



ERIK S. NEWTON  
**NEWTON'S LAW**



# Understanding Dental Practice Valuations

An overview of the complexities involved in dental practice valuations, focusing on EBITDA, add-backs, and factors that influence transaction prices.

# Understanding Dental Practice Valuations



## EBITDA Basics

Earnings Before Interest, Taxes, Depreciation, and Amortization - a key metric in practice valuations



## Adjusting EBITDA

Add-backs are judgment calls, not entitlements, that are often overstated by sellers



## Buyer's Perspective

Buyers focus on risk, stability, and control - not just top-line revenue or EBITDA

Understanding the nuances of dental practice valuation, including EBITDA, add-backs, and buyer priorities, is critical for practice owners considering a sale to achieve the best possible outcome.

# Why Valuation Confusion Is So Common



## Brokers, buyers, and sellers speak different "valuation languages"

Brokers may focus on market comparisons, buyers on risk and sustainability, and sellers on their own perceived value. This can lead to disconnected perspectives on what a practice is truly worth.



## EBITDA is not a fixed number

Earnings before interest, taxes, depreciation, and amortization can be adjusted in various ways, leading to different interpretations of a practice's profitability and value.



## Add-backs are judgment calls, not entitlements

Sellers often view add-backs as automatic adjustments, but buyers will scrutinize them closely and only accept those that truly reflect the practice's normalized, sustainable earnings.

The differing perspectives, fluid nature of key valuation metrics, and subjective adjustments can create significant confusion and disconnects between dental practice owners, brokers, and buyers. Understanding these dynamics is crucial for navigating the valuation process successfully.

# Valuation Is Not a Formula



## Same revenue does not equal same value

Practice profitability, growth potential, and risk profile all impact valuation, not just topline numbers.



## Risk, sustainability, and control drive pricing

Buyers prioritize long-term stability, scalability, and owner involvement when determining what to pay.



## Buyers price downside before upside

Purchasers focus on mitigating risk first before factoring in future growth opportunities.

Valuation is a complex, multifaceted process that extends far beyond simplistic revenue or EBITDA-based formulas. By understanding the nuanced factors that influence buyer pricing, practice owners can better position themselves for a successful transaction.

# What EBITDA Actually Means in Dental Deals



## Earnings before interest, taxes, depreciation, and amortization

EBITDA is a key metric used to evaluate a business's profitability and cash flow, excluding the impact of financing and accounting decisions.



## Starting point, not final value

EBITDA is the starting point for determining the value of a dental practice, but it undergoes significant adjustments to arrive at the final transaction price.



## Heavily adjusted in dental transactions

In dental practice acquisitions, EBITDA is heavily adjusted through the use of add-backs and normalization to reflect the true, sustainable earnings of the practice.

EBITDA is a critical component of dental practice valuations, but it is important to understand that it is just a starting point. The final transaction price is heavily influenced by the adjustments made to EBITDA, which can have a significant impact on the perceived value of the practice.



# Why EBITDA Gets Misunderstood

Dental practice EBITDA (earnings before interest, taxes, depreciation, and amortization) can be easily misunderstood due to several factors, including owner compensation distortions, personal expenses running through the practice, and the distinction between one-time and recurring items.

# What Are Add-Backs?



## Adjustments to normalize earnings

These are changes made to a practice's financial statements to account for non-recurring or owner-specific expenses, in order to reflect the true operating performance of the business.



## Intended to reflect "buyer-run" economics

The goal of add-backs is to adjust the financial statements to show how the practice would operate under new ownership, without the idiosyncratic expenses of the current owner.



## Often overstated by sellers

Sellers may be tempted to maximize add-backs in order to inflate the practice's apparent profitability and valuation, but buyers will closely scrutinize these adjustments.

Add-backs are a critical component of the valuation process, but they must be justified and defensible. Careful analysis of add-backs can help ensure a fair and accurate assessment of the practice's true earnings potential.

# Legitimate vs Aggressive Add-Backs

Generally Accepted	Commonly Rejected
Reasonable owner compensation	Excessive owner compensation
Documented one-time expenses	Questionable one-time expenses
Documented practice upgrades	Unsubstantiated upgrades
Reasonable employee bonuses	Discretionary employee bonuses
Documented insurance claims	Unsubstantiated insurance claims

# Why Buyers Discount Add-Backs



## Sustainability matters more than explanation

Buyers are more concerned with the long-term viability and reliability of a practice's earnings rather than the justification for add-backs.



## Buyers assume risk, not promises

Buyers are taking on the risk of the practice and are less interested in sellers' promises about future performance.



## Over-adjusted EBITDA kills credibility

When add-backs are overstated, it undermines the credibility of the seller's financial representations and makes buyers skeptical of the practice's true earning potential.

Buyers carefully scrutinize add-backs to ensure they accurately reflect the practice's sustainable earnings, as this is a critical factor in determining the true value of the business. Sellers who provide transparent and well-justified add-backs are more likely to maintain credibility and reach a favorable transaction outcome.



# Erik S. Newton, Esq.

With 20+ years' experience, Erik S. Newton is a seasoned Dental and Healthcare M&A Counsel and Founder of Newton's Law PA. He advises clients on complex valuation disputes, LOI negotiations, and the economic aspects of healthcare transactions. With a focus on post-closing reality, Erik helps ensure his clients achieve the best possible outcomes and navigate the intricacies of the deal process.



# How Buyers Actually Think About Value



## Risk first

Buyers prioritize protecting against downside risk over chasing upside potential



## Stability over growth projections

Buyers value consistent, reliable earnings over aggressive growth forecasts



## Control and scalability

Buyers seek practices that can be efficiently integrated and scaled under new ownership

In summary, buyers take a pragmatic, risk-averse approach, prioritizing the practice's stability, control, and scalability over ambitious growth projections. Understanding this buyer mentality is crucial for practice owners to effectively position their business for a successful transaction.

# DSO vs Private Buyer Valuation Lens

Risk Tolerance	Growth Assumptions	Multiple Range
High	Aggressive	6x-8x
Moderate	Moderate	5x-7x
Low	Stable	4x-6x

\*Based on industry research and deal experience from Newton's Law PA

Multiples are NOT universal: Same EBITDA, Different Multiples. Quality of Earnings Matters. Buyer Profile Changes Pricing  
Multiples are not a one-size-fits-all metric, as they can vary significantly based on the specific characteristics and risks of a dental practice. Understanding how different buyers assess value is crucial for dental practice owners.

# How Structure Impacts Value



## Rollover equity vs cash

Buyers may offer a combination of cash and equity, with varying impacts on valuation and risk



## Earn-outs vs guaranteed price

Earn-out structures tie part of the purchase price to future performance, introducing uncertainty



## Employment obligations affect risk

Buyers may require the seller to stay on as an employee post-closing, which impacts their risk profile

The deal structure, including cash vs. equity, earn-outs, and employment obligations, can significantly influence the valuation and risk profile of a dental practice transaction.

# Common Valuation Myths



## "My broker says it's worth X"

Broker opinions can be biased or outdated. Rely on a comprehensive valuation analysis.



## "Add-backs always get accepted"

Buyers closely scrutinize add-backs and will challenge unjustified adjustments.



## "Highest multiple wins"

Multiples alone don't tell the full story. Buyers focus on risk, stability, and deal structure.

These common valuation myths can lead practice owners astray. Understanding the nuances of how buyers truly evaluate value is critical for a successful transaction.

# When Valuation Changes Dramatically



## Pre-LOI Valuation

Practice valuation may be higher before a letter of intent is signed, as the buyer has not yet fully assessed the risks and challenges.



## During Diligence

As the buyer conducts due diligence, they may uncover issues that lead to a lower valuation, such as financial irregularities or operational concerns.



## After Buyer Pushback

Even after an LOI is signed, the buyer may push back on the valuation and demand further adjustments, shifting more risk to the seller.

Dental practice valuations can change dramatically at various stages of the transaction process, highlighting the importance of realistic expectations and strong legal representation to protect the seller's interests.

# Valuation vs Reality at Closing



## Retrades are common

Buyers often seek to renegotiate the purchase price or terms during the due diligence process, shifting more risk to the seller.



## Adjustments shift risk to sellers

Buyers typically demand more concessions and modifications to the deal structure, placing greater risk and liability on the selling practice owner.

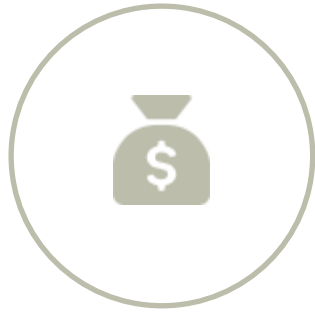


## Final economics often differ materially

The ultimately agreed-upon transaction economics can vary significantly from the original valuation and projections, leading to unexpected outcomes for the seller.

This slide highlights the common reality that the final transaction economics often differ materially from the initial valuation, with buyers frequently seeking to renegotiate and shift more risk to the selling practice owner. Understanding these dynamics is critical for sellers to manage expectations and protect their interests throughout the deal process.

# How Sellers Should Think About Value



## Net proceeds, not headline price

Focus on the actual cash in your pocket after taxes, fees, and post-closing obligations rather than the top-line sale price.



## Risk-adjusted outcomes

Consider the likelihood and impact of price adjustments, earn-outs, and other risks that can significantly reduce your final take-home.



## Post-closing obligations

Understand the ongoing responsibilities and potential liabilities you may face as part of the transaction, such as non-compete agreements or indemnification.

By considering the full scope of value - not just the headline number - dental practice owners can make more informed decisions that align with their long-term financial goals and risk tolerance.

# Role of Legal Counsel in Valuation



## Translate economics into legal risk

Counsel can interpret the financial and operational implications of a deal and identify potential legal pitfalls.



## Push back on unjustified discounts

Counsel can advocate for the seller's interests and challenge unreasonable concessions by the buyer.



## Preserve leverage before LOI

Counsel can help maintain the seller's negotiating power by advising on the timing and structure of the transaction before the Letter of Intent is signed.

By providing legal expertise and strategic guidance throughout the valuation and negotiation process, counsel can help dental practice owners achieve the best possible outcome in a transaction.

# Next Steps

Service	Description
Valuation Reality Check	We'll review your practice's financial data and provide an accurate, objective assessment of its true market value.
LOI Review Before Signing	Our team will carefully analyze any Letter of Intent, ensuring the terms and economics align with your goals before you commit.
Strategy Consult	In a private consultation, we'll work with you to develop a tailored strategy for maximizing the value and mitigating the risks of your transaction.



This presentation has provided an overview of the complexities involved in dental practice valuations, highlighting the key concepts of EBITDA, add-backs, and the factors that influence real-world transaction prices. By understanding these nuances, dental practice owners can make more informed decisions when considering a sale and navigate the process with greater confidence. The importance of seeking legal counsel to ensure the best possible outcome has also been emphasized.