



Concurrently published in the Manitoba Bulletin, Newfoundland Bits & Bites, and the Saskatchewan Newsletter

## What is a Practice Appraisal?

Sept 2018

The simple answer to this question would be that a practice appraisal is a document that establishes the fair market value of a dental practice; the basis for that value; and an explanation of the methodology used by the appraiser to arrive at the value.

A good practice appraisal should serve these goals:

- It should answer any reasonable question that a buyer might pose in order to make an informed opinion as to whether or not they might want to buy this practice.
- It should give the seller all the information that they need in order to decide if they want to sell their practice as well as information about the strengths and challenges in their practice.
- It is one of the basic components in the transition planning process.
- It should give the bank the information that they require in order to finance the purchase.
- If the decision is to sell, then the appraisal becomes the primary marketing tool for used to sell the practice.

There are three methodologies that are commonly used to appraise businesses (and a dental practice is a business) and/or properties:

- Discounted cash flow or earnings multiple valuation
- Asset-based valuation
- Comparable valuation (using comparable practices)

Let's briefly look at each of these approaches.

The comparable methodology is most commonly used when valuing houses or commercial properties. Simply put, the valuator looks for recent sales of properties in the same area as the subject property and compares the subject property to those recent sales. Because dental practices are complex businesses with many variables that need to be considered when determining their value, it is difficult to find recently sold practices that are totally comparable. That leads to the need for “adjustments” to do the comparison and these “adjustments” necessarily introduce a lot of subjectivity to the appraisal process.

An asset valuation breaks the business into its component assets, the two main ones being capital or “hard” assets, and goodwill which is a “soft” asset. The “hard” assets would include dental equipment, computer hardware, software, instruments, consumables and leasehold improvements. In most mature dental practices goodwill will comprise 60-80% of the value so it becomes the key component of the appraisal. Most appraisers who use the asset valuation approach tend to use “filters” to appraise the goodwill which again introduces a lot of subjectivity to the process.

The discounted cash flow/earnings multiple approach is the one that is most commonly used to evaluate businesses. It tries to answer the question: what is this business or practice worth as an investment. Anyone who follows the financial media will have read about businesses that have sold for a 2, 3 or 11 or some other number as the multiple. What this means is that the business sold for that number times the earnings or net profits of the business. It is the most transparent approach to business valuation and is preferred by the banks as well as the increasing number of people that are investing in dental practices.

As we have stated in previous articles, by far the most valuable asset in a general dental practice is the patient base. All of the most important business and professional factors that influence value flow from the patient base. These include revenue (gross production); earnings (profitability); new patient flow/attrition; languages spoken; and ethnicity. Any appraisal that doesn't pay a lot of attention to the patient metrics will not give an accurate, in-depth analysis of the basis for the practice's value.

There are a myriad of other factors that also need to be considered in a good appraisal document, some of the most important of which are: the demand for practices in a given location; premises lease health; the strength and quantity of

hygiene done in the practice; the costs (employee wages, rent, dental supplies); staff considerations; procedures that are referred out; treatment of the co-pay; associates in the practice; size of the premises; condition of the equipment; and more.

If you are buying a practice then you need to have a good appraisal to allow you to make an informed decision. If you are thinking of selling your practice getting an appraisal has to be one of the most important steps in your planning process. How can you possibly get a fair price for something if you don't know its value?

Remember, an appraisal is much more than a number, it is a document that needs to answer a host of questions and meet several requirements.

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