How to maximize your deal price during a sale?

Working Capital and Net Debt	Normalised EBITDA	Investor readiness

- What is EBITDA?
- Can you adjust EBITDA?
- What is Adjusted or Normalised EBITDA?
- Types of adjustments
- Expense vs CAPEX and other ambiguities
- Key questions to bear in mind

investor insights

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What is EBITDA?

EBITDA is a financial indicator (an acronym for Earnings Before Interest Taxes Depreciation and Amortization) that shows your company's profit before subtracting the interest you have to pay for the debt incurred, the taxes applicable to your business, the depreciation for impairment and amortization of the investments made. The purpose of EBITDA is to get a true picture of what the company is gaining or losing in the core business.

Although it is not part of a company's income statement, EBITDA is a ratio that **allows you to know quickly and easily if your business is profitable or not**, since it represents the gross operating profit calculated before deducting financial costs.

How is EBITDA calculated?

EBITDA is calculated on the basis of the company's final operating profit, excluding financial items (interest on debt), taxes, changes in the value of fixed assets (depreciation) and investment recovery.

Steps for calculating EBITDA:

1

1. The first thing to do is to find the operating profit in the income statement, which is also known as EBIT (Earnings Before Interests, TaxThe first thing to do is to find the operating profit in the income statement, which is also known as EBIT (Earnings Before Interests, Taxes).es).

2

2. To this figure the amounts allocated to provisions must be added.
3. Finally, the amount corresponding to productive amortization is also added. 3

$$I(t)=I(t\text{-}1)\times\frac{\Sigma_{i=1}^{35}Cap_i(t)}{[\Sigma_{i=1}^{35}Cap_i(t\text{-}1)+J]}$$

?

https://www.bancosantander.es/en/glosario/ebitda

On the left is an EBITDA definition from Santander bank's website. The following are at least __3__ __**observations that may impact your EBITDA**__ calculation:

1. Operating profit ≠ EBIT as the latter may include non-operating items
2. Adding back all provisions is arguable as some of the provisions may indicate an operating cash outflow
3. Entire depreciation and amortisation expense that reduces EBIT may be added back, not only "productive amortisation" as Santander suggests

?. Formula suggested by Santander appears confusing and not relevant.

Typos in the first bullet are original investor insights

Can you adjust EBITDA?

- Where to start from?
- Cash vs non-cash nature
- True operating performance
- Any objective reference?

Two different EBITDA levels reported by Heineken NV

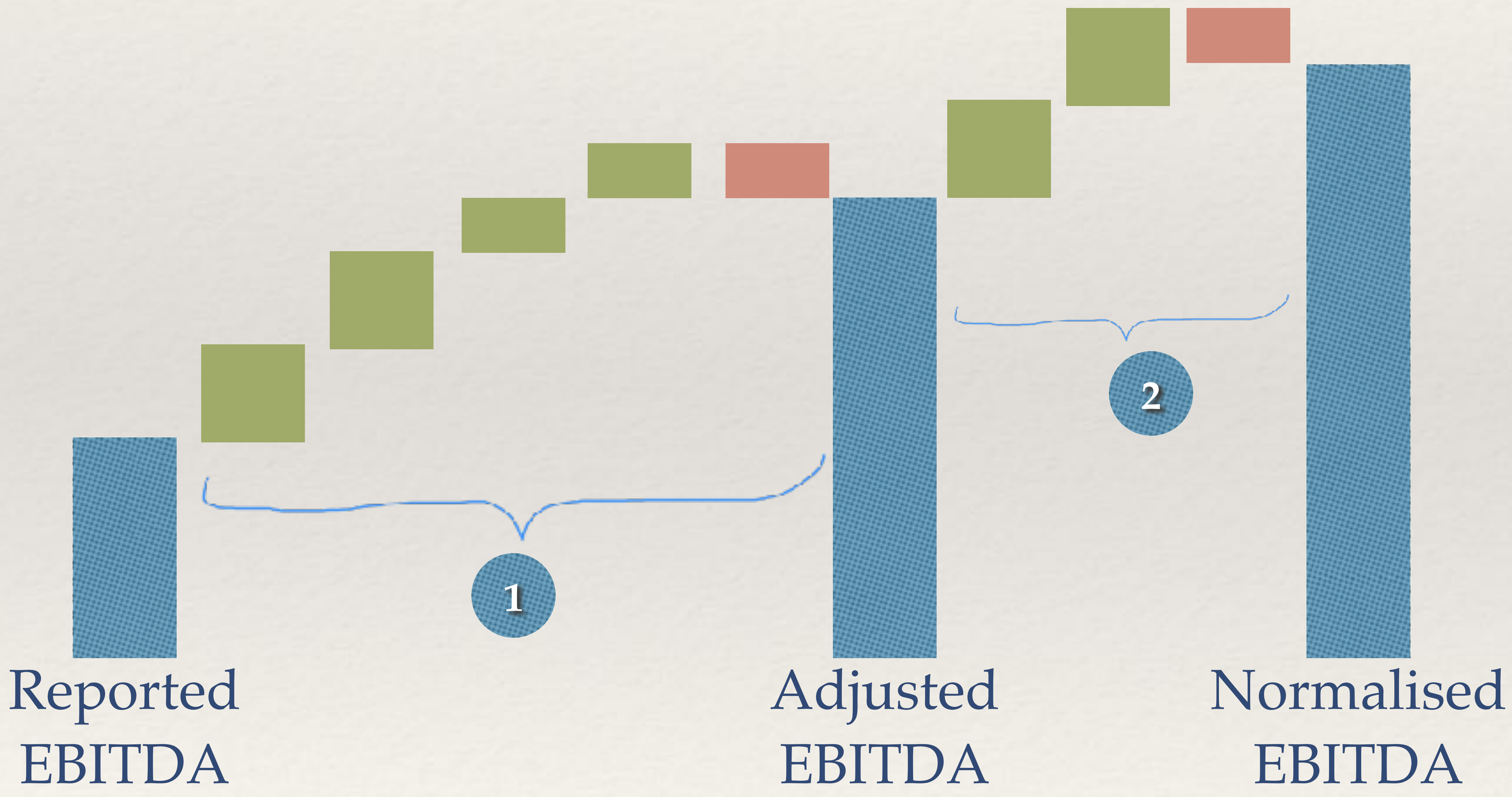
In millions of €	2021	2020
Operating profit	4,483	778
Share of profit/(loss) of associates and joint ventures	250	(31)
Depreciation and impairments of property, plant and equipment	1,487	1,981
Amortisation and impairment of intangible assets	461	855
EBITDA	**6,681**	**3,583**
Exceptional items	(1,491)	568
EBITDA (beia)	**5,190**	**4,151**

https://www.theheinekencompany.com/sites/theheinekencompany/files/Downloads/PDF/AR-2021/heineken-nv-annual-report-2021-25-02-2022.pdf

Consider:

- Heineken discloses EBITDA both prior to and after "exceptional items". EBITDA (beia) is higher in one year and lower in another year
- Clearly, exceptional gains/losses are significantly affecting EBITDA and, therefore, valuation
- What other factors affect EBITDA and which ones may be applied on your deal?

What is Adjusted / Normalised EBITDA?



- It is customary to discuss a deal price referencing a multiple of **“normalised” or ”sustainable” EBITDA**
- There is a wide discretion as to the definition and scope of normalisation adjustments. Broadly these adjustments may be divided into:

    1. One-offs, non-cash, non-operating, and
    2. Costs related to standalone particular business

Types of adjustments

- P&L and balance sheet adjustments
- Reconciliation to cashflow statement
- Historical vs "pro-forma"
- Negative & positive
- Synergies & dis-synergies

Reported EBITDA
Non-recurring
Non-core
Non-operating
Non-cash
Bad debt provisions [1)]
Inventory provisions [2)]
Other accounting
Adjusted EBITDA
Shared costs
Allocated costs
Transaction-related costs
Normalised EBITDA

1. *If recorded in a relevant period and other than specific*
2. *Depending on nature of provision*

Expense vs CAPEX and other ambiguities

You may analyse a number of different areas in order to understand if an adjustment is possible:

- R&D expense or Intangible asset?
- Is CAPEX maintenance or expansion?
- Inventory or fixed asset?
- Are prepaid expenses straight-lined over useful life?
- Capital or operating lease (IFRS16)?
- ESOP expense - is it truly non-cash?

Your ability to provide **support will determine** the strength or weakness of your argument:

- Any reference to a widely accepted accounting framework, eg. IFRS, US GAAP
- Any examples of widely accepted market practice
- Supporting documentation
- Business rationale

Note that the tax treatment of an item may significantly differ to the deal environment EBITDA calculation

Key questions to bear in mind

- Sources of information - Management or IFRS accounts
- Difference between end-of-year and intra-year adjustments
- Specific accounting policies and hierarchy of principles
- Earn-outs and future accounting policies changes
- Reconciling between tax accounts and EBITDA calculation

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