EV/EBITDA and EV/EBIT

EV/EBITDA and EV/EBIT

- We are going to look at two Enterprise Valuation Ratios
  - EV/EBITDA
  - EV/EBIT
- They are similar but the differences between them are important to appreciate

EV/EBITDA and EV/EBIT

- Enterprise Value is the market capitalisation plus market value of debt less net cash and cash equivalents
- Both ratios are used in the Comparable Companies valuation method

EV/EBITDA and EV/EBIT

- It is also used in M&A transactions as its an easy way to discuss and negotiate price in a way that is meaningful to both sides
- It can also be used as an easy to calculate terminal value in a DCF valuation

EV/EBITDA and EV/EBIT

- EV/EBITDA
- How many times EBITDA do you have to pay if you want to buy the company or its shares?
- It can be use as a short hand valuation method - as done by VCs particularly

EV/EBITDA and EV/EBIT

- While EBITDA is easy to use and is frequently applied to valuation calculations, it may not be a good proxy for cash flow, particularly in capital intensive businesses
- It omits Depreciation and Amortisation - which while non cash items do reflect a value reduction of capital assets - so it fails to account for capital expenditure

EV/EBITDA and EV/EBIT

- The EV/EBIT ratio included Depreciation and Amortisation and addresses this weakness
- This is important for capital intensive businesses as EBIT is being used as a proxy for cash flow
- It should be noted that Warren Buffet does not like using EBITDA as he believes it is important to factor Capex into the valuation calculation.

EV/EBITDA and EV/EBIT

- While both EV/EBITDA and EV/EBIT enable comparisons between companies, neither are very helpful for assessing growth or for judging over or under valuation
- You have to make the judgement when conducting valuations as to which of these two metrics best suits the business you are valuing

EV/EBITDA and EV/EBIT