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The Prevalence and Validity of EBITDA as a Performance Measure

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Abstract

This study evaluates EBITDA as a financial performance measure and investigates the use of EBITDA in financial reporting. First, we take issue with recent comments that both the SEC and the IASB have levied against non-GAAP earnings numbers, and in particular EBITDA. While EBITDA allegedly provides an accurate reflection of the operations and abstracts from how assets are financed, we argue that (net) operating profit already provides this information without the necessity of making subjective adjustments. Also, our evidence suggests that EBITDA paints a rosy picture of the firm's profitability and cash-generating ability. Next, using textual analysis, we investigate the prevalence of EBITDA in financial disclosures based on a large sample of 15,895 annual reports and 51,758 earnings releases from S&P 1500 firms between 2005 and 2016. We find that 14.8% of sample firms disclose and emphasize EBITDA numbers. EBITDA disclosures modestly increase over time and tend to be rather sticky in nature. In our cross-sectional analyses, we find that, consistent with our hypotheses, EBITDA-reporting firms are smaller, more leveraged, more capital-intensive, less profitable and have longer operating cycles than non-EBITDA reporting firms. They also exhibit higher forecast errors and a higher likelihood of missing the analyst forecast benchmark. Additional tests further underscore the opportunistic nature of EBITDA disclosures as we find that these firm characteristics are more strongly associated with the disclosure of adjusted EBITDA measures, and less strongly associated with the disclosure of EBITA and EBIT.

Keywords: EBITDA NongAAP Measures

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