



Post-acquisition truths

When is an EBITDA adjustment warranted? Never mind that – the key thing is being aware of what tweaks have been made, says **Jon Moulton**

More thoughts on the frankly crazy goings-on across the Pond and rippling across the world? My experience so far of the first six months of this second Trump term suggests that between the time of me writing about his latest headline-grabbing stunt and the feature hitting your desks (or tablets or phones or computers), reality will have bitten and a U-turn (dressed up as something else, of course) will have ensued. Or a different bigger chaos will have taken over.

But one new phrase that is widely used in descriptions of the Trump administration's culture is 'post-truth'. It's not a term that I have heard applied to private equity often, but actually there might be some justification in using it. EBITDA (earnings before interest, taxes, depreciation and amortisation) is the most frequently used number on which to base the value of a business.

Many readers will have seen pitchbooks for investors to be charmed into a new buy-out fund. There will be considerable use of EBITDAs. Sometimes they are simply numbers that match with statutory audited accounts, but that is actually rare.

EBITDAs are generally 'adjusted'. And sometimes this is not stated. Sometimes it is, but what the adjustments are or why adjustments might be appropriate, or even helpful, remains unelaborated upon. It is exceptional to have full disclosure around adjustments. There are no accounting standards in a pitchbook to guide the presentation or preparation of EBITDA numbers, so it's a wide-open playing field.

For example, the EBITDA used to value an acquisition at the time of that acquisition can be shown advantageously as low if the fund is mainly seeking to demonstrate EBITDA growth in the period of ownership of the leveraged buy-out (LBO) sponsor. This is easily achieved by booking substantial accounting provisions effective as at the acquisition date and bleeding any unneeded excess back to profits during the period of ownership.

However, there is a flipside to this. Reducing EBITDAs at acquisition can make it look as though the LBO firm has paid a higher price multiple for the business. Of course, it might actually be a high price regardless of accounting games. In which case, showing a higher adjusted EBITDA at the time of acquisition could be

desirable. As with reducing EBITDAs to produce a result that paints the desired picture, there are a range of possible techniques for getting to the magic number of choice. One example is adding back overheads that will not be incurred post-acquisition, on the basis that this tweak gets to 'sustainable' profit.

Performative acts

So the best-looking adjusted EBITDA may vary. Using a high EBITDA figure to report an acquisition will demonstrate great deal-doing skills – a lower EBITDA multiple comes from high EBITDA. Some years later, as a business is sold or prepared for exit, the lowest credible EBITDA figure at acquisition will show apparent improved business performance post-acquisition by the buy-out fund. Credit for such performance is naturally credited to the LBO sponsor and its operating partners.

The use of different EBITDAs, for the same period but at different times, can deliver different 'truths' for a fund manager. Often this is easy – acquisitions, divestitures and closures, changing accounting principles and perhaps changing the reporting currency often mean that only a financial wizard can follow the evolution of adjusted EBITDAs. There are some simple games to be played – in describing a new acquisition the sponsor might say: "We paid 8x EBITDA". Is that before or after deal costs? Is that for the last 12 months (unaudited) or the last audited period? And, what are the adjustments?

Post-acquisition there is a choice for LBO sponsors over some costs. Big reorganisations may or may not be deducted in arriving at annual EBITDA that is used for reporting to LPs and valuation. The temptation is to use 'sustainable' profits and exclude the reorganisation costs from the EBITDA computation.

From the fund portfolio at Perscitus and the funds that we get to look at, all of these practices are in play. With luck, manipulations can be spotted in filed audited accounts, although of course they may not be available in the holding company's jurisdiction or be too old to be of much use.

Sponsors vary from being conservative to making full use of all these tools. Caveat investor. And back to Trump – he has form in valuation techniques, too.

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