Physicians, What is Your Practice Really Worth?

By Ike Devji, JD [5]

Here's really how the experts figure out what to pay or ask for when it comes to the price of a medical practice.

We are at a time when millions of boomers of every profession are considering the sale of their business and furiously working with "succession planners" that are in seemingly endless supply. Doctors are certainly not excluded from this demographic and both buyers and sellers of medical practices are struggling with how to determine what a practice is really worth. In previous articles we've discussed why buyers of medical practices need their own representation as well as a series of issues to consider when starting up a practice or incurring practice related debt.

This week I turned to attorney Thomas Cooper of Thomas Cooper and Associates, a medical practice taxation and transition specialist, for some thoughts on how he and other professionals in the field figure out exactly what their clients should demand or pay for a practice.

“The most common ‘urban myth’ is that your practice is worth 60 percent (or 70 percent) of revenue,” said Cooper, demonstrating the fallacy of this, so-called valuation method.

“Let’s say that we have two practices. Each is producing $1 million of revenue. Each has the same size facility. Each is nicely furnished and equipped. Each has a great team and patient base. Each is valued at 60 percent, or $600,000. Now, let me introduce a couple of new facts: one practice is 40 percent profitable and the other is 20 percent profitable.

“Which practice would you rather purchase? Obviously, you would buy the practice that is 40 percent profitable. And yet, both practices are valued at $600,000.”

Despite Cooper’s clear explanation we commonly see that, at least internally among doctors, this kind of speculative determination of value is the norm. This is still how most practices are valued. Why?

“The reason is that most practices are valued by brokers, who use this shorthand approach to valuation. The revenue multiple is often as high as 70 percent to 80 percent. This is natural; since the sales commission is usually calculated as 10 percent of the sale price,” he said.

A result of this inherent conflict, one of the biggest challenges brokers face is getting the buyer and seller to agree on a reasonable valuation.

“We see practices whose valuations end up at 40 percent and 90 percent of revenue,” he said. Cooper went on to explain that the correct determination of value is not some random “rule of thumb” approach as described above. Value is driven by a number of factors; but most importantly profit and revenue. I asked Tom how that was best reduced to math, to a hard number.

“The standards of a qualified valuation specialist, such as a Certified Mergers & Acquisitions Analyst (CM&A), Accredited Senior Appraiser (ASA), or a Chartered Financial Analyst (CFA) are often invaluable to the process of valuation,” he said. Cooper explained how the objective, numbers-based formulas were easier to ascertain and explain and were harder to argue with, moving both parties closer to the real number.

“These valuation specialists use the Uniform Standards of Professional Appraisal Practice (USPAP) as such are prohibited from basing their compensation (e.g. commission), in any way, on the valuation conclusion. They must, by definition, be objective,” Cooper said.

Finally, Cooper recommended a buyer’s finance analysis, called a Purchase Feasibility Analysis (PFA). Just because you like the car does not mean you can afford it and this analysis “self-qualifies” and shows the purchasing doctor, in a clear and conservative way, whether he or she will be able to finance and execute the transaction in a profitable way. It also shows the selling doctor how the sale (especially in the case of a partnership buy-in) will affect their income.

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