

What is the Value of Your Professional Practice? The Use and Misuse of Rules of Thumb



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Owners of professional practices, and, potentially, their advisors, may have inaccurate conceptions of the value of their practices due to changes in economic conditions, regulations, practice performance, etc. It is generally important for owners of a professional practice to have current and reasonable estimates of the values of their practices for reasons such as admitting new owners, retirement or death of owners, mergers and acquisitions, evaluating a purchase offer, evolving industry and economic conditions, or divorcing owners. The value of a professional practice may be based upon the present value of its future earnings discounted to present value at an appropriate discount rate. However, depending on the characteristics of the practice, the value of its tangible assets (i.e. inventory, property, and equipment) may exceed the value indicated by its earnings. The valuation analysis is complex and typically involves an analysis of professional compensation which generally requires the specialized expertise of a qualified valuation professional.

As an easy-to-apply alternative, industry-specific rules of thumb provide an estimate of the range of value. Rules of thumb are developed based upon actual market transactions of similar types of professional practices. Rules of thumb are typically expressed as a multiple of a financial measure such as 1.0 times revenue, 2.0 times seller's discretionary earnings (SDE), or 3.5 times earnings before interest, taxes, and depreciation (EBITDA). **A sampling of rules of thumbs for certain types of professional practices is presented below.**

- > Architecture - 0.40 times revenue
- > Dental - 0.50 to 0.70 times annual collections or 1.5 to 2.0 times EBITDA
- > Engineering - 0.40 to 0.45 times annual revenue plus a potential earn-out
- > Law firms - 0.90 to 1.0 times annual revenue or 3.5 times EBITDA
- > Medical - 0.35 to 0.40 times annual revenue or 1.0 to 3.0 times SDE
- > Optometry - 0.55 to 0.65 times annual revenue or 2.0 to 3.0 times EBITDA
- > Physical Therapy - 0.75 times annual revenue or 1.5 to 2.0 times EBITDA
- > Veterinary - 0.70 times annual sales and includes inventory or 3.0 times EBITDA ¹

¹*Business Reference Guide Online*. Westford:Business Brokerage Press, 2013.

The values indicated by the application of certain of the above-referenced rules of thumb may also require adjustments for specific assets held by the practice such as inventory, equipment, or real property.

Market-derived rules of thumb can provide an owner with a an estimate of the range of value. ***However, an owner should be aware that the range of value only represents an estimate and should be mindful of its limitations.*** The specific characteristics of a professional practice can largely influence its value, and the value indicated by a rule of thumb may be unreasonable. These characteristics may include the following:

- > Specialties and fee schedules
- > Stability of earnings
- > Profitability of the practice
- > Professional qualifications and productivity
- > Professional compensation
- > Client relationships and client contracts
- > Referral relationships
- > Geographic location
- > Supply of professionals and competition
- > Transferability of client relationships
- > Trained and assembled workforce

If you would like to discuss rules of thumb in more detail or a valuation of your practice, please contact [Brian Burns](#) | 804.474.7925 for more information.

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