

Perpetual knowledge bank series: EBITDA

12 September 2021



EBITDA, or earnings before interest, taxes, depreciation, and amortisation, is one of many ways to assess a company's financial health. It can be a useful formula for investors wanting to use an alternative to net income when comparing one business to another. EBITDA allows analysts to generate insightful comparisons between companies, project a company's long-term profitability and gauge its ability to pay off future financing. However, it can also be misused as

stripping out the cost of capital investments like property, plant and equipment makes a company's earnings appear greater than they really are.

Put another way, EBITDA is capital-structure neutral, meaning it doesn't account for the different ways a company may use debt, equity, cash, or other capital sources to finance its operations. The usual shortcut to calculate EBITDA is to start with operating profit, also called earnings before interest and tax (EBIT) and then add depreciation and amortisation. As with profit, the higher EBITDA figure, the better because the company is making more money. Unlike terms like 'net profit' or 'net earnings', EBITDA is not an official accounting term.

While EBITDA is a handy tool for normalising a company's results to evaluate the business more easily, it should not be a substitute for other metrics such as net income. Investors must not lose sight of the fact that many items excluded from EBITDA – such as interest, taxes, and non-cash expenses – are still real items with financial implications that should not be dismissed or ignored. High-profile investor Warren Buffet has a particular dislike for this metric based on it not accounting for the depreciation of a company's assets.

This analysis has been prepared by [Perpetual Investment Management Limited \(PIML\)](#) ABN 18 000 866 535, AFSL 234426. It is general information only and is not intended to provide you with financial advice or take into account your objectives, financial situation or needs. You should consider, with a financial adviser, whether the information is suitable for your circumstances. To the extent permitted by law, no liability is accepted for any loss or damage as a result of any reliance on this information.

The information is believed to be accurate at the time of compilation and is provided in good faith. This document may contain information contributed by third parties. PIML does not warrant the accuracy or completeness of any information contributed by a third party. Any views expressed in this document are opinions of the author at the time of writing and do not constitute a recommendation to act.

The product disclosure statement(PDS) for the Perpetual Diversified Income Fund issued by PIML, should be considered before deciding whether to acquire or hold units in the fund. The PDS and Target Market Determination can be obtained by calling 1800 022 033 or visiting our website <http://www.perpetual.com.au> .

No company in the Perpetual Group (Perpetual Limited ABN 86 000 431 827 and its subsidiaries) guarantees the performance of any fund or the return of an investor's capital. Past performance is not indicative of future performance.