How is the current downturn affecting practice values?

Director of R A Valuations Mark Ridout looks at the current state of play in the sector's business property market, and details the essential things to do to increase a practice's worth

OVERALL, optical practices have not suffered the knocks that other small businesses have. However, many have, nonetheless, taken a significant hit on their profits in the last two years.

Overheads have risen against static sales levels as patients strive to save money by extending intervals between eye tests and shopping around for lower dispensing charges.

The credit crunch is taking its toll on practice ownership transfers too.

Bottlenecks are occurring as purchasing parties struggle in their attempt to raise finance after an internal or open market deal has otherwise been successfully agreed. Indeed, banks will continue to request firm evidence of a achievable return on any investment well after the green shoots of recovery have genuinely sprung.

As a result of this, common sense suggests that if a practice is going on the open market today, it will be restricted by fewer potential purchasers in its catchment area compared with a few years ago.

An economic downturn inevitably creates opportunities for the shrewd, such as those seeking to buy up smaller practices to form a multi-site business.

However, ambitious owners of single site practices seeking to build a group of networked practices should be mindful that overheads incurred in running more than one site can be disproportionately high when compared to the enlarged revenue.

Market value

Business valuation for professional practices is a prerequisite for many circumstances including partnership or director change, practice sale or purchase, incorporation, tax negotiations, divorce settlements and so on. Arriving at an accurate valuation is not easy; it depends very much on the individual business and the intended purpose of the valuation.

A 'market value' is determined by valuation professionals as the price a practice should be able to justify and achieve on the open market; reflecting a justifiable return on investment (ROI), and what a willing purchaser is likely to pay and a willing vendor likely to accept in the current market conditions.

Market value may or may not include a margin for negotiation. A 'fair price' also takes both ROI and market value into consideration to derive a pinpointed figure without a negotiating margin. It is typically used for the purposes of incorporation, internal transfers, partnership or director change, matrimonial and litigation, and so on, ie, purposes where no one party should perceive a gain over and above the Goodwill from the value held within the business.

Goodwill usually represents the bulk of the business value. It is, therefore, the most critical and influential figure effecting a valuation figure. Goodwill valuation is a function of the profit – or surplus – left after taking account of all legitimate trading expenses and making appropriate adjustments necessary to arrive at a 'true' trading value.

The days when an asking price was arrived at using empirical means such as a multiple of Annual Turnover (Sales) are, thankfully, long since gone. It is rare for two practices having the same level of turnover to show identical levels of profit and, therefore, Goodwill. The RA Valuation Services database contains many examples of this comparison. Clearly, a practice having, say, £500,000 annual turnover and a surplus (or pre-tax profit) of £100,000 is worth more than another practice also showing £500,000 turnover but a surplus of only £50,000.

That said, a practice with little or no surplus (or profit) may still have a useful market value and could appeal to a prospective owner not wanting the hassle of setting up an organic – or green field – business from scratch. There is, however, no substitute in valuation for a recent set of trading accounts showing healthy profits.

Valuation process

Other criteria that can influence value, and should be taken into consideration in the valuation process, include external factors, such as the economic climate, the market conditions within the business sector, location/demographics/competition, regulation, red tape and threat of litigation. Also internal influences, turnover (sales or income), gross profit (sales less cost of sales), trading trends, practice presentation, premises and permanence of location, and potential.

Whilst it requires complete independence, expertise, experience and industry knowledge to value a particular business, it is the business owners who, knowingly or not, exercise the greatest influence on Goodwill by the way they run their business. If they do it right, they could be enhancing their retirement plans. If they get it wrong, they could be in for a prolonged struggle to realise the full potential value of their business.


Mark Ridout

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When thinking of how to increase your practice's value during a downturn, there are steps that can be taken to maintain, or even increase, the potential value of your practice.

Firstly, exit strategy. All business owners should have in mind an exit strategy. This may simply be a 'wish list' reflecting the owners' desires, or it could comprise part of a detailed formal business plan. Either way, an exit strategy should, ideally, be planned at least three years ahead if a satisfactory valuation and successful sale or transfer are to be achieved. If you feel you haven't got the experience or the time to develop a plan, hire a consultant or someone who can help you.

In addition you must prepare your business for sale. There are many things to do, most of them simple, if you are planning to put your practice on the open market. For example, you must ensure that the physical appearance is up to scratch. As with selling a house, so called 'kerb appeal' is vitally important. When a homeowner wants to sell their house, they may paint it and fix up a couple of things that needed to have been done during the last few years. First impressions count and can be the difference between a successful or unsuccessful sale.

Last but not least profits – and profit growth – are the most important.

Clearly, financial performance - and growing trading profit in particular – must validate that the practice is performing well. As an example of the dramatic effect of profit growth on business value, in a recent one-year update valuation of a business undertaken by R A for a client one year after the original valuation, sales had increased over the last year by an insignificant 5% but purchases were maintained at the same level and overheads cut by 5%. The resultant goodwill was valued at over 40% higher than the previous year solely as a result of these changes.

Keep purchases of supplies at sensible and pragmatic levels, and a close eye on all overheads, effectively manage budgeting and cash flow, and be realistic about the value of your practice. Don't underestimate it, but do be realistic. Remember that the bank will want to see that the potential buyer can pay back the loan. Ultimately, it all comes down to profit. Get all of the above right and the financial figures will speak for themselves.

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