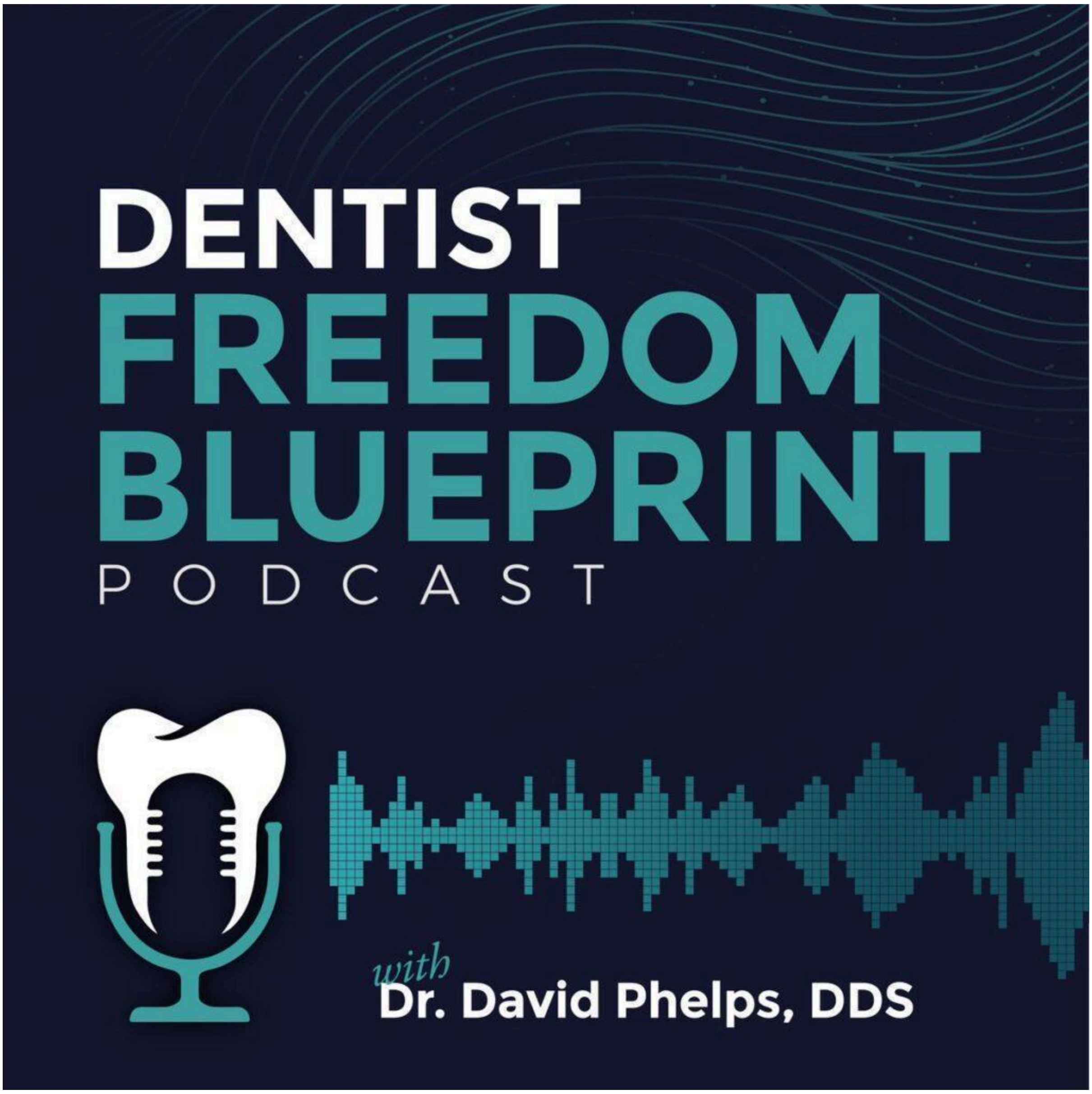
Planning for Your Practice Exit - What You Need to Know - Brannon Moncrief: Ep #510



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Dr. David Phelps

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Brannon Moncrief: The demand in valuations for quality assets has been steady in the dental industry. So we'll have our best year ever, more activity than ever, higher valuations for a lot of our clients than ever this year. And that's been honestly a little surprising to us, very surprising, I think, to probably some of the people on this call. But if you've built a real, sustainable business that's profitable and positioned for long-term success, it's always going to have value. There's always going to be buyers. So my advice is not to wait if now's the right time.

"David was of course a dentist, but he was a very sophisticated real estate investor. He had run with a circle of probably the most sophisticated housebuyer types in the country."

"David is a student of the game."

"I would never say this about most people. I would get in a foxhole with David."

"His knowledge is unreal. I mean, it's off the charts."

"This is not some person in front of you going, 'Yeah, just give me your money and I'm going to invest it in real estate.' It's way more elevated than that."

"The most common message I get, 'I want to thank you so much for introducing me to Dr. Phelps because my wife and I—we went to Freedom Founders. We're on a path. We're going to be financially free. We are going to retire sooner. We are going to be happier. This changed our life.'"

Dr. David Phelps: Good day, everyone. Dr. David Phelps here with the Freedom Founders podcast. Back with somebody I've really enjoyed having in the past and he brings a lot of relevance to the conversations that we get to have today because Mr. Brannon Moncrief, by the way, Brannon, thanks for jumping in today to have this conversation.

Brannon Moncrief: Absolutely. Thanks for having me.

Dr. David Phelps: Brannon Moncrief has been in the industry, and I'll say the industry overall in the dental industry, but also is a banker, a broker, and a sell-side advisor for over 20 years. His firm is McLerran & Associates out of Austin. They are really an industry leader in providing the practice valuation services and sell-side advisory to large practice owners seeking a DSO affiliation or a private equity partner.

And you can find them, you can find Brannon at dentaltransitions.com. So, Brannon, we've had these conversations in the past because we've been in an era, we would both say, particularly in the last, say, half a dozen years, where the foment of a lot of liquidity, a lot of investors, hedge funds, private equity, chasing yield, have brought to the forefront in our industry, probably for the first time ever, some of the highest levels of multiples that, well, certainly I've seen in my lifetime, I've been around for a few years, so I missed out on that, by the way, I could go back and try it again, but I don't think I will.

But anyway, you've been in the midst of all this too. You've seen this ramp up. We've been talking recently about where we are on the market. And we'll get to some of that right now. But as we talk about your years of experience in helping on the sales side, what's been your oversight, your insights regarding the involvement of private equity up until now, particularly, you can go back as far as you want to, but just kind of bring us up to what you've seen that involvement be in and how's that been beneficial or possibly even detrimental to certain dentists who have desired or actually have sold their practice.

Brannon Moncrief: Yeah, it's a great question. So, I mean, dentistry was arguably the hottest vertical that private equity was investing in going into COVID. A lot of private equity firms already had a DSO that they were in the process of growing. Many private equity firms were eyeing an investment in dentistry at that time.

And dentistry proved once again to be recession-proof, now pandemic-proof. Private equity doubled down. Their interest exponentially increased coming out of COVID and supply and demand as a result of more money flowing into the space, a pretty steady supply of sellers, valuations went up substantially comparative to pre-COVID. So coming out of COVID, you saw valuations increase by 30, 40, 50% compared to where they were pre-COVID. So practices that were trading for five, six times even a pre-COVID trading for seven, eight, nine times even a post-COVID. Private equity was operating really in ideal macroeconomic environment until about 24 months ago.

Interest rates were at a historic low, the capital markets are wide open, money was easy to access and cheap. But that's obviously changed over the past 24 months. Interest rates doubled, capital markets tightened up considerably, and that changed the marketplace to some degree. Now, a lot of people think that valuations cooled off, but valuations peaked in the two years post-COVID and have stayed relatively steady for quality assets, right?

So class A assets, clean assets, multi-million dollar revenue practices, multi-doctor practices that have healthy EBITDA margins still trading at seven, eight, up to nine times EBITDA. Those practices that have a little hair on them or have a long story to tell to explain their financial performance and the post-closing plans of the seller, those practices, those assets are harder to move and have seen a significant decline in demand and valuation.

So it's still been a good time to sell over the past 24 months. We've been busier than ever. I think that's a product of the fact that a lot of people have built large successful businesses. They want to de-risk, take some chips off the table, maybe get some help administratively. And I think the narrative's out there that you need a good team if you're going to take your practice to market.

You need to position it properly. You need to go to market at the right time. You need to control the narrative regarding EBITDA, and you need to date around. You need to create a competitive environment to make sure that you find the right partner, the right deal structure, and then maximize the economics.

Dr. David Phelps: What you just said is I think it's so critical is that we need every one of us in different respects, different phase transitions of our lives. We need a team around us, building a team, certainly with people I work with and people you work with as well, certainly a financial team. We talk about having a good attorney and good CPA, and maybe you have a Chief Financial Officer, some part that helps you with cash flows, different parts of a team. You're part of a team for sure.

And I think too many people, I don't know why, maybe it's just the fact that I'm speaking from a dentist hat is that we work hard to get the education. And I think we feel like we're supposed to know everything. Like people look at it, doctor, and I'm not saying it's an ego trip. It's just people think, you're a doctor or you've got some high education. You're an engineer. You should know a lot and you should know a lot about everything. And the fact is we don't, and we shouldn't even think we do. So it's not to show vulnerability. It's not to show weakness, but surrounding yourself with wise people, counsel to help you make a major decision. This is a major financial decision. Major.

Even if you think you might do it again, if you're younger, you might do this again, good for you, but most people are going to do this well, hopefully, well, one time. Speak to a little bit about your place on the team. How do you involve the other team players? You are different in a good way from a lot of just, I'd say, run-of-the-mill people who are in the transition arena.

What makes you and your team different in how you orchestrate and help guide your clients to their final decision, whatever that may be?

Brannon Moncrief: I think so many people in our position are very transactional and not very consultative, and they want to speak with the doctor and get from that point to a commission as fast as possible.

And that's not really how we work. A lot of the relationships we have with our clients are long-term relationships where we get involved early, right? Three years, five years out from a potential liquidity event or exit, talking about what drives demand and marketability. What is your EBITDA today? And how do we help reverse engineer the outcome that you're looking for?

It's really about defining the current value of your business and your options. And then figuring out which path you want to follow. That might be just keeping your head down, doing what you're doing, not selling, that's always an option. It might be to sell to a private buyer, or it may be to pursue a DSO affiliation.

So first and foremost, you need somebody like us on your team in addition to the other advisors that I'll get to in just a second, but you need somebody that's going to give you objective guidance, that's actually there to educate you regarding what your business is worth and what your options are and not try to convince you to go down one path or the other.

So that's where we come at it from, a purely educational approach. Let's talk about EBITDA. Let's talk about cash flow. Let's talk about what a private buyer sale looks like. Let's talk about what a DSO sale or private equity partnership looks like. And let's decide what path you ultimately want to go down.

Are you at a point where it makes sense to go to market? Or should we wait a year, two years, three years to allow the business to mature a little bit further? Maybe allow your runway to shorten to your potential exit from your business before we go to market. It's all about education, timing, building the right team.

So you need a strong sell-side advisor on your team. You're also going to need to get your CPA involved, talk about the tax implications and maybe do some planning to mitigate or defer taxes. Certainly need your financial advisor involved to quantify, is the sale going to throw off enough cash to fund your retirement. Or at least put you in a strong position to reach your ultimate financial goals.

And then looking at how is a potential sale going to change your annual income and comparing that to your annual burn rate, right? Can you live off your post-closing income? Making sure you've got an experienced dental attorney on your team when you actually go to transact to explain and negotiate the legal agreements.

Those are all the people that need to be at the table really, in my opinion, along the way leading up to a sale, and then obviously at a time where you pursue a transaction.

Dr. David Phelps: And Brannon, as you are working with these different team players, is there one person that tends to be the quarterback or is that different for each client based on their relationship with these different team players?

Brannon Moncrief: I would definitely say that we act as the quarterback. The sell-side advisor acts as the quarterback and taps the appropriate team members at the appropriate time. So oftentimes the conversation starts with us and then we'll talk about when does it make sense to talk to your CPA about the tax implications of a sale.

When does it make sense to talk to your financial advisor? I would prefer both of those conversations to occur before we go to market, right? So our clients understand the full economic implications of a potential sale, and then we typically loop in the attorney around the time that we're negotiating letters of intent and obviously at the time that we're negotiating legally binding agreements.

Dr. David Phelps: As you well know, there are both qualitative and quantitative aspects of making this decision, the transition, how I'm going to sell, when I sell, who do I sell it to, to whom, and what am I going to do after the fact?

Do I still practice? Am I going to stay on for a contract? Am I going to do a walk away? I am not a financial advisor. I am not a CPA, full disclosure, but because like you, I get to have these conversations with a lot of people that we work with from the standpoint of what you just said is working with financial advisor and CPA.

What am I going to have after tax and transaction costs? And the financial advisor helping look at, well, is that gonna be enough to fund what I want to do for the rest of my life? And there's a lot of variables that come into place there. I think the biggest one today is what we've seen recently is the cost of living, the CPI inflation.

And even though they say the numbers are coming down. I don't think we're going to see going back to the era that we had for many years, decades with globalization and technology, which kept inflation at a very low rate. I think inflation is here to stay and probably in certain sectors more than others.

Scary thing for any of us who leave active income production is do I have enough? And I'm just going to take a quick moment to plug my book, because it's called “How Much Is Enough” and people who want that book, you can get it at howmuchisenough.com. But again, the reason I wrote that book is again, not being a financial advisor, but taking some of the things that I learned and the conversations we have, I was wondering, do you get involved?

I mean, I know you're not advising on this, but does that come back to you through the financial advisor, through the CPA, do you sometimes have to come back and that becomes part of, well, is this a good move for you to take this offer or we're gonna put out other offers? I mean, how much do you get involved there assisting with this? How much is enough after I go this path or not?

Brannon Moncrief: Yeah, I mean, the economics matter in every deal, right? So a lot of our clients are looking to de-risk, maybe get some help operationally, but the global economic implications play a major role in every decision to monetize your business. We always are having the conversation, is it going to be enough? And talking about the cash at close component, talking about what your compensation is going to look like annually post-sale if you're going to stay on, and then talking about the equity component of the deal and the likelihood that equity is going to be liquidated in the future and what that return may look like.

We always start doing an EBIT analysis valuation and then doing some economic modeling to show our clients cash at close, annual compensation. Here's what the equity may look like and there is some risk around that equity, right? We don't sugarcoat that. We try to quantify realistically when you may be able to liquidate that equity and what it may be worth.

And yeah, wrapping in the accountant to quantify the tax implications, the financial advisor to weigh in. Is it enough? And then obviously consulting with people like you because you're going to have a windfall of cash and how you invest that money is in large part going to determine if it's enough at the end of the day. We're having all of those conversations with our clients pre-market to make sure that they are financially ready to make this decision.

And then we also talk a lot, obviously about the emotional aspects, monetizing your business and how important, not just the economics are, but the fit is, because especially if we're talking about going down the DSO path. You're picking a partner, not a buyer. You are going to agree to stay on for three to five years post-sale.

Now that comes with a lot of autonomy. You can work as much or as little as you want chairside, but you're going to have a vested interest in your business long-term post-sale. So picking the right partner is critically important. All of these things collectively come into decision as to should you sell your practice, if and when you should take your practice to market, and what path you should go down.

So we're looking at the 10,000-foot perspective anytime we're talking about monetizing a client's business and making sure that they've got all their ducks in a row and they're ready to go to market before we start fielding interest from potential buyers because the worst nightmare for me is to not have those conversations and go to market, spend our time, our client's time, the buyer's time, talking about getting a transaction done only to have the CPA come in at the last minute, the financial advisor come in at the last minute, or the client to get cold feet and back out of the deal late in the process.

I'd rather vet that out pre-market and figure out if it makes sense, and then have everybody in alignment with the same goals in mind and committed to reaching and closing.

Dr. David Phelps: Yeah, simple analogy here, very simple, but just think about people in the real estate space, realtors who have a client, let's say a couple, and they want to buy a new home in a certain area.

Does the realtor just hop them in the car and drive around to any old property or house? No, they want to pre-qualify. And pre-qualifying means, looking at financials, look and see what they can afford. That's a very simple model, but same thing. You don't want to get all the way down the road and find out, gee, we were way above our means or whatever it was, that's not going to make this work.

So same thing. You don't want to waste anybody's time. And I know you're very good about not doing that. Another thing that you mentioned a minute ago, and I want to just bring this back up again. There is, I think, more uncertainty with volatility in the marketplace today. Is that a reason why people should just hold off and wait for things to normalize? I know what you're going to say, but should I wait for things to normalize, Brannon, or what should I do?

Brannon Moncrief: You let me know when they normalize, David. It certainly hasn't seemed normal for about the past decade. We are in a period of uncertainty, in large part because of the election cycle and some of what's going on geopolitically in the world.

Along with the fact that we've been in an elevated interest rate environment with high inflation over the past 24 months, it looks like that's cooling off. Rates are going to start coming back down. The capital markets are going to start opening back up. But like I said before, despite the fact that some DSOs have been under duress because of the high interest rates, or because maybe they were growing too quickly and not really operating and integrating the assets they acquired post-COVID, the demand in valuations for quality assets has been steady in the dental industry.

So we'll have our best year ever, more activity than ever, higher valuations for a lot of our clients than ever this year. And that's been honestly a little surprising to us, very surprising I think to probably some of the people on this call, but if you've built a real sustainable business that's profitable and positioned for long-term success, it's always going to have value. There's always going to be buyers. So my advice is not to wait. If now's the right time, it's not like today valuations are five times EBITDA, and next year, three years from now, they're going to be eight, nine, 10 times EBITDA. I think valuations for quality assets are going to remain relatively steady over the next few years.

So timing the market, in my opinion, thinking you're going to get it a more robust outcome in the future, I think would be a mistake. Now, timing your individual situation is critically important. Evaluating all the things that we've been talking about on this call is now the right time to take your business to market.

I don't think you need to pay too close attention to the macroeconomic conditions. It's more about your own personal situation and positioning your practice and your life for a successful transaction rather than trying to time the market.

Dr. David Phelps: Yeah, I like what you said, and again, I tie a lot of what you say because the capital markets are the capital markets, so whether it's a dental practice, transition, or in real estate, we're looking at the same thing from the standpoint of evaluating real estate, because we have to look at the capital markets, interest rates, the whole thing is all similar, and what we're focusing on, which is what you said at the top of the call, is quality assets.

Well, what's a quality asset? You can definitely define, you sort of have, what's a quality dental practice. Well, it's got systems, processes, it's got longevity built into it. That's what an investor wants to invest in. Same thing with real estate. We're looking at who are the best operators.

We're not looking at financial arbitrage like we did just a few years ago, where you can just flip things really quickly, which is a game to play in the right market. But today, I think you'd say the same thing. Your buyers, particularly the private equity buyers are looking really hard at operational efficiency.

Sure, they want to make the turns, the recaps when they can, but when the market gets elongated like it is right now, to some degree, then the operational efficiency. So what I'm asking you is you know all the players and that's why your advice is very helpful because you have the experience with different DSOs.

Some have been around for a good long time and you really know what their model is and what are they looking for. And do they have the durability to get those recaps of the equity in a decent market, right? Notwithstanding things can change versus maybe newer money. And I'm not saying newer money is bad money, but again, you do the back-end work to say what's this culture about, what are they about, right? I know it's important, but how important is that for our listeners to understand the differentiation between who your potential buyer may be?

Brannon Moncrief: Yeah. So you mentioned it earlier, we're in a period of time with a lot of volatility and uncertainty, and risk. And just as DSOs have gotten more discerning about the quality of the assets they're buying and their diligence process is elongated as a result of that, you are also a consumer in this transaction.

You are partnering with somebody. You are basically buying equity in their business and betting on them to be successful from a financial standpoint. So I will say diligence from a seller's perspective on the buyers that are at the table is at an all-time high.

It's extremely critical. Three, four years ago, any private equity-backed DSO could likely hit anywhere from a 2 to 5x return on invested capital with making a lot of mistakes. That ship has sailed. Now, only the best operators, those that are fiscally responsible, good at integrating and operating the businesses that they acquire are going to be successful long term.

And we've already seen some fallout with a handful of DSOs. Thankfully, we have not had a client lose a single dollar of equity up to this point. We sold no practices to the handful of DSOs that have, quote-unquote, failed. They haven't gone to zero, but they're having substantial financial problems and the doctor's equity TBD on what it may be worth and when it's going to be liquid.

A big part of our job is to be very vigilant in regards to betting DSOs and only allowing those DSOs that we feel are sustainable long-term to sit at the table and bid on our client's practices. So we spent a crazy amount of time meeting with the executives of DSOs and private equity firms, really trying to take a look under the hood and figure out, and honestly, a lot of it's gut feel on who we think is positioned to be successful long term and who is not.

And really it comes down to who's their financial sponsor. What type of assets do they own? Have they been successful in dentistry or healthcare in the past? What's the pedigree of their management team? And then also analyzing their deal structure. Do they have proper alignment with their doctors, both at the parent company level and the local level?

There's a lot of elements of these DSOs that you can evaluate to get a feel as to whether or not they're going to be successful long term or not.

Dr. David Phelps: Brannon, what would make a doctor feel like they've made the best decision that they could once they complete their practice sale? In other words, with all of your experience, all the transitions you've done, what are some commonalities that doctor, not just the day after, because that always feels good, but you know, several years after, whether it was a private sale and they just walked away, or they stayed on in some additional transition, what are the commonalities?

Brannon Moncrief: In a private sale, obviously, it's more finite, right? In most of those sales, it's a walk away or a short-term transition. I think so long as you're still in your community, still talk to your staff, maybe you have a relationship with them, or you're running into patients at the grocery store, and they're having a good experience with the new doctor that took over, and you sold at the right time, monetize the business for what it was worth, and you're happy in retirement, then, that's pretty simplistic when you talk about a private sale.

From a DSO sale, I think it's in large part two things. Did your culture stay intact? And are you happy? Is your staff happy? Are your patients happy being involved in your practice post-sale? Whether that's the day after closing or three years after closing. In other words, has the DSO turned out to be the people that they were during the courting process? Has everything they told you was going to happen with your practice actually come to fruition?

Whether that was, hey, we're going to be hands-off and let you still kind of run the business and have pure clinical and operational autonomy, or we're going to be hands-on because you want us to be, and we're going to help bring efficiencies to your practice and help you operate the business and offload that management burden or somewhere in between.

Have those things actually come to fruition post-sale? And then how has the equity component played out, right? If there were promises that there was going to be a recap at a certain multiple, did that recap occur? Did the doctor have the opportunity to liquidate the equity they thought they were going to have the ability to take off the table?

And what were the financial outcomes from that regard? So far so good. I mean, obviously, some recap processes have been elongated, have been postponed as a result of the high interest rate environment in the Titan Capital Markets. Some outcomes have not been the 5x or 7x that was promised, but they've still been good.

2, 3, 4x outcomes way better than you can get putting your money anywhere else. So those are the things that we evaluate with our clients post-sale. Like I said, have yet to have a client lose a dollar of equity value. All but one of our clients has stayed on in their business and been happy post-sale.

Some of those clients have now reached the maturity of their post-closing obligation and exited the practice in full at their own volition. We've only had one client that, out of over 200 DSO transactions, that exited the practice maybe before they were planning or before they wanted to.

Dr. David Phelps: Well, that's a great track record. It's funny you said if someone doesn't walk away that they're going to be good if they stay involved in the community. And this is why I know you're not a dentist because you mentioned going to the grocery store. I'll just tell you, we typically see the patient at the grocery store, we go down another aisle. Just to be clear, sort of kidding, but sort of not.

Brannon Moncrief: No, I get it. I get it. We have clients that tell us they don't want to own a practice where they live. So I understand.

Dr. David Phelps: Well, because you're going to get into a lot of conversations maybe you don't want to have, it's all good. But listen, Brannon Moncrief, it's always a pleasure. Thanks for coming on today.

Again, you can find Brannon, McLerran & Associates at dentaltransitions.com. Appreciate your time. We'll bring you back again because the markets are changing. And I think people want to keep up with what's going on. So appreciate you very much.

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Brannon Moncrief: Thanks for having me, David.

Brannon Moncrief: When we think about transitioning in our life, personal life, relationships, business life, business transitions, we've often got to let go of some of the old paradigms, the old identities that we have become so accustomed to, so comfortable with. I know it happened to me in my life. You get into a certain place of feeling like you've got things pretty well settled, things are running pretty well, you're working hard, but you're feeling somewhat like you've got things in good hand.

What's going to get you to the next level? For me, as you remember in my story, it wasn't about more money, a bigger practice it was about more time. And I had to change completely the way I thought about what I was focusing on in my life to get there. So think about what is your focus. What are you really trying to achieve in your life?

Is a bigger practice is higher revenue, more EBITDA, is that the goal? If it is, great. Then focus on that. Find the mentors, find the people, find the environment that's going to propel you into that particular goal. But if that's not what it is, if it's something else, if it's more time or freedom or flexibility, more peace of mind, then what's going to give that to you?

You've got to move away from comparing yourself with industry or societal standards. That's the thing that causes most people the most dissonance that I find in my life and with people I have the opportunity to work with. As we compare ourselves to other people and we think, "Well, I have to do that or I'm not successful. I need to be doing that or I'm being left behind." No, you're not. You've got to cut the grips with who you are and the best way to do is to really do some self-reflection and put yourself around other people who have also gone down the same path of inquiry and are also moving forward with their lives in a very intentional way.

The other part that I had to figure out in my life was that going alone, going solo where I can control everything and I can certainly use my hard work ethic, my desire to do what was needed to be done to get to where I want to go, we've all done that. Going through school and passing the test, the grades, the licensure, the credentials, the boards.

We've all had to put that on our back and do it. And so we think, well, that's the way to do everything in life. And I'll tell you, that's not the way. When you go solo, you can go fast, but if you want to go farther in life, farther in your dreams, your vision, your goals, you need to do it with other people.

So collaborating with the right people, I found, is the best way to do it. That means you've got to give up some of that control that we're so used to. You've got to be able to find and curate the right people. And that takes some work, that takes some practice, it takes some experience. You're not going to get it right the first time, second time, maybe third time.

I know when I was trying to find the right executive assistant, something I'd never done in my life, I'd always done everything myself. And finding that right person, I had to go through two other people before I found the right one. But has it been worth it? Yes, it's been absolutely worth it. The goals I'm able to achieve today with less resistance, less friction, and putting my time where my time is best used has been the best part of my life and my journey.

And I hope you'll explore the same things in your life. In my own transitions from being a small business owner in my own dental practice to moving past that some 20 years ago and into an entirely new vision, which wasn't even apparent on my vision board, and that was the Freedom Founders Community. I again had to reestablish a team.

Now back in the days when I was a dental practitioner, I had the tendency to try to manage people. I hired staff, I hired people, and then because I really wanted to control everything and make sure it was done just right, I tried to overmanage. Well, that caused stress everywhere. It caused stress for me, it caused stress for them.

I didn't hire necessarily the right people, or in some cases I hired the right people, but I didn't engage and empower them to become the best they could be and give them the armamentarium, the tools, resources, to let them grow into leaders that I really need it. Since I matured over the years, thankfully, I have learned instead of micromanaging to empower other people who take on the mission and that's critical part of the mission, the vision that you have as the leader, if they believe in what you do and you hire the right people with the right aptitude and attitude, they can learn anything.

And that's been the biggest revelation for me in the last 10, 15 years is finding the right people and building that team of cohorts that lead themselves. It's a self-managed team. I don't have to manage them, but we all create a vision and we all go forward together. When you get in that kind of a run, then work is no longer work. Work is the thing you love to do. I never need a vacation because I enjoy what I do and the people I get to do it with. I want the same for you.

If you're interested in learning how to create a freedom blueprint through market volatility using real estate as a cashflow machine to replace your active income, I encourage you to schedule a call with my team at freedomfounders.com/discover.

That's freedomfounders.com/discover. And don't forget to hit that and subscribe and follow button whenever you're listening or watching so you don't miss a single episode of the Freedom Founders Podcast. I'll see you next time.