Emerging factors leading to record practice values: Maximizing the sale of your practice

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Just as technological advancements have altered the clinical practice of orthodontics, new business models have altered the way practices are bought and sold. With the evolution of the practice transition industry and the inroads being made by corporate dentistry, the old methods of selling your practice have given way to new, innovative finance models. As a practice broker I have observed these new and emerging transition models and their impact on your practice. Although there is still a place for the old models of practice transition, the newer approaches have shaken up the industry and opened new and exciting opportunities for transitioning your practice. (Semin Orthod 2022; 28:5–7) ***© 2022 The Author. Published by Elsevier Inc. This is an open access article under the CC BY-NC-ND license (http://creativecommons.org/licenses/by-nc-nd/4.0/)***

The profession of orthodontics has morphed into the business of orthodontics. Orthodontic practices have evolved to produce practices of different sizes, scale, and geographic locations. The business models break down into three distinct types of practices: (1) the neighborhood groups that have a single location or a couple of satellite offices (2) regional groups that occupy a broader geographic area, often in multiple states, and (3) national groups that have a presence throughout a large portion of the country, such as Smile Doctors or myOrthos. Founded 2015. Smile Doctors has grown to over 290 locations in 25 states; myOrthos, started in 2019 has approximately 50 locations in 10 states. The market now has international players as well. with Corus having a footprint in both the US and Canada.

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1073-8746/12/1801-$30.00/0

https://doi.org/10.1053/j.sodo.2022.02.001

[1] *JW Practice Advisory is a dental advisory firm that specializes in transitioning orthodontic practices to strategic and capital partners.*

Every orthodontic service organization (OSO) offers a unique value proposition to practitioners. Each has a different operating culture and basket of services it provides to the orthodontist. Each OSO believes its operating model will provide the best support and quality of life for the practitioner whose practice it purchases, with the underlying goal to bring financial rewards both to the selling doctor and the acquiring OSO. Ultimately, the goal is better quality of life for the practice owner and enhanced practice performance. Although this is not always the case, more often than not joining an OSO proves to be advantageous to the selling orthodontist.

Historically, orthodontists would sell to other orthodontists based on a percentage of collections. Now, with the pool of potential buyers getting larger and savvier and with the emerging prevalence of corporate buyers, selling an orthodontic practice has become more of a numbers-driven transaction. It often comes down to the bottom line—what multiple of EBITDA is the purchasing OSO willing to pay.

The acronym “EBITDA” stands for Earnings Before Interest Taxes Depreciation and Amortization. The intent of using EBITDA as a metric for practice valuation is to remove variable factors and non-cash expenses in an effort to normalize actual profits. To approximate your practice's EBITDA, take your total practice collections, subtract all your true operating expenses (not those "add backs" that are not essential to the operation of your practice), and exclude your interest, taxes, depreciation, amortization from the calculation. Be sure to include your own compensation in operating expenses when you calculate your EBITDA. Most OSO buyers use a per diem rate that can range from $1,250 to $1,750 per day to calculate owner's compensation for EBITDA purposes. Note that as your per diem rate goes up your EBITDA goes down and so does the value of your practice. Determining EBITDA is best left to your accountant or practice broker but the above will give you an idea of the elements that go into determining this new practice valuation metric.

Although EBITDA should ideally be a strict accounting definition that does not vary regardless of who calculates it, in reality it can vary depending on the methodology of the person doing the calculation. A buyer's EBITDA calculation can differ from that of an owner/seller. A buyer wants to take into account the need to pay the owner to provide post-transition services to the practice; this will reduce the practice's EBITDA accordingly. A seller will calculate EBITDA based upon how much the owner realizes in both owner-compensation and profits of the practice. Usually though, regardless of who calculates EBITDA, the end result is a sale prices much higher than the old-school percentage-of-collections model. That is why we are seeing record valuations and sale prices in the marketplace.

Here are some recent examples of ortho practice transitions I have been involved with that reflect the increased demand for quality practices and the enhanced values that OSO's are willing to pay for those practices:

- A single location orthodontic practice with 1.5 million dollar collections, which would historically sell for $750,000, sold for over 2 million dollars.
- A multi-location 7.2 million dollar collections orthodontic group sold for over 18 million dollars.
- A multi-location 9 million dollar collections group just transacted for 28.5 million dollars.

Four factors leading to higher valuations:

1. Goodwill truly matters

An important factor in obtaining a high EBITDA multiple is the willingness of a seller to stay in the organization for up to five years after the sale. Why is this important? Seller's goodwill. Over 80% of the value of these practices is in the goodwill or continuity of patients coming in for care. Keeping the selling orthodontist on to help transition is important to reduce patient attrition and help to retain the staff. The longer an orthodontist will stay on, the better the value a buyer will can expect. If a selling doctor only wants to stay a short time after the sale a corporate buyer will want to discount the purchase price to reflect the risk that the primary asset being purchased, doctor goodwill, will depart when the doctor does.

2. Rolling some of the purchase price into equity

Another factor leading to the high practice valuations is that the selling doctor is often offered the opportunity to "roll equity" into the purchasing company or into a sub-entity. Rolling equity means leaving a portion of the overall enterprise value and reinvesting (letting it roll) it into a new or existing organization. In many cases, this can be a tax-deferred event, postponing the inevitable.

If a seller is comfortable rolling equity and taking the educated journey of being part of a larger organization, there can be significant returns not only in the enterprise value but also the future equity growth, colloquially know as the "second bite at the apple." Equity growth can happen in a couple of different ways:

- Seller-doctor now owns a certain specific number of shares in the purchasing organization. As the organization grows, your share price grows.
- Seller now owns a percentage of a shared entity with the parent organization, leading to an increase in value tied to an exit or recapitalization, in which some organizations allow for some or all the equity arbitrage value.

Leaving part of the purchase price to roll with the new buyer is a new concept and it is not without risk. Corporate buyers can and do fail or lose market share. When you leave part of the purchase price on the table when you sell, you are betting on that "second bite" but occasionally, the apple has a worm in it and you do not see the return you had hoped for.

3. Size of the practice

When buyers are reviewing a practice, there needs to be enough profit to add immediate value to their infrastructure but also room for internal organic growth. Many buyers set their value based off a multiplier to the profit or EBITDA. Typically, the higher the profit the higher the multiplier. This is where the practice platform and enterprise scale can have a large impact on the purchase price. Underlying factors such as the number of providers, chairs, locations, square footage, participation in discount-fee plans affect how big the profits are and how much potential there is for a buyer to increase the practice's profitability.

The mindset of most corporate buyers is along the lines of, "How can I take a practice with a good fire already started and pour jet fuel on it to make it bigger?" Your practice needs to be large enough to be desirable with enough opportunity for growth to make a potential buyer recognize the upside.

4. Putting the "Cult" in culture

The fourth factor that leads to a higher valuation is the intangible of practice culture. A buyer looks for two important elements when considering whether a practice is suitable to acquire: the financial fit and the culture fit. In most cases, this culture fit outweighs the economics. Why? Most practice owners have a deep-rooted relationship with their team and their patients. They also have a certain clinical and personal standard of care. Without a superior internal culture there would be no value to the buyer. Same goes for the seller, especially if an equity roll is involved. No seller wants to defer receiving a portion of the purchase price if there is not a good cultural fit. The organizations with the highest growth potential succeed when there is a match between the selling doctor's office culture and the corporate buyer's mindset. Make sure you are aligned with the culture of your buyer, especially if you are rolling equity into the deal hoping for that second bite. If you are not able to walk the corporate walk it might be better to transition using the more traditional route—finding one buyer to buy you out in full, eliminating any future risks of non-payment.

It is a brave new world out there when it comes to practice transitions. Go to any AAO meeting and there are multiple group and corporate buyers enticing doctors to transition to them. The AAO itself, in an effort to embrace all members, has recognized corporate OSO's as valued participants in the big-tent that covers all orthodontists and invites them to participate in AAO-sanctioned events. The fundamentals are still there—good practices are in great demand. With the additional financial and management rigor that corporate buyers are able to impart to otherwise successful practices, record values are being realized. I have had a front-row seat to the evolving and changing paradigms of practice transitions. When you are ready to transition your practice surround yourself with a good team, get your house in order, and get ready for an exciting journey into the new world of practice transitions.