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UNDERSTANDING EBITDA

WHAT EVERY BUSINESS OWNER SHOULD KNOW BEFORE SELLING

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Introduction

If you're a founder or CEO exploring the sale of your business, one term will show up early - and often: **EBITDA**. You've probably seen it in news articles, heard it from various advisors, or had it tossed around in early buyer conversations. But behind the acronym lies a common, uncomfortable truth for many owners:
"I know it's important... but I'm not sure I fully understand it."

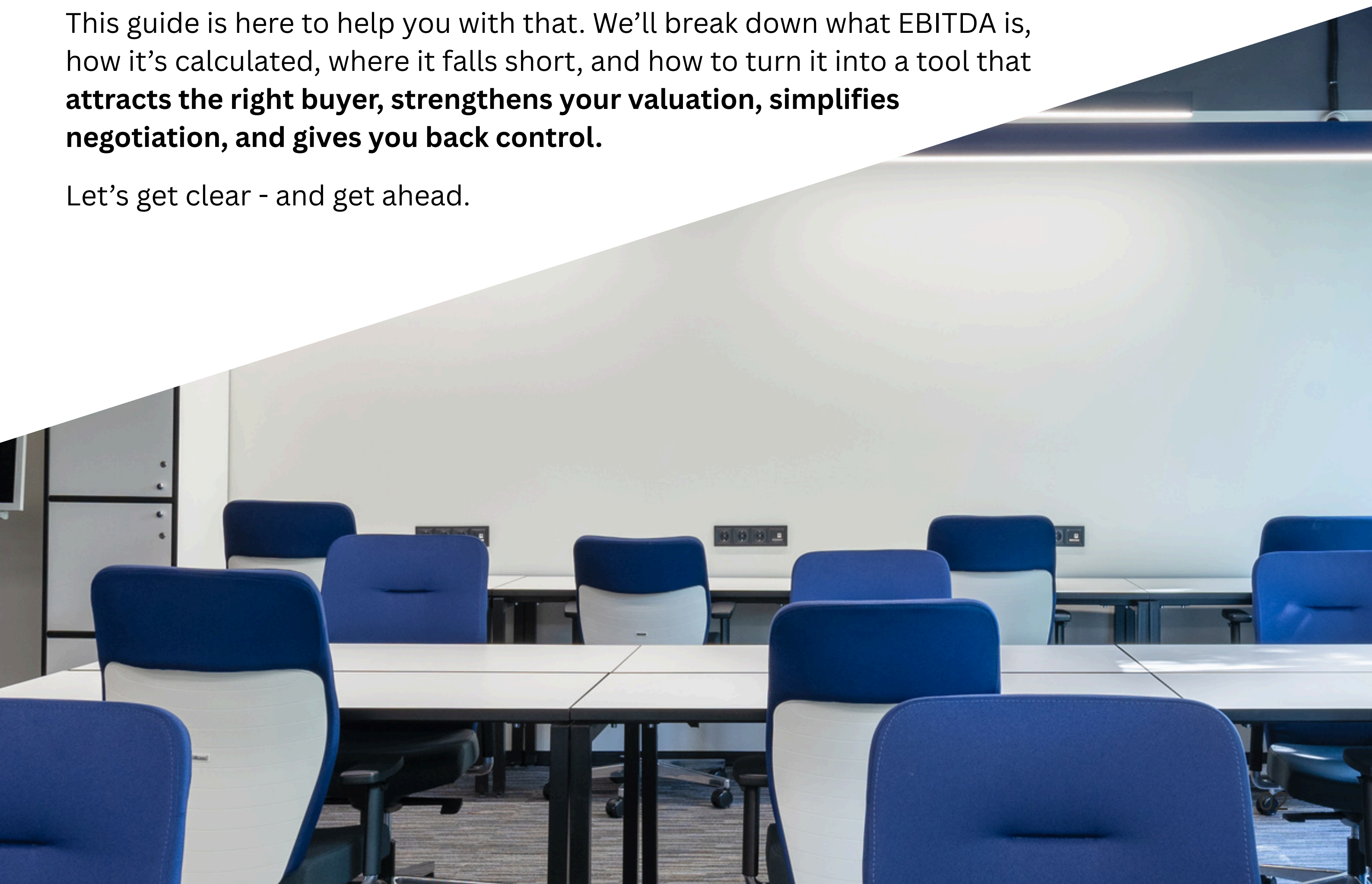
This lack of clarity can quietly erode your confidence. It leads to questions you're afraid to ask, financial comparisons you don't feel ready for, and - worst of all - a sense that you're at a disadvantage in the deal.

EBITDA isn't just a formula; it's the language of buyers. It's the starting point for how they value your business, structure offers, and assess risk. And if you don't understand what's behind the number, or how to defend and adjust it, you're not just unprepared - you're vulnerable exactly when the stakes are highest.

Buyers use EBITDA as a **common baseline to compare businesses across industries, normalize performance, and project returns**. But not all EBITDA is created equal. Strategic add-backs, one-time adjustments, and forward-looking indicators can meaningfully shift the number and, with it, your valuation. That's why **sellers must know how to present a clear, defensible EBITDA story backed by documentation and logic, not guesswork.**

This guide is here to help you with that. We'll break down what EBITDA is, how it's calculated, where it falls short, and how to turn it into a tool that **attracts the right buyer, strengthens your valuation, simplifies negotiation, and gives you back control.**

Let's get clear - and get ahead.



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What is EBITDA?

If you're a business owner preparing for a sale, you'll quickly find that **EBITDA becomes the center of nearly every conversation** - even if no one ever takes the time to explain it properly.

EBITDA stands for Earnings Before Interest, Taxes, Depreciation, and Amortization. In plain terms, it's a way to measure how profitable your business is from its core operations - **before** things like debt, taxes, or non-cash expenses come into play.

Buyers love it because it strips out variables like capital structure or tax strategy and lets them compare companies on equal footing. It's their go-to shorthand for your company's earning power.

EBITDA gives buyers a clean, apples-to-apples view of performance. It removes **financing decisions, depreciation schedules, and tax differences - focusing purely on operational profitability**. That's why buyers rely on it so heavily during valuation and due diligence. It tells them how efficiently the core business runs, what cash it could generate under new ownership, and whether it aligns with their investment model.

Even if EBITDA doesn't show the whole picture, **it's often the number that drives your valuation** - usually as a multiple (e.g., 4x to 8x). That means **misunderstanding or misrepresenting EBITDA can cost you millions.**

In summary, EBITDA is a key metric in any M&A process for these reasons:

- It **creates a standard way to compare** companies.
- It **helps buyers isolate true operating performance**.
- It's **often the baseline for offer calculations** and valuation multiples.
- It **acts as a proxy** for your company's cash-generating potential.

If you're following but not fully confident in how EBITDA works, you're not alone - but that gap can cost you. The more you understand it, the more leverage, confidence, and clarity you'll bring to the deal. **Buyers will test your grasp of the number, and your ability to explain it can directly impact what they're willing to pay.**

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HOW IS EBITDA CALCULATED?

It's one of the most common moments of confusion in an M&A process: you calculate one EBITDA number, the buyer calculates another one - and suddenly your entire valuation is up for debate.

EBITDA isn't pulled from a single line item - it's a reconstruction. That means there's room for interpretation, and that's where tension often creeps in.

At its core, EBITDA starts with your net income and adds back expenses that don't reflect your company's day-to-day operating performance - things like:

- **Interest** (your financing decisions)
- **Taxes** (which vary by geography and structure)
- **Depreciation & Amortization** (non-cash accounting items)

Classic formula

EBITDA = Net Income
+ Other expenses
- Other income
+ Interest
+ Taxes
+ Depreciation
+ Amortization

Commonly Used Shortcut

EBITDA = Operating Profit (EBIT)
+ Depreciation
+ Amortization

This approach helps strip out non-operational noise - **but only if your numbers are clean and clearly documented.**

If not? Expect buyers to ask questions, make adjustments, or worse - use ambiguity to negotiate your price down.

That's why understanding how EBITDA is built - and aligning your version with clean, defensible data - is a crucial step in preparing for a successful exit.

HOW TO ADJUST YOUR EBITDA

Buyers aren't making decisions based on your **standard EBITDA** - they care about **Adjusted EBITDA**, because it reflects **what the business will actually earn under their ownership**. It's not just about what the company achieved with you at the helm - it's about the underlying earnings potential that buyers can realistically sustain, optimize, and grow well into the future.

Adjusted EBITDA is your chance to **reshape the financial story** - to reflect what the company would earn under new ownership, without personal, one-off, or legacy costs. But presenting these adjustments can spark doubt.

- **Credibility risk**: "Will buyers think I'm inflating numbers?"
- **Transparency dilemma**: "How much detail is too much?"
- **Expense guilt**: "What will they say about my car lease... or that family trip booked on the business card?"

Common Adjustments Include:

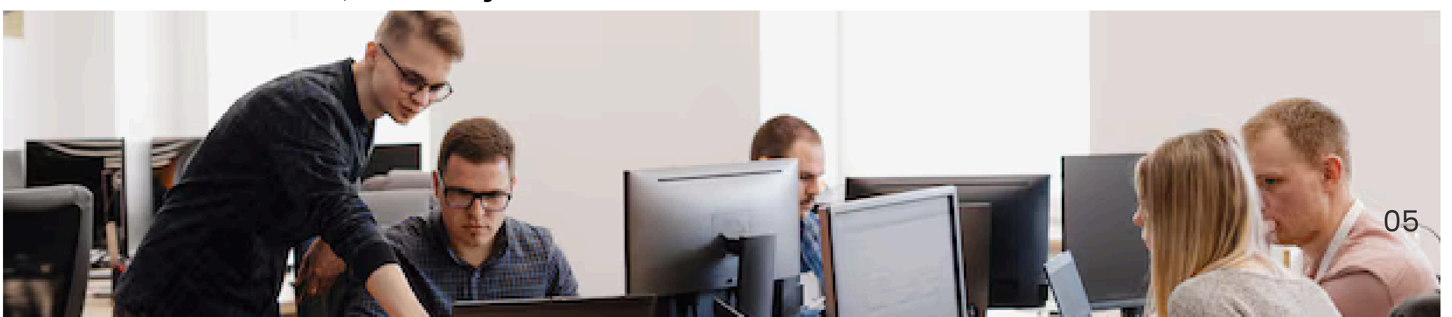
- **Owner salary** above market rate
- **One-time legal or professional fees**
- Personal or other **non-business expenses**
- Non-recurring marketing or other **launch costs**
- Severance or restructuring **fees**
- **Related party transactions at non-market rates**

The key? Own it with clarity and evidence!

Show your math. Be consistent. Back it up with documentation.

When done right, Adjusted EBITDA doesn't only justify your valuation - it **boosts buyer confidence**. It tells them: "Here's what this business can do for you - clean, scalable, and ready to perform without me."

Adjusted EBITDA is what buyers care about most. It tells them what the business would earn for them, not for you.



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WHEN EBITDA NEEDS TO TELL A STORY

You've worked hard to build a strong **EBITDA** - but deep down, you're worried:

- *"What if buyers pull it apart in diligence?"*
- *"What if they don't see the real value behind the number?"*

This is the point where surface-level profit meets scrutiny. Buyers know EBITDA can be massaged. What they really want is a business with earnings that are **repeatable, explainable, and defensible**.

Deeper Fears in This Stage Include:

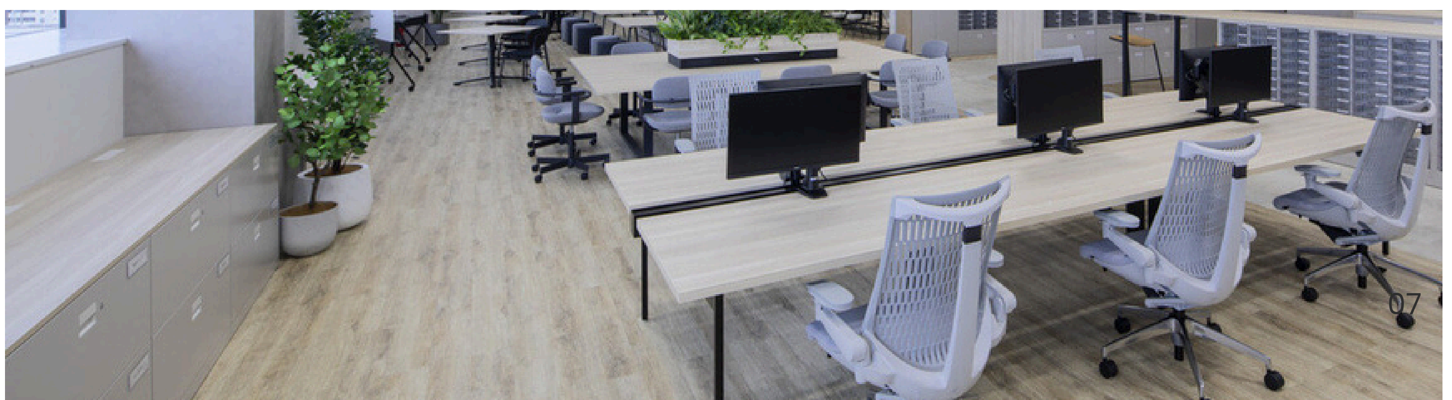
- **Due diligence dread**: "Will they find holes in our numbers?"
- **Perception gap**: "How do I clearly demonstrate the value of my team, systems, and operations, not just the bottom-line profit?"
- **One-time gain panic**: "Last year was great - but what if that's the peak?"

Common Buyer Red Flags:

- **Big one-time deals** that inflate earnings
- **Aggressive cost-cutting** with unclear sustainability
- **EBITDA growth unsupported by matching cash flow**
- **Adjustments with little documentation**
- **Large year-over-year swings in EBITDA** with no clear trend, underlying rationale or any long-term potential

What to do:

Show that your **EBITDA isn't a lucky spike** - it's a reflection of a business built **on solid, repeatable foundations**. Validate it with data, systems, retention metrics, and context. When **EBITDA becomes a story** - and not just a stat - it becomes a credible valuation anchor, not a number buyers try to chip away at.



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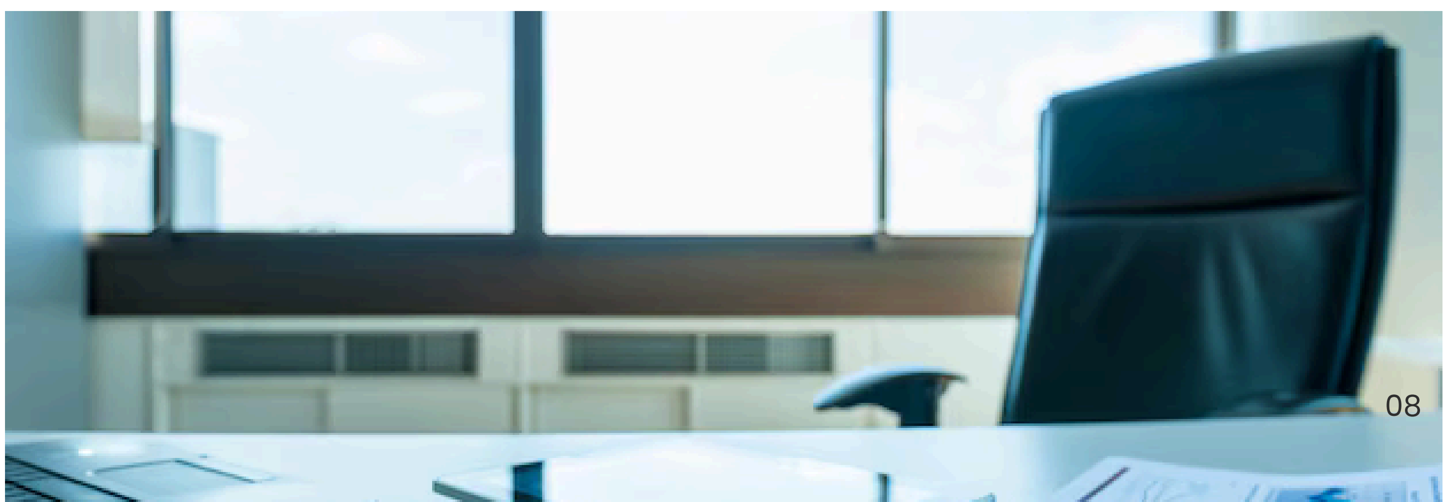
BUILD TO EXIT, DON'T EXIT TO ESCAPE

Too many founders wait until they're burned out, overwhelmed, or facing declining performance before considering a sale. They hold on for too long, **hoping for a rebound**, or telling themselves they'll fix things "next quarter." But by the time they're ready to sell, **energy is depleted**, **metrics are slipping, and urgency replaces strategy. It's understandable** - building a company is personal - but waiting until you're exhausted is the worst possible moment to explore an exit.

The strongest exits come from businesses that are built to be sold, not those looking for a quick way out under pressure. That means building reliable systems, generating sustainable EBITDA, thoroughly documenting your operations, and adopting a buyer's mindset long before you ever step into a negotiation.

Buyers are looking for stability, growth potential, and transparency. They want to acquire a business that runs smoothly, has reliable performance, and shows clear signs of future upside. That means **predictable revenue, recurring customers, efficient operations, and clean, verifiable data.** A business that's professionally managed - with documented processes, a capable team, and forward-looking strategy - commands far more interest and higher offers. On the flip side, if your business depends entirely on you, lacks clean financials, or is coasting on outdated momentum, the exit will be difficult - and likely underwhelming. **Buyers will see risk everywhere: in your absence, in the numbers they can't verify, and in growth that peaked years ago. You're not just selling revenue - you're selling confidence. And without that, you lose both leverage and value.**

The earlier you prepare, the more leverage, clarity, and options you'll have. Whether you plan to sell in 12 months or 5 years, start now. Build with purpose, measure with discipline, and prepare to exit on your own terms, not out of necessity, but because the business, the timing, and your vision all align.



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THANK YOU

WANT TO KNOW WHERE YOU STAND?

Schedule a free 30-min Exit Readiness Call with Meliora Group.

You have built your business.
We can build your exit.

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