



Getting familiar with business valuations

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THEY SAY BEAUTY IS IN THE EYE OF THE BEHOLDER. apply when asking a dentist what their dental practice is worth.

That adage can undoubtedly

There's significant subjectivity involved in any valuation, especially where the current owner is concerned. After all, the actual price of anything is *not* what the seller is asking, but *what a willing buyer will pay*. Everything else is merely an estimate.

When building, selling, or buying a dental practice, it is crucial to understand standard business valuation approaches to ensure you look at the practice with realistic eyes.

WHAT IS A BUSINESS VALUATION?

Chen defines valuation as “the analytical process of determining the current (or

projected) worth of an asset or a company.”¹ Such an analytical process of determining the worth results in what's called the “fair market value” of a business.

A valuation is a complex concept based on multiple internal and external factors, such as business ownership, financial position, outcomes of current and past operations, financial forecasts of future operations, industry competition, and general economic conditions. Though simplification of such a complex concept may not be suitable, some analysts see business valuation “as a process and a set of procedures used to establish what a business is worth.”²

This definition does not give the process its due. The process of valuation and determining a company's fair market value is a complicated task. Besides, as with any other complex task, it requires understanding, analytical skills, and expertise.

When evaluating a business, there are a few critical points to remember:

- A business valuation is a process of determining a business's economic value based on commonly accepted valuation techniques and processes.
- Several formulas and strategies commonly used in the process are scientifically sound, but calculating a business's value isn't an exact science.
- While determining an economic business's value, it's essential to know that business value is an indication of what

a business enterprise is worth—not a guarantee but, rather, an indication of the sales price.

- Valuation is perhaps the most efficient way to relay economic information to a potential buyer, presenting the data a potential investor wants.

IS COMPANY VALUATION A SIMPLE COMPUTATION BASED ON DATA?

Company valuation involves assessing the total economic value of a business and its assets, which is primarily based on historical performance and values. Does such a retrospective view confine the actual value of the business enterprise to past performance? Perhaps, but as with many other things in life, it depends.

Recent technological developments make it easy to access online valuation calculators that practice owners can use to input limited financial information and “calculate business value.” This approach has multiple problems that can be consequential for buyers and sellers alike. Relying on the values produced by these calculators can seriously affect important business and investment decisions.

As we have often heard, valuation is primarily an art based on the science of finance. While many readily available online business appraisals use the historical performance of the business, these calculations miss the “art” component of the valuation.

Some online valuation providers have purely computer-based models, which sounds ideal in theory, but many have significant blind spots. For example, a favorable, nontransferable office lease or practice understaffing can positively affect profitability; these will become significant financial burdens once the practice is sold. Such factors can’t be included in a financially driven valuation model, but they could impact the company’s prospects under different ownership.

Accurate valuation should not be viewed as a simple mathematical summary of data derived from past performances, but instead a synthesis of multiple elements of business performance derived with current analytical techniques.

IS BUSINESS VALUATION A RETROSPECTIVE ANALYSIS?

Although business valuation is a process primarily based on financial analysis of historical data, many professional evaluators would agree that properly developed valuation is a forward-looking financial model that focuses on future projections of business performance with a reasonable degree of certainty.

Well-designed business valuation encompasses *assessing opportunities and evaluating risks* that come with the professional judgment of a business valuator.

Finally, the business valuation is an investment analysis that allows the owner and potential buyer to predict, with a relative degree of certainty, the future benefits available to a hypothetical investor at a given point in time.

THE ART AND SCIENCE OF BUSINESS VALUATION

As we and many others have said, business valuations are partly an art and partly a science.

Business valuers put a great deal of thought and research into every aspect of an valuation, but we do acknowledge that there can be a fair amount of subjectivity involved.

To minimize the bias and maximize the calculations’ validity, modern valuation analysis utilizes multiple statistical methodologies that elevate that reasonable degree of certainty.

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WHAT MAKES BUSINESS VALUATION OBJECTIVE?

While some assumptions are made in any business valuation, applying the following principles and techniques will help valuers reduce bias and increase a reasonable degree of certainty while evaluating the business enterprise.

- Establish benchmarks of the company’s performance with further application of analytical techniques to evaluate past performance and estimate future performance.
- Utilize a comparative analysis of the industry data to the subject company’s performance.
- Analyze current economic conditions and outlooks.
- Examine administrative performance and interview management to gain an understanding of the company’s internal structure.
- Evaluate and understand the company’s risks and opportunities.

UNDERSTANDING BUSINESS VALUATION FOR DENTAL PRACTICES

How is dental practice valuation different from valuation of many other businesses? The dental practice is driven by one specific engine: the dentist. Dental practice valuation is the economic value of an owner’s clinical and administrative performance.

The nature of dental practice valuation is unique because a practice is as unique as a dentist-owner. The dental practice valuator’s job is to project the practice’s strengths, whether you’re looking to sell, bring in a partner, or plan for retirement. This is precisely the point where simply relying on well-documented methods is insufficient, and this is where the art element is as important as the science.

THE MANY WAYS TO VALUE A DENTAL PRACTICE

The process used to determine a reliable economic value for a dental practice can vary widely. Formal valuations usually involve analyzing various factors ranging from the physical assets of the practice and the number of active patients to the

reputation of the business and its location.³

One significant factor you may not see listed in textbooks is *who is doing the appraisal*. The best valuations come from those actively involved with buying and selling practices, since they see the values people pay out there in the real world. Valuation analysis is a skill that comes with knowledge of finance and valuation experience.

FACTORS THAT DRIVE THE DENTAL PRACTICE VALUE

Dental practice valuation is not a one-size-fits-all process; it's far from it. Although there are a variety of approaches, most methods tend to draw from these general areas:

- **Financial performance:** Revenue, expenses, and net profits are central to assessing the company's value.
- **Patient base:** The number of active patients, visit frequency, and spending patterns also contribute to value.
- **Location:** Demographics, population growth, competition, and accessibility are taken into account.
- **Facilities and equipment:** The quality and condition of the facilities and equipment are considerations.
- **Goodwill:** The practice's reputation, patient satisfaction, online reviews, and brand recognition matter.

Other factors that may impact the value include staffing and administration, the efficiency of clinical and managerial operations, and the practice's fee structure in relation to the local market. While some of these can be evaluated purely from financial statements, many contributing factors require in-depth research, much of which may be conducted on-site.⁴

MAXIMIZING THE VALUE OF YOUR PRACTICE

How do you go about increasing the value of your practice? It starts with understanding the key drivers of value in a dental practice and strategically working to enhance them. These usually include the practice's profitability, quality of patient care, efficiency of operations, and brand strength.

The first steps are setting goals and implementing improvements, which could

involve developing marketing campaigns to increase sales, adding new products to offer to patients, or investing in new equipment. Or you can work on the cost side of the equation to reduce expenses.

Unsurprisingly, industry research shows that dental practices with higher profit margins typically sell for higher multiples of earnings, so increasing your profitability will almost always result in an easier sale and a better price. The more valuable your dental practice is, the more profitable an exit you can usually secure. That is where the real work begins.

Because of the importance of this topic, we'll go into more detail on valuation methods in future articles in this series.

CONCLUSION

Understanding business valuation and how to use these concepts is critical for dental practice owners. It's recommended that every practice have an initial dental practice valuation with periodic updates.

Along with helping you increase the value of your practice, you'll also get conversant in these concepts, helping you be a more informed seller when the time is right. By focusing on increasing practice value today, you'll know you're doing everything possible to grow your asset and maximize your investment.

Knowing your enterprise value provides you, as business owner, with great insight into the most important investment of your life: your dental practice. Not only that; establishing a value can help you monitor your practice's growth.

The sooner you start paying attention to valuation, the better, because it's a critical part of the evolution of your practice.

Disclosure: The authors have no financial interest in any companies mentioned in this article. **DE**

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