WHITE PAPER

Terminology to Know When Valuing Your Practice's Worth

At some point, there will come a time to sell your practice. It could be in part to a partner or as a whole to another group or hospital. In any case, the practice will need to undergo a valuation, which is a detailed and complicated process, oftentimes confusing because let's face it, it is not like you sell your practice every year. One thing that can help you on your path is to understand some of the basic tenants of practice valuation.

Understanding Terminology

If you are considering selling your practice, make sure you understand terms and appraisal definitions. Oftentimes a physician will ask their accountant to appraise the business, but the physician may be surprised to find that the "book value" given by the accountant is far different than the "Fair Market Value (FMV)" that he could actually receive at time of sale. It is not that the accountant is incorrect at all. Rather, the accountant and the physician may be operating under a different set of terms and definitions, without knowledge of each other's perspectives. Realizing that there is no absolute sales price is the essence of FMV. When determining valuation, look for a price range with a reasonable floor and ceiling.

Understanding Value

For starters, value isn't an absolute number. A medical practice's tangible and intangible assets can be grouped into two broad categories: physical assets and non-physical assets. Examples of physical assets include accounts receivable, leaseholds, medical equipment and furnishings, medical records, and real estate. Examples of non-physical assets include buy/sell agreements, goodwill, managed-care contracts, restrictive covenants, and staffing. Estimates of value differ significantly, depending on the purpose of the appraisal, the acumen of the appraiser, etc. Astute appraisers will consider a host of questions. What is the value of the practice for purchase or sale? What is the value of a practice for merger? What is the value of practice assets for joint venture with a corporate partner? What is the value to establish buy-in or buy-out arrangements for partners? What is the value of practice assets for purchase or sale, apart from ongoing operations? To answer these questions, physicians must understand how practices are valuated.

Informal Terms of Valuation

The "asking price" is often arbitrary and difficult to substantiate, and typically is reduced by a significant percent during negotiations. The "creative price" is derived by way of creative financing. For example, the practice may provide the down payment. The "emotional price" may involve either a motivated buyer or seller, who pays an under- or overinflated price for the practice. The "friendly price" is reserved for associates, partners, or other colleagues. The "realistic price" is one that both buyer and seller believe is fair.

Formal Terms of Valuation

Practice appraisers use FMV as the standard to derive a reasonable value for a practice. FMV means an arm's length transaction between an unpressured, informed buyer and an unpressured, informed seller. The "business enterprise value" of a practice equals a combination of all assets (tangible and intangible), and the working capital, of a continuing business. The value of "owner's equity" equals the combined values of all practice assets (tangible and intangible), less all practice liabilities (booked and contingent). The "working capital value" equals the excess of current assets (cash, A/R, supplies, inventory, prepaid expenses, etc.) over current liabilities (accounts payable, accrued liabilities, etc.).

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