

EBITDA FORMULA



$$\text{EBITDA} = \text{Net Income} + \text{Interest} + \text{Tax} + \text{Depreciation} + \text{Amortization}$$

EBITDA DEFINITION

Earnings – Net income of the business after all operating expenses.

Before – “Earnings Before” ...

Interest – Includes interest from all debt financing, such as loans provided by banks. Different companies have different capital structures (i.e., varying levels of debt), resulting in different interest payments, which results in varying net incomes. EBITDA allows you to easily compare two businesses while ignoring the capital structure of each business, which changes post-acquisition anyway. In other words, EBITDA includes interest payments because interest payments discontinue post-acquisition, except in rare cases.

Taxes – Includes city, county, state, and federal income taxes. Income taxes vary based on many factors and are likely to change post-acquisition. As a result, EBITDA includes taxes in its calculation.

Depreciation – Depreciation is an accounting practice used to spread the cost of a tangible or physical asset, such as a piece of machinery or a fleet of cars, over its useful life. The amount an asset is depreciated in a given period of time is a representation of how much of that asset's value has been used up. Companies depreciate assets for both tax and accounting purposes. There are several different depreciation methods, including straight-line depreciation and accelerated depreciation.

Amortization - Amortization is the accounting practice of spreading the cost of an intangible asset over its useful life. Intangible assets aren't physical but they're still assets of value. They can include patents, trademarks, franchise agreements, copyrights, costs of issuing bonds to raise capital, and organizational costs. Amortization is typically expensed on a straight-line basis. The same amount is expensed in each period over the asset's useful life. Assets that are expensed using the amortization method typically don't have any resale or salvage value