The Deal Room Podcast

Episode 163 – The inside story from an aggregator: how to drive transaction success part 1

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Transcript

Joanna: Hi, it's Joanna Oakey here and welcome back to The Deal Room podcast, a podcast proudly brought to you by our commercial legal practice, Aspect Legal. Now today is a discussion with one of our clients Peter Hughes of Kikada Lane dental discussing a different take on aggregation models.

Kikada Lane is a dental aggregator created to disrupt the industry by offering a true partnership model to dental practice principles. And in this two-part series, Peter and I discussed the real story of being in the middle of the transaction. Now on this podcast, we have a number of interviews with professionals who work in the industry, but also really love to bring new stories from the coalface, stories from the people who are actually doing and leading these acquisitions and sales. And in this

episode today, we get really deep into the reality of acquisitions. We talk about the unique model Kikada Lane has employed as an aggregator of dental practices.

We discussed the identification of opportunity for aggregation we talk about the biggest issues aggregators have we talked about how models can be built to minimize aggregation risks, we look at the practical steps Kikada Lane takes to enhance deal success. We look at valuation models, we look at the normalization process and explain all of that, from an accounts perspective. We talk about how a dental practice can line themselves up for a sale. We also talk about potentially adding checking out the vibe to our DD checklists. We look at where deals can go wrong. And we look at a hell of a lot of insights into the deal process as a whole. So buckle in here we go for a really great episode with one of our clients, Peter Hughes from Kikada Lane Dental.

Joanna: Peter Hughes, welcome to The Deal Room podcast.

Peter: Thank you for having me, Jo.

Joanna: I am absolutely excited to have you on the show, Peter, we do a lot of work together. And I guess I really just wanted you on the show today because I wanted to dig into the real stories of being involved in the middle of the transaction. You know, we have a lot of people on guests on the podcast that are talking about it from the advisor space, but I just think it's always really interesting to get into it and look at what the inside of the transaction looks like. So let's take it away. Maybe if you can kick it off, Peter, just by giving us a little bit of an outline of Kikada Lane on what you're doing at the moment what is the model that you're following currently, with your acquisitions,

Peter: I suppose to put it in fairly basic terms, we are a dental aggregator. So we look for high performing cure dental practices, we acquire those practices based on set criteria of valuation. And we provide all the back office and corporate service, I guess, things that are required to operate the practice. From a non-clinical standpoint, we've got practices at the moment in Queensland, New South Wales and Victoria, we're about to enter South Australia, we've got a transaction almost complete there. And we've got a fairly deep pipeline of potential acquisitions lined up. And I suppose the thing that differentiates us from other aggregators out there is we have a more flexible model insofar as we can either acquire 100% of practice or we can acquire a 50% or greater proprietary interest in practice. And we create a partnership opportunity with the principle that can reap, I think, far higher rewards in terms of wealth creation for the participant.

Joanna: Yeah. And that's what I think your model is really unique. And I guess there are lots of models around aggregations. And you know, I guess the dental industry itself, as we know, has gone through some changes. And, you know, has some, perhaps challenges at the moment for an aggregation model. So maybe Can you talk to us a little bit about the industry as a whole and why you've gone with the sort of unique take on the model.

Peter: The industry is a $10 billion-plus industry sector in Australia. So it's a large exercise, there are about 8000 odd registered dental practices in the country, and they vary in size from a single man practice to multiple owner practices, and only about 7% of the market has been aggregated. So it's a very low level in comparison to the UK and the USA. So there is, I guess, from my standpoint, a significant opportunity to acquire a number of practices and to build a solid business portfolio from that.

Why we do what we do is I think the biggest issue most aggregators have is the retention of key performance and sustainability of earnings. So, our model has put a lot of thought into how we can retain the services of the dentist through locking mechanisms that incentivize them to perform rather than create, I suppose relationships that require, you know, the big, big stick over the head approach, which we think doesn't work. So it's all about relationships for us, and how we work in an aligned and cohesive manner with the principles.

Joanna: And like getting really practical. Let's talk about what you practically do to give life to that, how is it that you're, you know, you're giving life to those things that you're talking about.

Peter: We source practices from a variety of mechanisms, we have brokers that we work with, right around the country, who knows, particularly me and my team, and know what we're looking for. We often have practices that approach us directly, we market directly to some practices. So we don't really have an issue or a problem in terms of sourcing product that we can place in our portfolio, it's really working through what fits our model best, and what relationships we believe will best suit us and the participant. And that's really it around the culture that exists in the practice, I suppose, in comparison to the culture that we've got at our head office. So there's a number of factors that we look at in terms of making an acquisition.

But once we've built a relationship with the principal, it then comes down to being able to assess, particularly the financials of that practice, and looking at the empirical earnings over usually a three year period. And we go through what we call a normalization process, where we cut out a lot of the non-operational expense lines at some businesses or some practices around through their books. And we, we come up with an operational EBITDA. And we apply multiple to that EBITDA and that's how we get a valuation of the practice.

Joanna: And so for any of our listeners, who might be running dental practices and be interested in this process, Can you maybe perhaps don't understand the normalization process? Can you just talk about a little bit, just briefly, what is it that you're pulling out,

Peter: We pull out things like if a principal is running in a motor vehicle, or personal vehicle through practice, or has personal insurances running through the practice might be running other things through the books that are not pertinent to the operation of the practice, we strip those out, we also take out depreciation

because we look for any interest in any financing charges, because we're actually assessing the valuation on the on an EBITDA our basis.

Joanna: Right. Okay. All right, wonderful. And so and so you've talked a little bit about the process that you go through, but just from a more general perspective, what is the kind of dental practice that you're looking for? So So you mentioned culture as being one of those things, but what does that look like? Or what should dental practices be thinking that they should be doing to line themselves up for these type of potential relationships in the future of sale?

Peter: Yeah, I think one of the key things we see is that there are a lot of great practices out there, but a lot of the earnings revolve around one individual, so that personal exertion levels of a principal, play a big role in determining one the level of attractiveness of the practice. And secondly, the impact on valuation, because obviously, that key person goes down, the earnings of the practice will be impacted significantly. So we will for a spread of earnings spread of practice for learning practitioners, most of our acquisitions are multi chair, so three chairs and above top practices.

And in terms of culture, it's very interesting, because as soon as you walk into some practices, you can see the level of vibrancy, the happiness of the team, the way they meet and greet their patients, you know, the energy in that practice. And there are others that you go into, and you wonder how they've got patients through the door. So yeah, it's because I've been in this industry now for many, many years. It's a pretty easy thing for me to walk through and and see how that practice operates from a process standpoint. So that plays a big part on my decision making in terms of does this practice actually fit what we're trying to do most of the business?

Joanna: I love that because I'm just thinking as you're talking, you know, I've seen lots of m&a and due diligence checklists over the time but walking in and feeling the vibe of the place is not usually on there, but I love it. That's it's such a good point, isn't it that maybe, is overlooked quite often by the practice owners themselves.

Peter: Yeah, I think it is, you know, and it's like, we have all our due diligence checklists like everyone else. And we go through formal DD processes, we use external parties to do both the legal and the financial DD as a check mechanism for us. So we've got all those processes in place. But you're right, unless you walk in the door and you meet and greet people only talk face to face with the principles and the fee earners, you just don't have a feel for how that practice operates.

And even post acquisition, it's really important for me to be able to walk into any practice that we've acquired, or we've got a proprietary interest in and the staff in their practice, know me, they greet me by name, I can greet them when I can remember their names because we've got quite a few team members now. But I take the time to explain to them that just because I'm wearing a suit, or a different set of clothes and not scrubs that I am no more important or no less important than

anyone else, we just have different roles in the business. So I trade everyone the same on an equal basis. And that works really well for us.

Joanna: And so and I'll ask you in a moment to talk a little bit about your history, because I think, you know, there are some interesting things there we can talk about, but you've had a long history in understanding how sales and acquisitions in this space can work. What do you think is some warnings like where have you seen in the past this sort of go wrong for practice owners that are selling it?

Peter: I think, if you get past, let's say, you know, appointed term sheet and you move into contracts, and the contracts are fairly simple, you've got a sale or an acquisition agreement. And that can buy shares or assets and goodwill, and then you've got a service level agreement that locks in the principal or principals into our relationship with you for a period of time, I guess, where we've seen things go wrong, is when you don't define, I guess, some key points in the contracts. And even when you do, some of the vendors were pushed back very heavily on those.

But I guess from our perspective of were putting millions of dollars on the table to acquire high performing practice, we have an expectation that what we're acquiring in terms of equipment, and the gear that's in that practice, and the tools that are used, are in good working order. So what we like to have in place is a warranty or a set of warranties around some of those types of matters that create less of a risk for us when we start to operate the practice. I guess another hotbed at the moment is information technology systems because the rules and the laws now around privacy and data breaches are very significant. And we find a lot of practices are still running, what you would term domestic style, IT setups, even using a computer as a server and antivirus protection, really poor firewall protection.

So we really need to have the proper systems in place when we acquire the practice because we've actually suffered data encryption or ransomware attack in one of our practices. And it can create havoc and you know, bring down production for weeks at a time. So I think we've learned some lessons from what we need from that. And we work with our IT provider, in undertaking an audit along with the other DD items prior to acquisition.

Joanna: I think one interesting element in what you're talking about here is I think, sometimes the benefit for practice owners who are exiting to exit to sell to an acquirer who knows what they're doing with the process. Because, you know, there's a lot of issues in selling any sort of business, including a dental practice, to a buyer who doesn't know what they're doing in the process.

But also, you know, there can be a lot of issues when acting from the buy-side when you're dealing with sellers who, you know, generally have never done this before. But even worse still, if they have, you know, advisors and deal teams who haven't dealt with this area a lot, you know, that that can be a tricky tightrope to walk, I guess. And, you know, you and I have had many discussions over time of how do we ensure that we're able to properly bring the parties along in the process when they may not be well educated and because I haven't done this before. What

insights Have you had over time about what works well, and what doesn't work well?

Peter: I think you rose a very good point and if I was a vendor, selling a dental practice, I would try and get some advice from a lawyer who's been down that pathway before. Because it's a very different business, I suppose. Any clinical service business has its nuances. And what we found is that sometimes we get stonewalled with, I guess, a commercial viewpoint, are keen to sell a building or property or another type, you know, in industrial business, etc.

So it's a specific and, I guess, contentious issue if you don't get the right advice at the outset. And as I said, at the start, what we try and do is make sure our contracts are written in clear English. They're not difficult to comprehend or read. And they lay things out fairly simply. But we've been in situations where lawyers have tried to rewrite the whole things.

Joanna: Yeah, being overzealous. Yeah, there are lots of stories there Peter, quite lots of stories. And but I guess the point is, as well, when you're working with lawyers to put together, you know, contracts that you're using, one of the important things, I think, is to also have somewhat balanced contracts, you know, because otherwise, you'll end up, you know, we've had lots of these discussions as well. But the benefit of having these more balanced contracts that are going out is that you know, you're really reducing the real issues that should be coming up in that, you know, contract negotiation phase.

Peter: That's absolutely right. All contracts need to be balanced and equitable. It can't wait for one heavily one way or the other, it just doesn't work for anybody like that. So, you know, one of the things are supposed to have some pushback on occasionally, as we hold a small retention sum at settlement to account for adjustments that occur, post-settlement. So often supply bills come in late, it might be superannuation, that's outstanding, or employee entitlements that need to be adjusted.

So you know, there are invoices that have been sent, and the payments come live, which should go back to the vendor. So we use that sum, and we only hold it for a month to make those adjustments, and then we release the balance back to the vendor. But we've had pushback on things like that. But to me, they're just sensible, commercial things to do to make the process go smoothly rather than trying to create, you know, a barrier to something in someone else's mind.

Joanna: Yeah, absolutely and the other thing that also comes up, you know, in my mind about the process is, you know, things sometimes just drive me nuts about because we deal with lots of other lawyers. So I can comment on what drives me nuts about many lawyers, with authority, because we deal with so many but constant forwards and backwards of emails, you know, I just find a lot of lawyers just hate getting on the phone, hate getting together, and actually talking through issues. So it's a bugbear of mine. But you know, and I just think, you know, deals are best done in a rapid way. And, you know, getting on the phone quickly, or

getting an all parties meeting together to resolve issues. What're your thoughts on that process sort of side?

Peter: Oh, boy, you're absolutely right. We've been through it together in quite a few times and there was one instance on a transaction we did this year up in Queensland, where we had one of those lawyers, but yeah, it makes a hell of a lot of sense just to get on the phone and talk things through and put it out there, rather than send reams of emails back and forth, it, it just racks up unnecessary time and costs for everyone. So, you know, I think if you're going to do this sort of deal, I think even like, a pre-contract meeting with the lawyers involved, to talk about how we're going to approach completion of the transaction. One of the key components that we're going to include in the contract over and above what we've stipulated or articulated in the term sheet, and just talk it out. And maybe that's a better way to, to approach it, and then everyone's on the same table before we start.

Joanna: I completely agree. I've always loved this area of law, particularly because it's all about the parties that are all driving for the same thing at the end of the day, you know, you're driving for the win-win for everyone. And I think When you can put a process in place that helps support that communication between everyone because what you're talking about here is, you know, quite often embarking on a long term, ongoing relationship, you know, it's not just signing the contract and be done in many instances. And so setting it up right from the beginning, but not allowing, you know, the lawyers or other components of the deal team to come in and create elements of mistrust by, you know, by wrong communication style, I think is such an important part of making sure it stays a win-win for everyone throughout the process.

Peter: I think, again, you're absolutely right, and I guess when contracts have finished with our acquisitions, it is very, very rare when I've had to go back and pull one out to reroute a clause in something. You know, because there's been a query raised so everyone's pretty much on the same page when the deals are done.

And we are in long term relationships with our principals because some of them have burnouts and, you know, ongoing, I guess, agreements with us. And we are, you know, we're partners, and we see them in many ways as our clients rather than the patients because we have to provide them with a service to enable him to be able to deploy treatment plans to their patients. So it's a very important relationship, it's really important, we get off on the right foot together, and we keep that momentum going the whole way through.

Joanna: Well, that's it for our first part of our two-part series, all about the real story of being in the middle of a transaction, discussing a different take on aggregation models. Now, if you'd like more information about this topic, then just head over to our website at www.thedealroompodcast.com, where you'll be able to download a transcript of this podcast episode if you're one of those people who just like to read these things in fine detail, and they're at our website, and in our show notes, you'll be able to find out how to contact Peter Hughes or the team at Kikada

Lane Dental if you're a dental practice, who liked the idea of partnering with Kikada Lane Dental, or in fact if you're an accountant, and you have clients that you think might be suited to this model, and of course, on our website, we also have details of how you can contact our lawyers at Aspect Legal If you or your clients would like to discuss any legal aspects of sales or acquisitions, we've got a number of great services that help businesses prepare for a sale or acquisition or to guide them through the journey of sale or acquisition.

We work with clients both big and small and have different types of services depending on size and complexity. So don't hesitate to book an appointment with one of our legal eagles, if you'd like to find out how we might be able to assist. And that's it. Thanks again for listening in today, make sure you tune into part two of our two-part series as we continue the discussion with Peter and in the second part of our two-part series will be digging deeper into different acquisition models. We'll look at the risks of losing high performers, we'll look at a better way to eradicate risks of acquisition. We look at the importance of HR advisory in recruitment for aggregators, we look at the benefit for smaller businesses and practices of having a larger support team behind them. We talk about rebranding, we talk about early wins that the model that Kikada Lane Dental is using is really showing and we also give a bit of a client perspective on working with the team at Aspect Legal.

Well that's it I hope you join us for our second part of our two-part series. But for today, if you enjoyed what you heard today, make sure you hit that subscribe button on your favourite podcast player, and maybe even leave us a review and you can do that by going to Apple Podcasts or your favourite podcast player. Thanks again. You've been listening to Joanna Oakey and The Deal Room Podcast, a podcast proudly brought to you by our commercial legal practice Aspect Legal. See you next time.