

The DSO Reckoning – What Every Doctor Needs to Know Before Selling Their Practice – Brannon Moncrief: Ep #564

Guest: Brannon Moncrief



Brannon Moncrief:

A lot of DSOs were buying every practice they could get their hands on, not using a lot of discipline, very loose underwriting criteria, but then almost overnight, capital market and the interest rate environment changed very rapidly. And doctors have realized that if they're going to pursue a DSO affiliation, or at least consider it, today, I would argue that almost in every instance, it's not a no-brainer. There's a lot to think about. There's a lot to unpack.

Dr. David Phelps:

Decades ago, I hustled to grow my dental practice and real estate empire. Society patted me on the back and every new deal and patient reinforced the success they said I had. Then my daughter Jenna was diagnosed with leukemia. Nine years, several intense chemo treatments and years of epileptic seizures, my daughter was given one more miracle, a life-saving liver transplant.

In that hospital, I realized I wasn't successful. I had money, I had real estate assets and a business, but the only thing that mattered was time with my daughter. In that hospital room, I

decided to sell my business, leave active income and sustain my lifestyle with my real estate assets. Now, Jenna is healthy and all grown up and me, I am teaching others to do what I did. And I continue to uncover the principles, strategies and lessons we can apply in business and investing to create ultimate freedom for what matters most to each of us. Welcome to the Freedom Founders podcast. For any doctor even thinking about selling their practice, the game has changed. Joining me today is Brannon Moncrief, a former Wall Street investment banker turned dental transition expert.

As the principal at McLaren and Associates, Brannon has spent the last two decades helping doctors navigate complex, high stakes practice sales, especially in the never evolving DSO and private equity landscape. In this episode, we get an update on the dental marketplace. post-DSO gold rush, the fallout from rising interest rates, zombie companies, dangerous equity traps, and the silent killers buried in deal documents. Brandon breaks down what makes a great partner, what red flags to watch out for, and why reverse engineering your exit years in advance is the key to both freedom and peace of mind.

Let's get into it. Brand, it's great to have you back. love the conversations we get to have because you we are in a very dynamic marketplace across the board, you economically, culturally, geopolitically. I talk to people all the time that were kind of sift and sort where are we in the construct of our career paths and we're talking primarily obviously today to those in the medical dental field who are in practice and they've seen over the last number of years that there's been some huge opportunities.

I mean multiples on on sales and buyouts. that we've never seen in the marketplace before. It's like, this a one time in history that we'll ever see this again? And so people are like, I want that, I want that.

Everything has its cycle and what we found in Freedom Founders, because our focus has not been in practice transitions, that's what you do very well, but what we've been is strong advocates for our doctors being their own best financial advisor, not saying that they don't have advisors around them, but figuring out how do they navigate where they wanna go with their life. And a big part of that, of course, is when it's time, the right time to consider exiting or transitioning out of the practice, the baby that they built, the baby that's carried the weight, that's provided all the income and all the opportunities and the lifestyle and all the great stuff. It's like, okay, it's time to deal with that now. I need to, I have to, my back hurts, whatever it is. And now they get to that point and they're trying to figure out, okay, well, I've heard about all this great opportunities in the marketplace. What we've seen in Freedom Banners, I'm gonna toss it to you in a second, I promise. What we've seen in freedom founders in the capital markets that we've dealt in, which has been primarily a lot with real estate, which has always been my backdrop, what I've built my freedom on, put the market cycle. And we've had the fastest rate of rise interest rates going back to 2022 that we've seen in history.

We've had this lower interest rates since 1980, which provide a lot of tailwinds to people like me, the baby boomers who we rode that in a very, very good way. I see it turning of the tide in some respects. I certainly have seen it in the real estate markets, which were very, very familiar with, give us kind of the your outlay of how that has affected the private equity DSO marketplace. Cause that's a lot of what people are still looking at today.

And with good, good reason. mean, there's opportunities still there as we know there are in real estate, but you have to be discerning about it. So I'm going to hand the ball to you and let you kind of talk about the big picture and how you help people be discerning about their

future.

Brannon Moncrief:

Cool, appreciate it, David. Always good to see you. As you know, we help doctors transition their practice, both to private buyers and DSOs, but the capital markets, interest rates don't play a major role in the doctor to doctor space. That space has been relatively consistent over the past decade.

Given that private equity backed businesses, DSOs are typically highly levered. The capital markets and the interest rate markets play a major role in buying behavior, valuations and the long-term success and sustainability of these businesses. You know, I would say that demand and valuations were white hot coming out of COVID in 21 and 22 when the macroeconomic environment was still ideal from the standpoint of historically low interest rates, wide open capital markets, wide open lending markets.

And during that period of time, valuations peaked and demand peaked. But a lot of DSOs were buying every practice they could get their hands on, not using a lot of discipline, a very loose underwriting criteria, not really integrating and operating the businesses that they were acquiring with the hope that they can monetize that business in a recapitalization event before the macroeconomic environment changed substantially. And some did. Some exited those companies at amazing multiples in 21, 22, 13, 14, 15, 16 times EBITDA.

But then almost overnight, the capital market and the interest rate environment changed very rapidly. Interest rates went up in 2023 faster than they have in the history of the Fed. And I think a lot of DSOs coming off of period of time where they were buying practices without discipline at elevated multiples didn't plan for a rainy day, didn't plan for the macroeconomic environment to change or certainly not change as quickly as it did. And many of them were caught off guard and over their skis operationally.

They weren't actually prepared to integrate and operate the businesses that they were acquiring. They weren't building the infrastructure to keep up with the growth. A lot of them, think, were kind of looking at, we're going to recap this business and that will be the next investor's problem to actually operate the asset. So they were either over their skis operationally or over their skis from a financial leverage perspective or a combination of both. As a result, the DSO market has gone through a tremendous amount of turbulence over the past 24 at 36 months and what you've seen is those that were built responsibly, sustainably, on a strong foundation, good operators, but they've kind of stayed the course and done well.

■ There's been a handful of DSOs fail and all other outcomes have been somewhere in between. So there's been a lot of DSOs that have been hamstrung, know, sidelined, unable to buy practices, unable to grow over the past couple of years. And they've had to really focus on operations and organic growth.

in order to come out of this in a sustainable way. ■ But it's been interesting to observe. think it was a bit of a reckoning that was called for, and I think healthy from a long-term perspective. But it's been painful for some DSOs.

And as a sell-side advisor, it's been harder to get deals done. The market's not quite as frothy as it was back in 21 and 22. Evaluations have softened. Slightly for class A assets.

mean, there's still a lot of demand out there, good valuations and deals are still happening, but class B, class C assets are not trading or the valuations are significantly depressed. And I think you've got to be far more prudent about how you approach this conversation and who

you partner with and really taking a hard look at the deal structure, what type of equity you're going to have, what your rights are with that equity, both along the way and at a recapitalization event, because Long-term satisfaction in a DSO deal is not going to come down to your initial valuation. Now, initial valuation, cash at close is certainly incredibly important. But once closing occurs, that money hits the bank.

Let's talk about six months later, a year later, two years later. Are you going to be happy getting out of bed and driving to work? And a lot of that's going to be dependent upon who you sold to. Are they a good partner?

Have they been able to fulfill the promises that they've made? ■ on the front end, as well as what deal structure you accepted, where your equity lies and what your future opportunities look like. So for all of those reasons, we've actually been busier over the past 48 months than we ever have been in the history of the company. And I think that's because a lot of the FOMO has left the marketplace and doctors have realized that if they're going to pursue a DSO affiliation or at least consider it, there's a lot more to unpack.

There's a lot more nuance. There's a lot more involved than just, you know, selling to the DSO that your buddy down the street sold to because, you know, you're in a bubble, the market's frothy, and it's a no-brainer. Today, I would argue that almost in every instance, it's not a no-brainer. There's a lot to think about.

There's a lot to unpack.

Dr. David Phelps:

You brought up everything that we looked at and I've looked at in my many years of investing in real estate. It's exactly the same thing. The macroeconomics back, as you said, in 2021 were off the charts where a lot of late comers with good intentions jumped into the bandwagon of I can syndicate, raise capital. I'm talking about real estate again and make it all work.

And what we found was, what the market found was that good intentions don't necessarily make for a good operation. The game was, in many cases in that market, was get in, ■ aggregate, right? And sell or recap to somebody else because someone else will take it. As long as interest rates were where they were, then that model worked.

So you're right. We all have to be more discerning and understand this. because, like we do in Freedom Founders, we get really into the heart of that area that we work in. Well, that's what you do in your marketplace.

So let me ask you this. are some of the criteria? Obviously, in looking at who are good operators, because as you said, today it's about operations. It's not about just aggregating and doing the quick flip.

Those days, I think, are behind us. But it doesn't mean you can't align with or partner with someone who has shown to be good operators first, and then we'll take the recap when the time is right. I would say the marketplace is going to dictate that. So what are some of the key aspects that you look at, because you know who all the players are.

You've watched them. There's certain players, as you said, who have... gone through this iteration of the rapid rise of interest rates and they're still going moving forward. Is that where you start?

What are some of the criteria you look at when you're trying to align with those who you think still have a very good positioning for the right seller of the practice that has a model that will follow the alignment that you're looking for?

Brannon Moncrief:

So our team spends a tremendous amount of time vetting the marketplace, right? Trying to understand, you know, who are the A players in the market and only allowing those players to sit at the table and have a conversation with our client when they're ready to affiliate with a DSO. It's definitely a multifaceted approach. So first we're evaluating how large is the organization?

Do they actually have a real infrastructure? Are they prepared to support our doctor from an operations perspective? but not support them to the degree that they're completely gonna rob them of both their clinical and operational autonomy. But a lot of our clients are looking for that support.

Well, you have to have infrastructure, typically a corporate office with a lot of people coming to work every day to support your doctor partners and actually integrate, operate, and grow the businesses post affiliation. So support and infrastructure are critically important. We're looking at their history, a financial perspective. Have they had a recapitalization of it in the past? If so, when did that occur? What was the result? And how have they grown since? And then also looking at the pedigree of their private equity sponsor, have they been successful with other investments in the DSO space or at least other healthcare related dental adjacent companies?

We're looking at their management team and what is their pedigree? What is their experience? A lot of times you're looking at how their C-suite is built out and in what cadence did they build out the C-suite? where they focused on operations or growth first.

If you really want to build a sustainable business in the dental space, mean, operating at scale is the biggest challenge. It's a provider-centric business, staff and patient-centric business, and it takes a village to make it all work. So did they start with corporate development and aggregating EBITDA, or did they start with hiring a COO and really focus on buttoning up their operations before they looked to scale the business? And I think many of them put the cart before the horse in that way.

Also, what was their investment thesis, right? What types of practices did they set out to buy at their onset? What type of dentistry, what type of payer mix, what type of procedure mix, what's their geographic focus? And have they stuck to that investment thesis, you know, throughout the evolution of the DSO, rather than just putting darts on a map.

Also looking at their buying behavior, how disciplined are they? How sharp are they from an underwriting perspective? How thoughtful is their deal structure? What type of alignment do they have with their partner doctors, both at the hold co level and the practice level?

And we always joke with our clients that look, you want your buyer to be incredibly irresponsible on your deal, right? You want them to give you 10 times EBITDA, 90 % cash at close, no downside protection, but If they're doing that on your deal, they're probably doing that on every acquisition that they're making, meaning that the equity is likely going to turn out to be worthless. So, you you need to balance that when you're entertaining offers, because if they're being irresponsible with you, they're probably being irresponsible across the board. When you play in the sandbox every day, it's relatively easy within a short period of time to figure out who we think is going to be successful long-term and who is not going to be successful.

And it's actually incredible to see that there are still quite a few DSOs out there that are of the mindset. can aggregate EBITDA, not really build a real integrated platform and then sell for an accretive multiple. There are a lot of DSOs out there that I would argue are complete zombie companies that are going to be very rudely surprised when they go to recap in 12 to 24 months from now. We'll be in a little bit better.

macroeconomic environment than we've been over the previous 24 months, but there's not going to be a suitor. And at that point, what do you do? So you've already seen some aggregation among the aggregators, right? Some of the strong operators by some of the weak operators.

I think you're going to see a little bit more of that on a go-forward basis. And then you're going to see some BSO's just fall into the trap that they are what they are. And until significant times goes by, they're able to really focus on our get at growth and get their operations in order, waiting for the macroeconomic environment to improve substantially, they're not going to trade in the interim. there's been several DSOs that have recapped over the past 12 months. I think you'll see quite a few more recap over the next 12 months because of the fact that so few of them have recapped over the past 24 months. All of them are essentially going to be looking to go to market around the same time. So all related to the real estate market, the housing market. Imagine every house in a particular neighborhood going up for sale all at once.

Some are gonna trade. Those that have been updated that were built on a strong foundation and been well taken care of, they're gonna trade probably at a premium. Those that have been neglected that look very poor from a foundational perspective and operations perspective, same store sale growth perspective, quality of underlying asset perspective. they're likely not going to trade at all.

And everybody else is going to have maybe a marginal or moderate outcome in between.

Dr. David Phelps:

So what you're saying is just because I have a three bedroom, two bath, two car garage with a roof and a neighborhood and a fence yard, I'm not gonna, just because I have that doesn't mean I have something that the market's gonna want.

Brannon Moncrief:

Absolutely.

Dr. David Phelps:

Imagine waking up one day and not having a practice to run. No patience, no charts, no 6 a.m. staff texts. Just space to think, to breathe, live the life you've put off for years.

But here's the truth. You don't stumble into that kind of an exit. You build it intentionally. That's why we created the Exit Strategy Playbook, a free, brutally practical guide for practice owners who want more than just a payout.

You want peace, purpose, financial security, and a path that honors your values. Inside the Playbook, you'll find how to align with your spouse, what your numbers really need to look like, deal terms that protect you, and how not to lose your identity when you hang up the coat. This is your literal blueprint for exiting on your timeline with no regrets. Download it free at

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That's freedomfounders.com slash Playbook. Real freedom doesn't just show up with a check, it shows up with a plan. Download it now for free at freedomfounders.com slash playbook. Let's talk a little bit about what, again, and I've seen this, we saw the same thing in real estate.

■ The market was prime for those who want to get in and with what I call the era of easy money. Anybody could do it because capital was flowing, as you said, everywhere. And what we found was the Johnny-come-lately's that had no idea what operations were about. They thought, just flip these deals.

you are, as you said, just like some of the DSOs are sitting, you know, in a, in a really sideways holding on, you hoping, and again, the investors are hoping that, you know, they can get through and to when the macro changes and then ideally get some kind of return, ideally get your principal back. If you get that done and some, got some return in many cases, you're in good shape. That's our real estate market today. But I'm talking about, again, Johnny come lately.

I think, I think you came up with a, with a very affectionate term, duct tape. organizations where we're founders. again, I understand it, right? So founders that have a good practice and they've built some influence in a certain arena of dentistry.

They look to as good leaders in what they've done and they have done something well with maybe they got a couple of practices or two or three or they've done that part well and they're thinking, hey, why do we need to share profits with other organizations? Why do we need a DSO to come in and do this for us? We can do it ourselves. Yeah, right?

Whereas I get the intention, but where's the fallacy, particularly today in that kind of a grouping together aggregation?

Brannon Moncrief:

Yeah, I think, you when the dumb money left the market back in 2023, when interest rates skyrocketed, the premise that you could duct tape together a bunch of unaffiliated practices and loosely integrate them kind of pretend like we're one company and at some point sell the group for an accretive, even a multiple comparative to what the individual pieces are worth on their own. I would argue that that ship is safe, right? That that is almost impossible pull off. When some of the best operators, fully integrated profitable DSOs have struggled to recap or recapped at what I would say are muted multiples compared to 21 and 22, private equity has gotten wise, right?

We are no longer early in the iteration of the consolidation of the dental space. So private equity has gotten far more sophisticated and has made enough mistakes in the space to understand what is a worthwhile investment and what is not, right? They now know what they're good at and what they're bad at. At least the institutional investors on the back end do. So when these DSOs go to recap, they are being scrutinized more heavily than ever before. And that's also trickling down to the deals that we do, the smaller transactions, know, million to \$5 million and EBITDA, \$5 million to \$50 million valuations. They're undergoing more scrutiny because on the back end, their buyer is going to be scrutinized when they go to recap. So you can imagine that if I now take 20 practices to market that are completely unaffiliated, Different specialties across different geographies, they're not fully integrated.

We haven't combined the cap table. We haven't combined the operating system. And there's really no infrastructure. It's not currently a scalable business.

It's just simply a lot of EBITDA on a spreadsheet. That is not palatable to private equity marketplace. They are not going to pay in a creative multiple because they know the amount of time and energy and money it's going to take to fully integrate that operation before you can actually scale it. It's not worth it.

not, it's not worth the risk. So unless you're willing to make that investment and time and energy and money to combine the cap table and build a fully integrated scalable platform and show that you can scale it with that infrastructure before you go to transact, the multiple is gonna look very similar than it would if you sold the individual pieces. And what you're losing when you're part of these roll-ups or co-ops or collectives or whatever you wanna call it is optionality. Because once you join a group like that, you have been robbed of your optionality to sell when you want to to who you want to, because you're all forced to sell simultaneously to the same buyer with the same deal structure.

Most of those deals are set up so that the proprietor, the influencer that set up that platform to begin with, they're getting rich along the way, no matter what, in the form of management fees. They actually don't have to deliver that unicorn outcome at ReCap in order for it to be accretive to them. They're going to get rich irregardless. And there's actually a misalignment of incentives a lot of the time because they actually make more money if the platform doesn't.

Dr. David Phelps:

Yeah, that's gonna sell, exactly.

Brannon Moncrief:

In the form of ongoing management fees. What's been interesting is we've actually seen a trick that some of these have pulled recently in that they almost, I imagine they had this conversation with themselves. We're charging everybody in our co-op, our collective, whatever, \$5,000 a month in management fees. Well, why are we charging them \$5,000 a month when we could actually buy them and get a hundred percent of their EBITDA as opposed to \$5,000 a month?

So they've pivoted to actually raising a small amount of capital. buying the practices within the co-op for six to seven times EBITDA, but only trading 20 % cash at close and doing a 70 or 80 % equity rollover into the whole Co. So now rather than taking five grand a month, they're taking all of the EBITDA with the promise of this unicorn outcome when they go to recap the entire collective, which is never going to happen. So at that point you're stuck in a zombie company that you cannot get your equity out of, but the people that pitched you on the concept from the beginning are getting, you know, uber wealthy because they're reaping the reward of your EBITDA with very little return in infrastructure and operational help and not delivering on that promise on the back end.

Dr. David Phelps:

Yeah, no, you brought some really, really good points there. And so we're talking about autonomy, optionality, which is what I want everybody who aligns with what I teach, same thing. You want as much optionality as you can in your life and everything you do. What are

some other red flags that doctors should maybe be aware of?

Because you talked earlier about, I wanna make sure that the partner, if they're partnering with somebody that... There's alignment with cultural values that they're not gonna come in and strip away your ability to continue to operate the way you've operated to get to where you are. Other particular red flags, do they show up in conversations? Do they show up in term sheets?

Do they show up in the actual operating agreements? Where would people miss the mark, I guess, in certain red flags that you can spot in an instance?

Brannon Moncrief:

Well, I they show up everywhere, right? You've got to understand the nuances of the deal structure, not just the initial valuation in the cash at close, but where your equity is going to lie, what your rights are with that equity along the way, right? Are you going to get distributions associated with that equity or not? And then what are your rights with that equity at recap? And how does that operating agreement function and who has the control, right? And typically in most situations, the private equity firm or the DSO is going to have the majority of the control because they have majority ownership and those agreements are likely going to be written in a way that's favorable to them. So you want to make sure that you counter that with as many protective provisions within the legal agreements as you possibly can. But even moving back a little bit before talking about when you're speaking with DSOs, what are the red flags?

I think even more important than that is how you decide to make the decision to affiliate with a DSO to begin with, right? And that's where we start the conversation is unpacking the why, right? Is this economic? Are you looking to de-risk and diversify your net worth and your personal wealth?

Are you looking for administrative and operational support? Is this a succession planning tool? And then, unpacking, you how is your practice engineered from a financial perspective and will it fetch a premium in the DSO space comparative to either hanging on to it for now or monetizing it to a private buyer. So getting fully educated regarding what you have, what it's worth, what all of your options are, and going through that exercise before starting a serious conversation with a potential DSO buyer is critical.

And doing it with somebody like us that can take an objective approach that understands how the doctor to doctor world functions, that understands how the DSO world functions that can execute at a high level in both of those arenas. But we'll also have the conversation with you about who you are, right? What keeps you up at night? What gets you out of the bed in the morning and how your practice is engineered to decide if and when it's even appropriate to pursue a DSO affiliation.

And then at that point, only entertaining the best of the best options and then doing a lot of diligence to make sure that you're picking the right partner, the right deal structure and maximizing the valuation. If you don't take that type of holistic approach to this conversation, you are prone to make some serious mistakes that are going to either cost you a lot of money ■ or a lot of ■ emotional stability over time because Typically, you only have this opportunity to do this once and you got to do it right or you're going to regret it. Having sellers remorse of selling the goose, selling your baby, selling your main source of income or maybe your only source of income, as well as your legacy and your identity, there's nothing worse. We

engineer the process so that it's predictable and we don't have our clients calling us a year or two later saying, hey, this is the worst decision I ever made.

Dr. David Phelps:

Let's take off a few of the will hang fruit. I'll call it that of not red flags, but going back to what you said about about the why I still talk to in our group doctors who come in and they're definitely are looking to make a sale transition of some kind. many of them are have very astute. I say how high caliber experiential solo practices five ops, right?

And they are still thinking or asking the questions like, I'm thinking about the DSO route. And I go, well, you know, it's not my area of expertise, but I think, you know, you need to talk to somebody. Let's just give a few of the frameworks of people who probably should not even consider a DSO, know, capacity size, EBITDA numbers, ■ total revenue, associate, no associate. What are some of the ones that would just stalemate somebody from like, let's not even go down that road.

Let's talk about private sale.

Brannon Moncrief:

Yes, the size alone is a big indication of whether or not it makes sense to give serious consideration to going the DSO route. But with most of our clients, the way I explain it from a purely economic perspective, unless there's a substantial gap between what the private market will bear and what the DSO market will bear, substantial gap in valuation, it typically makes no sense, at least from an economic perspective, to go the DSO route. So what we typically say is if the cash closing on the DSO deal is not equivalent to or greater than the valuation from a private buyer perspective, economically speaking, I think there's too much risk on the equity component to consider going down the DSO road. Just hang on to your practice until you're 12 months away from looking to retire and sell it to a private buyer. You're gonna likely come out ahead economically in that scenario. We normally find that practices with revenue below 1.5 million with EBITDA below 300,000, the gap between a private buyer evaluation and a DSO valuation is not significant enough to consider going the DSO route. The vast majority of our clients that transact in the DSO world have larger multi-doc practices with annual revenue of 2 million plus, EBITDA of \$500,000 plus. where the valuation of the DSO world is double what it would be in the private buyer world. And the cash it closed on the DSO transaction, while it might only be 60 to 70 % of the valuation, is still significantly higher than what that asset would trade for from a private buyer perspective. So that's why a lot of times when we do valuations for clients, which is where we always start the conversation to quantify the potential economic outcomes, we're looking at it through a dual lens. We're doing evaluation from a private buyer perspective, comparative to evaluation from a DSO perspective, and then educating them about the nuances, all the strings attached to each of those types of transactions so that they fully understand the pros and cons of each path. And then from there, it's, pick your own adventure.

Like, I don't care. Sell to a DSO, we'll make sure you crush it. Sell to a private buyer, we might want to wait. a little while until you're closer to exit before we pull that trigger and monetize the business.

Dr. David Phelps:

You said earlier, and I agree, you know, that private equity has become a lot smarter. Well, we all get a lot smarter with the markets shift and change. imagine, well, let's me put it this way, let's it this way. I have the privilege of talking to docs who have partnered and sold to a DSO and are happy as they can be.

And they're two, three years down the road and maybe they sold two or three years ago, but it's been really good. So they've partnered with the right buyer. I know others who are, as you said, you know, ■ in a, horror story. lot of what comes up that I've seen is that the, let's call it the creativity, put a good frame, creativity of the documents that are being used that tend to purport more of the risk on a seller in the fine language.

How do you, how do you help your doctors and particularly even with good operators that you've worked, that you've personally had a good relationship with in your, in your sellers have, but still the iterations of the documents coming forth, I mean, Who's digging into those documents to really look the clauses and the clawbacks and the, not the pro forma, but the actual numbers that have to be hit. Otherwise, the seller owes back. Are you doing that? Do they have their own attorneys do that?

I mean, how are they helped through that? Because that's a very intricate piece that, as you said, most people only do this once. And it's not gonna be their bailiwick to figure this stuff out on their own.

Brannon Moncrief:

Yeah. And you make a valid point, especially when the market tightens and we're mid consolidation. So, you know, private equity knows how to hedge risk, right? DSOs have gotten smarter about how to hedge risk and how to create alignment with their providers.

And that's a huge talking point these days because this is a provider centric business, right? If you don't have the doctors, if you don't have the founders and everybody's not swimming the same direction, you're going to have a problem. You're probably not going to be successful long-term as the owner and operator. of a DSO.

So because of the change in the macroeconomic environment, because of the fact that private equity investors and DSOs have gotten wiser in regards to the potential downside risk of these transactions, you're seeing deal structures evolve. know, cash closing has come down, comparative to where it was a few years ago. And in almost every instance, there's going to be some type of provision designed to protect the downside for the DSO. And To some degree, rightly so, right?

They want to make sure that the founders are still incentivized to keep their foot on the gas post-close. Whether that be a joint venture, you know, retained equity component at the practice level, whether that be some type of equity dilution provision, earn out, seller note, hold back, whatever it may be, you're going to find that in almost every transaction today because they want to make sure they don't have a free rider problem where the seller now only holds equity at the hold co level. They no longer have any incentive to keep the foot on the gas at the practice level. And therefore, as a result, globally, the organization suffers. It just has too much misalignment, too much downside risk. As far as when we get in the nitty gritty on evaluating the operating agreement, negotiating the legal contracts, our team, in combination with an experienced DSO attorney, is involved on the doctor side to make sure

that we mitigate as much of the risk as possible and at least make sure our client is aware of the risk. Right now. Look, some DSOs are more flexible than others in regards to how much they're willing to negotiate on their legal agreements.

But more than anything, you need to go into this eyes wide open regarding what level of control do you have, which is going to be relatively limited as the minority owner of a private equity backed business. And what are the potential ramifications if things don't go perfectly. And again, though, I think that's where it's so important on the front end to decide, does this make sense in the first place? And what is my valuation premium going to be if I go the DSO route?

What is my cash at closing? That's protected, right? And then what is the risk versus benefit proposition on the equity side of the conversation? And all the DSOs are going to tell you that their equity is risk-free and they're going to hit three recapitalization events with a 20 X return on equity over the next 15 years.

I mean, the reality is that's possible. There's been a handful of DSOs accomplish that financial outcome, but you cannot make a sell decision off a risk-free return on the equity component. mean, at 20 X return, everybody's a seller. You have to work with much more.

modest expectations regarding the back end outcome and understand that there is risk there. There's potential reward, but there is risk and dependent upon who you choose as the buyer, that risk could be significant. What I'll also say is nothing is typically set in stone as far as what is going to happen with the equity when the recap occurs. There is a transaction that will be negotiated at recap between the DSO and the buyer at that po are not known at the point with that D.

S. O. So th regarding what the return to look like when that re going to occur and how going to be able to liquid to negotiate some type of Most DSOs are not willing to provide that level of safety because for them it's also an open ended TBD conversation. have risk in the deal as well.

So at least in that way you are aligned in that you both have risk, but there is so much to unpack in those operating agreements that is so important when we get there. And that's why we make sure that our clients have third party legal counsel that's very astute in the DSO space. to come in, evaluate, and negotiate those nuances.

Dr. David Phelps:

Very good. So let's end with this. Brandon, what do you say to the dentist who is reluctant to start any kind of planning for a transition or exit because they're just not ready yet?

Brannon Moncrief:

Look, it's a very financially impactful conversation, but it's also a very emotional impactful conversation, right? A lot of times, especially if we're talking about this from a succession planning standpoint, you're talking about, you know, giving up a piece of your identity and thinking about your own mortality. And it's not easy to start those conversations. But if you fail to plan, then you should plan to fail, right?

you've got to start getting educated early and often regarding your options. If you wait till the last minute, like so many of our clients do, it is what it is. The practice is worth what it's worth. The cashflow or EBITDA is what it is and your options are going to be relatively limited.

But if you start planning five to seven years in advance and start having these conversations, get evaluation done, understand what's happening in the private buyer world, what's happening in the DSO world. what your business is worth in each of those arenas today and what those options look like, then you can reverse engineer whatever outcome you ultimately want to achieve if you've got the runway to do it. start those conversations early. You know, I'd love the opportunity with anybody listening to this podcast to have a discovery call, just to get to know each other casually and decide, Hey, does it make sense to do evaluation to quantify what your business has worked and what your options are with no pressure to go to market in short order?

It's about education and through education comes optionality and the probability of ■ realizing a much better outcome than if you just procrastinate and have the conversation, you know, the day after you were ready to sell.

Dr. David Phelps:

That's exactly where I want to go because too many people think that, I don't want to call in this case, Brandon Moncrief, because he's the guy who helps you figure out how to sell your practice. Well, I'm not even, that's out in the future. But if you don't have the conversations now to determine what your why is, you can help people discern what levers they can turn or pull that they might want to or something they don't want to at all. And now that person has a clear path to the, now I know what I want to do because Brandon's told me here's what's gonna make a difference and I choose this one, this one, this one and now I know in three years, four years, five years, seven years, whatever it is, I've got a path.

They can even check in with you from time to time and say, hey, here's where we are today, how's it looking? Life changes, circumstances change and if you plan ahead, who knows what that preparation may do for somebody in a positive, not a negative way, a positive way because there's maybe an opportunity exit that someone never saw, an exit to give them, again, what are we looking for? more freedom, more optionality. Not necessarily to get out of dentistry.

That's not what we're talking about. For some it is, for others it's like, can I actually have a game plan that allows me to enjoy the ride as long as I want to enjoy it?

Brannon Moncrief:

Absolutely. And I do think that the broker community has done a bit of a disservice to the dental industry in respect that a lot of people that sit in my seat are trying to figure out how to get from an initial conversation to a commission as fast as possible. And that's just not how we've built our business, not how we've built our reputation. We have about 75 clients that we are doing annual EBITDA updates for and trying to time the market, right?

From a macroeconomic perspective and combination with how their business is performing. when is the right time to pull a trigger on the sale and we're blessed to be busy. So we don't have to convince somebody to go to market prematurely or pursue a certain type of transition when maybe that's not in their best interest. So it's a great place to be and it allows me to just kind of sit back and be objective and educate people.

And if and when it makes sense, we'll make sure that you crush the outcome. Until then, we're gonna try to advise you on how to reverse engineer the outcome you want.

Dr. David Phelps:

Perfect, Brand, great conversation today. I really love digging in with you because I think we see so much of the playing field, the macro economics, you know, from our vantage points, your history coming from the banking sector and then being in dentistry for 25 years in the capacity you are. It's fun to talk to you because so many similarities. What's the best way for people to connect with you at McLaren and get some help to start that conversation?

Brannon Moncrief:

Yeah, check out our website. It's dentaltransitions.com. It's got a lot of conversations, articles just like this. Website's really just designed to educate doctors regarding everything we've talked about today.

I always give out my cell phone number. You can text me to schedule a 30 minute casual discovery call, 512-660-8505. And my email is Brandon, B-R-A-N-N-O-N at dentaltransitions.com. Yeah, please reach out.

to get to know you and figure out if now's the right time to at least start having a little bit more serious conversation about the eventual accident. But thanks for having me, David. It's always a pleasure talking with you.

Dr. David Phelps:

Very much. Thank you, Brandon. We'll talk to you soon. One of the greatest fallacies that I see in my privilege working with hundreds and hundreds of doctors, dentists over many, many years is that they wait or delay their exit planning until it's too late or until they're ready to make things happen.

The problem with that is there's a lot of complexities and putting any business on the market to sell. And just because something happens to one's life. that turns the tables could be a health crisis, could be a marital breakup. could be a child that needs help.

It could be a plethora of things that cause that. could be, it could be just flat out burnout and just had it with the practice. The problem is unless a doctor is willing to put their practice on the market and sell it at a lesser value than what it could obtain in a marketplace where the valuation is held based on certain standards of criteria, rushing a practice to market too quickly. is a big problem.

Doctors wait because we're, this is something that we only do once in our lifetime. Usually most doctors will sell their practice one time and that's it. So it's not something we have a lot of understanding about. It's something that we don't really want to deal with until the day we feel like we have to deal with it.

It's kind of like estate planning. lot of people don't even have a basic will, let alone have a trust or additional documents to help deal with themselves, their life. and their state at the end of their life. People put it off thinking, well, I have a lot of time left.

We never know how much time we have left. That's the problem. So it's not something that moves the needle forward for us in any direction. It's just something that has to be done when it's time to do it.

Getting a handle on what it takes to sell a practice makes sense even if you're years out because I've always said that building a practice to sell, even though you don't intend to sell it, at least not right away, means that practice is going to have better metrics better systems,

better protocols, better SOPs and be a practice that when you show it to sell it, when it's time to do so, it's going to stand out. It's gonna get you the higher valuation. They're a practice that you put together at the last minute. Your books aren't good, they're not complete.

The practice doesn't have a lot of regiment of protocols involved in it. And the buyer is gonna look at that and say, I'm gonna undervalue, underprice this practice because it's gonna take a lot of work. That's what you don't wanna show to the marketplace. One area of constant confusion in the marketplace regarding private equity and private equity backed DSO offers and platforms is the difference between an equity rollover and a recap.

Two completely different things. An equity rollover is when the equity that's aggregated, it's brought together by an aggregator, DSO group, actually, that equity is actually sold. It's sold to another buyer through the DSO conduit. A buyer actually buys out that equity and takes it on in a larger platform.

That's an equity roll-up and that's what's desired in private equity. That's the way private equity is meant to work when it works. A recap is nothing more than a refinance. Just think about the difference between selling your house.

Let's say you've got a house that has a lot of equity in it and you'd like to tap that equity. So there's two ways to do it. You could sell the house and yes, there's gonna be some commissions and perhaps some tax on the capital gain depending upon how long you've lived in the house, et cetera, but let's just put that aside for a minute. You actually sell it and take that equity and it becomes liquid.

It's cash, it goes into the bank and then you do what you want to with it. That's an equity rollover. The other way to do it is not sell the house and simply go to the bank and refinance. Refinance and pull out your equity and refinance.

You still own the house. but now it has more debt on it. If you can service that debt and do something wise with the money that you pulled out through a refinance, then that could be a good thing. But debt is debt.

And today the problem is with recaps or refinances in the DSL private equity world is that these recaps, the refinance are being done at higher and higher interest rates. I've seen some recently as high as 12, 14%. That can't be a good thing for the mothership to be ladening the practices with this kind of debt. and thinking going into the future that the profit margins, the EBITDA is gonna stand up.

It just can't happen. The math just doesn't math. So again, big difference between an equity rollover, which is a sale, an actual sale, and a recap, which is a refinance. Keep those two in mind when you're looking at the terminology and understand that there is a big difference.

Understanding incentives. In a capitalistic marketplace, which is what we're blessed to have in this country, even though some people say it's not the right thing. Capitalism is pure form is the best system available on the planet. Realize again, it's not in its true form in this country. It's been prostituted quite a bit. Nevertheless, understanding incentives. In a capitalistic environment, incentives are everything. Now we all have incentives.

We want to take care of ourselves, but in a capitalistic environment, there has to be a value exchange. The value exchange has to be seen by both parties and realized actually realized and the trust is to be there that it's going to be an exchange. That's why sometimes when someone sells something, product, a vehicle, a house, or even a service, they put some kind of warranty or guarantee behind it let the other person feel like, hey, I'm not buying a lemon here. Well, same thing goes for selling a business or a practice.

There are incentives. Everybody who's part of the transition from you, the seller of that practice, well, your incentive is to get the most you can for the practice and do it in a way that best serves you and hopefully maybe your patients and your staff as well. but serves you and your family the way you think it should be done. Whether that's to sell to a private buyer or you sell through partnership tranches or you sell to a DSO ■ backed by private equity, whichever you choose, you wanna do it and you've got your reasons why.

The other side, whoever's gonna be the buyer also is incentivized to do what? Well, they want to make a deal that works for them, whatever that means. It can be different for different buyers, right? But everyone's gonna have incentive.

Now there's other people, other ancillary players that are also involved. There's the broker, there's a CPA, there's the bank, the lender, there's the attorney, attorneys, I should say, that are working on it. There's a lot of people that have a stake in the outcome. And just realize that the more time that anybody puts into a transaction, the more they're incentivized to see it go through because they want to get what they deem as theirs.

Either a percentage or fees or commissions or whatever it may be, everyone wants to see that. So just understand that when you are putting yourself out there to sell something, make sure that the advice you're getting or the motivation you're getting from some parties in the transaction are right for you. Not saying that people aren't trustworthy, but everybody's gonna have a stake in the deal and you wanna make sure that they are aligned with you or you make sure that you stay true to yourself when you're selling.

to make sure you get what you want the way you want it. Don't let other people turn or twist the model in a way that doesn't suit you. If you're inspired by today's conversation and you're realizing it's time to take ownership, not just of your health, but your time, your practice and your future, then you're not alone. At Freedom Founders, we help dentists and professionals like you build a life where freedom isn't just an idea, it's a reality.

If you're ready to explore what that could look like for you, schedule a discovery call with our team. Let's talk about your goals, your vision, and how we can help you create the roadmap to get there. Start your journey at freedomfounders.com. Remember, freedom doesn't just happen, it's created.

And as always, hit that like and subscribe button wherever you're watching and listening. I'll see you next