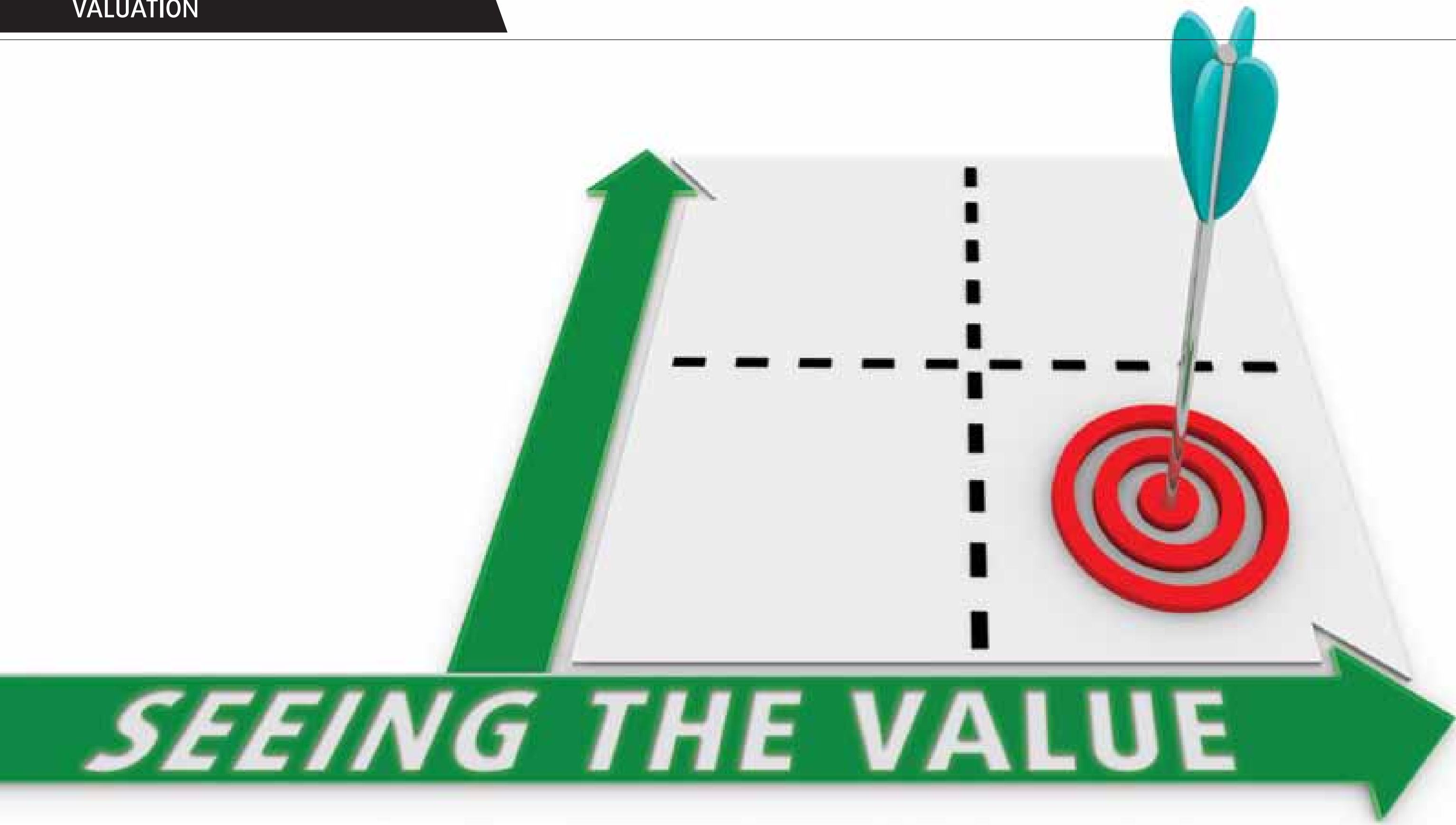

SEEING THE VALUE

Pat Mannix, senior consultant at Physio Accountant, provides advice on getting a valuation for your physiotherapy business.

Physiotherapy practices are valued in a number of different ways, depending on the party valuing. There is no clear industry standard of valuation like there is, for example, in pharmacy businesses. If the party valuing a larger practice are the existing partners, then they will often have their valuation formula similar to the formula that was used when they bought into the practice.

On the other side, financiers in the field will give their valuation of physiotherapy practices based on their own credit standards for the industry. The discrepancy between these different valuation approaches can be large when an independent valuer from within the industry is asked to value. The independent valuer needs to be able to analyse and prepare a valuation that will hold up in a court of law if personal partners, business partners or indeed the financiers are in dispute.

It is worth explaining these different approaches so that existing physiotherapy practice owners and those looking to enter the world of physiotherapy business understand the approaches. Most large physiotherapy practices have developed valuation models from their predecessors. When looking for new partners or when partners are exiting the practice, a valuation is required; this is usually documented in a partnership agreement.

A partnership agreement should stipulate whether the full physiotherapist's fee paid for the hours spent by the partners on patients is included as an expense or a reasonable portion of that full fee is attributed for the valuation model. Often, partners will pay themselves above an experienced physiotherapist's market rate, which will distort the valuation.

In addition, the work that is required to manage the practice should also be stipulated in the agreement. There will be a large number of duties in a big practice that require management time. These hours are paid for by some practices as part of their valuation model, whereas others will exclude these hours. Whether they are included or not must be clear and consistent for those partners entering or exiting the practice.

For a financier in the industry, they will focus on the risk attached to a larger practice based on the history of that practice and more importantly, the cash produced in profit to enable a reasonable payback period. If this bottom line profit is not high enough, the financiers will not just have the goodwill of the practice as security, they will look for some property security.

For smaller practices, the expenses of the business will become less relevant and it will be the amount of income of the practice that will be the primary driver of the valuation. These practices will produce different results depending on the physiotherapists' expenses and equipment used to produce the income. In many cases the actual bottom line profit of these smaller practices is very low, but their value is still evident based on the patient fees. Partners will also apply different percentages of the turnover of their practice compared to others in the industry. Once again, this is usually the result of predecessors' percentage applications that follow on to new entrants.

Financiers are usually comfortable lending to a smaller physiotherapy practice. They will also finance a percentage of the top line turnover of the practice based on the fact that they are dealing with the physiotherapy services sector. That means that historically, physiotherapists are a very low risk for bank lenders, their training and standing in the community being big factors in easier lending. This is good news for those physiotherapists entering the private sector because, potentially, they don't require property security to buy a fee base and get a flying start.

So there are financiers lending to physiotherapists and there are physiotherapists rating their own practices with internal valuation models that are varying and often don't equate. As a result, knowing an independent valuer's approach based on their small business valuation training as well as their physiotherapy services industry knowledge will be useful.

A valuation prepared by an independent valuer will be either based on an earnings before interest and tax (EBIT) model for larger practices or a percentage of the income turnover (PIT) for smaller practices.

An EBIT model for an independent valuation will require a full analysis of the business, including its strengths, weaknesses, opportunities and threats. In addition, the growth path of the last five years will be taken into account when assessing a practice's value. If there has been steady growth in the last three years then the most recent completed financial year will likely be the basis for producing the valuation.

If the practice has had some ups and downs over the last 3–5 years, then further analysis as to why this has occurred will reveal whether the valuer will smooth 3–5 years' worth of results when basing the valuation.

The EBIT model requires a multiple to achieve its result and it is widely accepted in the industry and like industries that a multiple of four is used to produce the result. Many small businesses of a similar size would have a 2–3 multiple attached, but the professionalism and higher barriers to entry into physiotherapy practices results in them commanding a multiple of four.

An independent valuer standing behind their valuation for disputes will require an exhaustive analysis of personal exertion work of the practice partners to produce their EBIT model valuation. Some partners will be spending little time on patients but large amounts of time in management. Others will be spending time the opposite way and, further still, there are some partners that spend little of both but will still demand a return on their equity.

Depending on these factors, physiotherapy practices may have wildly varying valuations if assessed by someone independent compared to their own internal partnership agreement calculations.

The PIT model is also a way that an independent valuer will value a smaller practice. The financier's risk analysis will be similar to analysis that the independent valuer undertakes in assessing the commercial worth of the practice. The financier's margin for risk is factored into their model more aggressively, so in most instances an independent valuation will yield a higher value for a smaller practice than the bank's valuation.

Objective analysis is required here by the valuer of smaller practices but the knowledge of the industry is also a key in determining the more accurate percentage rate.

Independent valuations are vital in disputes involving any interested party in a physiotherapy services business. However, they can also be useful for existing partners of practices if they want to know the real financial return on their practice.

In this industry especially, we find that partners are quite surprised at what their practice is valued at when a qualified valuer is engaged. They may still rely on their own model, but it may also sway their thoughts on their future direction regarding their business worth.

Physio Accountant is Australia's first accounting team specialising in providing accounting and financial solutions to the physiotherapy services industry. Their extensive knowledge and understanding of the industry can provide cutting-edge financial help and client service for every stage of a physiotherapist's career. Visit physioaccountant.com.au.

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