

EBITDA

INTRODUCTION

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MEANING OF EBITDA

This is an acronym that stands for Earning before Interest, Taxes, Depreciation and Amortization

- **E** - Earning
- **B** - Before
- **I** - Interest
- **T** - Taxes
- **D** - Depreciation
- **A** - Amortization



FIVE STEPS TO CALCULATING EBITDA



1 Start with Net Income add back interest expense

2 Subtract interest income

3 Add back taxes

4 Add back depreciation

5 Add back amortization

Note: your tax here represent income tax not payee or other forms of tax

IMPORTANCE OF EBITDA



- EBITDA is one of the common metrics used in valuation
- It is often used as an approximation to cashflow because it provides a normalized measure of a Company's financial performance that is not affected by tax of differences in accounting practices
- EBITDA is often multiplied by a market multiple to arrive at a business valuation. Market multiples can be arrived at by looking at previous comparable companies in the same industry to see what the company is trading for
- Note as a cashflow alternative, it can be misleading as variables such as capital expenditures, changes in working capital and equity distributions are excluded.



TO EBITDA



CASH FLOW

Can be a good proxy for cashflows. EBITDA can be a good measure of Companies free cash flows – though not perfect

Widely accepted



TO EBITDA



Valuation of Company: its common to use EBITDA as a multiple in order to a valuation

Useful for high growth Companies since depreciation and amortization are not included, it dwells more on growth and profitability



TO EBITDA



Simplifies Comparisons: it helps compare businesses in a similar sector of industry

Focuses on Operating performance: EBITDA excludes metrics that aren't part of the normal course of business



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- Ignores Changes in working capital: EBITDA doesn't account for changes in working capital like accounts payable and receivables, inventory etc.
- Its not a GAAP metric i.e.. Its not a metric you find in your profit or loss
- It doesn't recognize capital structure; EBITDA doesn't show how the Company is capitalized and how much debt needs to be repaid.
- Its Vulnerable to manipulation
- Does not fully represent cashflow



TO EBITDA

- Lacks industry specific consideration: EBITDA does not represent strong or weak performance in the industry
- It sidelines the quality of earnings: income from recurring sources are more attractive than no recurring sources: EBITDA wont tell you this
- Excludes important expenses: Taxes, Interest, Depreciation and Amortization can all be material expenses

REFERENCE

- Josh Aharanoff, CPA
- Chris Reilly
- Oana Labes, MBA, CPA

PROFILE

Innocent Chukwuma Nwaokoma (Innocent Gaius) is a seasoned accountant, who is interested in financial planning and analysis (FP&A) with proven experience in the auditing sector, financial management, tax advisory and planning, debt management, bank forensics and consistently striving for improvement, creative and critical thinker with sound judgement and decision making.

