

**PRESENTATION TO
THE FAMILY LAW SECTION
OF THE
CONNECTICUT BAR ASSOCIATION**

**THE VALUATION OF PROFESSIONAL PRACTICES
FOR DIVORCE PURPOSES**

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INTRODUCTION

Black's Law Dictionary defines a profession as “a vocation or occupation requiring special advanced education, knowledge and skills.” As applications of science and learning have extended to other fields, other such vocations have received the same designation.

The valuation of professional practices has now evolved into a profession.

ONE . CHARACTERISTICS OF PROFESSIONAL PRACTICES

- ◆ Service business with few tangible assets,
- ◆ Relationship of trust between client and professional,
- ◆ Practice or professional(s) rely on referrals,
- ◆ Specific college or graduate degree often required,
- ◆ License required by governmental or regulatory agency, or certification by recognized professional organization(s.)

Does that mean that price is generally not a factor? How does the practitioner get business? Cost of education vs. Pay-back.

TWO . PROFESSIONAL PRACTICES VS. SMALL BUSINESS

- ◆ Larger reliance on intangible assets; thus valuation methods generally used are based on earnings capability as opposed to assets.
- ◆ Dependence on the professional: somewhat akin to key man issue. What's the difference between professional and practice goodwill?
- ◆ Limitations on license transfer, effect on the market.
- ◆ Supply and demand of specialty.
- ◆ Cash basis accounting.
- ◆ Value drivers. See **Chart A**.

CHART A

Checklist of factors affecting the values of professional practices

Factor	More Desirable	Less Desirable
Location + demographics	Urban High growth Affluent Stable population	Rural Mature or declining market Poor Transient population
Client persistence	Very stable	High turnover
Dependence on referrals vs. direct client contact	Large direct client base	One or few referral sources
Contractual relationships	Strong relationships	Relationships threatened by termination
Supply/Demand [for acquisition]	High demand, low supply	High supply, low demand
Reputation	Stellar, far and wide	Non-existent or tarnished
Facilities + technology	State of the art	Antiquated
Employees	Adequate and dedicated	Inadequate or departing
Practitioner's work habits	Light work load	Workaholic
% of "managed care" patients [medical only]	Few or none	High percentage from HMO
Potential synergies	high propensity to be revenue source for potential acquirer.	No such potential

Source: Shannon P. Pratt, Robert F. Reilly, Robert P. Schweih's Op. cit. p.566.

THREE . ADJUSTING THE BALANCE SHEET OF A PROFESSIONAL PRACTICE

- ◆ Cash
- ◆ Accounts Receivables: collectible or not.
- ◆ Work-In-Process Inventory: adjust for % unbilled, % uncollected.
- ◆ Supplies
- ◆ Prepaid Expenses
- ◆ Equipment
- ◆ Leasehold improvements
- ◆ Intangible assets -see **Chart B**

- ◆ Accounts Payable
- ◆ Accruals
- ◆ Deferred Liabilities
- ◆ Contingent Liabilities

CHART B

Intangible Assets Commonly Found in Various Professional Practices

Computer software	Licenses
Computerized databases	Literary works
Cooperative agreements	Litigation awards & damages
Copyrights	Management contracts
Customer contacts	Marketing/Promotional materials
Customer lists	Noncompete covenants
Customer relationships	Patents + Patent applications
Designs and drawings	Patient charts and records
Employment contracts	Permits
Favorable leases	Procedural manuals
Franchise agreements	Royalty agreements
Going-concern value	Schematics + diagrams
Goodwill	Know-how

Government contracts	Laboratory notebooks
Historical documents	Subscription lists
HMO enrollment lists	Supplier contracts
Insurance expirations	Technical + Specialty library/documentation
Joint ventures	Trade secrets
Library	Trained + Assembled workforce

Source: Shannon P. Pratt, Robert F. Reilly, Robert P. Schweih's Op. cit. p.576.

FOUR . ELEMENTS CREATING PROFESSIONAL AND PRACTICE GOODWILL IN THE LAW

- ◆ Practice vs. Professional's Goodwill: New York cases O'Brien vs. O'Brien (1985) and McSparron vs. McSparron (1995.)
- ◆ Elements of Goodwill for buy/sell transactions:
 - ◆ Expected Earning levels.
 - ◆ Competition levels.
 - ◆ Referral base.
 - ◆ Type of clients/patients.
 - ◆ Work habits of the practitioner
 - ◆ Fees earned compared to peers.
 - ◆ Location of the practice.
 - ◆ Employees of the practice.
 - ◆ General marketability of the practice.
- ◆ Elements of Goodwill for marital dissolution: Lopez vs. Lopez [CA] same as above but relative importance different. Lopez specifically covers:
 - ◆ Age/Health of practitioner
 - ◆ Demonstrated past earnings power
 - ◆ Reputation for judgement, skills and knowledge
 - ◆ Comparative professional success
 - ◆ Nature, duration of the practice.
- ◆ Eslami vs. Eslami 218 Conn. 801 (1991) and Cardillo vs. Cardillo WL139248 Conn. Sup. Ct. (1992.)

**FIVE . METHODS COMMONLY USED
TO VALUE PRACTICES**

- ◆ Discounting of economic income.
- ◆ Capitalization of economic income.
- ◆ Multiples of revenues see **Chart C**.
- ◆ Comparative transactions/buy-ins.
- ◆ Punitive and retirement formulas.
- ◆ Capitalized excess earnings.
- ◆ Asset accumulation or adjusted book value method.

CHART C

Rule-Of-Thumb Methods

Accounting:	net assets + 75-150% revenues.
Dental:	fixed assets + 25-35% revenues.
Engineering/Architecture:	net asset + 20-40% revenues; much more akin to small business.
Law Practices:	not enough data to generalize.
Medical Practices:	up to 40-100% of revenues, depending on the specialty.
Veterinary Practices:	net assets + 75-125% revenues.

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