Practice Valuations Part 1: How much is your practice really worth?

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Agenda

PART ONE
• What is a Chartered Business Valuator?
• 3 most common valuation strategies in Canada
  o Asset approach
  o Market approach
  o Income approach
• Case Study
• Things to consider for a proper valuation
• Tax Planning: How should I structure my sale?

PART TWO: Topics

Q&A Discussions
Why Choose a CBV?

• Chartered Business Valuators
  • provide independent, objective valuations of your practice
  • determine fair market value of all or part of a business: intangible assets, brand and intellectual property
• CBV designation is recognized by courts and industry
  • retained in business and legal matters, including shareholder disputes, matrimonial litigation and to quantify economic loss (e.g. breach of contract, personal injury, commercial litigation)
• CBV will provide a valuation report prepared in accordance with the standards of the Canadian Institute of CBVs
• Fees not based on contingency, unlike business brokers
In Canada, we have defined *Fair Market Value* to be:

- Highest price available
- Open and unrestricted market
- Between informed parties
- Under no compulsion to act
- Expressed in terms of money or money’s worth (transactions can be completed with shares or involving a management contract)
There are three main methods to valuing your practice:

1. **Asset Approach**: value based on underlying asset base
2. **Market Approach**: value based on market transactions and market multiples
3. **Income Approach**: value based on a multiple of financial performance (after-tax earnings, EBIDTA, EBIT, seller’s discretionary earnings)

It is best to use more than one valuation method. Ideally, we would use the **income approach** as the primary method, supported by the **market approach**.
THE INCOME APPROACH

- This approach estimates the total fair market value of your practice, including:
  - tangible asset base, the intangible assets and the goodwill
- Business value is ‘more than meets the eye’
- Intangible assets which add value to your practice:
  - location, patient profiles, referral network, SEO rankings, diversity in services offered
- The income approach values your practice by normalizing the practice earnings or cash flow and applying a multiple
- The multiple is selected by analyzing a variety of quantitative and qualitative factors
Valuation Methodology

THE INCOME APPROACH

• The most detailed method of valuation
• Careful analysis of revenue, cost of sales, and expenses
  • Should use previous 5 years of financial performance if available
  • Should use forecasts and budget for the next 3–5 years
• A secondary approach is used to check the conclusion of the income method
THE MARKET APPROACH

- An evaluation of prior transactions in your industry can give an indication of value for your business.
- Differences in size, location, quality of staff, etc. should all be considered.
- There may be a lack of information for comparable businesses.
- It is inefficient to simply apply a multiple (based on a rule of thumb) for a prior transaction to your own business.
Case Study: Practice A

- Revenues of $800,000
- Operating income of $150,000 (before management salary)
- Add back: vehicle
- Practice pays higher than market commission to its associates
  - adjust this to market wage
- Practice pays lower than market to its office manager (family member)
General Items to Consider

- If available, 5 years of historical financial performance
- Lease terms
  - How much longer does the lease last? Can they renew the lease?
- Practice space
  - How many treatment rooms? Can the space be converted into more rooms?
  - Can practice space be used for other treatments (acupuncture, massage therapy, naturopathy, physiotherapy)?
- Forecasts
  - Is the practice operating at capacity? If not, what would revenue levels be if it were?
- Competition in area
- Advertising
  - Online presence is extremely important in generating new patients
- Patient profiles
  - Younger/older/mix of patients?
General Items to Consider

- Normalize your earnings
  - Keep track of personal/discretionary expenses every year: vehicle/computer/cell phone/home office/travel & entertainment

- Knowledge of the market
  - Can be limited due to private practices, but there are databases of transactions
In Canada, a business can usually be purchased through one of two means:

1. Asset Purchase
2. Share Purchase

Each has its own pros and cons and SRJ will review the advantages and disadvantages of both.
Share Purchase

• All of the shares of a corporation or units in a partnership are transferred from seller to the buyer

• Seller Advantage
  • Use of Lifetime Capital Gains Exemption (see next slide)

• Buyer Disadvantage
  • Share purchase leads to inheriting all the risks and prior liabilities of the corporation; Will not get a ‘step-up’ in cost base for tax purposes of the assets acquired

• Overall, more advantageous for the seller.
Lifetime Capital Gains Exemption

Each individual in Canada is entitled to a Lifetime Capital Gains Exemption in the amount of $800,000 on the sale of Qualified Small Business Corporation (“QSBC”) Shares.

To qualify as QSBC shares, the shares must meet the following conditions:

- The corporation must be a Canadian Controlled Private Corporation;
- At least 90% of the assets of the business must be used to earn active business income;
- The shares must be held for a period of at least 2 years by the individual or a family member (see next slide). During this 2 year period, at least 50% of the assets must have been used to earn active business income over the previous 2 years.
As the CCO requires all chiropractors to be incorporated under a Professional Corporation, all share purchases must be made to other members of the profession only (i.e. other chiropractors) who are allowed to operate under a professional corporation status.

That is, a share purchase is only allowed between chiropractors, NOT between chiropractors and any other professionals or individual.

This requirement makes share purchases less common within the industry.
Asset Purchase

- In an asset purchase, the vendor sells the target assets in a corporation or partnership but retains ownership of the shares or units of the entity

- **Buyer Advantages**
  - More transparency on what is being bought and sold
  - Purchase price becomes future tax base

- **Seller Disadvantages**
  - Lost ability to use the aforementioned lifetime capital gains exemption

- Overall, more advantageous for the buyer.
Comparative Study between two Chiropractic Offices
Valuation based on multiple methods
Tax Impact of each method
What are best strategies for negotiating the best selling or buying price?
Tax Tips upon the purchase of a business
Tax Tips upon the sale of a business
On behalf of our Partners at SRJ Chartered Accountants, we are proud to be working alongside the Ontario Chiropractic Association and all of its members. As per our arrangement with the OCA, we are offering preferred rates to its members for the following services:

- Incorporations and business registration;
- Personal income tax returns;
- Corporate income tax returns; and
- Bookkeeping services;
- **Valuation Services**

Should you have any questions on these matters, please do not hesitate to contact us for some further guidance.

Thank you.

SRJ Chartered Accountants

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