch that I ran.

Charlotte won a handful of awards the last, four out of the last five years that I was there. So, I'm grateful for my time at Patterson, and they were really, really good to me, but mid-career, mid-forties, I started thinking I didn't want, I didn't have another 20 years in me to do that. I wasn't going to move to Minneapolis to take a job with a corporate office.

And so I pulled the ripcord and became a full-fledged entrepreneur and that's worked out pretty well too. So I'm grateful all the way around.

David Phelps: Great. Very good. All right. So I want to focus a little bit more so today on your sell-side advisory, and but also, as we've spoken in the past, with that sell-side advisory, it's different, I would say, and you would say as well, than a conventional practice transition broker.

And that is you love to do, which I love too. When I work with my clients, I love to be on a consultative side before we start figuring out, well, what's the strategy for whatever we're doing? What investments or that kind of thing? So let's start there. Let's talk about really define the avatar for someone who might come to players, come to you, and say, “I'd like to get some help with looking at my opportunities or my options. I might want to sell my practice,” and that could be one solo practice, but with a certain revenue, a run rate, or it could be a group practice that doesn't want to grow anymore, right? So let's define that and then let's talk about why consultation is something that you really want to make that the pillar of where things go next.

Perrin DesPortes: Yeah. I mean, it's a good question. And I love the fact that you even prefaced it by saying if you came to me and said that you're thinking about this, you're already in the right direction with it. I think all too often people who own businesses and dentists are no different. They reach a point of finality in their mind where they've had a bad week or a bad year, a bad day or something like that, and they just kind of throw their hands up and they want to be done with it.

And that's a really bad position to be in as a business owner. If you want to transact your business, transition your business, it is a very forward-looking type of set of decision criteria. We don't work with traditional solo practices. So think, you know, ADA average 750,000 in revenue or something like that.

These are businesses that would value in such a way that a young associate can probably qualify for the amount of funds necessary from a bank to buy out a senior seller at that point, and it can be a point of finality in terms of their transaction. That being said, I think we're seeing a lot more business owners now that have larger footprint, single locations that generate 2, 3, 4, 5 million in revenue, some of them that are much larger and generate a lot more than that.

These are not traditional solo practices and they value much higher than that. So when somebody comes, and for that reason, they value at a level that a

bank's probably not going to loan the money to any individual buyer to buy out that senior founder, right? So now we have a little bit of a question in our mind about how do we transact the business and to whom?

So the first thing about this is if you own a high-value solo practice or a multi-location group, your transaction is going to be a process and not an event, and you need to approach it that way if you intend to get maximum value out of it. Nobody really wants to take a discount on their life's work. I don't think so.

If you want to get maximum value out of it, it needs to be a process and not an event. The second thing is you need to understand who the logical buyers are. And more often than not, I would say for a high-value practice or small group, it's probably going to be a private equity-backed venture. That could be a majority transaction, it could be a minority transaction, and there are pluses and minuses to both, but the likelihood of it being a bank-funded, young associate is a very tall ask. I'm not saying that they've built a business that's too valuable to be sold, but I think it takes a process to work through the specifics.

The next thing I would say is, we need to be eyes wide open about how the business values and how we calculate valuation for that type of a high-value practice and whatever it values at, what's the transaction structure? So there's some amount that a private equity-backed venture will pay in cash and probably some amount in an equity role into the parent company.

Beyond that, there are fees that are involved to the advisor, to the accountant, the attorney, and unfortunately, some taxes probably to the government as well. And most of the clients we end up working with in a sell-side advisory role have some amount of debt on the business. So when we start thinking about valuation, less taxes, less fees, and we subtract the amount you got to pay off to the bank, the question becomes, “Well, what’s left?”

And is the transaction worth actually going through the process to do? Are you going to put enough in the bank to make it worth your while? And if the answer is no, we'd rather find out about that before we're in market, before we start spending money, before we start getting emotionally invested in it, and before we have other people interested in the business that we're representing. So it could very well be, David, on the very, very front end, when somebody comes to us in the consultative approach that we say, “Hey, Dr. Phelps, we think you have a valuable business. But through our consulting lens, we think there may be a couple of ways to improve the business operationally, financially, systems, fees, profitability-wise, we think there may be an untapped potential of an additional 10 to 20 percent in this business. Wouldn't it be better if we work together maybe for six months or something to improve the business and then took it to market at that point?” And our company has sell-side advisory and consulting services so we always look at a potential sell side advisory client through the lens of consulting first.

David Phelps: Well, again, as I said earlier, I think that it's just so much wisdom. And I think it shows your experience in overall business. When I look at the same thing, what I'm in, of course I don't do what you do. I'm not in the consultation, a consultative, a basis of practice, growth or management.

I have some of my own experience, but that doesn't mean I have the ability, but I understand it. You know what we do, so what we do is we really, with our clients, we go really far upstream or you could say, well, I could say, you could say downstream, then we'll go back upstream. So we go way out and say, to your point, well, how much do I have when all this is said and done? And that's where you start. That was beginning with the end in mind and then working backwards to where we are and say, “Oh, well, if that's not enough,” then to your point, “Well, what are some things we can do to leverage, turn some dials that could potentially get it to where we need?” Where I start is kind of where you help someone in with that endpoint is, “Well, if this is enough, how much is that?”

And then if they're happy with that, then you can go forward. If not, we're gonna get to where you need to be. Where I start with people is, “Well, how much is enough for you?” After we go through all the iterations of the fees and the paying off the debt, and the advisors and the taxes of course, that we like to not think about that, but then Uncle Sam's right there with his hand at the table and you go, “Wait, where did that come from?”

This is a small detail, but it's important to understand that because as we said, we talked about earlier, Perrin, is people start doing the math in their heads and they go, “Okay, well, private sale, traditionally,70 to 90% of the last three years collections, or if I'm looking at DSO, gosh, they're paying X, Y, Z multiples. And I can do that math in my head. Wow. That sounds like a pretty big number.” And then we have to say, “Well, that's not what you end up with. So we take it from, “Well, here's what you could end up with. Now how can you make that capital work for you?” And that's another conversation that we have at Freedom Founders, but I want to back into what you're doing because that's so important.

So in, in the process of talking to those and doing the consultation, I'm just curious what percentage that come to you for sell-side advisory when you go through the consultation and show them, “Well, this is likely if you go to market now and maybe get a transaction done in the next six or nine months, here's what you're into.”

How many say, “Oh, that's good.” Versus how many say, “I'm not quite ready to pull the trigger yet.” I'm just curious.

Perrin DesPortes: I would say if they have not been working with us in a consulting capacity up to this point, if they have been a follower of our podcast or seen us speak on a stage or something like that, and they reach out to us kind of without any prior work history together, I think we have that same initial conversation around, “Okay, what are your expectations in terms of the bare minimum number you need a net cash in the bank?” And they'll tell us and we'll work the number backwards to the transit through the fees,

taxes, debt, and up to the transaction value and then work the multiples back to the EBITDA volume where they are now.

It's kind of connecting the dots in reverse order. So I would say for those that have never had any experience with us in a consulting relationship, probably about 60 percent of them end up going to market. For those that do have an experience working with us and consulting, we're involved in the conversations along the way to where if somebody says, “Hey, Perrin, my net number is 10 million,” or whatever the number is, right? I can usually tell them before they ask me that, “Hey, Dr. Phelps. I think you're at your number,” based on the financial analysis we do every quarter with our consulting clients to be able to say, “David you said your number was this. Here's what I'm looking at on the numbers and in terms of financial analysis, I think you're there if you're ready. So it's your call, but I'm just saying that I feel pretty certain that based on our prior conversations, you're where you need to be.” And that's all but a hundred percent at that point.

David Phelps: When you ask the question, how much doctor do you want or desire to have net after the transaction is completed? How many could actually give you that number? What specimen? I mean, what and what's some math behind it.

Perrin DesPortes: I knew you were gonna ask me this question and I'm almost reluctant to say not many and the reason for that is our industry is suffering from–remember Alan Greenspan's comment about delusional grandeur or delusions of grandeur and irrational exuberance from back in the Clinton administration or anything.

Some of your audience may not remember the Clinton administration. I remember bits and pieces of it so, you know, I think that irrational exuberance around valuations, multiples, dollar sale amounts are the top line number. They're the three-inch headline at the front of the newspaper or on your newsfeed, right?

And coming out of COVID when private equity-backed ventures were spending money like drunken sailors and the cost of debt funds was all but zero and they could borrow unlimited amounts of funds, you had decent businesses being overvalued by one to two to three turns or more. And I think people got seduced into thinking that their businesses were worth more than what they actually were because back then somebody was willing to pay for it and they didn't really have the discipline to look at the valuation all the way through to what the bottom line net is.

Or they weren't equipped to do that, or nobody had ever taken them through that process to do it, those calculations to do it. And I think when somebody doesn't know what their true walkaway number is, they start to compound bad decisions. And there's some things that we can figure out along the way to guide the client, but there's some things that we just can't.

Because we don't know what are–they haven't really sold themselves on what their answer is to us, and what you find is that selling a business is an emotional roller coaster. People start spending money in their mind before it's in their bank account. They get vested in an outcome that may be not the one they ultimately really aspired to have.

And this all creates complications when there's a lot of dollars involved. On the other hand, when you do have somebody that says, "Hey Perrin, look, I know my EBITDA is four million dollars. At a minimum, I need 35 million out of this transaction to pay off debt, pay off taxes, to put 18 million in my investment account for me to be willing to walk away from this business that's firing on all cylinders."

Now, that's not a point of desperation. That's an entrepreneur saying, "Hey, Perrin, for me to make this worth my while and take my hands off the wheel, here's the number I got to get to net." At that point, the onus is on us to drive the process to yield the outcome that creates the transaction that our client wants, but we're all operating from a point of certainty.

And if the market-marketed sales process starts to come up short, well, there's no grievance by any party to simply go back to work in the business and come back to the market six months later or a year later or something like that. And it's not a–with us, another beauty of our business is that with a consulting side of the business, that's the retainer-based business for us.

That's how we make all of our internal investment decisions around hiring and everything. We're not dependent upon a client's transaction to keep the doors open or to keep Polaris afloat. So when we may tell a client, “It's not in your best interest to take this deal that's being offered.Let's go back to work for six months. Let's come back to market in six months or however long, and let's revisit it at that point.” And we've done that before because we're not desperate to force a client into a transaction. That was a little bit of a winding answer, but it was a really good question, so I hope I didn't go off message.

David Phelps: No, I think it was perfect. and that's what I try to, I guess, give a little bit of a warning or just advice from my experience in all things transactions is that there are, there's a group of people that once they get involved, and that could be a broker and the attorney and the CPA, and there's other answer by people that are part of getting it done.

But none of those people get anything out of it for themselves, which is important at some point, until the transaction goes through. In many business, models are set that way. I mean, realtors that list properties, they don't make anything off that commission until the property sells. So as long as people are aware of where the incentives are, I think, are important.

Again, I'm not saying anything derogatory about the expertise that people bring to the table. We need those people. But if they're driven by incentives that at some point reflect on their needs, then you just gotta be a little bit careful. So I really appreciate the fact that you're holistic and you have no bias on whether a transaction goes through or not, you want to do what's right with the client at the right time. That's where I love to be, and what I do.

Perrin DesPortes: Yeah, I mean, let's be honest. I'd rather close a multimillion-dollar transaction than not, but the viability of our business is not dependent, and I mean, I think that gives us a point of confidence that we think we can give the right recommendation to the client that's in their best interest because we're not under any urgency of time or making payroll or anything like that. And I mean, I think that's, I'd like to think that gives us a little bit more unbiased opinion, but, you know.

David Phelps: Yeah. So you said earlier that some of the structures of the buyers, and I assume we're talking about private equity-backed DSOs, you mentioned something I wasn't aware of, you said there could be a majority interest buy which is what I thought most of them did, but you said also a minority interest. I was not aware that, I mean, explain that because I don't really understand how that model works and where it works.

Perrin DesPortes: Yeah. So I think that the vast majority of our world, as it relates to private equity-backed DSOs and MSOs, it's always been, just for example, the private equity back venture buying 80% of your business or group practice, and the balance of 20% being a, an equity role into the parent company to help align our interests and to also give you the opportunity at something called the second bite of the apple, which is when the private equity owner of the business decides to recap it and another private equity venture buys them out and the equity releases and it's usually or historically, it's been a very advantageous internal rate of return for people who've done that.

That being said, not all private equity groups are alike, or our private equity is not just one type of a monolithic industry. There is something called family offices and minority investment firms that typically have longer hold cycles or around their investment. A typical private equity group probably holds an asset, meaning they own a company, for five to seven years before they start going through the process of divesting of it. Family offices and pension funds and things like that are a longer hold type of discipline. and they typically are a bit more of a, a little bit more hands-off, I would say, as it relates to

operational control. Now, David, you may have built a very valuable company that you've taken as far as you can. You want to stay in it, but you know that you need somebody to bring in a CFO or a COO or some HR specialists and things like that, build a bench that you just haven't had the wherewithal time or expertise to do.

And a private equity firm can sometimes furnish that type of leadership structure. All right. So they bring more than just capital. They bring boots on the ground, operational experience. On the other hand, you may say, “Look. I've kind of exhausted the possibilities of growing with traditional senior debt. I'm looking to take some chips off the table for me and my family, but I want both hands on the wheel. I'm just at halftime of this business. I feel like I'm the right leader. I'm the founder. I can continue to take this thing a lot, lot further. And furthermore, I've got a good team around me. And we are not at our ceiling in terms of expertise or capability. I want to keep growing.” And that may be a scenario where you say, “I'm not interested in somebody buying 80% of my business. For me to stay in it and continue working the way I have with the guts and the verve and the excitement that I have, I might want to bring somebody in at a 40% ownership stake.”

Now that's an equity investment from a third-party entity. But it's not 80% of the business. You and maybe your executive team or your associate minority partners still own 60% of the business, but you've taken some chips off the table from a minority partner standpoint. So they don't own a majority of the equity.

They own a minority position in the equity, in the cap table. We can get into things like. voting control around seats on the board and all that kind of stuff on a subsequent podcast. But the rationale behind this is that I think they're more mid-career entrepreneurs who built successful businesses, who aren't ready to sell them and walk away, but they'd also like to de-risk part of their position for them and themselves and their families, and maybe use some of that taking chips off the table into diversified portfolio like what y'all do and what you're great at. And I think a minority position facilitates some of that.

David Phelps: Well, yes, I really, this is the first time I was aware that was an option. And it makes sense that there are family offices or pension funds are not in the game of relatively quick turns that they want to stay in and ride a good business in an equity position.

So I'm just guessing, I don't go out like I don't have all the contacts that you and Diwakar have, but that's what you do. I guess my question is like today, what percentage in the last couple of years, what percentage of transactions are majority versus minority? Maybe let's start there. I'm just getting some idea what that represents in the marketplace and dentistry.

Perrin DesPortes: I mean, I think that the vast majority are majority equity positions from buyers. Probably, I think about our client base, it's probably 90% or more.

Now, the reason for that is a lot of these were later-stage owners of mature businesses, and they're looking to certainly de-risk their position, take some chips off the table, but also from a standpoint of a little bit of the work-life balance, they don't want to be on the limit as much as they have been in the last couple of decades of building the business, and there's nothing wrong with that. I think what we're seeing, though, is that there's a–and they're not many, I don't hear a minority position being talked about too terribly often on podcasts or the stage or otherwise.

So I think the minority investment piece of it is just unknown to most of the marketplace and they don't know the questions to ask. And probably their sell-side advisor isn’t opening up the complete envelope in terms of all the possibilities here. So some of it's a, if you don't know the questions to ask and maybe if the sell side advisor isn't going through a thorough process to find out what really moves the needle for the prospective client at hand, then there is no solution there. But I would say there are more and more firms, investment firms that are willing to take minority positions, and I would also say that they're more family office type firms that love the returns of dentistry.

Yeah, I mean of all health care services, it usually these businesses are very sticky from a customer retention or a patient retention standpoint. And that bodes well for cashflow, which is usually what these businesses are after, what would these investors are after. So it makes sense in a lot of scenarios when the business owner is at the right stage of their career and if they have the right kind of mindset as it relates to the next potentially decade or more.

David Phelps: Yeah. Because we both know there's seemed like the liberation of younger doctors, dentists in their career who have managed to build somewhat of an enterprise solo or multi-practice, but they're maybe younger than 50 years of age.

And maybe not really burned out, but they've, but you said, I want to take some chips off the table. I mean, and I've seen, watched many of them make the complete sale and whether they're happy with that afterwards, I think it takes some time to let that settle, but it is what it is. I'm just thinking if you're younger and you've done a good job just to take risks a minority stake would, to me, certainly have some reasonable reason less in decision-making to look at.

Perrin DesPortes: It absolutely does. And I think, you know, I think we're in the early stages of a bit of a seismic shift and by that, I mean, if you rewind the tape pre-COVID, private equities, influence in dentistry was prolific and driven by a lot of the returns that we were seeing, right? And I think you had a lot of people who were building group practices for the sole purpose of exiting group practices.

Coming out of COVID, there was still some of that for sure. The flames were fanned by sell-side advisors and business development people that didn't make their number and it was the perfect feeding frenzy capitalized on the anxiety of a lot of dentist owners that just didn't want to own businesses anymore based on what they went through during COVID. I get all that, but I think now you're seeing a lot of what I call mid-career dentists that are really early forties that are enjoying the journey.

These are entrepreneurs at heart. They don't play golf. They've got nowhere to go. They've got more than half their life ahead of them, and they love practicing clinically being a business owner and being an entrepreneur. And simply they're looking at the growing debt burden of borrowing more and more money from a bank to keep acquiring, buying or building practices.

And they're sitting there saying to themselves like, "Gosh, I know the business cash flows wonderfully, but when am I going to get out from under all this debt? I mean, I'd like to take some chips off the table for me and my family." Well, the way to do that, especially if you're still committed to the journey and you love it, is a minority investment, de-risks your position, puts a little bit of cash in the bank, and gives you a second vehicle for growth especially if they love the business you're building too, they probably make subsequent investments in it.

So this is a phenomenon of build and operate. Not built for sale. And I think, I don't want to get on a soapbox, I think that's a good thing for the profession.

David Phelps: Oh, I would agree a hundred percent. And I love the fact that you're looking at this kind of a sea change, a seismic shift. Because the dynamics, as we well know, pre-COVID, post-COVID are completely different today. We have the inflation that came out of, a lot of that came out of COVID and a lot of other factors, of course, but at the same time, we've seen the interest rates go up by 500 basis points and now looking like they're stickier than many thought them to be, which has got to be changing. The dynamics of private equity, again, from those who are more aggregators and looking at the financialization of a dental practice, really what we would call trading practices. And now probably, again, as a good thing, those that are wise are looking more well, more like a family office.

We need to be operators or work with operators, or if we're going to take a majority, we better be operators. or if we're being a minority, let's work with an operator because we're going to run this thing, we're not going to be

flipping practices like we did back in the day. That's what I think. Is that what you're sensing?

Perrin DesPortes: Yeah. So I said I wouldn't get on my soapbox and I'm only going to put one foot on it right now with you. So here's the implications of the problem that you just described. When lending rates are so low and when banks are willing to lend, for all intents and purposes, unlimited sums of money to private equity-type ventures that are of an aggregator mindset, all I'm interested in is buying as many practices as I can because the debt doesn't cost me anything. It's akin to an interest-only loan, right? I'm not even paying the principal on it most of the time. So I'm just buying practices. I'm willing to overpay for practices to get more of them. Why? Because I know that after I reach a certain threshold of EBITDA, I'm going to take this thing to the market.

I'm going to recap it to another private equity group. It's going to buy me out. I'm going to make money on the equity position above the cost of the debt. That's the theory. Well, what happens to that theory when you have a 500 basis point improvement in banking terms, meaning escalation of rate, and all of a sudden, that dirt cheap cost of funds now cost me a lot, and because I'm not an operator of a mentality, oh gosh, there's not enough cash flow or EBITDA at a practice level to now offset the rising cost of the debt

David Phelps: Yes,

Perrin DesPortes: There are a number of enterprise-level businesses that are in a workout procedure which is basically a legal restructuring where the private equity owner hands the asset back to the bank because their equity position is worth nothing. What happened to everybody who had a business that should have valued at six times EBITDA, but their sell-side advisor recommended that they take the deal that was at nine times EBITDA? Now, it's not like selling a house, David, alright? If somebody is willing to pay you two to three turns more than what the asset should be valued at in a business, and structure only part of it in cash and some of it in equity, what

happens to your equity position when the parent company goes up in smoke?

Well, that return that you were sold on doesn't materialize, and you got a lot of hard work ahead of you to make it work out. There are a handful of larger groups that are very disciplined in what they will pay and what they won't. And when the flames were hottest, they were losing a lot of deals by a turn or two.

Now that they're running sound operations that generate same-store sales and EBITDA margin improvement, cost containment, and they're attracting us, they're doing all the fundamentals. Those businesses all of a sudden look a lot better, right? And those are the ones that are going to survive. They're in a better balance sheet position on a forward-looking aspect.

And these are the ones that candidly, when we recommend to a client, not to take an 11 times deal in favor of one that's eight and a half, you would look at me like I've lost my mind, right? But we've had to do that with a couple of businesses who are very, very valued. And we would have made more in commission if they took the higher deal, but we knew, or we felt that the best thing for our client, because he had been a legacy client, a consulting client, that we were not just going to grab the highest offer, “See you later, Dr. Smith,” and we're on to the next one, right? So I think all of this has caused a lot of that mid-tier market that I referenced in the prior answer. There've been a lot of people that are saying, “I don't know that I'm in a rush to sell my business because I don't want to see my life's work kind of go up in smoke the way some of my colleagues who were bragging about the transactions they did a couple of years ago that now might not look so good.”

David Phelps: Well, that's so well said. And my experience in the markets and the interest rates and the recaps as you know comes from real estate, but it's all essentially the same thing. Limited partners, equity can be gone in a flame because they put their money with many real estate syndicators or a lot of the private equity that when that was cheap, it's like, “Let's just get an

asset. We might add a little bit of value to it and we're going to flip this thing and we're all going to make big money." And then, whoa, interest rates come on big. And now there's this pressure, these headwinds, that are pushing all that back. And so we see the same thing in real estate today where the banks are taking the keys back and waving goodbye to the equity partners who were hoping for some big wins on their money.

Well, Parrin, this is really helpful. I love talking to you and, if not, that it's late in the day, and you probably have some better things to do with your time. I think it just means we need to come back and do another segment is what it means, right? I think that's where we need to leave this today.

I just want to thank you for your time and the insights and I learned something from you every time we speak. So it helps me 'cause I learned something about the minority versus majority structures that I wasn't aware of. And hopefully, this is valuable to other people who are looking ahead and making decisions to potentially sell or how to sell and the options that they have to do it.

There's more than just sell majority or don't sell at all. I mean, you've given us something, a hybrid in between that could be viable for some people. So that's really helpful.

Perrin DesPortes: Well, thanks for having me on David. I always love being with you. I learned from you on all of our calls as well.

And hopefully, I've shared a couple of things that maybe make some of your audience think a little bit differently about stuff. It's, to your point, it's not a binary decision. It's not a yes-no, it's not an either-or, but if you work with the right advisor, hopefully, they're challenging your assumptions and hopefully they're making you think about things differently and hopefully, they have a methodical approach that's not with any urgency or emotion to lead you in a direction that you might, that might not be in your best interest.

David Phelps: Yeah. So well said. All right. Thank you, sir. Thank you so much.

Perrin DesPortes: My pleasure. Great being on with you, David. Thank you.

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