The Deal Room Podcast

Episode 204 – Podcast Replay: The inside story from an aggregator: how to drive transaction success with Peter Hughes

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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. 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 real partnership model to dental practice principles. And in this two-part series, Peter and I discussed the whole story of being in the middle of the transaction. Now on this podcast, we have several interviews with professionals who work in the industry and love to bring new stories from the coalface, reports from the people who are doing and leading these acquisitions and sales. And in this episode today, we get 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 most significant issues aggregators have we talked about how we can build models to minimise aggregation risks. We talk about the practical steps Kikada Lane takes to enhance deal success. We look at valuation models. We look at the normalisation process and explain all of that, from an accounts perspective. We talk about how a dental practice can line themselves up for 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 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 excited to have you on the show, Peter, we do a lot of work together. And I guess I 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 many guests on the podcast that are talking about it from the advisor space, but I just think it's always exciting to get into it and look at what it looks like the inside of the transaction. 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 and 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 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 relatively deep pipeline of potential acquisitions lined up. And I suppose the thing that differentiates us from other aggregators is that we have a more flexible model insofar as we can either acquire 100% of practice or acquire a 50% or greater proprietary interest in Practice. And we create a partnership opportunity with the principal that can reap, I think, far higher rewards in terms of wealth creation for the participant.

Joanna: Yeah. And that's where I think your model is unique. And I guess there are lots of models around aggregations. And I think 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 this unique take on the model.

Peter: The industry is a $10 billion-plus industry sector in Australia. So it's an extensive exercise, there are about 8,000 odd registered Dental Practices in the country, and they vary in size from a single man practice to multiple owner practices. Only about 7% of the market has been aggregated. So it's a deficient level in comparison to the UK and the USA. So there is, I guess, from my standpoint, a significant opportunity to acquire several Practices and to build a solid business portfolio from that.

We do what we do because I think the biggest issue most aggregators have is retaining critical performance and earnings sustainability. Our model has put a lot of thought into maintaining the dentist's services through mechanisms that incentivise them to perform rather than create relationships that require the big stick over the head approach, which we think doesn't work. It's all about relationships for us, and how we work in an aligned and cohesive manner with the principles.

Joanna: And getting practical: let's talk about what you practically do to give life to that. How is it that you're giving energy to those things you have discussed?

Peter: We source practices from various mechanisms. We have brokers that we work with, right around the country, who know my team and me, and understand what we're looking for. We often have practices that approach us directly. We market directly to some Practices. So we don't have an issue in terms of sourcing practices that we can place in our portfolio, it's working through what fits our model best, and what relationships we believe will best suit the principal and us. And that's the culture in the Practice, I suppose, compared to the culture that we've got at our head office. So there are several 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 assessing the financials of that practice and looking at the empirical earnings over usually three years. And we go through what we call a normalisation process, where we cut out a lot of the non-operational expense lines. And we come up with an operational EBITDA. And we apply a 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, and perhaps don't understand the normalisation process, can you just talk a little bit, about 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 car through the practice, or has private insurances running through the Practice and 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 assessing the valuation on an EBITDA basis.

Joanna: Right. Okay. 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 you're looking for? ou mentioned culture as being one of those things, but what does that look like? what should Dental Practices be thinking about doing to line themselves up for these type of potential relationships in the future of their sale?

Peter: Yeah, I think one of the key things we see is that there are a lot of excellent practices out there, but a lot of the earnings revolve around one individual so that personal exertion levels of a principal play a significant role in determining: 1. the level of attractiveness of the practice. And 2. the impact on valuation is that if a crucial person goes down, it will significantly impact the practice's earnings. So we will account for a spread of profits.

And in terms of culture, it's fascinating, because as soon as you walk into some practices, you can see the level of vibrancy, the team's happiness, the way they meet and greet their patients, you know, the energy in that practice. And there are others you go into, and you wonder how they've got patients through the door. So, 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 see how that practice operates from a process standpoint. So that plays a big part in my decision making in terms of whether this practice fits 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 time but walking in and "feeling the vibe" is not usually on there! But I love it! That's such a good point that it may be overlooked quite often by even 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. 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 crucial for me 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 necessary than anyone else, we just have different roles the business. So I treat everyone the same on an equal basis. And that works well for us.

Joanna: I'll ask you in a moment to talk a little bit about your history because I think there are some exciting 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 are some warnings where you have seen in the past this going wrong for practice owners that are selling?

Peter: I think, if you get past, a term sheet and you move into contracts, and the contracts are relatively simple. Then you've reached a service level agreement that locks in the principal or principals into our relationship with you for a period of time. Where we've seen things go wrong, is when you don't define, critical points in the contracts. And even when you do, some of the vendors have pushed back very heavily on those.

But I guess from our perspective : we are putting millions of dollars on the table to acquire high performing practices, we have an expectation that what we're developing in terms of equipment, and the gear that's in that practice, and that the tools that are used are in good working order. We like to have a warranty or a set of proofs around some of those types of matters that create less 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 many practices are still running, what you would term domestic style, IT setups, even using a computer as a server and antivirus protection, inadequate firewall protection.

So we need to have the proper systems in place when we acquire the practice because we've 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 to undertake an audit and the other DD items before the acquisition.

Joanna: I think one interesting element in what you're talking about here is that sometimes the benefit for practice owners who are exiting to sell to an acquirer who knows what they're doing with the process. Because, there can be 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, there can be a lot of issues when acting from the buy-side when you're dealing with sellers who often have never done this before. But even worse still, if they have advisors and deal teams who haven't dealt with this area a lot, you know, that that can be a tricky tightrope to walk!

You and I have had many discussions over time of how we ensure that we're able to properly bring the parties along in the process when they may not be well educated and because they 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 raise an excellent point, and if I were 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.

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, what we try and do is make sure our contracts are written in clear English at the start. They're not difficult to comprehend or read. And they lay things out reasonably tightly, but we've been in situations where lawyers have tried to rewrite the whole stuff.

Joanna: Yeah, being overzealous. There are lots of stories there, Peter, lots of stories! ut I guess the point is that when you're working with lawyers to put together contracts that you're using, one of the essential things, is also to have somewhat balanced agreements. 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're reducing the real issues that should be coming up in that contract negotiation phase.

Peter: That's right. All contracts need to be balanced and equitable. It can't weigh heavily one way or the other. It just doesn't work for anybody like that. So, one of the things we have some pushback on occasionally, are that we hold a small retention sum at settlement to account for adjustments that occu post-settlement. This is because often supply bills come in late, or it might be outstanding superannuation or employee entitlements that need to be adjusted. 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, are issues in dealing with the lawyers – in particular, the constant forwards and backwards of emails. I feel like I can comment on what drives me nuts about many lawyers, with authority, because we deal with so many! . I just find many lawyers just hate getting on the phone, hate getting together, and talking through issues. t's a bugbear of mine! But I just think deals are best done rapidly. Getting on the phone quickly, or getting an all parties meeting together to resolve issues. What're your thoughts on that process side?

Peter: Oh, boy, you're right. We've been through it together in quite a few times. One instance on a transaction we did this year up in Queensland was one of those types of lawyers. Still, 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, that just rack up unnecessary time and costs for everyone. So, if you're going to do this sort of deal, I think you should even be thinking about a pre-contract meeting with the lawyers involved, to talk about how we're going to approach completion of the transaction. We're going to include one of the contract's critical components 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 approach it, and then everyone's on the same table before we start.

Joanna: I agree. I've always loved this area of law, mainly 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 going for the win-win for everyone. When you can put a process in place that helps support that communication between everyone because what you're talking about here is quite often embarking on a long term, ongoing relationship, it's not just signing the contract and being done in many instances. Setting it up right from the beginning, but not allowing the lawyers or other advisors to create mistrust because of the wrong communication style, I think is such an essential part of making sure it stays a win-win for everyone throughout the process.

Peter: I think, again, you're 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 the contracts to work out how to deal with aa query raised, because 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 earnouts and ongoing agreements with us. And we are 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 them to deploy treatment plans to their patients. So it's a significant relationship, it's essential, we get off on the right foot together, and we keep that momentum going the whole way through.

Joanna: Well, that's it for the 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 sufficient detail. 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. You have clients that you think might be suited to this model. 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 several excellent services that help businesses prepare for a sale or acquisition or guide them through the sale or acquisition journey.

We work with clients, both big and small and have different 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 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 risk in acquisitions. We look at the importance of HR advisory 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 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.