

WHY ARE APPRAISALS SO COMPLICATED?



6 to 7 MINUTE READ TIME

For those who want to know what their practice is worth, and if you are intrigued by the furious debate about how to properly place a fair market value on a practice, this article will interest you.

This is the longest Sunday morning post that I have published (over 500 articles are now published).

A good read when you need something boring to put you to sleep. Nerds like me love this stuff 😊

First, an apology: there is shameless self-promotion in this article. I am a marketer and a capitalist – but also an educator – and I hope that you can notice the difference.

I am trying to help you to understand and prosper.

And a second apology – I was so frustrated after critiquing an appraisal from a very suspect firm (owned by a Grifter) that I decided it's time to call out the pathetic appraisal work that is making the rounds.

Lazy appraisers are not good for your profession. They publish spurious and plagiarized work. In doing so they demean and diminish the integrity of the practice valuation landscape.

This ultimately lowers practice values as confidence is eroded at the banks.

Start with the knowledge of who are the intended readers of an appraisal:

1. Doctors
2. Bankers
3. Accountants
4. Lawyers
5. Trusted family advisors
6. Consultants



7. Professors
8. Insurance advisors
9. Credit Analysts - those who grant or deny bank loans...
10. and more...

Each has a unique view of the appraisal, and all are biased towards their client - as they should be.

Why does this article matter?

In the business appraisal community, there is a lot of fancy language, acronyms, spread sheets, formulae - and to be blunt - a great deal of nonsensical terminology being bantered about.

New entrants to the business appraisal arena often try to invent novel words to appear sophisticated, when in fact, they have nothing but an AI search and a spreadsheet to reply upon.

The only common denominator I can find amongst the plethora of appraisal gurus is the search for the holy grail of appraisal – the mythical “*X-factor*.”

Where: the bottom line multiplied by X = business value expressed in dollars (\$).

It could be that simple. But no! Consensus has ghosted the key players, and we do not share our data.

Too many egos and too many Gurus!

Yes, I am one of them.

Please watch this short film: [Too many GURUS](#)

First off, determining the bottom line is subject to bias, manipulation, and imperfect science.

And then, selecting the X-factor is a total wild card. If we all relied solely on the actual data, the amateur opinions (which are abundant) would be washed away and flushed down the toilet where they belong.

We don't share our data, as it is proprietary and confidential to the clients – thus, it remains locked in the vaults of each appraisal firm. Sometimes never to be seen again - especially when the embarrassing sale price is much lower than the “experts” appraised value – how convenient it is to hide lackluster results.

By comparison, just ask a realtor about recent sales. They will not publish nor brag about the houses that sold under asking. You will always see their little mailers saying SOLD for X% OVER asking.

Yes, this is highly predictable behavior for an incredibly low barrier of entry career (not a profession).

Those practice appraisers with small vaults of data must use more of their opinion to determine value. Most of them talk too much, listen too little, and rely far too much upon the abundance of rumor and gossip about actual sale prices.

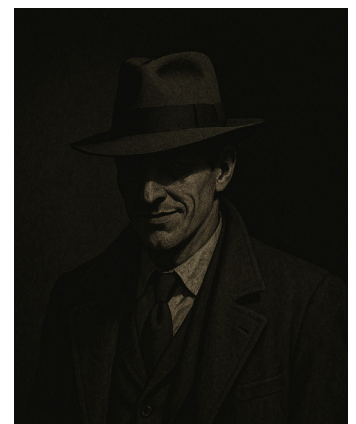
You may recall that I have written about hustlers, fraudsters, scammers, and pathological liars.

The appraisal world is a perfect place for the Grifter to hide!

BTW – many of you ventured a guess at whom I was referring to as [The GRIFTER](#) and some got it right – he continues to make his rounds.

But sadly, there are many more unnamed grifters lurking in the shadows salivating at your cash flow.

Amateurs prevail in all industries. They believe they have the recipe, yet few have baked a cake!



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Many business appraisals are nothing more than a 'best guess', with little to no evidence-based backing.

Here's a simple example: X number of square feet multiplied by \$X per square foot = leasehold value.

Poppycock! Count the plugs, you lazy buggers.

Watch this short film, please: [Count the PLUGS](#)

Did you know that no license is required to deliver an opinion of value? Welcome to my world.

OK – enough of my ranting and raving... Let's try to figure out how to do it.

How to start (Business Appraisal 101)

1. Determine the bottom line. Turns out there are many definitions:
 - In the United Kingdom, they call it reconstituted profit
 - In the USA, they call it net profit
2. In Canada, the most common phrases are:
 - EBITDA
 - Net Income
 - Free cash flow (FCF)
 - Discounted cash flow (DCF)

So, what is the best bottom line to rely upon before applying the mysterious X-factor?

We all recognize **net income** - the figure found at the bottom line of accountant-prepared financial statements. This is what we report to the Canada Revenue Agency and pay personal or corporate taxes on.

But net income is rarely used as the bottom-line number for appraisals. What? Are you confused now?

But wait, it gets more interesting.

3. Then we decide which report type to publish:
 - Appraisal
 - Valuation
 - Evaluation
 - Market Estimate
 - Letter of Opinion
 - Napkin Valuation (slang)
4. Then we select the approach to value:
 - Income approach
 - Market approach
 - Cost approach
 - And this one is a mouthful, used by accountants at times:
Capitalized Invested Capital Net Cash Flow Method (CICNCFM).
5. And finally, we state a conclusion such as:
 - Enterprise value
 - Fair Market value
 - Salvage value
 - Terminal value
 - Present value



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Are you confused? You should be!

One dude says he can 'invert' the numbers to arrive at ROI. What? It is or it is not an ROI! Silly man.

Another fast talker says he got it all "in the Clouds". Isn't everything in the cloud now? Whatever.

And then there is this dandy of a formula: **Weighted Average Cost of Capital (WACC)**.

$$WACC = (Ke * We) + (Kd * Wd)$$

Where:

Ke = Cost of Equity

We = Equity weight (value of Equity divided by Invested Capital)

Kd = After-tax cost of debt

Wd = Debt weight (value of interest-bearing debt divided by Invested Capital)

Or this beauty: **Capital Asset Pricing Model (CAPM)**.

$$CAPM = E(Ri) = Rf + \beta(RPm) + RPs + RPU$$

Where:

E(Ri) = Expected (market required) rate of return on security

Rf = Rate of return available on a risk-free security as of the Valuation Date

β = Subject company's beta coefficient

RPm = General Equity Risk Premium for the "market"

RPs = Risk Premium for small size

RPU = Risk Premium

Oh, my goodness! I am getting a headache!

What the heck is a beta coefficient anyways?

Shame on the business appraisal industry for making it far too complex. We are not impressed!

Complexity keeps the appraisal gurus busy – and in the chips! Whoops – I am one of those gurus.

Has anyone found simplicity?

Yes. The real estate agents made it simple by using the direct sales comparison method (aka market approach). The majority of residential appraisals rely almost entirely on the most comparable properties, those that recently sold on the open market, as the primary basis for determining fair market value.

I have much distaste for the real estate industry at large – primarily due to its adherence to the dangerous practice of dual agency (working for both sides), but at least the industry agrees on direct sales comparison as the empirical appraisal method.



Finding X

And now we begin the search for the ever-elusive X-factor... your guess is as good as mine. 2X? 6X? 10X? So much to consider.

My data reveals a minimum of four important variables to get us started – the location:

1. Urban
2. Suburban
3. Rural
4. Remote locations



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Add to this a list of exceptions:

1. General vs specialty practice (type)
2. High- or low-growth operation
3. Growing or declining local population trends
4. Cost of capital
5. Human resource availability
6. Dominance of key income producer(s)
7. And more...

Consider Location as a starting point

My data also reveals that an urban location can have more than one X-factor.

Why? Because let's be honest, not all parts of the big city are equal. Take Vancouver, for example. The Lower East Side is downtown – but is it representative of the entire downtown Vancouver area? The Lower East Side is known for its complex social dynamics. Would you want to buy a dental practice there?

The amateur says that Vancouver deserves a specific X-factor. He is oblivious to the address and applies the standard, spreadsheet-driven metric to his appraisal. Take that to the bank!

What about all the other variables? Interest rates, premise lease terms, systems, fees, collections, staff configuration, individual skill sets, days and hours of operation, marketing and social media, reputation management, I could go on...

How can anyone break all that down into a singular X-factor?

It can't be done. No one possesses the holy grail – even Monty Python could not find it.

But everybody you talk to is going to give you differing terminology, a different approach, and will promote their methodology as empirical to all others. Therefore, they should be trusted.

Rather than listening to all the biased opinionators, including myself, why don't you ask your bank what information they prefer?

If you need to know the value of your practice, ask whom the banks approve and the accountants respect. All other choices may not serve you well for proper, documented, professional planning.

I have rattled sabers with accountants on many occasions, spending considerable energy - not to mention the hourly charges paid by the dentist to those accountants – to explain my methodology.

My advice

Select a company that speaks plain language and presents its findings in a format you can clearly understand.

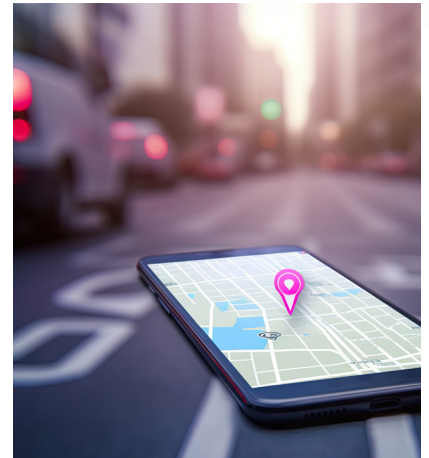
Hiring an appraiser and then being absolutely bamboozled by their mathematical gymnastics and spreadsheets (and then paying your accountant thousands of dollars to interpret and decipher them) is a foolish investment.

Ask for a sample appraisal from the company before you decide which one you choose to engage.

If they cannot share a sample of their work, move on.

Conclusion

I submit that free cash flow, supported by direct sales comparison, is king of all methods.



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Note of caution: Earnings before income taxes, depreciation, and amortization, typically used by major industries, are inappropriate for small, privately held Canadian corporations. You will continue hearing that acronym. It is easily manipulated and can be custom designed to suit the purpose of the spreadsheet creator. Do not trust EBITDA when calculated by a purchaser.

Thanks for reading this far. I hope I didn't give you a headache – I got one just writing this nonsense!

Enjoy this cold, harsh winter, folks...

Elbows up – screw that!

BUY CANADIAN and keep your money **UP** north of the border!

Show up, don't bugger it up and work our butts off! It will be like this for 3 to 5 years and may never go back to where we once were... sorry to be a downer.

Would you like a **FREE estimate** of the value of your practice? TEXT me @ [\(416\) 520-7420](tel:4165207420).

This is your before (NOT after) New Year's resolutions:

- ✓ Buy Canadian, please
- ✓ Stop the madness and turn away all the hustlers at your door
- ✓ Give your staff and patients 100% of your energy – they are valuable assets
- ✓ Put all elective spending on hold – for at least 1 year
- ✓ Call every supplier and ask them for a better deal – even your bank – they will listen
- ✓ Focus on FREE marketing – ask your patients for their referrals
- ✓ TEXT me for the best FREE referral sign – it works!
- ✓ Reviews matter – make sure they are organic and ask for more!
- ✓ TEXT me for a FREE market estimate of your practice worth – no obligation
- ✓ Create or update your will – do it now, please. Do not be naïve or stubborn – it is expensive to be unprepared for the unforeseen – EXTREMELY expensive!
- ✓ Save up some [MAD MONEY](#)
- ✓ Subscribe to my newsletter: [Timothy's Newsletter](#)
- ✓ Need to chat? TEXT me @ [\(416\) 520-7420](tel:4165207420)
- ✓ ROI REWARDS: Refer a classmate or colleague and you earn a \$1,500 **REVERSE TARIFF** toward your next appraisal. I will give them the exact same credit. **A total savings of \$3,000!**

And for the love of all thing's family – let's all put our phones down for a few days! I will try to follow my own advice 😊

Go JAYS!

BIG NEWS: The Master Class for those planning their exit strategy is happening this November!

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FRI, CEO & Broker of
Record



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