SYNSTRAT

The Rise and Fall of MegaDent

Jim, a dentist who had departed private practice to work for a corporate and run its dental division, had become disenchanted with the manipulation of the senior management. Jim wondered, more in hope than belief, whether there was an idealistic way in which he could bind together a large number of dentists in a visionary enterprise. He spoke to a few dentists who were interested in finding a way to sell their practices as a prelude to retirement. Most seemed to be willing to work for a year or two for a new owner or in somebody else's practice.

Jim scratched out a rough idea of how his idealistic dental corporate might work. The bottom line didn't look encouraging at first. Jim figured, if only dentists would work for a bit less; and if only they could be made a bit more productive; and if the purchases and laboratory costs could be made a bit cheaper, and…etc. He came up with more 'ands' and stretched his sums. Jim's model was pretty rickety, but he went to see a contact at Massive Bank who introduced him to Massive's deal-making division. The deal-makers got paid substantial bonuses if they hooked a profitable deal for Massive. Most deals they examined turned out to be impractical, but a small percentage showed promise.

The Families

Massive Bank was connected to a network of corporate advisers who operated small private companies. The advisers in turn were connected to "The Families". The Families were the private companies of some of Australia's wealthiest business identities. The Families examined business deals closely. They liked to put a modest amount of capital at risk, with the strong probability that they would get it back at a significant profit within a short time. They looked for returns of 30% or more with their money at risk for six to twelve months, but often made much more, sometimes very quickly. The Families were wealthy because they knew how to make large sums of money move between profitable deals quickly. The corporate advisers who fed business to The Families knew that if they came up with deals that they could make profitable they would get future backing from The Families for other deals.

Massive Bank was prepared to lend if:

1. The corporate adviser on their prepared list put a deal together.

2. The corporate adviser brought in one of The Families as an equity investor to take a share of the risk.

3. If the period between Massive putting up finance and receiving a substantial portion of it back following IPO was short.

Hopefully Massive received other business from the deal such as having moderately wealthy dentists transfer their banking to Massive's private banking division. Massive wasn't any better or worse than the other large banks. They all charged heaps of fees and were equally inefficient. The fees that they put on every transaction, no matter how minute, raked in billions of dollars of profit. The personal bankers sounded impressive, but served up the same formula to everybody. They were fairly inexperienced individuals who were either going to jump into a more senior role in the bank or leave to pursue a career elsewhere.

Massive introduced Jim to G Reed (known in the trade as Greedy), a corporate adviser who had put together a number of consolidations which had successfully floated onto the stock market. Only one or two were successful long-term, however Greedy had extracted fast fees and cheap shares along the way. Massive Bank and The Family had been in and out of the deals fast enough to reap good rewards. Neither the staff of Massive nor the managers of The Family's investment company cared so long as they made a profit.

Along the way various business groups had sold out too early and too cheaply, in some cases receiving barely more than half the value of their enterprises at IPO. The rest went to Massive, The Families and to Greedy. The former owners of the businesses which had been consolidated were isolated from each other. Each had signed off a document that indicated that they had received independent accounting and legal advice. Each of them had individual accountants who were ill-equipped to deal with the likes of Greedy, the deal-making division at Massive or The Families. In effect they were powerless.

Jim's ideals were bound up in the deal but at close examination it revealed a significant gap between Jim's perception of what was being put together and the hard nosed legal reality.

Greedy formed a company, MegaDent Pty Ltd (MegaDent) – see below. Dentists were offered a price for their practice which seemed to be too good, but it broke down as follows:

1. The theoretical consideration was 125% of recent fees, which was high by dental practice valuation standards; but

2. Only half of that amount was payable up front. In turn the up front payment was further divided into:

   a. 30% of the total consideration in share scrip, the value of which was a nominal 50 cents per share; and
   b. 32.5% paid in cash.

3. A further payment was delayed for one year from IPO on the stock market and was subject to a clawback of their earnings if performance didn't meet contractual targets. Dentists gained the impression from talking to Greedy that the shares were sure to launch on the stock market at a healthy price, and with some of the magic that MegaDent's management would be able to provide each of the practices, would easily make their targets. There was to be a "Dental Advisory Board". Dentists didn't realise that MegaDent's post IPO board and management structure didn't exist at this stage, nor that Greedy's company had only $10 of capital and no other full-time employee.

   Dentists were told that Massive Bank and The Family were standing by to finance these practice acquisitions. There was some finely worded detail concerning settlement of the contract. In reality, neither Massive Bank nor The Family were prepared to put their money in until a predetermined critical mass of dentists had signed the contracts. Only then were Massive and The Family prepared to hand over the first payment, which was via loans to MegaDent.

Ian Innocent, a dentist aged 50, had begun to think about the future when Greedy contacted him indicating that he had been given his name by Jim, a mutual good friend. Innocent agreed to meet Greedy on his rostered admin day, and was overwhelmed by the fact that Greedy wanted to buy his practice and leave him to run it with “complete autonomy”. Innocent eagerly signed the confidentiality agreement after mentioning that he was advised by a local accountant, Penink, and a local solicitor, Scribers. Innocent could take his contract to Penink and Scribers, but it was otherwise confidential. Greedy asked him whether he had any other friends in the dental profession who might be in a similar situation to him. Innocent was happy to provide some names. Greedy told Innocent that he was glad to meet the owner of such a good practice, and that Innocent too would be grateful that he had come into contact with Greedy. In due course Greedy worked his way across many practices.

How Greedy Got Started

He trained as an accountant, but after experiencing the tedium of an accounting practice he left for a job in a large corporate’s accounting department. He quickly realised that, as with the accounting practice, many years of hard slog was involved in order to reach a moderately well-paid level. Greedy had an uncle who was a stockbroker at Oldfirm, a traditional stockbroking practice. His uncle was able to give him a start. Initially, he worked in the analyst department doing unfashionable smaller company studies. The big fashionable companies were the province of the senior people who had been in the firm for years and built up networks and relationships with them. Greedy found the work fascinating. He found it particularly interesting that Oldfirm’s corporate advisory arm periodically put together a float of a relatively small business (or sometimes a consolidation of several businesses) and managed to achieve a lift in its PE multiple from what the business had been worth privately to what it could achieve on the stock market. Oldfirm prided itself on its business ethics. Its partners came from the days of “my word is my bond” stockbroking. Its fees from floats were lower than those achieved by some other firms.

Oldfirm’s senior brokers had graduated from the analyst room and had then spent years building up trusted relationships with clients. Brokers often bought or sold shares for three generations of the same family. It was a conservative business, and there were healthy but not spectacular rewards for those who had reached his uncle’s level. Greedy didn’t have the patience to work for 25 years to reach that status. He looked around town and realised that there were young brokers and corporate advisers who were making money at a faster pace.

Sleazes

Greedy learned that a faster talking stock broking business, *“Sleazes Ltd Stockbrokers and Corporate Advisers”* (Sleazes), extracted a lot more profit out of small floats than was possible at Oldfirm.

After a couple of years, Greedy decided that he’d better move on. He met with a senior figure at Sleazes. Greedy played his cards well, having quietly noted a few prospective businesses and professional groupings which he thought might be ripe for the plucking. He’d established one or two tentative contacts in those areas. The Sleazes partners recognised a fellow traveller. They explained that he’d be expected to find the prospects. They’d help him put together the business for IPO, and if he brought in the bacon there’d be a healthy share of the fees for him. If he couldn’t bring in prospects, he’d have to find other employment, as Sleazes didn’t keep chairs warm for people who were undergoing a lengthy apprenticeship. Greedy had the basic qualifications and the combination of his experience in a tax accounting practice, in a large company’s finance division and at Oldfirm gave him the business and analytical experience to sell. He had a glib tongue. It promised to be a profitable relationship with Sleazes. He had also met with the investment managers of a couple of The Families, who said “If you find a profitable deal, we’re interested!”

Greedy's first effort was in acquiring a couple of mini debt collection businesses, consolidating them and then selling the consolidated offering to a larger business, which was attempting to gain critical mass in order to float. Greedy had arranged for one of The Families to put in a share of the equity capital to arrange the consolidation to occur. Massive Bank topped up the equity with a loan. The business was then on-sold to a larger business which was prepared to pay a higher PE multiple. The whole deal created an exit for the owners of the original small business. The Family made a tidy profit and got its capital back quickly, as did Massive Bank and Sleazes. Greedy was paid a share of the profit he generated for Sleazes. Different tranches of shares had been issued at different times, and a value transfer had occurred as well as corporate advisory fees. This had enabled Sleazes, Greedy, Massive and The Family to each take a significant slice of profit from the deal.

Greedy had a natural networking ability, and Sleazes had shown him how to polish up his story. They had also introduced him to an accountant who specialised in writing "investigating accountant's reports" for the prospectuses of soon to be IPO businesses. "Figures", as he was known, could take the separate accounts of a number of businesses, consolidate them and, after eliminating expenses not deemed to be part of the business and estimating some cost savings and growth opportunities, was able to come up with "beautiful figures". The stock market was in a long-term bull phase and nobody questioned Figures' investigating accountant's reports. The market mantra was that:

"A prospectus is only the fat bit in front of the application form" for an IPO.

With the right timing and hype, the wood duck investors would buy almost anything that floated.

Over several years of the IPO's related to Sleazes and Figures, there was a high failure rate but it was pointed out to anybody who complained that all the warnings had been made in the prospectus, that you only had to turn to the footnotes in the fine print at the bottom of page 67 to find them. Investors who put their money in without understanding the prospectus only had themselves to blame.

Occasionally (but not too frequently) one of the IPO companies succeeded, generally because the company's board realised that its IPO price was ludicrous, but that the reputations of the board and CEO would be severely damaged by its failure. In a few instances, boards and CEOs worked heroically to re-engineer businesses and emerged with their reputation intact. While Sleazes had had nothing to do with the operating of the business after IPO, they nevertheless pointed out these successes. Over the years there were a credible number of them. Their mistakes were never mentioned.

Greedy thrived, and had the ability to personally juggle several deals at a time. He was always in a hurry, talking to clients one after the other, madly juggling figures and dreaming of where it was all going to take him. He dreamed of owning his own private jet and yacht, and of having memberships at the world's most prestigious golf clubs.

When, three years after joining, the economy wavered and the stock market turned down, Greedy correctly divined that there wasn't going to be much point in hanging around in this new environment which would take a while to recover to a point at which he could put together more floats. His and Sleazes had been a happy partnership. Both had made money out of it. The firm was used to going into a bit of a slump periodically, happy in the knowledge that stock market conditions would return to a point which would enable them to dust off their plans and get out there and acquire businesses.

Greedy had had the happiest days of his working life at Sleazes, but his talents had widened and he gave thought to hanging out his own corporate advisory firm shingle, now that he had built up personal capital from his successful deals. He had met several of the Families, and became familiar with the workings of Massive Bank's deal-making division. He pulled together enough deals to make The Families and Massive sizeable amounts of money, and their doors were open.

He called on the deal-makers and the Families before heading overseas for a holiday and to make some international contacts.

Whilst overseas he managed to wangle contact with some of the charming characters who work in London's investment banks. Over a few meals and drinks, Greedy learned to polish up his approach whilst regaling London investment bankers with the deal-making potential in Australia.

Greedy Starts His Own Business

On return to Australia he registered a private company with $10 of capital and called it *"Jogans Corporate Advisory Pty Ltd"*. He had read that the mother of the legendary Negro boxing champion Joe Gans had asked him whether he had brought home the bacon the morning after he had won the World Lightweight Title.

Greedy arranged serviced office facilities in the financial hub of the city, with his own dedicated phone line. The receptionist answered about eight different business lines, but each was answered as though she worked for that particular company. Greedy polished up a website with a bit of basic information about himself and Jogans Corporate Advisory. This embellished his past work history and deal-making a little, but not so much that anybody would say that he was telling outright porkies. He spent a little more of his savings on lunching with the dealmakers at Massive Bank, hinting that he was on the trail of a few good businesses. They indicated that they were glad he was back in town and would keep him in mind if a deal came their way, and gave him a couple of tentative leads, one of which was an outline put together by Jim. He also called on the managers of the private arms of The Families to renew old acquaintances and remind them briefly of the deals on which they had both made money. He was pleased to find that the Families were keenly on the lookout for further deals in which to make money with limited exposure.

Jim Meets Greedy

On first meeting, Greedy summed up Jim as being naively idealistic. He said that he would give his proposal some thought. Obviously if it was a 'goer' there would be a place in it for Jim, and Jim would be a foundation shareholder. Greedy thought that Jim was going to be superfluous in the long term but he needed somebody respected among dentists to gain him initial introductions to the right practices.

Shares Issued By MegaDent

Before making his pitch to dentists, Greedy's company, MegaDent Pty Ltd, had the following share issues:

		Subscribed Capital
1.	10 shares to Greedy at $1 each	$10
2.	A further 50,000 shares to Greedy at 10 cents each	$5,000
3.	30,000 to Jim at 10 cents each	$3,000
4.	An issue to The Family's private company of 30,000 shares at 20 cents each	$6,000
	Total shares issued at this juncture were 110,010 shares	**$14,010**

The shareholders then resolved to split the shares on the basis of 1000 new shares for one existing share. At the completion of this exercise, MegaDent Pty Ltd had 110,010,000 on issue, with a total subscription of $14,010.

The Proposal to Dentists

There were slight variations, but typically the proposals involved offering dentists 120% of their annual gross fees as follows:

For a practice with $1 million of fees, the offer came down to:

1. $300,000 of cash, to be paid up front.

2. $300,000 worth of shares, with the shares valued at 50 cents each on the basis that that is what Greedy predicted would be the IPO price.

3. $600,000 to be paid one year out from the IPO. This was subject to some performance criteria.

The $300,000 upfront payment by MegaDent amounted to $30,000,000 when all practices were considered. People who got their contracts early were frustrated because they had to wait several months while Greedy rounded up enough dentists to satisfy The Family and Massive Bank. At that point, The Family advanced $10 million to MegaDent, and Massive Bank advanced $20,000,000 to make the payment. Massive also loaned $20,000,000 for MegaDent's working capital.

MegaDent immediately signed up practices with total fees of $100,000,000 per annum.

The IPO

Greedy arranged the IPO quickly thereafter, based upon proforma accounts produced by Figures and some creative writing. The IPO struck a market hungry for floats. Immediately after the IPO, the original share issues looked like this:

1. 50,010,000 shares originally issued to Greedy for which he had paid $5,010

2. 30,000,000 shares issued to The Family, for which it had paid $6,000

3. 30,000,000 shares issued to Jim for which he had paid $3,000.

4. 25,000,000 shares issued to a subsidiary of Massive Bank at 20 cents each, for which it had made a total payment of $5,000,000

5. 60,000,000 shares issued to vendor shares at a theoretical value of 50 cents each, representing $30,000,000 of capital. This payment was for consideration of goodwill, not cash.

6. 150,000,000 shares issued to the public at 50 cents each, a total of $75,000,000

The company had therefore issued 345,010,000 shares for a total consideration in cash and practice equity of $110,014,010 or an average of 31.9 cents each. The company's presentation had looked so good in a market hungry for floats that there were massive over-subscriptions, which were partially satisfied by Greedy and The Family generously selling most of their shares into the float at 50 cents each. They had therefore managed to shed most of their holdings. Jim also sold a proportion of his into the float. Furthermore, since Greedy had held his original shares, which had split, for more than one year he received a capital gains tax concession. Greedy and The Family had been shrewd enough to leave some unsatisfied demand for the after market. The after market share price settled at a healthy 63 cents a few weeks after the float, which was a 26% premium to the issue price. The dentists who had been sceptical about taking share scrip began to feel a little bit more comfortable. Massive Bank had taken the opportunity to shift its shareholding to some managed funds controlled by its investment arm, at a modest discount to the market. This represented a healthy profit to the deal-making division of Massive Bank, but left a little bit of fat for its managed funds. Soon after the IPO, the managed funds began to sell. MegaDent's cash position was:

Subscribed cash	$80,614,010
Less cost of floats including various fees to meet Greedy, The Family, Figures, the lead brokers, lawyers and other brokers who had helped distribute the issue	$15,000,000
Cash left	$65,014,010
Plus cash on hand from Massive Bank capital loan	$20,000,000
Total	**$85,014,010**

At this point it owed the following:

1.	Loan from The Family	$10,000,000
2.	Loans from Massive Bank	$40,000,000
3.	Amounts owed to vendor dentists due in one year	$60,000,000

Since Massive Bank's condition of having additional equity invested had been met via the float, The Family was able to be repaid its $10 million, having received healthy interest payments as well as various fees and having been rewarded with shares received at nominal cost then sold at 50 cents. The Family was very happy with Greedy's performance. Greedy himself exited handsomely rewarded for his efforts. He had nothing further to do with MegaDent.

MegaDent now had $75 million in cash, but owed $40 million to massive bank and $60 million to vendor dentists in one year's time. It repaid $15 million to Massive and invested the remainder of $60 million in short-term money market instruments and some cash.

Hardcase

A new board of directors had been appointed and Greedy and the Family's representative had resigned from the board, as did Jim. MegaDent had become a public company just prior to its float. The new board included several minor business figures and one retired dentist, Dr Jolly. The board's first action was to appoint Ted Hardcase as the new CEO. Hardcase had been the CEO of a moderately successful enterprise which had recently been taken over by a larger business. He had lost his job in the consolidation.

Much had been made to dentists prior to signing up about a proposed Dental Advisory Board, but it rapidly became apparent that this was no more than an ad-hoc committee with no executive status. All power rested in Hardcase, who reported to the directors. The token dentist on the board, Dr Jolly, was unlikely to rock the boat. Jim was appointed to the position of Chief Operating Officer.

Hardcase's first action was to appoint the Chief Financial Officer (CFO) of his old business, known as "Numbers", who had also been displaced by the merger, to be MegaDent's CFO. Numbers sharpened his pencil at both ends so as not to waste energy turning it around. He was utterly without humour, and spent his days engrossed in balance sheets. Numbers immediately went off to inspect the financial workings of some of the dental practices. On return he reported to Hardcase. Their conversation went like this:

Hardcase: *"What did you find?"*
Numbers: *(Shaking his head sadly) "Utterly hopeless. I need Geek."*

Geek was an IT genius known to them, who worked on financial reporting systems. Geek's conversation mainly consisted of grunting at computer terminals in the early hours of the morning, but he was good at what he did.

Changes to Practices

Numbers and Geek set out on a fast change program. The dental principals and their staff found this utterly unnerving, and protested to the “Dental Advisory Board” that their practices were being overturned. The chairman of the Advisory Board rang Hardcase, but was smartly told that it was Hardcase’s responsibility to run the company on behalf of the shareholders, under the direction of the board of directors. The Dental Advisory Board had no legal status. It rapidly became apparent that the advisory board would have no resources and no influence. Jim quickly recognised that his position was a sop. Hardcase and Numbers ran the show. Numbers, who had the personality of a mortician, and Geek rapidly upturned the practice IT systems and financial reporting. Almost overnight all of the financial reporting and control landed on Hardcase’s terminal on a daily basis. Although the former principal dentists were responsible to run their practices profitably, their decision making was rapidly confined to dentistry.

Where expenses appeared to be high, Numbers was dispatched to investigate. If a principal dentist protested he was told that Hardcase and Numbers were responsible to the board and the shareholders. After half an hour going through practice expenses with Numbers, dentists and practice administrators were made to feel that they had been profligate. Personal items like tea, coffee and milk weren’t MegaDent’s responsibility. If the staff wanted them, they would have to purchase them. It raised the question of how much time was being wasted. Numbers personally functioned quite adequately with a glass of water on his desk. It was tap water, not bottled water. In no time all the practices were ordering all of their materials from a specified supplier. Where multiple similar items existed, the approved product was the cheapest one. Previously, dental suppliers had occasionally included small gifts to practices, and dentists received points for paying by credit card. Numbers fixed all that. Goods were supplied under specified contracts, at lowest cost, and the agreement specified no points and no gifts.

Numbers then interested himself in nursing and reception rosters, and by comparing hours worked by support staff to dental hours and fees, quickly arrived at economical ratios. Numbers was oblivious to dentists’ needs. Every practice suffered cuts, ranging from a few hours of rostered time to whole persons.

Initially things looked good at MegaDent headquarters. Hardcase was seeing profitable accounts and fees were steady while costs were dropping. He had faith in Numbers and, thanks to Geek and a few forceful interventions by himself, practices were all putting in their data correctly and instantly. He reported that the process of consolidating the practices into an overall business was occurring. However he and Numbers had worked backwards through the proforma accounts prepared by Figures in the prospectus, and they pointed out to the board that they had been padded up. The board had better get ready for some criticism when the first half year’s results were announced, as the prospectus profits were unachievable.

Hardcase knew that at that early stage the board had little option but to go along with him. In due course, the stock market reacted negatively to the first six months’ figures, and the share price fell to 40 cents. Dentists who had hung onto scrip wondered whether they should have bailed out. It didn’t worry Greedy or The Family as they had long since sold and were busy on other schemes.

A disturbing trend began to appear. Practices were losing patients across the board, but neither Hardcase, Numbers or Geek could see why. At the practice level, the former happy workplaces had deteriorated to sullen groups. The Dental Advisory Board had ceased to function, and in a number of practices a former loyal staff member had tearfully resigned. Sally, the corporate HR person, was good at finding untrained school drop-outs who were supported by Centrelink bonus payments for a training period in a new job. The dentists quickly found that they were expected to train these as chairside assistants themselves. Practice efficiency was dropping, and whilst principal dentists were mostly contracted for five years, with a few for three, the other dentists weren’t. Numbers pointed out to Hardcase that if productivity and profit didn’t improve the principal dentists would be receiving a pay cut under the terms of their contract. Their final capital payments of $60 million would also be reduced if they didn’t make budget for the first year. Numbers figured that they would save $10 million off the capital payments, and they would be able to reduce the contractual payments in the succeeding year by $5 million. Needless to say, the former dental principals were not happy.

It was a waste of time for the principal dentists talking to Hardcase or them ringing up Dr Jolly, who was totally under the influence of the other directors and overawed by Hardcase. Where dental resignations occurred and no replacement was readily available, Hardcase and Numbers combined practices into one location to save resources.

New patient referrals had dried up. Existing loyal patients noted the changes in the practice environment and the unhappy staff. They were no longer prepared to recommend the practices to their friends.

Preferred Providers

Jim's idealistic practice model had excluded turning the practices into preferred providers. Jim himself had been pushed into an unimportant role by Hardcase, and had then resigned. Hardcase began talking to health funds to come up with a deal. One day the practices received a message on email that MegaDent had become a preferred provider to BIGFUND, who would provide patients under prescribed fee schedules. When the principals went back to their contracts, they found that although there had been early discussion about excluding health funds, in the final contracts they had signed that condition had been omitted. Principals who complained were told that they'd be losing more money if they didn't buck up and treat as many item numbers as possible.

As the end of the first financial year approached, Hardcase realised that profits were dropping. A share of the reduction was going to be clawed back from principal dentists, whose profit share was diminishing because they weren't making contract. The capital payment they would receive at the end of the financial year would be reduced in many cases also. However the trend was worrying. He knew he had to satisfy the stock market.

Doctoring the Profits

Privately, Hardcase and Numbers recognised that the whole business was doomed to long-term mediocrity – it was never the sort of business that should have been turned into a public company in the first place. However they needed about two to three years' reasonable results so Hardcase could polish up his own CV and pick up another CEO job. Numbers knew that his fate was tied to Hardcase's. They examined the balance sheet carefully and noted that plant, equipment, furniture, fixtures and fittings had been acquired with the practices at a very modest written down value of $1.5 million across the 100 practices. The overwhelming price of the practices had been in the form of goodwill. They engaged a firm of valuers who were sent from practice to practice "to take an inventory of the company's assets". In fact they were listing all items and assigning values to them. These lists produced a valuation goldmine. Hardcase and Numbers carefully divided the lists into two piles. They took approximately 40% of the valuations off to a finance company and arranged for the finance company to buy that equipment at valuation, but immediately lease it back to MegaDent on a five-year lease with a 30% residual. The effect of this transaction was to bring forward several million dollars worth of profit. That made the immediate year's financials look quite acceptable. If the transaction was thought about closely it would be recognised that the expenses of the practice in succeeding years had been increased appreciably by the leasing costs in order to book an immediate profit. It was the sort of transaction that a 1987 entrepreneur like Christopher Skase would have routinely engaged in. The transaction was sold to the board on the basis that it was putting lazy assets on the balance sheet to better use. Approximately 60% of the equipment valuations were left over for the succeeding financial year, as Hardcase needed to produce at least two good years' profits.

MegaDent declared a reasonable dividend and invited shareholders to participate in a dividend reinvestment scheme at a discount to the normal share price. Separately it offered a shareholders' purchase plan whereby shareholders could buy up to $5,000 worth of cheap shares each. As a result of the sale and lease back manoeuvre, the dividend reinvestment plan, the shareholders' purchase plan and reduced capital payments to dentists, MegaDent was able to reduce the debt to Massive. At first glance the balance sheet looked much healthier.

MegaDent was not big enough to excite the interests of analysts. Its profit announcement was broadly in line with expectations, and the share price remained at about 40 cents.

The Second Year

In the second year, the deterioration in practices continued. Occasionally principal dentists threatened to resign but were promptly advised of their legal obligations under their contract. The principal dentists were now having money clawed back because they weren't making contract. They realised that at this rate, at the end of five years the price that they had received for their practice was going to be significantly eroded. They told their colleagues that the atmosphere of working for MegaDent was corrosive.

Late in the second financial year, Hardcase and Numbers arranged for the remaining equipment to be sold to the finance company at a handsome profit and again leased back. This made the second full year's profit look marginally better than the previous year. They continued the dividend reinvestment scheme and repeated the shareholder purchase plan offer. They managed to further reduce the loan to Massive, and then refinance the remainder to Small Bank at a lower interest rate. Small Bank wasn't able to scrutinise the figures as accurately as Massive. The company's annual report to the Annual General Meeting spoke of consolidation and debt reduction. Left unsaid was the substantial leasing obligation which was off the balance sheet. The dentists inside the business knew that it was falling apart. The stock market announcement was breezy and spoke about the good future of the company.

Hardcase Resigns

Shortly after the release of the business's annual results, an announcement was made to the stock market that "Mr Edward Hardcase is resigning from MegaDent to take up an appointment as Chief Executive Officer of Mega Medics Ltd." The board of MegaDent thanked him for his services to the company and wished him well in his new role.

A few days later, another announcement advised that Numbers had also resigned to take up an appointment at Mega Medics.

What the New CEO Found

A new CEO was appointed. In doing due diligence, he was horrified to find the deteriorated state of the company. Everywhere he went he met dispirited dentists working at practices in which all capital expenditure and significant maintenance had been denied for the previous two and a half years. Cash flow was hurting badly, and the company was making substantial lease payments on aged equipment and fit-out, most of which he was advised was in urgent need of replacement. When he mentioned Sally, Numbers or BIGFUND, dentists recoiled in horror or started poking him in the chest and yelling obscenities.

The new CEO consulted the firm's auditors, then advised his chairman to call an urgent board meeting. The board were advised of the parlous state of the company. A massive write down of goodwill was announced to the stock market under the impairment conditions of IFRS. Soon after, the share price fell to eight cents. Those dentists who had held onto their shares who consulted brokers were told that they may as well sell them, but the sale of any significant quantity would flatten the price further.

It became evident that MegaDent was heading for either liquidation or absorption into some other enterprise. Two of the board members resigned.

Pretty soon the company was placed into administration. In due course the administrator advised placing it into liquidation. The liquidators called a meeting of creditors, which included the finance company. Staff entitlements were under threat. The liquidator concluded that the only viable option was to sell the practices for what they could bring. In reality, the only buyers were dentists who worked in the practices included the younger of the erstwhile principals. They bought the badly tarnished practices back at very reduced value. The finance company recognised that the equipment was uncollectible and unsaleable. The best it could do was to sell the fixtures, fittings, equipment and furniture in each practice at nominal value to the dentist who had purchased the goodwill. The liquidators satisfied employee entitlements and paid a few cents in the dollar to other creditors. MegaDent ceased to be a registered Australian company. Shareholders lost their money.

Prologue

Immediately Hardcase arrived at Mega Medics Ltd his first act was to appoint Numbers as that company's new Chief Financial Officer. He then sent Numbers off to visit some medical facilities. On his return, Numbers reported to Hardcase. Their conversation went like this:

Hardcase: *"What did you find?"*
Numbers: *(Shaking his head sadly) "Utterly hopeless. I need Geek."*

Greedy had gone from one profitable deal to another. He now owned an expensive mansion in Toorak, had a nice yacht moored at the marina and had moved Jogans Corporate Advisory Pty Ltd into showcase offices. He now had people on his staff, including several other advisers who had had similar earlier experience and glib tongues. They were employed on the basis that if they brought in prospects, the firm would help them put the business together for IPO and if they brought in the bacon, there would be a share of the fees for them; but if they didn't find prospects they'd have to move on, as Jogans didn't keep chairs warm for people who were undergoing lengthy apprenticeships.

In the 12 months after liquidation, the very rundown practices which the liquidator had sold to former principals and/or dentists working in them, had undergone a transformation. Almost immediately their owners refurnished and redecorated the waiting rooms and replaced badly worn equipment. In a number of cases, former loyal staff who had left tearfully had come back to their old jobs. The practices had suffered badly under MegaDent's rule, but were well on the way back to their old standards. Fortunately, MegaDent's liquidation had the effect of terminating all contracts, including contracts with BIGFUND.

Disclaimer

The characters in this story are fictional. Any resemblance to living persons is accidental.

By GRAHAM MIDDLETON, BA, MBA, AFAIM

Graham Middleton is a director of Synstrat Management Pty Ltd and Synstrat Accounting Pty Ltd. He has spent many years advising dentists in respect of their business and financial strategy and measuring their practice and financial performance. The Synstrat Group is an independent data-based organisation providing management, benchmarking, valuation, financial and accounting services to the dental profession. Synstrat Management Pty Ltd is a Licensed Dealer owned by its directors who work within the Synstrat Group. Graham Middleton personally has been an investment adviser to dentists located throughout Australia, and has been providing this service for 20 years, the last 13 as a partner and director of Synstrat Management Pty Ltd.

Tel: (03)9843 7777 ***Fax: (03)9843 7799*** ***Internet: www.synstrat.com.au***
Email: dental@synstrat.com.au