

Accounting Terms: Understanding the accounting term EBITDA and how to use it.

Article Highlights –

- Definition of EBITDA
- Use EBITDA to compare businesses
- One gauge of a business's financial health

The accounting term EBITDA is an acronym that is widely used. It stands for Earnings Before Interest, Taxation, Depreciation, and Amortization, and it is an extremely helpful tool for understanding how one business or industry is faring based on comparing it to others that are doing the same thing. EBITDA's value lies in the fact that it gives a very quick assessment of a business's earnings potential; but, because it is not part of generally accepted accounting principles, or GAAP, it is frequently excluded from a business's official financial statement.

Still, when a business owner is looking to attract additional investment or a potential buyer, EBITDA is often what is provided because it gives an easily understandable glimpse at earnings potential using existing information. With EBITDA, those who are assessing different businesses for possible investment are able to get an at-a-glance look at how the company is performing and use it to compare the business against companies that may be capitalized or accounting differently. The calculation is a simple formula, but requires access to the following information about a business:

- Income
- Expenses (excluding tax, interest, depreciation and amortization)
- Interest
- Taxes
- Depreciation of operational assets, such as equipment
- Amortization of intangible assets, such as patents

With those numbers in hand, the formula is:

EBITDA = Revenue - Expenses (excluding tax, interest, depreciation and amortization)

Or, more simply, EBITDA equals net income plus interest, taxes, depreciation and amortization.

Whichever way you approach it, it is important to know that, as useful as EBITDA can be, it is only one way to gauge an organization's financial health and potential. Making the decision to invest in or purchase a business requires a comprehensive view that ensures that you are well informed.

If you need additional assistance calculating a small business EBITDA or other accounting ratios, contact this office today to set up a consultation.