Practice Valuation

This **Do it Yourself Independent Guide** has been developed by Dr. Vince Timpano, and has been reviewed and accepted by OAO as a helpful resource guide for members in practice valuation.

OAO accepts no liability for the consequences of any actions taken on the basis of the information determined through usage of this formula.

Practice self-appraisals are useful as a *general* guideline. However, practice sales or partnership arrangements may require a more formal independent evaluation.

The author of the Formula, Dr. Vince Timpano - BIOGRAPHY

Dr. Timpano graduated from the School of Optometry at the University of Waterloo in 1981. Upon graduation he opened his practice in Guelph. His practice has evolved into the multi-practitioner practice that it is today. Dr. Timpano has been and continues to be an Adjunct Faculty Member at the School of Optometry since graduation. His relationship with optometric interns has extended to his practice. He lectures extensively on Practice Management at the School of Optometry and has also lectured on the topic both provincially and nationally. Dr. Timpano has also been involved with the Ontario Association of Optometrists (OAO). He was on the Practice Management Committee of the OAO for approximately 10 years including five years as chairperson. In addition, he has been involved with the College of Optometrists of Ontario (COO) in the Quality Assurance Program as a Practice Coach as well as chairperson of the QA Committee.

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If you are the Seller, the Buyer may want an independent source doing the valuation. If you are the Buyer, this may give you some insight on whether or not the value placed on the practice is reasonable and fair.

Most important if you are the Buyer, you should always take into consideration that even if the value is reasonable and fair, you may not be able to purchase the practice if the payback amount is such that it is an amount that does not allow you to live comfortably (meaning-you can't afford to buy the practice).

I believe that the purchase price should be payable to the Seller within a five year period, or, at the most, 10 years.

What follows is a number of methods that allow you to place a value on a practice. The first method is the only one that I will go into detail. It is the method that I used when placing a value on a practice. The first method is the only one that unfortunately, requires the person doing the valuation to make some subjective analysis of the practice to be purchased. The first method, I believe, is the only method that treats practices differently and considers the individual specifics of the practice.

These valuations are only for the practice and not the building purchase. Building purchases must be treated as a real estate purchase.

Method 1

The addition of 3 numbers: Inventory + Equipment + Goodwill

Inventory: Typically this is discounted in order to take into account the inventory that does not "sell" and cannot be sent back. The discount is typically 75% of the purchase value.

Equipment: This is most easily done by having a supplier of equipment place a value on the equipment. If the value cannot be done by a supplier then a value can be determined as follows:

- Equipment that is less than 7 years old is valued at 75% of the original invoice.
- Equipment that is older than 7 years old up to 15 years old is valued 50% of the original invoice.
- Equipment that is older than 15 years old is valued at 25% of the original invoice.
- Equipment that has technology attached to it will decrease in value much quicker than other equipment.

Goodwill: The average of the last 3 years net income (including the income that may be earned by associates) multiplied by the Coefficient Factor. How the Coefficient Factor is calculated follows on the next page.

**This method has been modified from an article by Jerome A. Legerton, O.D. in the journal "Optometric Economics". The article is entitled "So, Tell Me Then...*

Coefficient Factor (used to determine Goodwill for Method 1 only)

Factor is evaluated as:
0.0 (very poor), 0.5 (poor), 1.0 (average), 1.5 (above average) or 2.0 (excellent)

Location in Province	1.0
Location in Community	1.0
Practice History	1.0
Office Appearance	1.0
Volume of Patients	1.0
Ratio of Active to New Patients	1.0
Percent Third Party	1.0
Percent OHIP	1.0
Net as Percent of Gross (30%=1.0)	1.0
Value of Fees	1.0
Viability of Principal (1 to 2 years)	1.0
Viability of Employees	1.0
Quality of Care/Quality of Equipment	1.0
Recall System	1.0
Ongoing Marketing	1.0
Lease Rate/Lease Guarantee	1.0

Change in Community Demographics	1.0
Level of Personnel Management	1.0
Total	18.0

Coefficient Rating: Total divided by 18 =

Other Methods to Determine Total Valuation

Method 2: The total of 3 years net income.

Method 3: Average of gross income of the last 3 years.

Method 4: 50% of the average gross income from the last 2 years plus assets (Equipment, Inventory).

Method 5: 4 times the average of 3 years net income.

Method 6: 5 times the average of 3 years net income.

Method 7: 70% of the average of 3 years gross income.

Method 8: 2 times the average net income for the previous 3 years.

These methods are all being used and fairly straight forward. Depending on which "formula" is used, the value could be very different from one calculation to another.

Buyer Beware

Whether the practice valuation is reasonable or not, ultimately you have to decide on whether or not you can afford to buy the practice. The practice may be worth what the seller is asking for it, but if you cannot afford it then you shouldn't purchase the practice. In the end, when you purchase a practice, you should be not only able to pay back the purchase price but also live in the style that you have been accustomed to. Obvious statements but the buyer should strongly consider these comments including letting the seller know if you are not able to purchase the practice just because the price is too high.

Formula Author: Dr. Vince Timpano
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