Twitter Thread by Ali Ladha



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What is EBITDA?

Why is it important?

1/ What does it stand for?

EBITDA is an acronym that stands for:

Earnings
Before
Interest
Taxes
Depreciation
Amortization

2/ Not a GAAP measure

EBITDA is not a number that you will typically see on a company's financial statements

It's a measure that companies calculate separately in a 10K filing or one that you could calculate yourself

3/ What does it mean?

You probably have a good idea of what "Profit" is

Profit is what is left over after deducing expenses from a company's revenue

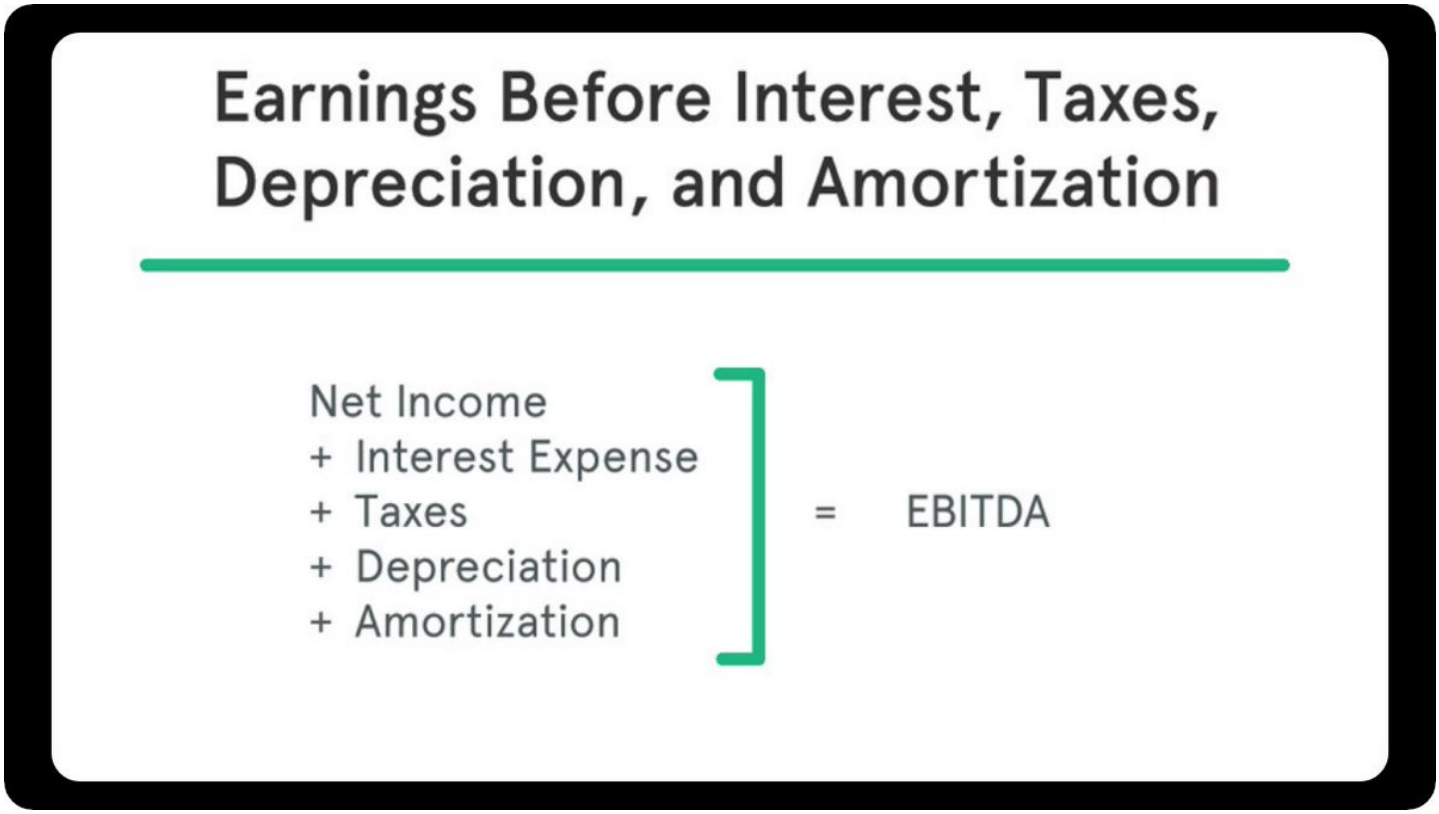
EBITDA is an adjusted measure of profit

You can calculate it as follows:

1) Start with Net Profit

2) Add: Interest, Taxes, Depreciation, Amortization

3) The result is EBITDA



4/ Is EBITDA better than earnings?

There is no right answer here. It depends on what you're measuring

I'm fully expecting commentators in this thread quoting Warren Buffet to me saying something along the lines of "EBITDA is a useless measure"

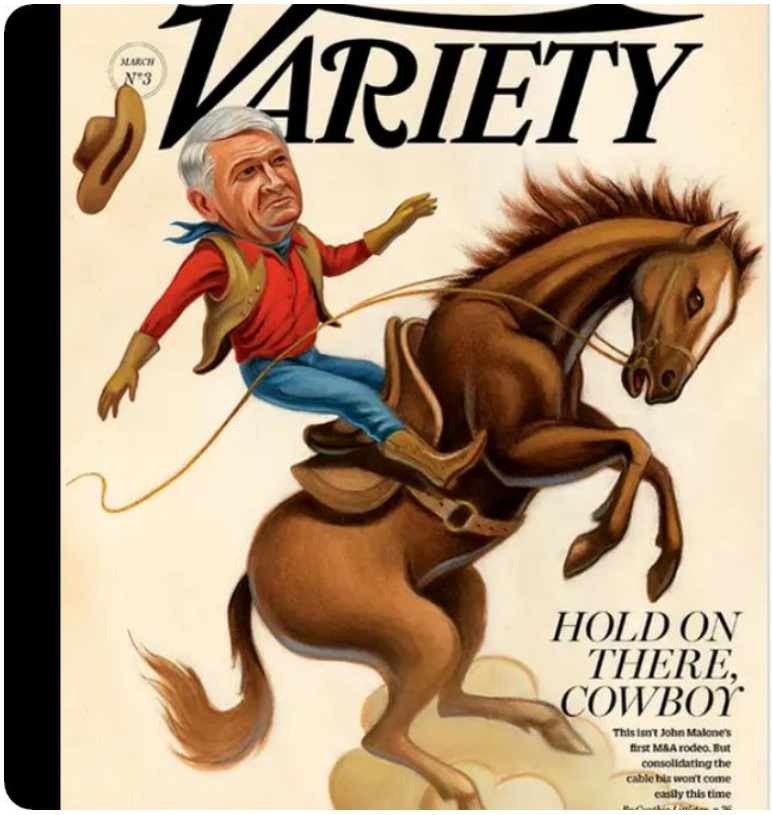
To answer this question, it's worthwhile to understand:

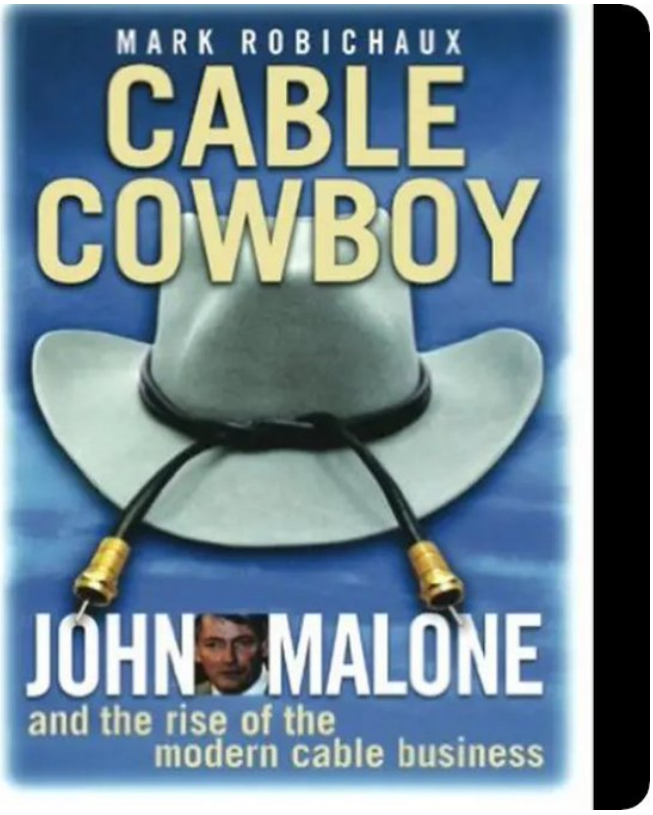
(i) who invented EBITDA
(ii) who uses EBITDA

5/ Who invented EBITDA?

EBITDA was invented by someone who you've probably never heard of but has had a huge impact on your life: John Malone

John Malone is a billionaire cable operator and investor



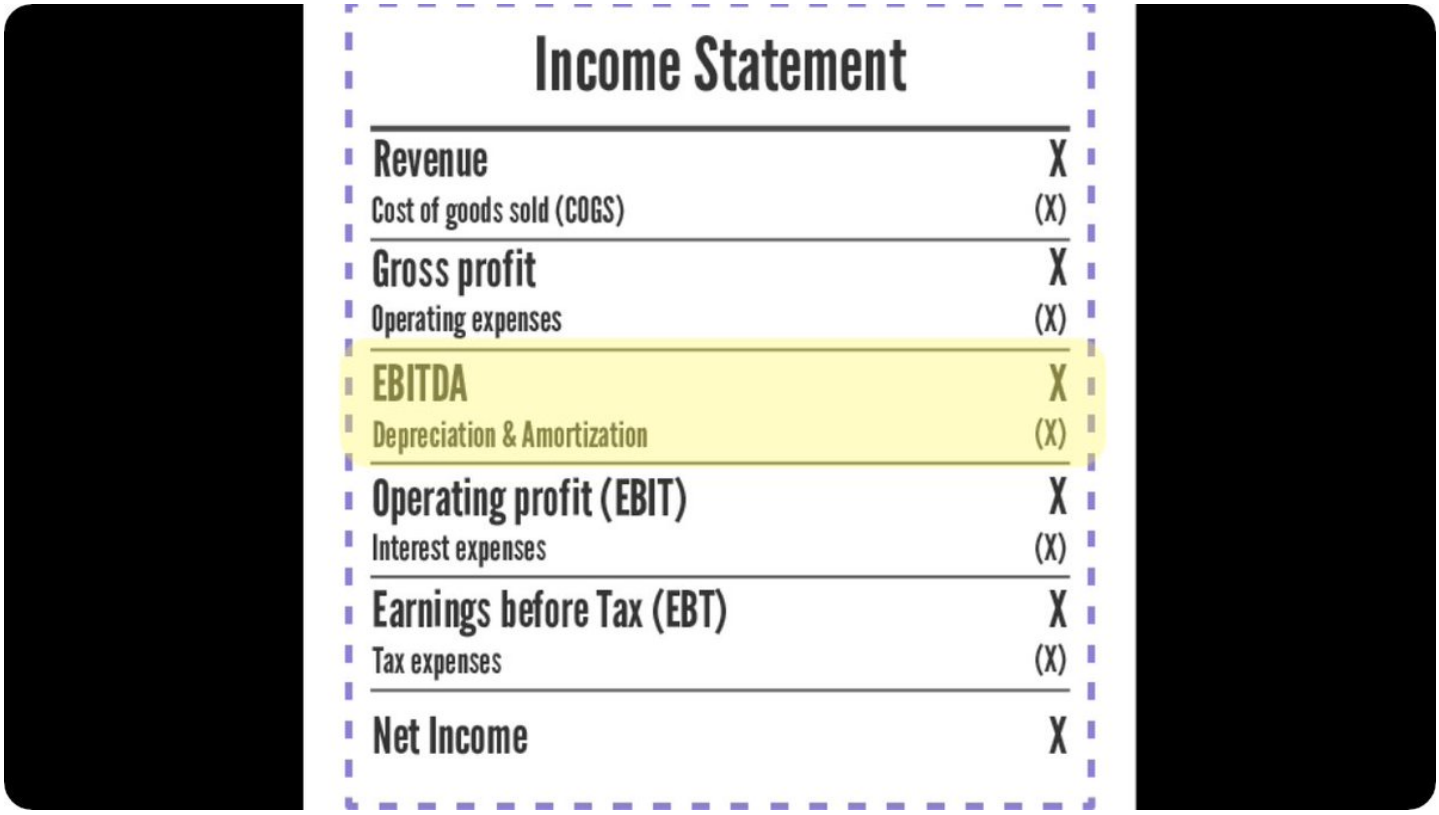


John Malone was hell-bent on lowering net income (via interest and depreciation) to pay less tax

So he convinced his investors and lenders to focus on “cash flow” and ignore earnings

In the process, John invented a proxy calculation to quickly arrive at cash flow

By simply focusing higher up the income statement - that’s how he invented EBITDA



6/ Who uses EBITDA?

From personal experience working in equity research

I can tell you that valuations multiples using EBITDA are more frequently used than valuation multiples using earnings

Folks who work in private equity will tell you the same thing:

Focus on EBITDA, not earnings

Why is this?

It’s because EBITDA is an un-levered (before debt) measure

This means EBITDA doesn’t care about how much debt you use to finance your business (that’s why you add back interest)

Let’s look at an example to understand this better:

Let’s assume that you have two companies:

Company A and Company B

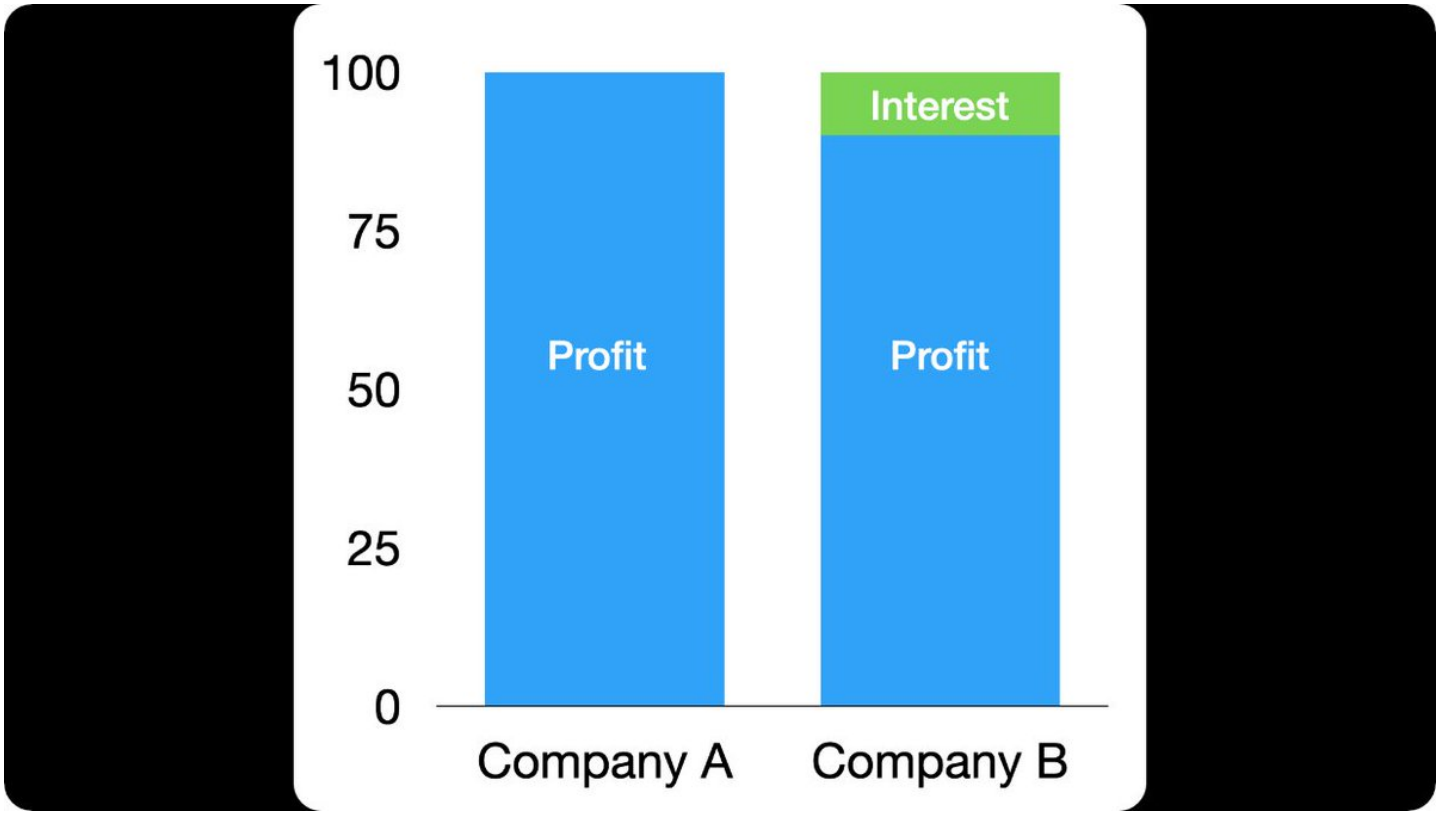
Both companies are exactly the same in every aspect:

(i) same industry
(ii) same financial performance
(iii) same size

Company A raises money from investors but has no debt and makes $100K in profit/year

Company B doesn’t raise money but instead uses debt and makes $90K in profit/year after deducting $10K in interest costs per year

Is Company A better than Company B?



No. The two companies are just “funded” differently.

• Company A used equity
• Company B used debt

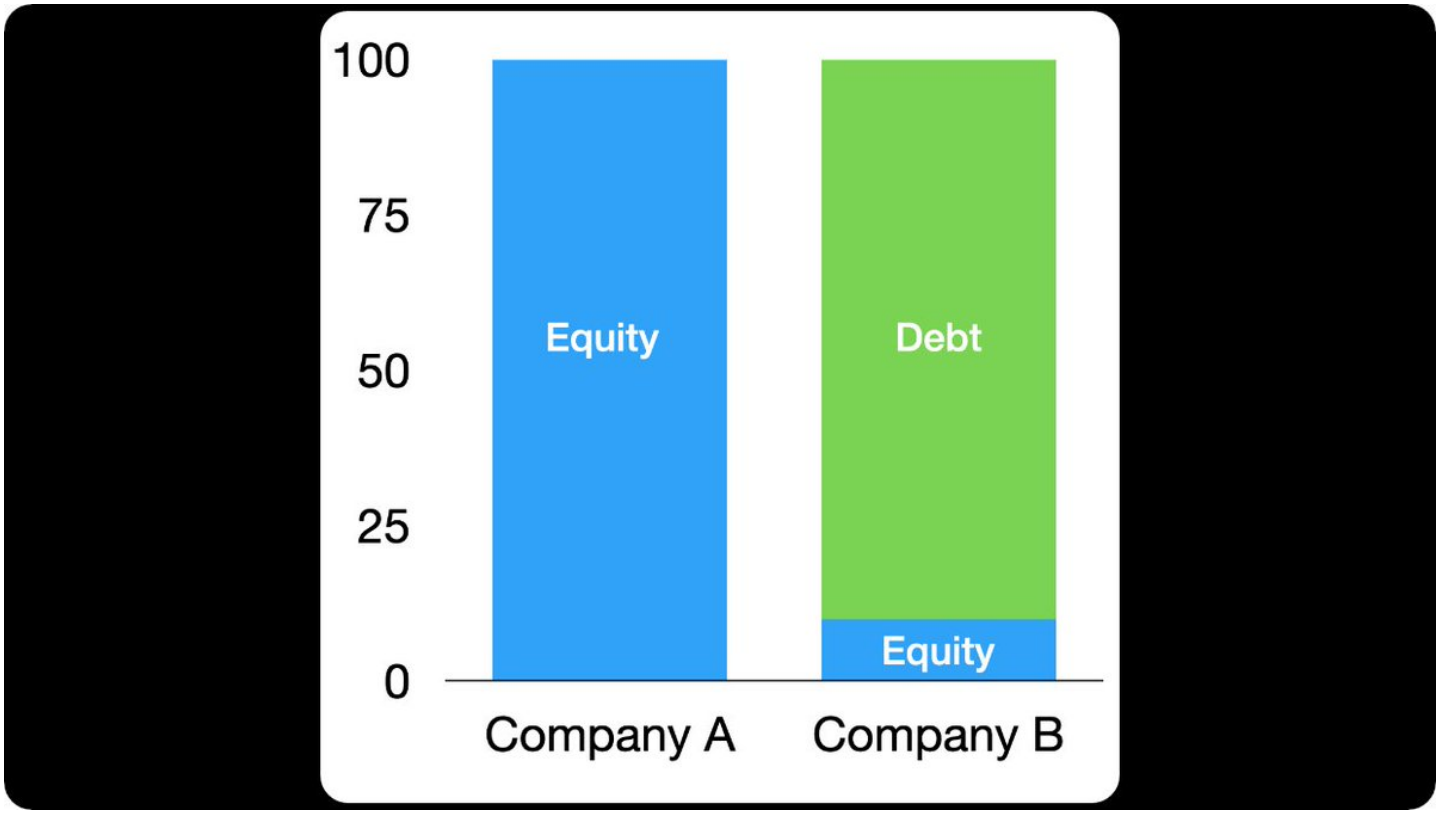
Funding decisions are not fixed and to a certain extent could be changed

Company A chose to dilute its shareholders and raise equity

Company B decided not to dilute shareholders and use debt

There is nothing stopping Company B from:

• Raising money from investors
• Paying back the debt it carries
• Be as profitable as Company A



Hence, the reason why most professionals in private equity use EBITDA to make comparisons between companies

EBITDA adjusts for how a company is funded making comparisons on an apples-to-apples basis

TL;DR:

1. EBITDA is a non-GAAP measure
2. You can calculate EBITDA yourself
3. EBITDA is more frequently used than earnings for valuations
4. EBITDA is an un-levered measure
5. EBITDA ignores how a company is funded

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