

The Dental Transition

N E W S L E T T E R

In this issue

Page 1

Understanding Cash Flow Analysis:
Hidden Risks for Buyers and Sellers

Page 3

Improving Your Practice Value Through Better
Practice Management Software Setup

Understanding Cash Flow Analysis: Hidden Risks for Buyers and Sellers

When evaluating a business or practice acquisition, the business's cash flow is the variable of consideration that carries the greatest weight in determining fair market value. Most financial statements, at first glance, will look underwhelming due to the fact that most business owners try to show as little profit as possible to pay less in taxes each year. The seller's goal when having a cash flow analysis conducted is to review their general ledger and inform the advisor of any personal or one-time, non-recurring expenses. In our industry, we call these adjustments "add-backs"; examples are outlined below. The buyer's goal is to verify that the adjustments are accurate, justified, and consistent with the facts. We will discuss several warning signs and pitfalls that buyers and sellers should identify before proceeding with a purchase or sale.

Examples of One-Time Non-Recurring Expenses:	Examples of Personal Expenses:
<ul style="list-style-type: none"> • Replacement of HVAC unit • Replacement of large dental equipment • Office renovations • Severance pay or signing bonus • Building a new website 	<ul style="list-style-type: none"> • Travel • Salaries & Wages for family members who do not work at the practice • Auto expenses • Meals & entertainment • Personal cell phone • Country club fees

Continued on Page 2

PRACTICE SALES + APPRAISALS + TRANSITION CONSULTING + BUYER REPRESENTATION

Brought to you by



www.ottenreydentalsales.com

E: Kim@ottenreydentalsales.com | Kim (314) 805-6257

Understanding Cash Flow Analysis: Hidden Risks for Buyers and Sellers

Continued from page 1

The Basics

As noted above, terms such as cash flow analysis, seller's discretionary earnings, or net earnings all refer to the same core concept: the amount a buyer is expected to take home before taxes, depreciation, amortization, and interest, after removing the seller's personal and one-time expenses. In simple terms, it reflects how much money a buyer would earn if they operated the practice with the same revenue and expense structure as the seller, before factoring in loan payments for the acquisition or income taxes.

A common mistake among first-time buyers, especially without proper guidance, is taking a financial statement at face value. The profit shown on paper is often misleading and, by itself, largely meaningless. An accountant's role is to help the owner minimize reported income to reduce tax liability, and the degree to which this is done can vary widely from one business and accountant to another.

Why This Is Important for a Seller

For a seller, engaging a broker or accounting firm to analyze cash flow allows for the proper identification of expenses that can be adjusted, or "added back," such as vehicle costs, travel, and officer compensation. In many cases, sellers also treat personal purchases as office expenses, utilities, or repairs and maintenance. These are common items that often go unnoticed unless specifically reviewed and discussed.

The seller's objective is to accurately present the highest defensible level of cash flow. As a general rule, practices are valued at approximately 2.25 times each dollar of profit. For example, overlooking \$10,000 in personal expenses can result in approximately \$22,500 in unrealized practice value.

Pro tip: : If you try to go by memory, you will forget something. We suggest obtaining a copy of your general ledger for the period under analysis and reviewing it line by line.

Another pitfall is when sellers make estimations. Since you will need to be definitive at some point in the process, we highly recommend doing the work on the front end, as it will pay dividends for several reasons. What if, during due diligence, a buyer determines that you thought your wife's salary was \$70,000 in the trailing twelve-month period being analyzed, but when a buyer asks for the payroll report, it is actually only \$40,000? Now you are working backward because this would reduce

the practice's profitability by \$30,000, which would likely be deemed material and could prompt a buyer to adjust their offer. Furthermore, when a buyer receives a clean, current, and accurate package of information, it builds trust and streamlines the process. We see it all the time: a buyer requests a document, but the seller takes weeks to put it together. Buyers often begin to question whether you're withholding information, which can slow down or jeopardize the deal.

Why This is Important for a Buyer

For a buyer, it is critical to validate the larger claimed expense adjustments to confirm it is accurate and supportable. Request source documentation and detailed reports to substantiate what is being represented. As noted earlier, reliance on a seller's estimates or memory is often where discrepancies arise and diligence issues begin.

By way of example, if a seller's office expenses are \$40,000 but the seller claimed an adjustment of \$20,000 because he estimated that 50% of this expense category was personal Amazon purchases, you will want to ask for a list of the seller's Amazon purchases for the time period being examined to verify. What if you determine that there was only \$5,000 in personal expenses instead of \$20,000? This would result in a \$15,000 reduction in the practice's profitability.

Another issue we see is that some brokers will simply adjust items such as dental labs or dental supplies to industry norms when certain expenses are above average, inflating the practice's profitability. This approach is often used to artificially inflate perceived profitability and is not appropriate in most cases. If a seller uses a top-tier, expensive lab in a cosmetic-driven practice, that lab could be a key contributor to the practice's performance and reputation. Normalizing or removing it can distort the true operating model and fundamentally alter the practice's character.

Key Takeaway

Cash flow is the foundation of practice value, yet it is also one of the most overlooked elements in transactions among buyers, sellers, and brokers. We reviewed how sellers can maximize value by properly identifying personal and one-time expenses, while on the flip side, highlighted why buyers must carefully verify the larger adjustments through documentation rather than estimates. As I tell all our sellers, make sure your financial statements are clean, current, and accurate.

Improving Your Practice Value Through Better Practice Management Software Setup

Preparing a dental practice for sale is not just about finding the right buyer. It begins years earlier with how you manage, organize, and document clinical and financial information in your practice management software. When this information is clean, consistent, and complete, it improves the perceived value of your practice, strengthens your appraisal, and builds buyer confidence. When the information is disorganized, missing, or inaccurate, it almost always lowers value and can even cause a sale to fall apart.

Below are practical, high-impact changes you can make now to ensure your software supports a smooth, successful transition later.

Organize Your Collections by Insurance Carrier

Most dental offices record income under general labels such as “patient check,” “credit card,” or “insurance check.” This makes it nearly impossible to determine which insurance plans generate the most revenue. Buyers, lenders, and appraisers rely heavily on this information when assessing risk and long-term sustainability.

The solution is to create categories or subcategories in your software that identify the specific insurance carrier. This can be done in Dentrax, SoftDent, Eaglesoft, PracticeWorks, Curve, Open Dental, or nearly any other program. Examples include “MetLife insurance check” or “Delta Dental insurance check.” If you have a mix of in-network and out-of-network plans with the same carrier, it is even more valuable to create categories such as “In Network BCBS” and “Out of Network BCBS.”

This helps you accurately track revenue by payer. It also helps you make decisions about insurance participation, reducing dependence on low-paying plans before you are ready to sell.

Clean Up Accounts Receivable and Patient Credits

Accounts receivable is one of the first financial items a buyer will examine. A high balance over 30 days indicates weak collections processes. A large balance over 90 days may signal significant operational issues that can reduce the value of your practice, or at very least, it shows a lack of attention, allowing old, delinquent accounts to accumulate over a period of years.

Equally important are patient credit balances. Many offices unintentionally allow credit balances to accumulate when patient refunds are not issued promptly. Buyers, lenders, and attorneys treat patient

credits as a liability. Any outstanding credits at closing are deducted from the purchase price. This can be a substantial financial hit if not proactively addressed.

If the balance of your receivables and credits has grown to a significant number, now is the time to correct the issue. This not only improves value but also demonstrates that your practice is well organized and financially accountable.

Separate Production by Provider

Accurate production reporting is crucial during due diligence. The cleanest setup is to list each provider separately: the owner doctor, hygienists, and any associate doctors. This allows buyers to clearly identify who produces what, and how the practice functions clinically.

Hygiene exams should be posted to the dentist. Cleanings and radiographs should typically be posted to the hygienist. If you have an associate dentist, that provider must be set up separately using their own license number and personal NPI. Posting their production under the owner’s credentials creates inaccurate reporting and complicates both valuation and future insurance credentialing for the buyer.

Audit Production Daily

Even the best software setup is only as accurate as the information entered. Reviewing all procedures billed to insurance each day confirms that nothing has been missed and that the treatment aligns with clinical notes. An astute buyer will often examine these records in detail. Missing codes, incorrect postings, or inconsistent charting can impact their trust in the data and their perception of your practice systems.

Track Watch Areas and Future Treatment

Treatment notes must reflect all watch areas and future treatment needs, even if you use paper charts. Most practice management software allows you to mark or log watch items and pending treatments. Buyers use this information to assess case acceptance, patient needs, and the potential for future production. Without it, buyers may assume your practice has fewer treatment options or less consistent diagnostics.

Maintain Clean Active Patient Lists and Update All Fees Your active patient count is one of the most significant drivers of value. Deactivate patients who have moved, passed away, or left the practice. Inflated active patient

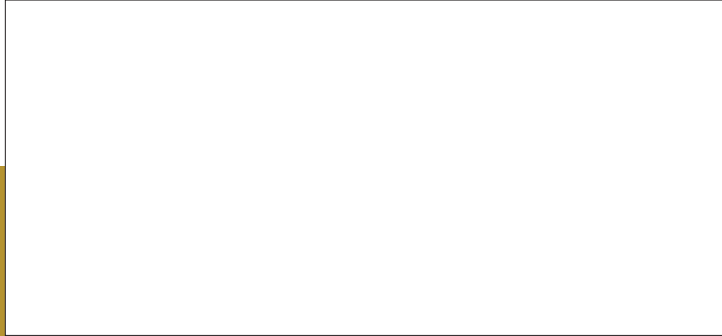
Continued on Page 4



402 Unity Crossing Ct. • St Peters, MO 63376

OTTEN-REY DENTAL
SALES

A Member of



Scan this with your
phone's camera for
more information
on O-RD

ARTICLES INSIDE:

*Understanding Cash Flow Analysis:
Hidden Risks for Buyers and Sellers*

*Improving Your Practice Value Through Better
Practice Management Software Setup*

WWW.OTTENREYDENTALS.COM

PRACTICE SALES + APPRAISALS + TRANSITION CONSULTING + BUYER REPRESENTATION

Improving Your Practice Value Through Better Practice Management Software Setup Continued from page 3

numbers weaken credibility during due diligence. Moreover, the most common buyer complaint after a sale is that the active patient count was inaccurate and overstated.

Equally important is keeping your fees current. Update your office fee schedule each year. Audit your insurance fee schedules annually to ensure accuracy. Always bill your full UCR fee whenever allowed. If you bill a reduced fee that matches the insurance allowable, the insurance will pay you the lower amount. This is a common and costly mistake that reduces practice revenue without buyers ever knowing why.

Final Thoughts and Why This Matters

A practice with clean data, organized reporting, and well-maintained records consistently sells for more and transitions more smoothly. Buyers judge practices not only on financial performance but also on the

systems that support day-to-day operations. Strong internal practice management systems improve a buyer's ability to replicate the practice's historical performance. When your reports are accurate, your AR is clean, production is properly tracked, and when your systems demonstrate discipline, buyers feel confident in the practice. Confidence directly translates into value.

If you are considering selling your practice in the next three to five years, or less, now is the time to begin preparing. These improvements take time, and the earlier you begin, the stronger your valuation and negotiations will be. If you would like help reviewing your software setup, understanding your true practice value, or planning the steps needed to maximize your price, I would be happy to assist. A short consultation can make a significant difference in your outcome.

Contact us TODAY to schedule a free consultation!

www.ottenreydentalsales.com

E: Kim@ottenreydentalsales.com | Kim (314) 805-6257