Putting a Value On Your Rehabilitation Business

straight from suppliers
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"Straight from Suppliers" is a forum in which manufacturers and suppliers of the products and services PTs use in practice can share scientific or clinical research as well as case studies submitted by practitioners about their products, or offer complimentary pertinent to the practice of physical therapy.

Before asking the question, What is my practice worth? Ask a more important question: Are there any buyers? Acquisition activity in rehabilitation over the past two years has been almost non-existent.

If there are no buyers in our marketplace, your practice has very little sale value. But the sale of a practice is certainly not the only reason owners should know the value of their business; partner buyouts, divorce, litigation and just good business practice should dictate an annual re-view of the potential value of your business. If, however, you are considering the sale of your business, I have some good news.

There are once again buyers emerging in our continued profitable marketplace and you must be ready if they come knocking at your door. A few of the national buyers are Select Medical, Kessler Rehab, Benchmark Medical, HealthSouth and others. These are buyers who are interested in building a market presence through the acquisition of strong private therapy practices. Now, with buyers vying for your business, let's talk “value”.

The Market
There are a number of valuation methodologies that are utilized to value a business: gross sales, percentage of sales, free cash flow and multiple of earnings are a few. The reality is that most of you are not valuing your business in a divorce settlement, bankruptcy or other various reasons. You want to understand value in order to possibly sell your business and achieve the optimum price and terms available. Therefore, the value of your business in regard to a sale is totally predicated on what the industry buyers are willing to pay - period.

The Numbers
The No. 1 consideration for a strategic buyer in purchasing a rehabilitation business is something called EBITDA, or earnings before interest, taxes, depreciation and amortizations. Let's run through an example to get a true understanding of this thing called EBITDA.

In this example, the practice bills $2.5 million and collects approximately $120,000 to replace them. It sounds harsh, but this is important in your calculation. Additionally, there are many other expenses that can reasonably considered add-backs. An add-back is an expense item that would no longer be a direct operating expense to the new owner after the acquisition. Add-backs are crucial. So, the owners' replacement cost difference, $120,000, and the other add-backs, $20,000, are added to the practice's operating profit to obtain a true adjusted EBITDA.

A therapy practice is ordinarily acquired for a total purchase price of three to five times the adjusted EBITDA. You can quickly ascertain how important add-backs become when you consider that for every dollar of add-backs, your purchase price can be increased by three to five dollars. You're probably saying to yourself, five times EBITDA sounds good, how do I achieve that? In addition to EBITDA, there are many other important factors in your business that can drive a purchaser from a 2.5 multiple up to a 5 or maybe even a 6 or 7 multiple. Here are some of those factors.

Size
A 10-location practice with $5 million in gross charges carries a much higher multiple value than a single-location, $500,000 practice. The acquirer is looking to gain additional market share and views multiple location businesses as less risky - especially if it is a new market for the acquiring company. Additionally, the big boys are cocky and many times believe that in their markets, they can essentially steamroll a small private practice based on their ability to attain exclusive managed care contracts, marketing resources and a lower cost to the services provided.
I firmly believe that the rehabilitation business continues to be locally driven and therefore the small private practices have many intrinsic values. So, if you fall into this category (sales less than $500,000), don’t give up hope if you want to sell your business.

**Physician Referral Base**
The strength of your referral base is key in attaining a good value for your therapy business. A buyer is looking for a broad referral base that is not substantially dependent on any one physician or physician group. I am sure most of you are aware of the “airplane theory”. If you’re not, the buyers are, and they will not pay a premium for a business that could be destroyed by a physician who flies on one of those super saver airlines that are guaranteed to crash about 50 percent of the time. So if you are considering selling your business, hit the street and expand your referral base.

**Payer Diversity**
A buyer will want to study closely the derivation of your revenues by payer class. Most buyers continue to view businesses that are highly dependent on Medicare as vulnerable to declining reimbursement. Buyers generally like to see a high percentage of commercial, workers’ compensation, and auto liability. A practice’s ability to attain and manage capitation and managed care agreements in a local market is an excellent indicator of continued access to patients as well as the ability to sustain cash flow.

**Operating Data**
An important factor in the attainment of a strong purchase price for your business is the availability and adequacy of the operating data. Financials will only tell part of the story to a potential buyer, especially if the buyer is in your line of business. Some of the key indicators that a rehab suitor will be examining are as follows:

- **Visits per referral.** The number of visits performed for each new patient is a key indicator of optimum utilization. This is especially important if your practice is in an area that has been inundated with managed care. Generally, 12 visits per referral is customary in a rural area, while high managed care zip codes can be as low as four to six visits per referral. If a buyer sees extraordinarily high visits per referral (20 to 25), they may question the efficacy of care as well as the sustainability of the cash flow being generated by these visits. Unfortunately, there continues to be very little national data to support or reject these visits per referral numbers.

- **Units per visit.** Generally, three to four units of service per visit seems to be an acceptable range. Again, a provider that is charging five plus units per visit may appear vulnerable to non-payment of future services.

- **Visits per therapist per day.** This is a good indicator to a buyer of productivity in the work force. It is measured by analyzing the number of patients each professional is treating on a daily basis. There can be a wide range for this indicator based on the patient diagnoses being treated and the physical setting, but generally a range of 12 to 20 visits/therapist/day is acceptable to a buyer.

A number much lower may indicate poor therapist time management and low practice productivity, while a number much higher may give the impression of poor quality care and the sustainability of cash flow.

If you don’t have this type of data available you may want to look into a system that will capture this key information. Reviewing your practice operating metrics on a routine basis will better prepare you for the successful sale of your business.

**The Team**
Don’t make the mistake of entering into one of the most important business decisions of your life alone. A well-seasoned buyer may eat you up and, in most cases, you will never get your business back again. Carefully choose your team with seasoned professionals who will maximize your post-tax net return from the sale of your business. Your team should consist of a mergers and acquisitions (M&A) consultant or business broker, a tax accountant, and an attorney with M&A experience. Be sure to get references on all parties and create guidelines as to the communication process for your team.

**The Ultimate Value... YOU**
Do not underestimate your personal value to an acquiring partner. You have built your practice through the development of valuable relationships with physicians, payers, employers and many others in your community. A buyer will need you in order to maintain and continue to grow in these relationships. The rehab industry is still predominately a local business with decisions being made by local physicians and payers.

In summary, if you have considered selling your business and have been reluctant to do so based on limited buyers; your opportunity may be just around the corner. So, when a potential buyer comes knocking at your door, take the opportunity to put your best foot forward and “show ‘em what you got”.

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