Key Characteristics That Drive Practice Valuation

It makes good business sense to optimize value, whether looking to sell soon, in the future, or never.

BY CLINT BUNDY

Whether a dermatology practice owner will eventually sell his or her practice to an external party or work out an internal transfer/sale to other physicians, it is advantageous for an owner to take steps to improve the value of a practice. A practice with strong fundamentals will attract a larger pool of buyers, as well as talented physicians, which increases the value of the practice and the options available to the practice owner.

PILLARS OF VALUE

The pillars of a strong, valuable practice are stability, profitability and growth. To support those pillars, there are a number of areas that a practice owner can focus on:

- **Talent.** To bolster the services of a firm, practice owners should focus on hiring and retaining physicians, physician assistants, and other medical talent. The practice’s “talent bench” would ideally be deeper than just the owner. In addition, a balanced ratio of physician assistants to dermatologists can help to service patients and increase the practice’s profitability.

- **Financials.** Sound, transparent books and records can be proven through reviewed or audited financial statements, which are provided by a practice owner’s accounting firm. Ken Doty, CPA, a Transaction Accounting specialist with Elliott Davis, stated, “Performing diligence in preparation of a sales transaction can help the seller understand the risks and opportunities within the business and help the seller best position the business. Furthermore, it shows potential buyers that you are serious about the potential sale and the use of an external firm provides a sense of credibility to the numbers.”

  In addition to clean financials, dermatology practice owners should also target Adjusted EBITDA margin\(^1\) (see Sidebar) percentages of 20 percent or greater in order to demonstrate practice profitability and performance. To achieve such financial milestones, a practice owner should complete a periodic review and elimination of overhead and expenses, which should translate to immediate impact on the practice’s profitability.

- **Diversification.** Dermatology practices that offer a range of services, such as Mohs surgery, medical dermatology, laser, spa, clinical research, and dermatopathology, tend to attract more demand from the buyer’s market. These various services can help a practice to remain stable and grow during both strong and recessionary economic periods.

- **Attractive Geographic Market.** The size and location of the market served can be a major determinant in

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**Sidebar**

Adjusted Earnings Before Interest Expense, Taxes, Depreciation, & Amortization Expense (EBITDA)

- **Practice Net Income**
  - + Interest Expense
  - + Income Taxes
  - + Depreciation Expense
  - + Amortization Expense
  - + Excessive Physician Owner’s Compensation: Represents the difference between a physician owner’s current compensation and market compensation that the physician will be paid under a new owner
  - + Non-Recurring Practice Expenses
  - + Extraordinary Practice Expenses
  - + Synergies with a Buyer’s Platform

Adjusted EBITDA For Practice
the ability of a practice to generate attractive performance, growth, and a healthy backlog of patients. Marc Darst, MD, practice owner of Darst Dermatology and a leader within the American Academy of Dermatology (AAD) community, provided his own observations from being in an attractive market. Dr. Darst stated, “The correct location is vital in terms of patient acquisition and also may decrease a physician’s marketing expense. I was fortunate to find a location facing a major thoroughfare in a rapidly developing area of a growth city, Charlotte, NC. This area of Charlotte has an average household income of over $100,000 in a three-mile radius. I still get patients from our signage, and my only marketing expense now is search engine optimization.”

- **Strategic Plan.** A written strategic plan can highlight practice financial goals and provide steps to more efficiently operate and grow the practice. In addition, this documented plan can offer a buyer a roadmap for success with the practice. Tom Ferkovic is a Managing Director with Medic Management Group and a specialist in management and operations of dermatology practices. When asked about the value of a practice strategic plan, Mr. Ferkovic compared it to a “TripTik Travel Planner from AAA” where, “the colored map highlights a route to a destination, gives us directions, tells us how long the trip will take, and highlights places to stop for sightseeing or food.” Mr. Ferkovic added, “Without a strategic plan or a list of goals, the practice has no ability to know where it is going, what it wants when it gets there or how to get there. Strategic plans do not need to be elaborate, as simpler is better, but they must be written and shared with those that are needed to achieve them.”

- **Growth.** When potential buyers assess a dermatology acquisition opportunity, they are very focused on the practice’s ability to substantially grow over a three to seven year period. To drive extra value in a sale, a practice owner should demonstrate historical practice performance as well as articulate the future growth opportunities.

- **Synergies.** In a transaction, buyers will also analyze the potential synergies of an acquisition. Synergies are defined as either cost savings or new revenue that are created by the combination of one dermatology practice with another one. Examples of cost synergies can include using improved negotiating leverage to obtain cheaper supply costs with vendors or sharing of resources across multiple locations in order to minimize administrative expenses. Revenue synergies can include a recently acquired practice referring new Mohs cases to the other practice’s Mohs surgeon or sending samples to a platform’s in-house lab. In a sale process, it is critical for a practice owner to complete a synergies analysis in order to communicate those figures to buyers and obtain maximum valuation in a sale.

**SOUND BUSINESS SENSE**

Dr. Darst, an advocate of value creation efforts for dermatology practices, states, “An owner should focus on growing and improving the value of the practice not only to improve the value for sale, but also because it is sound business sense.” He further elaborated that, “some offices in my area are closed to new patients; however, my belief has always been that if you are not growing, then you are dying.”

Other considerations for practice owners include adding new locations, avoiding legal or regulatory issues, and maintaining an efficient administrative support team. It is the goal of most practice owners to plan and work toward maximizing their fullest potential and value. When that happens, the buyer’s market certainly recognizes and rewards those practice owners who have solidified the fundamentals of success.

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1. Adjusted EBITDA Margin = Adjusted EBITDA / Practice Revenue (or Gross Collections)