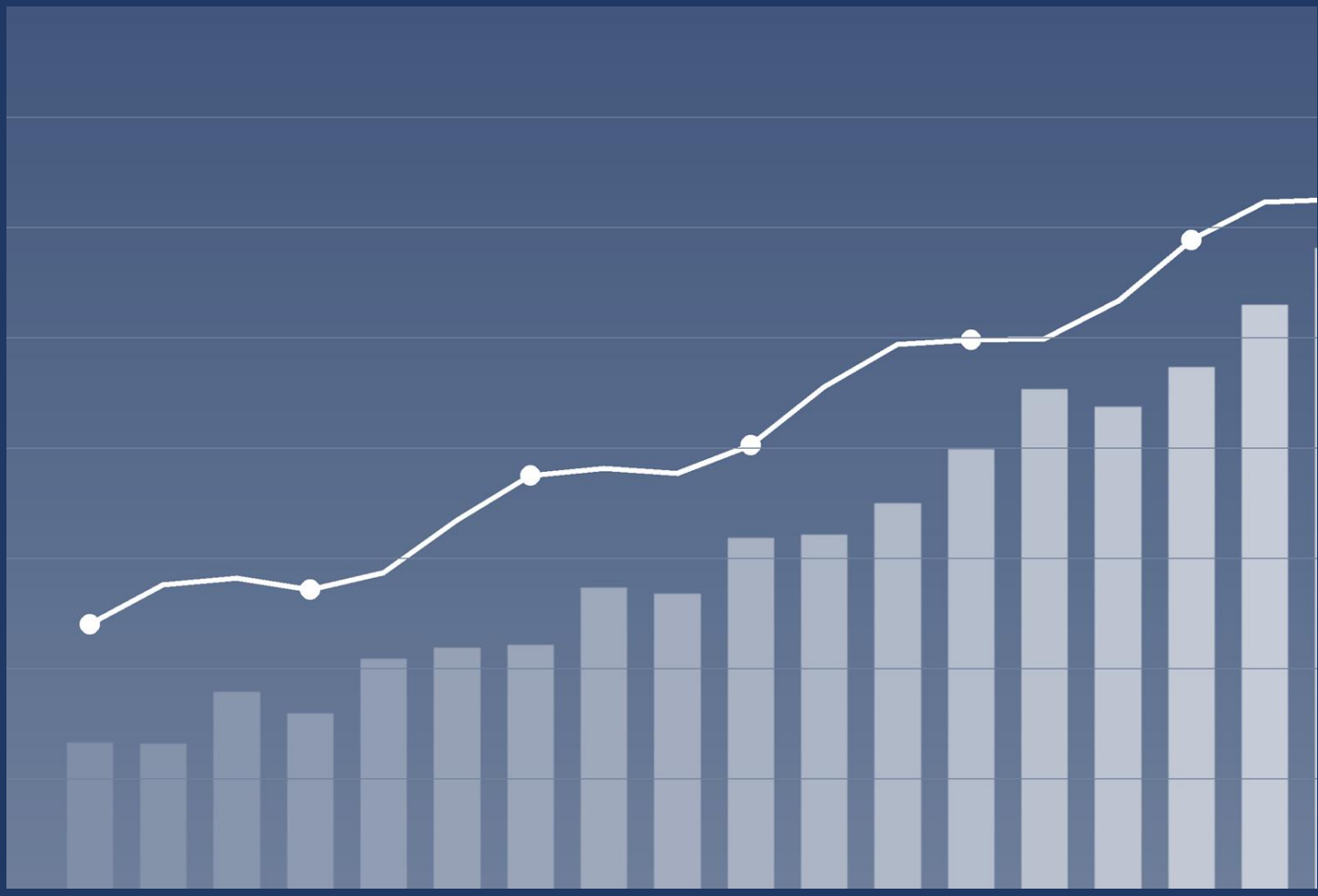
GETTING EBITDA RIGHT

EBITDA ADJUSTMENTS

HOW NORMALIZING EARNINGS SHAPES VALUE, AND WHY CREDIBILITY MATTERS AS MUCH AS THE NUMBER



AEKLVYA

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WHY EBITDA IS ADJUSTED

Reported EBITDA reflects the way an owner has chosen to run the business: how much they pay themselves, which expenses run through the company, and one-off events in a given year. A buyer wants something different: the sustainable, recurring earnings the business will generate under new ownership. Adjusted EBITDA bridges the two by normalizing reported results.

Because most middle-market businesses are valued as a multiple of adjusted EBITDA, every adjustment is magnified. **At a 7x multiple, each $100,000 of EBITDA is worth $700,000 of enterprise value**, in either direction.

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ADJUSTMENTS WORK BOTH WAYS

Normalizing is not only about adding back costs. A credible bridge moves EBITDA in both directions, reflecting what a buyer will actually experience after closing.

Add-backs

INCREASE EBITDA

- Owner pay above the cost of a market-rate replacement
- Personal or family expenses run through the business
- Genuinely one-time costs: a lawsuit settlement, relocation, or failed system rollout
- Transaction-related legal, accounting, and advisory fees

Deductions

REDUCE EBITDA

- Owner or family members paid below market, or not at all, for roles a buyer must fill
- Below-market rent on a seller-owned facility that resets after closing
- Non-recurring revenue: a one-off order, grant, or insurance recovery
- Missing functions a buyer must add, such as a CFO or quality lead; deferred maintenance

ILLUSTRATIVE EXAMPLE

Adjusted EBITDA bridge	$ millions
Reported EBITDA	**4.00**
+ Excess owner compensation	0.35
+ One-time litigation settlement	0.25
+ Personal expenses run through the business	0.10
– Below-market rent on owner-held facility	(0.15)
– Non-recurring revenue from a one-off contract	(0.15)
– Cost of a full-time CFO the buyer must hire	(0.20)
Adjusted EBITDA	**4.20**
Enterprise value at 7x: reported $28.0M vs. adjusted $29.4M	**+$1.4M**

Figures and multiple are illustrative only. Actual adjustments and multiples vary by business, sector, and market conditions.

03

WHEN ADJUSTMENTS BACKFIRE

It is tempting to present the highest possible number. In the example above, a seller who claimed only the add-backs and ignored the deductions would show $4.70 million of EBITDA and an implied value of $32.9 million. Buyers test every adjustment through their own quality of earnings (QoE) review, and an aggressive bridge rarely survives diligence. Common red flags include:

- "One-time" costs that recur year after year
- Pro forma savings from cost cuts not yet made, or buyer synergies claimed by the seller
- Annualizing a strong recent quarter, or adding back costs that are needed to run the business
- Adjustments without documentation, or that change from one presentation to the next

The cost is real. When a buyer's QoE finds a lower number, the price is typically renegotiated after the letter of intent, when the seller has the least leverage. In the example, a $0.50 million reduction becomes a **$3.5 million price cut**. Credibility suffers, diligence lengthens, and buyers protect themselves with larger escrows, earnouts, or a lower multiple. In some cases, the deal collapses.

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GETTING IT RIGHT

Credible adjustments share three traits: they are documented, they are genuinely non-recurring or owner-specific, and a buyer would not incur them after closing. Present deductions as openly as add-backs; doing so builds trust and makes the rest of the bridge easier to defend. Apply adjustments consistently across at least three years and the trailing twelve months, and consider a sell-side QoE before going to market so there are no surprises in diligence.

TAKEAWAY

CREDIBILITY IS WORTH MORE THAN ANY SINGLE ADD-BACK

A well-supported adjusted EBITDA shows a buyer the true earning power of the business and anchors the valuation discussion. An inflated one invites a re-trade at the worst possible moment. Owners who normalize earnings honestly, in both directions, protect both their price and their negotiating position.

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