



# Estimating the Value of Your O&P Practice

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An Overview of Selected Procedures

A VGM University<sup>TM</sup> White Paper

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***Important Note re Professional Valuations:***

A **professional** business valuation should not be restricted to business owners preparing for a sale. There are numerous business and legal situations in which a valuation is appropriate. For example, a detailed valuation is generally needed when a seller is considering a merger, sale or acquisition, or a shareholder wishes to buy-out other shareholders. Government or judicial authorities often require a business valuation for legal matters such as shareholder disputes, divorce proceedings, eminent domain takings, employee stock ownership plans (ESOPs), S corporation election, or breach of contract disputes. Taxable events, such as estate and gift planning, or charitable giving also necessitate a valuation. Finally, a detailed valuation can help identify what is needed to increase the value of the business or attract new capital.

The following document includes "rules of thumb" and other estimates to determine and indicate a **general** range of value for your O&P practice. The results should be viewed with a degree of caution, There are a large number of additional factors that impact the value of a business, and we encourage you to seek expert advice.

*Again, we strongly encourage O&P practice owners with situations similar as noted above to secure a professional estimate of the value of your business.*

# Estimating the Value of Your O&P Practice

Compiled by Mark J. Higley  
VGM Group Director of Development

When contemplating a merger, a sale, initiating estate planning and many other significant business events, the first question that comes to mind for many O&P practices is "How much is my business actually worth?" Unfortunately there is no cut-and-dried answer to the question. Entire books have been written about valuation, and there are so many variables involved (and many of them are very subjective) that different experts looking at the same company could end up with different selling prices. However, there are some commonly accepted techniques and rules of thumb used, which are presented here in this VGM University White Paper.

Generally, there are two common methods to roughly estimate the value of a small O&P practice. One is the company's ability to generate sales, cash flow and/or profits. The second method is to value the company based on its assets.

We will begin with estimating the value of the business based on sales.

Within many segments of the healthcare industry (most notably physician practices), the norm is to estimate value by using a multiplier times the company or practice's annual revenues/sales. Of course, the multiplier depends on the exact type of the business or practice, the predictability of revenues from year to year and many other factors. Generally, the multiplier is the starting point and is then adjusted based on specifics of the company.

To obtain a rough estimate of an appropriate "industry multiplier" let's look at some recent business listings of actual medical equipment businesses/homecare operations for sale, as posted on public Internet sites during late 2001:

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## Medical Supply (#1)

Industry:	<b>Health and Medical</b>
Segment:	<b>Other Health and Medical</b>
Geography:	<b>North America &gt; USA &gt; Southeast &gt; Florida &gt; South Florida</b>
Asking Price:	<b>\$500K - \$1.0M</b>
Gross Revenue:	<b>\$671,765</b>
Cash Flow:	<b>\$153,744</b>
Cash Flow Type:	<b>EBITDA</b>
Value of Inventory:	<b>\$140K</b>
Value of Equipment:	<b>\$20K</b>
Established:	<b>1990</b>
Employees:	<b>3</b>
Relocatable:	<b>No</b>
Mgmt/Training Support:	<b>Seller will train for 4 weeks</b>
Franchise:	<b>No</b>

*"Well established retail medical and surgical supply business. Retail sales of supplies and equipment along with rental and service of mobility products. Pre-qualified for SBA financing. "*

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## DME/Infusion Therapy Corporation (#2)

Industry:	Health and Medical
Segment:	Other Health and Medical
Geography:	North America > USA > South > Alabama
Asking Price:	\$1.5M - \$2.5M
Gross Revenue:	\$1600,000
Cash Flow:	\$675,000
Cash Flow Type:	EBITDA
Established:	1985
Employees:	10
Relocatable:	No
Franchise:	No

*"This is a fifteen -year-old home healthcare company that provides high quality respiratory, durable medical equipment, and infusion therapy to over 400 patients in the home. Also has two of the nicest retail locations in the Southeast and serves customers such as Hospice and nursing homes. Facilities are in strong growth locations close to main hospitals with plenty of room to grow. Company has provided years of consistent cash flow with 1999 as the best yet. Company does not sub-contract out its services and does its own billing with an experienced billing department. Partial owner financing for right buyer. "*

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## HOME HEALTH CARE (#3)

Industry:	Health and Medical
Segment:	Other Health and Medical
Geography:	North America > USA > Southeast
Asking Price:	\$1.5M - \$2.5M
Gross Revenue:	\$1,900,000
Cash Flow:	\$474,007
Cash Flow Type:	EBITDA
Established:	1991
Employees:	
Relocatable:	Yes
Franchise:	No

*"SUPERB REPUTATION OF PROVIDING FULL-SERVICE HOME CARE SERVICES IN 3 COUNTIES. LIC. MEDICARE/MEDICAID, WHICH ACCOUNTS FOR 80% OF REVENUE. OFFERS: SPEECH, PHYSICAL & OCCUPATIONAL THERAPY. APPROX 90+CURRENT PATIENTS. UNLIMITED GROWTH!"*

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## Durable Medical Equipment/O&P (#4)

Industry:	Health and Medical
Segment:	Other Health and Medical
Geography:	North America > USA > Southeast > Florida
Asking Price:	\$2.5141 - \$3.0M
Gross Revenue:	\$2,987,541
Cash Flow:	\$489,419
Cash Flow Type:	Seller's Discretionary Earnings
Seller Financing:	Seller will disclose
Established:	1996
Employees:	20
Mgmt/Training Support:	Seller will stay with company.
Franchise:	No
Real Estate Included:	No

*"Offers a full line of services including Durable Medical Equipment (DME) (beds, braces, wheel*

chairs, lift chairs, patient aids, ramps, respiratory, wound care), Mail Order Pharmacy, Orthotics & Prosthetics, Spas, Electrotherapy, Cryotherapy, IV Infusion, Exercise Equipment, and Enteral Nutrition. Special services include on site Continuing Education Courses on new products, product training & informal informational seminars. Insurances accepted are Worker's Compensation Claims, Private Insurance & Medicare Assignment w/an emphasis & specialization in Worker's Compensation Claims. Staff includes a Physical Therapist, Paramedic, Nurse, Rehab Equipment Technologist, Respiratory Therapist & highly trained Account Managers. Orders are placed & processed through a knowledgeable & friendly telephonic intake team or online. A stocked warehouse enables immediate delivery of most requested products by company vehicles or UPS & FedEx. Support from a national buying group allows the ability to offer the best prices available. In 1999 the company successfully implemented a two-fold marketing campaign to (1) secure contracts with Worker's Compensation Case Management Companies & insurers; (2) develop a network of participating DME suppliers nationwide. This has resulted in tremendous sales growth & high profit margins. "

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## Medical Equipment Business (#5)

Industry:	Health and Medical
Segment:	Other Health and Medical
Geography:	North America > USA > Southeast > Florida > Other Florida
Asking Price:	\$500K - \$1.0M
Gross Revenue:	\$844561
Cash Flow:	\$187,836
Cash Flow Type:	Seller's Discretionary Earnings
Value of Inventory:	\$20,000
Established:	1993
Employees:	3
Relocatable:	No
Mgmt/Training Support:	Owner will stay on to train for 4 weeks.
Franchise:	No
Real Estate Included:	No

*"This company specializes in selling mobility equipment, including Powerchairs and scooters. 50-60% of sales are private pay. The remainder of payments are received within 30 days. This is an excellent business and does not require a medical background to run. Although buyer will need to obtain Medicare and Medicaid provider numbers. Business is SBA pre-qualified. "*

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In these examples, it appears that the appropriate "industry" multiplier is around 1 - 1.25 times sales. Of course, specific circumstances vary. Assuming a particular firm has experienced strong, consistent growth in the past two or three years - that may boost the multiplier to 1.5 or higher. Or, on the other hand, perhaps the business has one referral source that makes up the large majority of its billings - the higher perceived risk may drive the multiplier down to .75 or lower. If you maintain relatively low fixed costs, few assets and little retained earnings, the sales multiplier technique may be appropriate for your practice.

Let's move onto valuing a company using cash flow or profits.

There's no need to split hairs here, even though there are some differences between cash flow and earnings, the philosophy is the same. The price is based on the company's ability to generate a stream of profit (which can be defined in different ways) or cash flow (sales less expenses). You then project this stream of cash over five or more years to calculate the worth of the business. Often, discounted future earnings are used which takes into account the time value of money - cash received in year five is discounted

based on projected interest rates. This is often called the "net present value" technique. For instance, the following chart shows net present value using 12% discount rate:

Year	Cash Flow	Discount Factor	Present Value
1	\$350,000	0.893	\$313,000
2	\$380,000	0.797	\$303,000
3	\$410,000	0.712	\$292,000
4	\$450,000	0.636	\$286,000
5	\$540,000	0.567	\$306,000
<b>TOTAL</b>			<b>\$ 1,500,000</b>

Note that the \$1.5 million is not necessarily the value – it is the projected money generating power of the business over five years, giving you a starting point.

In this method, disagreements can occur regarding calculation of cash flow and estimated sales projections. Many cash flow and EBITA (earnings before interest, taxes and amortization) projections use "recast" numbers to reflect the effect on profits of perks that a business owner takes from the business. This recasting is important; see further discussion below.

Let's now review what factors affect the multiplier.

It is arguable that the multiplier is a subjective number that, should the business be up for sale, a buyer or seller simply pulls out of the air. There is plenty of room for judgment, but by and large, a profitable, reasonably healthy, small O&P practice will sell in the 2.0 to 6.0 times EBIT range, with most of those in the 2.5 to 4.5 range.

Let's look at the five examples we used before.

Business#	Cash Flow/EBIT	Asking Price/Average	Effective Multiplier
#1	\$153,754	\$500K - \$1M/\$750K	4.87
#2	\$675,000	\$1.5M - \$2.5M/\$2M	2.96
#3	\$474,007	\$1.5M - \$2.5M/\$2M	4.22
#4	\$489,419	\$2.5M - \$3.0M/\$2.75M	5.61
#5	\$187,836	\$500K - \$1M/\$750K	3.99
Average	\$396,003	<b>\$1,650,000</b>	4.17

So, if annual cash flow is \$400,000, the valuation (selling price) will likely be between \$1,000,000 and \$1,800,000 (2.5x - 4.5x).

But there are many factors that affect the multiplier. Accordingly, if your business is not immediately for sale, the effective "valuation" will likely vary with time.

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Positive factors (that raise multipliers) include:

- Timing (e.g., a strong "seller's market" and low interest rates)
- Diversified customer and referral source base
- Strong management team with few key personnel
- Weak competitors and a healthy market share for your company
- Diversified product & service offering
- O&P industry trends - an expanding, growing industry
- Ability of the company to meet some growth with current plant and equipment
- New product/service offerings in the pipeline
- No pending regulatory, legal or government action
- Financial ratios that are near or above the industry average (e.g. contact AOPA or AAOP for additional information)

Negative factors (that lower multipliers) include:

- High interest rates and tight money market
- Few customers/referral sources make up large percentage of sales
- Key personnel that could leave and disrupt company operations
- Strong competitors and a weak or declining market share for your company
- Sales for key products/services are stagnant or declining
- Homecare industry trends - a stagnant or declining industry
- Major investment needed soon in plant and equipment
- No new products/services in the pipeline
- Pending regulatory, legal or government action
- Financial ratios that are below industry averages
- Obsolete product inventory
- Large, old receivables that will be difficult to collect

Here is a very important point about the factors just listed: If your practice has one, or even several, of the negative factors, you are typical! There is no perfect O&P practice.

A quick comment about valuing a company based on assets:

Many O&P practices are sold under less-than-ideal conditions. What if there are no profits or cash flow? What if the owner passed away suddenly, and there is high financial risk for a new owner taking over? In these cases assets may be used to value the business. The value of the tangible assets usually sets a rock-bottom selling price for the business. Intangible assets may be worth money too – goodwill, referral sources, trademarks, leases, permits and contracts are all intangible assets that can be factored into the price. Many buyers balk at paying a lot for intangibles, but for the seller it pays to evaluate each one for its worth. Hiring an appraiser is often a good idea when the price of a business will be based largely on assets rather than cash flow.

Now let's return to the matter of Recasting.

Finish by subtracting your recast expense total from your projected sales figures. The combination of recasting expenses and forecasting higher sales will have a dramatic impact on the value of your business. Remember, at a multiplier of four times earnings, \$25,000 in recast profit means a \$ 1 00,000 increase in selling price.

Conclusion:

We have reviewed a few common methods of estimating the value of a small O&P practice. There are variations within these techniques, and there are other methods that may more appropriately apply to specific situations. It is not uncommon to value a business by a number of different methods and use an average (or more likely a weighted average that gives more weight to some methods than to others) of the various methods used.

Remember, business valuation is a mix of art and science. The bottom line is, of course, that a business is worth what a buyer will pay for it.

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*Note: All content in this White Paper is for general information purposes only and does not constitute legal, accounting or other professional advice. Important financial and legal decisions should be made only after seeking appropriate professional advice.*