Financial Definitions Reference:

Income Statement / Profit & Loss Definitions

Gross Revenue[i]: The total amount of all procedures performed and billed based on a practice's fee schedule. This amount does not include adjustments for items such as insurance payment reductions, discounts, uncollectable accounts, donated care, or other reductions.

Net Revenue or Collections: How much cash the practice receives from insurance payors and patients for all the procedures it has performed, net of adjustments or uncollectable accounts.

Overhead: This term has many different meanings depending on the industry. With regards to dental & medical practices, this usually is intended to represent the percentage of expenses, before the owner doctor pays themselves, in relation to its Collections. For example: If a practice has $500,000 in Collections and $350,000 in expenses before owner compensation, the Overhead for the practice is 70%.

Cost of Goods Sold: Costs directly associated with the practice of dentistry. Includes: doctor, hygiene, and assistant salaries, supplies & inventory costs, lab costs, cost to own and operate the equipment, amongst other items.

Gross Profit: Net Revenue (Collections) - Cost of Goods Sold

Gross Margin Percentage: Gross Profit / Net Revenue (Collections)

Selling, General and Administrative Expenses (SG&A)[ii]: Costs not directly associated with the practice of dentistry. Includes: Front office staff, rent, marketing, office supplies, CE, amongst other items.

Fixed Expenses: Expenses which do not change month to month. Includes: rent, malpractice insurance, employee salaries, wages and benefits (mostly fixed), lease payments, subscriptions, software, amongst other items.

Variable Expenses[iii]: Expenses which change month to month. Includes: production based compensation, lab costs, supplies, inventory, utilities, marketing, CE and other discretionary expenses.

Depreciation & Amortization: Non-cash expenses usually related to the purchase of a dental practice, real estate, equipment, or other financing arrangements. For example: If you purchase a $200,000 piece of equipment, you pay cash or finance the purchase on day 1, however, the expense of that purchase is depreciated on the income statement over several years. These are important expenses to keep in mind for tax purposes.

EBITDA: Earnings Before Interest, Taxes, Depreciation and Amortization. This is a common business calculation to determine the cash flow being generated by the practice.

EBITDA = Net Income + Tax Expense + Interest Expense + Depreciation + Amortization or
EBITDA = Net Profit + Interest & Loan Expense + Depreciation + Amortization

Net Profit: Net Revenue (Collections) - Cost of Goods Sold – SG&A Expenses – Interest Expense – Depreciation & Amortization. This is usually a figure shown on a tax return.

Net Income: Net Profit - Tax Expense

Balance Sheet Definitions:

Accounts Receivable: Amounts owed to a practice by insurance companies and patients. AR Reports are usually categorized as 0-30 days (also current), 31-60 days, 61-90 days or 91+. Insurance receivables should generally be collected before 45 days, patient receivables can vary.

Inventory: Items consumed in your practice. Includes: Supplies, lab materials, sanitization materials, cleaning products, metals, patient giveaways,

Current Assets: Cash and any other company asset including Accounts Receivable & Inventory that will be turning to cash within one year.

Fixed Assets[iv]: Durable items which have a multi-year useful life. Includes: chairs, CAD/CAM, X-ray machines, lab equipment, instruments, building and leasehold improvements, amongst other items.

Accounts Payable: Amounts owed buy a practice to their suppliers and service provides or credit card balances which are used to purchase those items. These are amount which you have been billed for but not yet paid.

Accrued Liabilities: Amounts which you owe to employees, suppliers, and other providers for services rendered, but the practice has not been billed. For example: Accrued Payroll and Accrued Employee Benefits are most common for dental practices. The employees have already worked this week however their payday isn't until next week, or they have earned their PTO but are saving all PTO for the end of the year and not yet used it.

Current Liabilities: Company's debts or obligations that are due within one year. Includes short term debt, accounts payable, accrued liabilities and other debts.

Loans & Notes Payable: Amounts owed to banks and other creditors by a practice or a doctor. Loans may take the form of a line-of-credit, equipment loans, real estate loans, term loans, or other forms. The practice may also have Notes due to individual investors, themselves personally, or other non-traditional financing arrangements. Make sure to always run a filing and lien search when performing diligence on a practice.

Equity & Retained Earnings: There gets to be some accounting nuances when defining these terms, so it is often easiest to explain what these <u>do not</u> mean vs. what they do. Equity & Retained Earnings on a balance sheet <u>do not</u> represent what a practice or business is worth. They also <u>do not</u> represent excess cash balances.

Cash Flow Definitions:

Liquidity: Refers to how quickly and easily an asset can be sold and turned into cash or a measurement of your financial flexibility. For example, cash is the most liquid of all assets, then stocks (not held in a retirement accounts). Your home and business interests are relatively illiquid asset classes because they take more effort and time to sell.

Working Capital: The amount of current assets minus the amount of current liabilities. Working capital is a common measure of a company's liquidity, efficiency, and overall health. For example: Imagine a practice has $10,000 of Cash, $50,000 of AR, $5,000 of Inventory, $15,000 of Accounts Payable, $10,000 of Accrued Liabilities and $22,000 of debt payments due in 12-months. The working capital for this practice would be $18,000.

$18,000 = [($10,000 + $50,000 + $5,000) – ($15,000 + $10,000 + 22,000)]

Operating Cash Flow: This measures the profits (or losses) from the income statement, adds back non-cash expenses, as well as cash generated (or lost) because of changes to your working capital (mentioned above). current asset (accounts receivable) or current liabilities (accounts payable & accrued liabilities).

Capital expenditures (Capex): The amount spent on fixed asset purchases. *Gross Capex* would be the total amount spent during a period whereas *Net Capex* would account for the value of any fixed assets sold or traded-in during the same period.

Loan Amortization: The payment schedule in which you pay back your loans. The terms of the loan repayments can vary depending on loan type & structure. For example: 1) You may make equal payments over the life of the loan, 2) loans may be "interest only" for a period or duration of the loan, or 3) the principle payments can fluctuate with lower amounts due in early years and greater amounts required towards the end of the loan.

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[i] Revenue and Production are used interchangeably in discussing dental practices.
[ii] Selling, General & Administrative expenses are sometimes referred to as Operating Expenses
[iii] All else equal, a practice would prefer to have a higher percentage of total expenses as variance and a low number of fixed expenses.
[iv] Fixed Assets are sometimes referred to As Property, Plant & Equipment or PP&E