Valuation of a Medical Practice

You have poured your life into your practice and it represents a major asset, so how much is it worth? Unfortunately, there is not a simple answer to the question. Here are a few simplified considerations in determining the value of one’s practice.

**FMV**

What is fair market value (FMV)? The U.S. Supreme Court defined it this way: “The fair market value is the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or to sell and both having reasonable knowledge of relevant facts.”

**Rules of Thumb**

Physicians often times look for overly simplified valuation methods such as a multiple of earnings or a percentage of revenue. While these methods may provide some basis of value, and perhaps a helpful benchmarking of sorts, they paint an incomplete and often times erroneous picture of the business entity’s true value.

**Elements of the Valuation**

There are three distinct components to value in a medical practice. They are the tangible assets, the accounts receivable, and good will. There are numerous ways to determine value including various costing approaches, market transaction price comparisons, and numerous cash flow or income methodologies. Some common terms used in these calculations are EBITDA (earnings before interest, taxes, depreciation and amortization) and SDCF (Seller’s discretionary cash flow). Basically, these are ways of looking at the cash flow of the business on an objective basis. IRS guidance calls for a blended approach of income, cost and market valuations.

**Special Stark/Anti-Kickback Considerations**

Medical practices are unique from other business valuations in that they are subject to government regulatory scrutiny. Stark and Anti-kickback regulations restrict placing value on past or future potential referred business. These rules are of particular interest when a hospital or health system is the buyer.

**Valuation Purposes**

Medical practices are valued for a number of reasons including sale, divorce, partner buy-in, estate tax and various other purposes. The purpose of the valuation can determine whether minority share discounts or other criteria are applied to the value, thereby affecting the final value.

**Third Party Valuation**

Do you need a certified independent appraiser or can you rely upon a broker’s opinion of value? The answer here is it depends. Most brokers will provide an opinion of value for nominal to no cost, compared to an independent appraisal from a certified appraiser which can cost $2,000 to $15,000. While the gratis service may seem most desirable, if your buyer is a hospital or health system they will likely require an independent appraisal by a certified appraiser. Other parties or banks may make similar demands. Even if the broker has vast expertise in health care valuations, or is certified by one of the various accreditation societies, you will likely still need another appraisal since he is not independent.