

PROFESSIONAL PRACTICE VALUATION

Jane R. Smith, DDS

April 1, 2015

Prepared by:



101 E. PARK BLVD. SUITE 300

PLANO, TX 75074

972.881.1501

www.DME-Advisors.com

DEFINITION OF FAIR MARKET VALUE

The fair market value of a Dental practice can be defined as the most probable amount or price which will be paid by a willing buyer when the practice is offered for sale by a willing seller. This definition has previously been outlined in IRS Ruling 59-60 for valuing the stock of closely-held organizations where market quotations are simply not available. This IRS ruling further states that no general formula exists which is applicable to the infinite number of different situations arising in the valuation of stocks. The definition of fair market value and the purpose of the Revenue ruling apply equally to professional practice. The IRS ruling lists the following relevant factors:

- (1) Nature and history of the company.
- (2) Financial condition and book value of the corporation.
- (3) Earning capacity of the organization.
- (4) Goodwill, going concern and intangibles.

In February 1990, the Tax Court decided the case of "Newhouse vs. Commissioner," (94 T.C.No. 14 ((1990)) which was the first time the courts accepted the different classes of willing buyers concept. The court resolved in applying the "willing buyer" fair market value standard that there are four benchmarks of value which willing buyers may utilize to determine the value of the stock of corporations.

The Benchmarks are:

- I. The Control Investor
- II. The Active Investor
- III. The Passive Investor
- IV. The Public Investor

The appraisal made to determine a value for one class of willing buyer will be different from the appraised value for another class of willing buyer. The Control Investor would purchase the Dental practice with the goal of acquiring total equity ownership. Therefore, I appraised the practice owned by Dr. Jane D. Smith as being appropriate for the Control Investor classification of willing buyer.

Valuation Method #1

Earnings Multiple Method

The Earnings Multiple Method can be used to value Dental Practices by applying a factor, or multiple to the past earnings of the practice. The basis of this calculation was based on profits of the practice for the years 2013, 2012 and 2011.

Specialty dental practices often utilize multiples ranging between 1.0 - 1.75. The multiple used for the subject practice is **1.375**. This practice was valued around the average factor due to the perceived goodwill of Dr. Smith, the age of the practice, and the intrinsic value of the proprietary software developed by Dr. Smith. The calculation is illustrated below. In addition, the reader is reminded the profits of this practice were normalized to remove debt service, voluntary or personal expenses and the compensation package of the owner. The goal is to arrive at a true profitability figure based solely on those required overhead expenses.

Valuation Method #1

Earnings Multiple Method

<u>Fiscal Year</u>	<u>Collections</u>	<u>Profit</u>	<u>% Profit</u>			
2011	\$ 895,372	\$ 263,133	29.39%	x	1	\$ 263,133
2012	\$ 1,042,336	\$ 332,602	31.91%	x	2	\$ 665,204
2013	\$ 889,675	\$ 279,470	31.41%	x	3	\$ 838,410
	<u>\$2,827,383</u>	<u>\$ 875,205</u>	<u>30.95%</u>		<u>6</u>	<u>\$ 1,766,747</u>

Weighted average annual profit \$ 294,458

Selected earnings multiple **1.375**

\$294,458 x 1.375 \$ 404,880

Tangible Assets Value \$ 94,664

EARNINGS MULTIPLE VALUATION METHOD \$ 499,544

Valuation Method #2

Discounted Future Cash Flow Method

The discounted future cash flow method is probably the most widely employed technique in the valuation of businesses which are privately owned, and stock prices are subsequently not available to establish equitable value through the application of price/earnings ratios or market capitalization. The real value of a dental practice is its earnings power. The discounted cash flow method relies on specific earnings projected into the future. This method will clearly state in current dollars the amount a willing buyer might pay for the future earnings of the dental practice over a reasonable period of time. For dental practices, generally, a reasonable period of time is five (5) years.

There is usually an expectation of continuing future practice growth and increasing value beyond the five (5) year period, and the valuator should consider and establish a "terminal value" also known as an "annuity into perpetuity."

The discounted future cash flow method of valuation is based on the accepted theory that the value of a professional practice depends on the future benefits or future earnings the practice will produce **discounted** back to a **present value** at an appropriate **discount rate**. This technique is a version of the capitalization of income method relying on specific projections of earnings for five (5) years into the future.

In contrast to the capitalization rate method, the discount rate method employs a rate of return to convert a series of **future** income amounts into a current or **present value**. This discount rate should be established by utilizing the previously formulated capitalization rate and then adding a premium because of the additional risk over the period of five (5) years.

In this valuation, conservative projections of **3.0%** annual increases in pre-tax net income were made for the five (5) year period. The additional risk premium for long-term forecasting was set at **2.0%**, and when added to the **30.0%** capitalization rate the projections were discounted to their present value at the rate of **32.0%** following the necessary consideration of annual federal taxes payable. Additionally, a 30% tax base is utilized based on national averages for dental specialists, and based on the expected compensation levels this practice will produce.

The formula is illustrated on the next page.

Valuation Method #2
Discounted Future Cash Flow Method

YEAR	2014	2015	2016	2017	2018
Projected Cash Flow	\$293,000	\$301,000	\$310,000	\$319,000	\$328,000
Less: Taxes @ 30.0%	\$87,000	\$90,000	\$93,000	\$95,000	\$98,000
NET PROFIT	\$206,000	\$211,000	\$217,000	\$224,000	\$230,000
Present Value Discounted @ 32.0%	\$156,061	\$121,097	\$94,349	\$73,782	\$57,393
DFCF METHOD VALUE =					\$502,682

Valuation Method #3

Comparable Sales Method

Additional external factors also influence the valuation of dental practices. Profitability and cash flow are not the only measuring tools for determining Fair Market Value. Other items to be considered in valuing a dental practice include: practice location and demographics, condition of physical plant, personnel and years' experience, patient demographics, payer matrix, market saturation, local economy and other various factors.

Comparable sales data of dental practices is readily available through various professional publications, societies of dental consultants, and business valuation organizations. Some of these resources include the following: MGMA, National Society of Healthcare Business Consultants and Institute of Business Appraisers. Additionally, the comparable sales method is accepted by the Internal Revenue Service under code section 2031(b) which permits this type of valuation.

In reviewing data from the above mentioned resources, the most commonly utilized percentage of sales price relative to gross revenues for similar dental practices is 60%. These percentages usually fall between 45-75%. Considering the location of the practice, the current economy of Dallas, and the extraordinary length of time the practice has provided quality dental treatment, I applied a realistic rate of 60% to the calculations of value. These calculations are illustrated on the next page.

Valuation Method #3
Comparable Sales Method

2012 Patient Revenue	\$	1,042,336	x	1	=	\$ 1,042,336
2013 Patient Revenue	\$	889,675	x	2	=	\$ 1,779,350
2014 Patient Revenue*	\$	799,008	x	<u>3</u>	=	<u>\$ 2,397,024</u>
		TOTAL		6		\$ 5,218,710
		Divide total by		6		\$ 869,785
Weighted Average	\$	869,785	x	60%		\$ 521,871

COMPARABLE SALES METHOD VALUATION \$ 521,871

*2014 Annualized

SUMMARY OF VALUATION METHODS

Valuation Method #1 - Multiple of Earnings	\$ 499,544	x	33%	=	\$ 164,850
Valuation Method #2 – Discounted Future Cash Flow	\$ 502,682	x	34%	=	\$ 170,912
Valuation Method #3 – Comparable Sales	\$ 521,871	x	<u>33%</u>	=	<u>\$ 172,217</u>
			100%		\$ 507,979

OPINION OF FAIR MARKET VALUE - ROUNDED \$ 508,000

Tangible Assets*	\$ 93,229	<i>[* Refer to "Appendix A"]</i>
Intangible Assets	\$ 414,771	
ESTIMATE OF FAIR MARKET VALUE	\$ 508,000	

SPECIAL NOTE: The reader of this report is reminded that the above value DOES NOT include practice assets such as cash on hand or accounts receivables. The above value also has not taken into consideration any practice liability that existed as of August 31st, 2014.

This appraisal of the Fair Market Value of the practice of Jane R. Smith, DDS is based on the criteria of the assignment; to value the business for a potential sale. It is assumed that if a sale took place, the exiting practitioner would provide the required ingredients for successful transfer of practice goodwill. If the ingredients of a transition are not in place, the Fair market Value for this practice would decrease significantly.

Respectfully submitted,



Shane DuPree, Consultant
Dental-Medical Economics

ASSUMPTIONS, LIMITATIONS, AND CONTINGENCIES

The data contained in this valuation report has been obtained from telephonic and electronic correspondence with Dr. Jane Smith.

- To the best of my knowledge, there are no significant adverse circumstances nor any substantial contingent or undisclosed liabilities which could have a meaningful impact on the future profitability of the practice.
- Dental-Medical Economics and its agents are totally independent from this practice and have no financial interest whatsoever in the dental practice owned by Dr. Smith.
- This report is a limited appraisal analysis designed to provide a conclusion of value. It is not a comprehensive accounting report and should not be relied upon to disclose all assets, all liabilities, or to completely verify financial reporting.
- The reported analyses, opinions, and conclusions are limited by the reported assumptions and limiting conditions, and is my personal, unbiased, professional analyses, opinions, and conclusions.
- No responsibilities are assumed for matters of a legal nature or as to the title of the properties described.
- Had I performed additional review procedures or performed examinations of the underlying financial statements of the practice in accordance with generally accepted auditing standards, I may have observed factors which would have alerted the methods and calculations employed and possibly the final appraisal value.
- The valuator is not required to give testimony nor to appear in court by reason of this report unless specific arrangements have been made or will be made in the future.
- No reproduction, publication, distribution or other use of any part of this report is authorized for public release without the prior written consent of Dental-Medical Economics or Dr. Smith.

APPENDIX A

JANE R. SMITH, DDS
TANGIBLE ASSET FMV
ASSETS THRU DECEMBER 31, 2013

AST NO.	DESCRIPTION	DATE ACQUIRED	YEAR ACQ	COST	7 YEAR *		20% *	GREATER OF
					SL DEPR	BASIS	SALVAGE	BASIS OR SALVAGE
1	COMPUTER EQUIPMENT	2/19/2002	2002	778	778	0	78	78
2	COMPUTER EQUIPMENT	5/6/2002	2002	1,585	1,585	0	159	159
3	COMPUTER EQUIPMENT	12/22/2008	2008	2,864	2,455	409	286	409
4	COMPUTER EQUIPMENT	1/23/2004	2004	19,731	19,731	0	1,973	1,973
5	COMPUTER EQUIPMENT	2/12/2004	2004	9,802	9,802	0	980	980
6	COMPUTER EQUIPMENT	2/12/2004	2004	2,588	2,588	0	259	259
7	COMPUTER EQUIPMENT	1/23/2004	2004	779	779	0	78	78
8	PANO/TOMO MACHINE	10/9/2002	2002	39,000	39,000	0	7,800	7,800
9	DENTAL EQUIPMENT	4/25/2003	2003	3,912	3,912	0	782	782
10	DENTAL EQUIPMENT	12/31/2003	2003	130,446	130,446	0	26,089	26,089
11	DENTAL EQUIPMENT	1/23/2004	2004	3,592	3,592	0	718	718
12	FLASH FOR CAMERA	8/16/2005	2005	459	459	0	92	92
13	SHEER VISION #1	1/25/2010	2010	990	566	424	198	424
14	FURNITURE & FIXTURE	11/18/2003	2003	3,135	3,135	0	627	627
15	FURNITURE & FIXTURE	10/20/2003	2003	6,945	6,945	0	1,389	1,389
16	REFRIGERATOR	12/19/2003	2003	1,502	1,502	0	300	300
17	FURNITURE & FIXTURE	12/22/2003	2003	627	627	0	125	125
18	FURNITURE & FIXTURE	12/22/2003	2003	2,508	2,508	0	502	502
19	FURNITURE & FIXTURE	2/12/2004	2004	5,464	5,464	0	1,093	1,093
20	FURNITURE & FIXTURE	2/16/2004	2004	220	220	0	44	44
21	FURNITURE & FIXTURE	3/16/2004	2004	818	818	0	164	164
22	FISH HEAD FIXTURE	6/17/2004	2004	1,066	1,066	0	213	213
23	FURNITURE & FIXTURE	5/24/2004	2004	693	693	0	139	139
24	OFFICE EQUIPMENT	10/16/2003	2003	820	820	0	164	164
25	OFFICE EQUIPMENT	11/19/2003	2003	1,410	1,410	0	282	282
26	OFFICE EQUIPMENT	11/19/2003	2003	2,230	2,230	0	446	446
27	OFFICE EQUIPMENT	12/22/2003	2003	2,230	2,230	0	446	446
28	OFFICE EQUIPMENT	12/31/2003	2003	2,363	2,363	0	473	473
29	OFFICE EQUIPMENT	1/19/2004	2004	1,118	1,118	0	224	224
30	OFFICE EQUIPMENT	3/30/2004	2004	465	465	0	93	93
31	LASERJET PRINTER	6/2/2005	2005	2,382	2,382	0	476	476
32	TELECHECK TERMINAL	4/15/2008	2008	<u>500</u>	<u>429</u>	<u>71</u>	<u>100</u>	<u>100</u>
TOTAL VALUES				253,022	252,117	905	46,792	47,141
* COMPUTERS ARE DEPRECIATED ON A 3 YEAR STRAIGHT-LINE BASIS WITH A 10% SALVAGE VALUE								
PLUS INVENTORY ON HAND VALUED @ 2 MONTHS AVERAGE EXPENSES FOR SUPPLIES								28,693
PLUS INSTRUMENTS AND OTHER SMALL EQUIPMENT @ 2% OF REVENUE								17,396
TOTAL VALUE OF TANGIBLE ASSETS								93,229