

Evaluating Company Performance: The Role of EBITDA as a Key Financial Metric

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Abstract: In modern corporate finance, accurately evaluating company performance is essential for stakeholders, including investors, analysts, and management. Amidst the array of financial indicators available, Earnings Before Interest, Taxes, Depreciation, and Amortization (EBITDA) has emerged as a widely utilized metric due to its ability to provide a clearer view of operational profitability by excluding non-operational and non-cash items. From a broader perspective, financial analysis traditionally encompasses metrics such as net income, return on equity, and cash flow. However, these measures can be significantly influenced by accounting treatments, capital structure, and tax environments, often complicating inter-company and cross-industry comparisons. EBITDA addresses this challenge by isolating operating performance, allowing analysts to assess a company's core earnings capacity before financial and accounting distortions. This metric is especially valuable in mergers and acquisitions, leveraged buyouts, and credit analysis, where operational strength and debt service capabilities are central considerations. Nevertheless, while EBITDA offers practical benefits, it also presents limitations—particularly in industries with significant capital expenditure requirements or those where depreciation reflects true asset wear and tear. Overreliance on EBITDA without context can mask cash flow issues, understate capital intensity, or overestimate valuation multiples. This article critically evaluates the function of EBITDA within the broader financial performance framework, exploring its strengths, contextual relevance, and interpretive boundaries. By analyzing case applications and comparing EBITDA with complementary indicators, the discussion emphasizes the need for balanced metric interpretation in assessing corporate health.

Keywords: EBITDA; Financial performance; Operational profitability; Corporate valuation; Non-cash adjustment; Capital structure analysis

1. INTRODUCTION

1.1 Background and Importance of Financial Performance Evaluation

Financial performance evaluation is a fundamental aspect of decision-making in both corporate finance and investment analysis. It provides stakeholders—including investors, creditors, regulators, and management—with critical insights into a firm's profitability, efficiency, solvency, and overall financial health [1]. The ability to assess and compare financial outcomes over time or across industry peers enables organizations to benchmark strategic initiatives and allocate resources more effectively.

Traditionally, financial performance has been evaluated using metrics derived from financial statements such as return on equity (ROE), return on assets (ROA), net profit margin, and earnings per share (EPS). These indicators are widely accepted due to their standardization, ease of computation, and regulatory transparency. Financial ratio analysis, in particular, offers a concise and comparative view of business operations, risk exposure, and capital efficiency [2].

However, in an increasingly dynamic and competitive business environment, reliance solely on conventional metrics may offer a limited view of corporate success. Traditional measures often fail to capture intangible drivers such as innovation capacity, environmental impact, stakeholder

relationships, and brand value—factors that significantly influence long-term sustainability [3].

Moreover, the rise of global investment diversification and cross-border financial integration has intensified the need for comprehensive and adaptive performance measures. Financial performance evaluation must now account for volatility, market sentiment, and non-financial indicators, particularly in sectors such as technology, services, and impact investing [4]. Consequently, organizations and analysts are shifting toward a more holistic approach that balances traditional financial metrics with emerging alternative indicators for a fuller understanding of enterprise value [5].

1.2 Rise of Alternative Metrics in Modern Finance

In recent years, the financial industry has witnessed a growing emphasis on **alternative performance metrics**—non-traditional indicators that supplement or reframe conventional financial analysis. These include measures such as Economic Value Added (EVA), market value-added (MVA), sustainability scores, and environmental, social, and governance (ESG) ratings, all of which provide deeper insight into firm performance beyond accounting profits [6].

Driven by increased demand for transparency, ethical investing, and strategic accountability, alternative metrics help investors assess long-term value creation and resilience. For instance, EVA accounts for the cost of capital in determining

economic profitability, offering a more refined view than traditional net income [7]. Similarly, ESG metrics evaluate corporate responsibility practices and their potential financial implications, which are increasingly relevant in institutional investment decisions.

These metrics have gained traction in sectors where intangibles, innovation, and sustainability are central to competitive advantage. Technology firms, startups, and socially responsible enterprises frequently adopt customized performance dashboards that reflect both quantitative and qualitative outcomes [8]. The shift signals a broader transformation in financial evaluation paradigms—one that emphasizes adaptability, stakeholder relevance, and real-world impact in the pursuit of enduring financial excellence [9].

1.3 Scope, Objective, and Structure of the Article

This article explores the evolution and integration of alternative financial performance metrics within the broader landscape of corporate evaluation and decision-making. It aims to critically assess the strengths, limitations, and application contexts of both traditional and emerging indicators, while highlighting the growing need for multidimensional performance measurement frameworks in modern finance [10].

The primary objectives are threefold: first, to outline the theoretical and empirical foundations of financial performance evaluation; second, to examine the drivers behind the emergence of alternative metrics and their adoption across sectors; and third, to evaluate how these tools are influencing financial reporting, strategic management, and investment behavior. Through comparative analysis and case illustrations, the article seeks to provide a practical understanding of how organizations can leverage diverse performance indicators to improve financial transparency and value creation [11].

2. UNDERSTANDING FINANCIAL PERFORMANCE METRICS

2.1 Traditional Performance Measures

2.1.1 Net Income and EPS

Net income, often referred to as the "bottom line," has long been the cornerstone of corporate financial reporting. Derived from the income statement, it represents the profit remaining after all expenses—including operating costs, interest, taxes, and depreciation—have been deducted from total revenue. Net income offers a snapshot of overall profitability and is widely used by investors and stakeholders to assess company health [5].

Earnings per share (EPS), calculated by dividing net income by the number of outstanding common shares, provides a per-share profitability metric that facilitates cross-company comparisons and equity valuation. It is a core input in price-

to-earnings (P/E) ratios and significantly influences stock prices, especially in earnings-focused markets [6].

Despite its prevalence, net income can be sensitive to non-operational variables, such as extraordinary gains or losses, making it susceptible to fluctuations that may not reflect core business performance. This limitation underscores the need for complementary indicators that distinguish recurring profitability from one-off events [7].

2.1.2 Return on Equity and ROI

Return on equity (ROE) is a key metric that gauges a firm's ability to generate profit from shareholders' equity. It is computed as net income divided by average shareholder equity and serves as a measure of financial efficiency and management effectiveness [8]. A high ROE generally signals strong profit generation relative to equity investment, which is especially important for evaluating capital-intensive industries.

Return on investment (ROI), though more flexible in definition, typically compares net returns to the cost of investment, offering insight into project- or asset-level performance. ROI is widely used for capital budgeting decisions and strategic assessments, enabling businesses to allocate resources where the highest returns are expected [9].

While both ROE and ROI offer strategic clarity, they can be influenced by leverage, accounting policies, and time horizons. Therefore, their interpretation often requires contextual adjustment to avoid misjudging underlying performance dynamics [10].

2.2 Limitations of Conventional Metrics

2.2.1 Accounting and Capital Structure Effects

Traditional financial metrics are often rooted in accounting conventions that may obscure economic reality. Net income and ROE, for instance, are derived from accrual-based reporting systems that may defer or accelerate revenue and expense recognition based on managerial discretion or accounting standards [11]. Such manipulations—though legally permissible—can distort the comparability and reliability of financial ratios.

Capital structure decisions also affect key metrics. A highly leveraged firm may report elevated ROE due to reduced equity, even if its overall profitability is modest. This "equity shrinkage" effect can mislead investors about the true economic return on invested capital [12]. Additionally, interest payments on debt lower net income, thereby affecting EPS and ROI despite potentially boosting after-tax cash flows.

Moreover, accounting entries such as provisions, amortization, and revaluations introduce non-cash adjustments that influence reported earnings without affecting real-time cash generation. As a result, analysts increasingly question

whether conventional measures adequately capture business fundamentals in capital-intensive or asset-light industries [13].

2.2.2 Taxation and Depreciation Distortions

Taxation policies vary significantly across jurisdictions and time periods, complicating net income comparisons for multinational firms. Changes in tax legislation, deferred tax assets, or tax credits can introduce volatility in reported earnings that do not stem from operational performance. Consequently, metrics like EPS and net margin may swing considerably due to tax effects alone [14].

Depreciation methods further add complexity. Straight-line and accelerated depreciation approaches can yield vastly different expense profiles over time, affecting both net income and ROI. These distortions are especially pronounced in industries with significant fixed asset bases, such as manufacturing and utilities, where depreciation forms a substantial component of total costs [15].

As firms increasingly invest in intangible assets like software and R&D—often capitalized inconsistently—traditional depreciation rules may fail to capture the economic consumption of these assets. In such cases, the disconnect between book depreciation and economic reality challenges the credibility of performance metrics built on conventional accounting data [16].

Given these limitations, there is a growing demand for normalized indicators that adjust for structural and policy-based distortions while retaining analytical clarity.

2.3 Emergence and Relevance of EBITDA

2.3.1 Historical Origins

The concept of **EBITDA (Earnings Before Interest, Taxes, Depreciation, and Amortization)** emerged in the 1980s as a tool to evaluate leveraged buyouts and capital-intensive businesses. Initially championed by investment bankers and private equity firms, EBITDA aimed to provide a cleaner measure of operational profitability by excluding factors that varied by capital structure, tax regimes, and accounting policies [17].

By stripping away interest, taxes, and non-cash expenses, EBITDA focused on earnings derived purely from operational activity, making it useful for comparing firms with differing financing or asset strategies. It gained popularity during the mergers and acquisitions boom, where analysts needed a neutral profitability gauge to assess cash flow potential under alternative ownership scenarios [18].

Over time, EBITDA became entrenched in financial modeling and valuation practices, particularly in enterprise value (EV)-based multiples such as EV/EBITDA. These ratios facilitated cross-industry comparisons and offered insights into business efficiency independent of financial engineering or local tax policies [19].

2.3.2 Use in Modern Financial Analysis

Today, EBITDA remains a widely used financial indicator across sectors, especially in private equity, telecommunications, and infrastructure. Its focus on **core operating performance** makes it appealing in environments where earnings are distorted by high depreciation charges or complex capital structures. Investors frequently use EBITDA as a proxy for cash flow in debt servicing and investment screening [20].

EBITDA also supports **valuation standardization**, allowing analysts to benchmark firms within industries regardless of their financing choices. For instance, two firms with identical operating models but different capital mixes may report vastly different net income, but similar EBITDA figures—revealing operational comparability [21].

However, critics caution against overreliance on EBITDA, particularly because it omits interest expenses (a real cost in leveraged firms) and neglects capital expenditure needs. Some companies have been known to manipulate adjusted EBITDA figures by excluding recurring costs, leading to inflated profitability perceptions [22].

Figure 1 offers a conceptual comparison of Net Income, EBIT, and EBITDA, illustrating how each metric progresses through layers of financial adjustments to isolate various dimensions of profitability.

In sum, while not a replacement for comprehensive analysis, EBITDA offers valuable insight when used alongside other metrics. It helps reconcile performance distortions and supports normalized comparison across complex corporate environments, highlighting its enduring relevance in modern financial analysis [23].

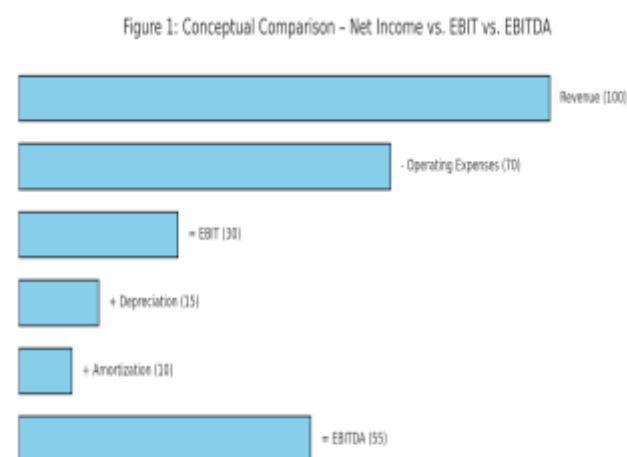


Figure 1: Conceptual Comparison – Net Income vs. EBIT vs. EBITDA

3. EBITDA EXPLAINED: STRUCTURE AND COMPONENTS

3.1 Definition and Formula of EBITDA

EBITDA, is a financial metric used to evaluate a company's operational profitability without the influence of financing decisions, tax policies, or accounting conventions. It is commonly considered a proxy for operating cash flow and is frequently used in comparative company analysis, private equity evaluation, and valuation modeling [9].

The standard formula for EBITDA is:

EBITDA = Net Income + Interest + Taxes + Depreciation + Amortization

Alternatively, it can also be derived from the income statement as:

EBITDA = Operating Income (EBIT) + Depreciation + Amortization

The dual formulations reflect whether one begins with net income or operating income. Regardless of the path, the aim remains to strip out costs that are not reflective of core operational efficiency. This includes financing costs (interest), state-imposed obligations (taxes), and non-cash accounting charges (depreciation and amortization) [10].

EBITDA is especially valuable for businesses in capital-intensive sectors or those undergoing restructuring. For instance, a manufacturing firm with large fixed assets may report low net income due to high depreciation charges, yet exhibit strong EBITDA reflecting operational strength. Similarly, early-stage firms that incur large amortization costs on intangible assets can still demonstrate promising business viability when analyzed through EBITDA [11].

Although not recognized under Generally Accepted Accounting Principles (GAAP) or International Financial Reporting Standards (IFRS), EBITDA has become an accepted performance benchmark in finance, provided it is used with transparency and consistency [12].

3.2 Non-Cash Items: Depreciation and Amortization

Depreciation and **amortization** are accounting mechanisms that allocate the cost of tangible and intangible assets, respectively, over their useful lives. They represent non-cash expenses that reduce reported net income, yet do not involve actual outflows of cash in the periods they are recognized [13].

Depreciation is typically applied to physical assets such as buildings, machinery, and equipment. It reflects wear and tear, obsolescence, or functional degradation. The choice of depreciation method—straight-line, declining balance, or units of production—can significantly affect earnings, despite no direct impact on cash flows. For instance, accelerated depreciation may lower taxable income in early years,

improving short-term liquidity, but reducing reported profits [14].

Amortization applies to intangible assets such as patents, trademarks, and software. Like depreciation, amortization spreads the acquisition cost over the asset's legal or estimated useful life. For technology companies and service-oriented firms, amortization charges can be substantial, especially when large investments are made in intellectual property or acquired goodwill [15].

By excluding depreciation and amortization, EBITDA aims to focus on the cash-generating capacity of the business before non-operational accounting treatments are applied. This is particularly relevant when comparing firms with different asset intensity levels or assessing performance across industries with varied accounting standards for fixed and intangible assets [16].

Nevertheless, it is essential to acknowledge that while depreciation and amortization are non-cash today, they reflect historical or anticipated capital investments. Overlooking these completely in long-term valuation models can result in overstated sustainability of free cash flow [17].

3.3 Exclusion of Interest and Tax Effects

3.3.1 Debt Neutrality

One of the most significant features of EBITDA is its **debt neutrality**—the intentional exclusion of **interest expenses** to isolate operational performance from capital structure. Companies with vastly different financing arrangements may report similar EBITDA even if their net income varies substantially due to debt servicing obligations. This allows investors and analysts to assess business productivity without the distortion of leverage levels [18].

For example, a firm operating with high levels of debt may have strong operating margins but low net income after interest payments. Conversely, a similar firm financed entirely with equity may show higher net income despite identical operations. By removing interest expenses, EBITDA enables a like-for-like comparison based solely on earnings before financial engineering [19].

This feature makes EBITDA particularly useful in merger and acquisition (M&A) analysis, where target companies are assessed independently of their existing capital structures. Buyers can reimagine financial leverage under their own debt frameworks, relying on EBITDA as a consistent profitability measure. It is also instrumental in evaluating debt service coverage ratios (DSCR) and loan covenants, especially in leveraged transactions [20].

3.3.2 Cross-Border Comparability

Another rationale for excluding **taxes** from EBITDA is to facilitate **cross-border comparability**. Tax regimes vary widely by jurisdiction, and corporate tax obligations are influenced by a myriad of factors including tax credits, loss

carryforwards, deferred liabilities, and government incentives. These variables introduce volatility in net income that is unrelated to a company's operational capability [21].

By excluding taxes, EBITDA allows analysts to compare multinational companies on a standardized operational basis. This is vital in globalized industries such as telecommunications, energy, and pharmaceuticals, where operations may span numerous tax jurisdictions. For instance, a pharmaceutical firm with R&D tax credits in one country may report lower taxes—and hence higher net income—than a competitor without similar incentives, despite comparable earnings before tax [22].

Furthermore, tax reforms—such as the U.S. Tax Cuts and Jobs Act or OECD's Base Erosion and Profit Shifting (BEPS) initiatives—can significantly affect bottom-line results across reporting periods. Removing tax effects from performance metrics ensures that operational analysis remains insulated from policy-driven fluctuations [23].

However, complete reliance on EBITDA may ignore real-world financial obligations. Taxes and interest, though excludable for analytical clarity, are eventually paid and affect cash availability. Thus, while EBITDA is a powerful tool for normalizing operating results, it must be contextualized with full financial disclosures and supplemental metrics to form comprehensive insights [24].

4. APPLICATIONS OF EBITDA IN FINANCIAL ANALYSIS

4.1 EBITDA in Corporate Valuation

4.1.1 EV/EBITDA Multiples

The **Enterprise Value to EBITDA (EV/EBITDA)** ratio is one of the most widely used valuation multiples in modern corporate finance. Enterprise value includes market capitalization, total debt, minority interest, and preferred shares, minus cash and equivalents—effectively capturing the entire economic value of a company. When divided by EBITDA, this ratio provides a standardized measure of how many times a company's EBITDA investors are willing to pay [12].

The EV/EBITDA multiple allows investors and analysts to evaluate a company's valuation while controlling for differences in capital structure, taxation, and accounting policies. Since EBITDA approximates operating profitability before these variables, the ratio is particularly useful in comparing firms across industries and geographies with varying financial and tax structures [13].

Lower EV/EBITDA multiples may indicate undervaluation or financial distress, while higher values could reflect market optimism or expected future growth. However, interpretation must consider industry norms and historical benchmarks. For instance, utilities and telecom sectors typically have lower EV/EBITDA multiples due to stable cash flows, while

technology firms often exhibit higher ratios reflecting growth potential [14].

4.1.2 Use in M&A and LBO Transactions

In mergers and acquisitions (M&A) and **leveraged buyouts (LBOs)**, EBITDA serves as a key determinant of valuation and transaction feasibility. Acquirers use EBITDA to estimate post-deal cash flow potential and determine acceptable purchase prices based on projected returns. A target company's EBITDA helps assess its ability to support debt in an LBO scenario, where financing relies heavily on future earnings [15].

Financial sponsors often structure deals using target EV/EBITDA multiples, considering synergy potential, cost-saving opportunities, and future scalability. This metric also supports sensitivity analyses under different performance assumptions. Thus, EBITDA becomes both a pricing tool and a risk assessment metric in high-stakes transaction environments [16].

4.2 EBITDA and Creditworthiness Analysis

4.2.1 Debt Service Coverage Ratios

EBITDA is essential in assessing a firm's **credit profile**, particularly through the **debt service coverage ratio (DSCR)** and related measures. The DSCR, typically calculated as EBITDA divided by total debt service (interest and principal repayments), evaluates whether a company generates sufficient earnings to meet its financial obligations [17].

A DSCR greater than 1.0 indicates that earnings can comfortably cover debt obligations, whereas a ratio below 1.0 may raise concerns about liquidity and solvency. Lenders often use forward-looking EBITDA estimates in structuring loan covenants, especially in syndicated loans and project finance arrangements. A predictable EBITDA trend reassures creditors of cash flow stability [18].

EBITDA-based DSCR is especially relevant in industries where capital expenditures are high, but earnings are relatively stable, such as energy, infrastructure, and logistics. In these sectors, EBITDA offers a cleaner signal than net income, which may fluctuate due to depreciation schedules or interest rate volatility [19].

4.2.2 Leverage Indicators

In addition to DSCR, **EBITDA is used to calculate leverage ratios**, such as **Net Debt/EBITDA**, which assess the burden of debt relative to the company's earnings capacity. This ratio informs decisions about refinancing, capital raising, or operational restructuring. A lower Net Debt/EBITDA ratio generally signals financial strength and a manageable risk profile [20].

Credit rating agencies rely heavily on EBITDA-based ratios to assign ratings and outlooks. For example, Standard & Poor's, Moody's, and Fitch consider both historical and adjusted EBITDA when evaluating issuer creditworthiness. These

assessments influence borrowing costs, bond issuance terms, and investor confidence [21].

Firms with stable or growing EBITDA levels often secure better credit terms and enjoy broader access to capital markets. Conversely, sudden declines in EBITDA may trigger covenant breaches, rating downgrades, or renegotiation of debt terms. This makes EBITDA not just a performance indicator but also a critical signal in credit risk management [22].

Table 1 presents average EV/EBITDA multiples across selected industries, reflecting the range of valuation norms based on capital intensity, risk profile, and growth outlook.

Table 1: Valuation Multiples Using EBITDA Across Selected Industries

Industry	Average EV/EBITDA Multiple	Commentary
Utilities	7.0–9.0	Stable cash flows, regulated returns
Telecommunications	6.5–8.5	High leverage but steady revenue
Consumer Goods	9.0–11.0	Moderate risk, brand equity valued
Technology	12.0–20.0	Growth-focused, high EBITDA margins
Healthcare	10.0–13.0	Resilient demand, R&D intensity
Manufacturing	6.0–9.0	Capital intensive, cyclical revenue
Real Estate	8.0–11.0	Asset-backed, sensitive to macroeconomic trends

4.3 Operational Benchmarking with EBITDA

4.3.1 Intra-Industry and Cross-Border Comparison

EBITDA enables **operational benchmarking** by facilitating performance comparisons across companies within the same industry or across national borders. Since it neutralizes differences arising from financing decisions and tax environments, EBITDA offers a more consistent basis for evaluating **core operating performance** [23].

Within an industry, companies can benchmark their EBITDA margins (EBITDA as a percentage of revenue) to understand relative efficiency. For instance, in the hospitality sector, where fixed costs are high, a firm with a 25% EBITDA

margin outperforms a peer operating at 15%. This comparison is valuable for identifying cost control opportunities, pricing effectiveness, and strategic positioning [24].

Cross-border benchmarking is particularly useful for multinational firms seeking acquisition targets or joint venture partners. Differences in tax regimes, accounting standards, and interest costs can distort net income comparisons. EBITDA mitigates these distortions, providing a common ground for assessing operational viability [25].

Furthermore, investors use EBITDA trends to gauge consistency and scalability. Firms demonstrating stable or improving EBITDA over multiple years are perceived as operationally sound and better positioned to withstand market shocks.

4.3.2 Adjustments for Normalization

While EBITDA is a standardized measure, analysts often apply **adjustments** to normalize figures for non-recurring or atypical items. These may include litigation expenses, restructuring charges, one-off impairments, or pandemic-related disruptions. The goal is to estimate a “normalized EBITDA” that reflects **sustainable earnings potential** [26].

For example, a company that reports a \$10 million EBITDA including \$2 million in one-time legal settlements might be adjusted to a normalized EBITDA of \$12 million. This adjusted figure is then used in valuation, debt analysis, or performance benchmarking to yield more accurate insights.

Additionally, **pro forma EBITDA** is often used in forward-looking projections, especially during M&A due diligence or IPO preparations. This version incorporates anticipated synergies, cost savings, or post-transaction changes. While helpful, pro forma estimates must be scrutinized for credibility and alignment with realistic assumptions [27].

Sector-specific adjustments are also common. In retail, seasonal fluctuations may distort EBITDA, prompting quarterly adjustments. In energy, commodity price shifts may lead to EBITDA smoothing across periods. These practices improve comparability and allow decision-makers to focus on core operational metrics rather than transient financial anomalies [28].

Ultimately, while EBITDA simplifies performance analysis by filtering out structural variables, it must be used alongside other metrics and contextual factors. Adjusted and normalized EBITDA enhance its interpretive value, especially in performance benchmarking, capital allocation, and strategic planning across diverse business environments [29].

5. PRACTICAL CONSIDERATIONS AND LIMITATIONS

5.1 Capital Intensity and Cash Flow Misrepresentation

5.1.1 CapEx Requirements and Omitted Cash Outflows

One of the major criticisms of EBITDA lies in its potential to **overstate financial performance** by excluding critical cash outflows such as capital expenditures (CapEx). While EBITDA is useful for evaluating operating profitability, it does not account for the investment required to sustain or grow the asset base—particularly in capital-intensive industries like manufacturing, energy, and infrastructure [15].

Companies in these sectors often incur substantial recurring CapEx for machinery maintenance, facility upgrades, and regulatory compliance. By omitting depreciation and amortization, EBITDA overlooks the cost associated with the wear and tear of capital assets. This omission can lead to misleading perceptions of free cash flow availability, especially when CapEx regularly exceeds depreciation expenses [16].

For example, an oil refinery may report a strong EBITDA margin, but if it requires frequent equipment replacement or pipeline investment, its **actual free cash flow** could be significantly lower. Investors focusing solely on EBITDA may therefore underestimate reinvestment risks or overvalue such firms relative to their true cash-generating capacity [17].

Moreover, **asset-heavy models** often exhibit low EBITDA-to-cash conversion, particularly when revenue growth demands continuous infrastructure expansion. In contrast, asset-light businesses such as digital platforms or consulting firms tend to convert EBITDA to cash more directly. As such, applying EBITDA uniformly across industries can result in distorted performance assessments and faulty valuation models [18].

Figure 2 illustrates this divergence by comparing EBITDA and free cash flow trends in capital-intensive firms, highlighting the mismatch between reported operating profits and actual cash retention over time.

To address this limitation, analysts often supplement EBITDA with capital efficiency ratios or use **Free Cash Flow (FCF)** as a more comprehensive measure of financial sustainability and value creation [19].

5.2 Adjusted EBITDA and Manipulation Risks

5.2.1 Pro Forma and One-time Adjustments

Another key concern in the application of EBITDA is the widespread use of **adjusted** or **pro forma EBITDA**, which can introduce significant subjectivity into performance reporting. While adjustments may be necessary to normalize figures for non-recurring items, excessive or discretionary modifications can distort financial transparency and inflate investor expectations [20].

Common adjustments include the exclusion of restructuring costs, legal settlements, stock-based compensation, and acquisition-related expenses. While these items may be non-core or irregular, some companies aggressively classify recurring expenditures as "one-time," resulting in inflated EBITDA figures. In some cases, companies have even removed recurring marketing costs or R&D expenses under the guise of normalization [21].

Pro forma EBITDA is especially prevalent in IPO filings and M&A negotiations, where firms aim to present the most favorable earnings profile. While forward-looking adjustments may reflect valid post-transaction expectations—such as cost synergies or margin expansion—they rely on management forecasts that can be difficult to verify. As a result, pro forma EBITDA should be scrutinized for credibility, consistency, and supportable assumptions [22].

Notably, regulators and analysts have raised concerns about **"EBITDA add-backs"**, where companies attempt to increase earnings figures through liberal adjustments without corresponding improvements in actual profitability. These practices can mislead stakeholders, especially when leveraged to justify higher valuations or credit ratings [23].

To mitigate manipulation risks, best practices recommend reconciling adjusted EBITDA with **audited GAAP metrics**, clearly disclosing all adjustment items, and ensuring alignment with industry standards. External auditors and investor analysts must remain vigilant in identifying opportunistic earnings enhancements that compromise comparability and reliability [24].

Ultimately, while adjusted EBITDA can provide useful insights into core performance, it must be applied with rigorous discipline and contextual awareness to avoid misleading financial interpretations.

5.3 Sectoral Sensitivity and Contextual Use

5.3.1 EBITDA Relevance by Sector (e.g., SaaS vs. Energy)

The utility of EBITDA varies significantly by industry, making **sectoral context** essential to its proper interpretation. In **capital-light industries** such as Software-as-a-Service (SaaS), consulting, or media, EBITDA often aligns closely with cash flow and profitability due to low fixed asset investments and limited financing complexity. As such, it serves as a robust indicator of operational scalability and efficiency [25].

SaaS firms, for instance, report high gross margins and relatively predictable cost structures, allowing EBITDA to serve as a leading indicator of enterprise value. These companies typically rely on subscription-based revenue models with low marginal costs, enabling strong EBITDA-to-cash conversion ratios. In this context, EBITDA is often used in calculating growth-adjusted valuation multiples, such as **EV/EBITDA-to-revenue growth ratios** [26].

In contrast, **energy and utilities sectors**, while benefiting from long-term contracts and stable earnings, require extensive capital expenditures and carry high debt loads. EBITDA, though helpful in comparing peer operations, can misrepresent financial health if viewed in isolation. For these firms, free cash flow, net income, and asset turnover ratios provide more comprehensive insights into capital discipline and return on investment [27].

Likewise, **retail and manufacturing sectors** experience variable EBITDA accuracy depending on inventory valuation methods, seasonality, and pricing volatility. In highly cyclical environments, EBITDA may obscure temporary performance shifts or structural inefficiencies. Analysts must therefore contextualize EBITDA trends within broader operational dynamics and market cycles [28].

In **regulated industries** such as healthcare or telecommunications, EBITDA may also require normalization for compliance costs, pricing controls, or licensing structures. Failure to adjust for such variables can lead to inappropriate benchmarking and flawed strategic decisions [29].

In conclusion, while EBITDA remains a valuable analytical tool, its **interpretive accuracy hinges on sectoral alignment**. Analysts must apply industry-specific filters, incorporate complementary metrics, and evaluate EBITDA trends alongside strategic, financial, and operational indicators to form well-rounded evaluations of firm performance [30].

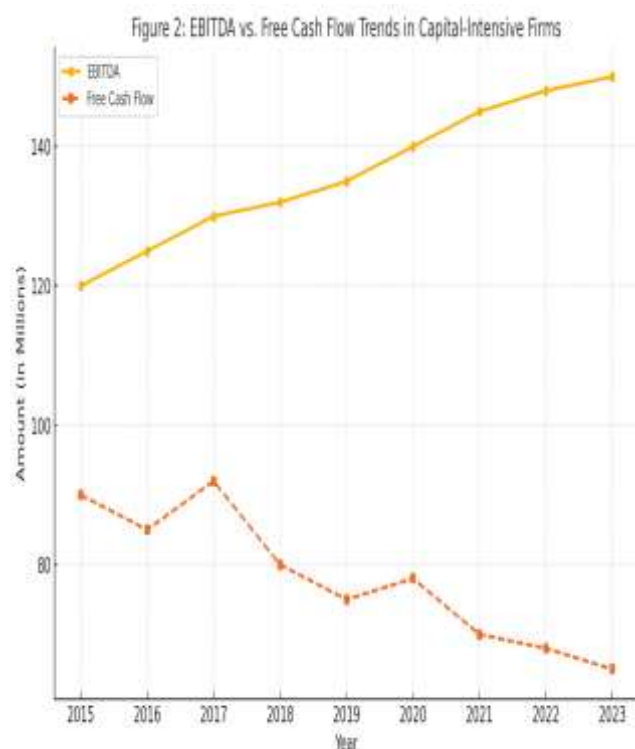


Figure 2: EBITDA vs. Free Cash Flow Trends in Capital-Intensive Firms

6. COMPARATIVE ANALYSIS WITH OTHER FINANCIAL METRICS

6.1 EBITDA vs. Operating Cash Flow

6.1.1 Working Capital Effects and True Liquidity

While EBITDA is often cited as a proxy for cash flow, it does not directly measure **operating cash flow (OCF)**, which includes changes in **working capital** and other operating inflows or outflows. This distinction is critical in evaluating a firm's true liquidity and near-term solvency [19]. Unlike EBITDA, OCF is derived from the cash flow statement and adjusts for actual cash inflows and outflows from operational activities, including changes in receivables, payables, and inventory.

For instance, a firm with growing revenues and stable EBITDA might still face cash shortages if its receivables increase or inventory accumulates disproportionately. These working capital requirements tie up cash, delaying its availability for other uses such as debt repayment or dividend distribution [20]. EBITDA fails to reflect these liquidity pressures because it ignores the timing and variability of cash movements.

In contrast, OCF provides a **real-time view of operational cash generation**, making it a better metric for evaluating a company's ability to fund day-to-day operations. This is especially important in businesses with long billing cycles or seasonality, such as construction or retail, where receivables and inventory levels fluctuate significantly throughout the year [21].

Moreover, OCF incorporates **non-EBITDA items** such as interest payments, taxes paid, and non-operating cash flows—offering a more comprehensive perspective. For creditors and equity investors concerned about short-term cash adequacy, OCF is a preferred measure for covenant compliance, dividend safety, and financial stress testing [22].

Thus, while EBITDA serves as a useful starting point for operational performance, **OCF provides deeper insight into liquidity and working capital efficiency**, particularly in cash-sensitive or cyclical sectors [23].

6.2 EBITDA vs. Net Income and EBIT

6.2.1 Accrual and Financing Impact

EBITDA, net income, and EBIT represent different stages of the income statement, each influenced by various elements of financial structure and accounting treatment. **EBIT (Earnings Before Interest and Taxes)** reflects operating income after accounting for depreciation and amortization, making it a GAAP-compliant measure of operational profitability. In contrast, **net income** captures the full impact of taxes, interest, and non-operating items, representing the bottom-line earnings attributable to shareholders [24].

Compared to these two, EBITDA offers a more **“stripped-down” measure**, eliminating non-cash and financing-related components. However, its exclusion of interest and taxes makes it **insensitive to financial leverage**, potentially overstating profitability in highly leveraged firms. Meanwhile, EBIT includes depreciation and amortization, which are critical for understanding the **capital intensity** of operations—an omission that limits EBITDA’s precision in CapEx-heavy sectors [25].

Additionally, net income incorporates **accrual accounting** elements such as deferred taxes, unrealized gains/losses, and provisions, making it susceptible to earnings management. EBITDA attempts to neutralize these elements to focus on cash-generative capacity, but at the cost of ignoring genuine liabilities or recurring obligations. For example, a firm with high pension expenses or legal provisions may report robust EBITDA but weak net income, revealing long-term financial stress not captured by EBITDA alone [26].

Ultimately, the choice between EBITDA, EBIT, and net income depends on **analytical goals**. While EBITDA emphasizes operational scale, EBIT focuses on core efficiency, and net income highlights shareholder profitability. Comparing them in tandem enhances interpretive depth across financial assessments [27].

6.3 Case Comparison: Tech vs. Industrial Firms

A comparative analysis of EBITDA’s utility in **technology** versus **industrial firms** reveals important differences in interpretive relevance and financial context. Technology companies, particularly in the SaaS and digital services sectors, tend to have minimal capital expenditures and limited tangible assets. Their EBITDA margins often align closely with free cash flow due to the asset-light nature of their operations and high gross margins [28].

For example, a software company generating recurring subscription revenue can produce consistent EBITDA that tracks closely with cash flow from operations. Because such firms incur lower depreciation and amortization charges, EBITDA becomes a near-equivalent of operational cash flow, making it a **reliable valuation proxy**. Moreover, their business models often rely on rapid scalability rather than large infrastructure investments, reducing the distortion caused by CapEx exclusions [29].

Conversely, industrial firms such as automobile manufacturers or construction equipment producers operate in asset-heavy environments with significant depreciation and financing costs. These firms may show strong EBITDA but require substantial reinvestment in machinery and facilities. Consequently, EBITDA in these cases **diverges from free cash flow**, and reliance on it without context can misrepresent economic performance.

In capital-intensive sectors, analysts supplement EBITDA with **capital turnover ratios**, **CapEx-to-sales metrics**, and **return on invested capital (ROIC)** to assess value creation.

Additionally, adjusted metrics such as EBITDAR (EBITDA + Rent) may be used in leasing-heavy industries to reflect full operational obligations [30].

The comparison underscores that **EBITDA’s effectiveness is sector-contingent**, and its interpretation must consider business models, asset intensity, and reinvestment needs to avoid flawed financial conclusions.

Table 2: Correlation Matrix – EBITDA and Alternative Metrics

Metric Pair	Tech Sector Correlation (R²)	Industrial Sector Correlation (R²)
EBITDA vs. Free Cash Flow	0.88	0.54
EBITDA vs. Net Income	0.75	0.62
EBITDA vs. Operating Cash Flow	0.91	0.67
EBIT vs. Net Income	0.81	0.84
Free Cash Flow vs. Net Income	0.69	0.71

7. INDUSTRY CASE STUDIES

7.1 EBITDA in Capital-Intensive Manufacturing

In **capital-intensive manufacturing**, EBITDA is frequently used to assess operational efficiency; however, it often falls short as a standalone measure of financial performance. Manufacturing firms typically maintain large fixed asset bases requiring ongoing capital expenditures for machinery upgrades, plant maintenance, and regulatory compliance. EBITDA’s omission of **depreciation and amortization** can therefore present a skewed view of profitability [23].

For instance, two companies with similar EBITDA margins may have vastly different capital expenditure requirements. One may invest heavily in upgrading production lines, while another operates on depreciated legacy equipment. In such cases, reliance solely on EBITDA fails to capture true cash retention and sustainability of operations [24].

Furthermore, **working capital volatility** in manufacturing—due to inventory build-up, raw material procurement, and supplier payment cycles—further distorts the relationship between EBITDA and actual cash flows. Thus, analysts in this sector often pair EBITDA with **free cash flow**, **CapEx ratios**,

and **return on assets (ROA)** to obtain a complete picture of financial health [25].

Nevertheless, EBITDA remains useful for internal benchmarking and peer comparison, particularly when normalized across similar operating models. It also plays a role in debt covenant calculations, where consistent operating profit levels are needed to support asset-based lending [26].

Ultimately, in manufacturing, EBITDA is best viewed as a **supplementary indicator**, valuable for performance tracking but insufficient for long-term valuation without deeper capital intensity adjustments.

7.2 EBITDA in Asset-Light Technology Firms

In contrast to capital-intensive industries, **asset-light technology firms** find EBITDA to be a much more representative measure of financial performance. Businesses in sectors such as **Software-as-a-Service (SaaS)**, **fintech**, and **online platforms** generally exhibit low depreciation and minimal physical infrastructure, making EBITDA closely aligned with operational cash flows [27].

SaaS companies, for example, operate subscription-based models with predictable recurring revenue and high gross margins. These firms often incur front-loaded expenses—like customer acquisition costs—that are expensed immediately rather than capitalized. As a result, net income may appear suppressed during growth phases, while EBITDA reflects the underlying business viability more clearly [28].

Moreover, technology firms frequently invest in intangible assets such as R&D and intellectual property, which may be expensed under GAAP but excluded in adjusted EBITDA formulations. This makes EBITDA a valuable tool for investors assessing scalability and **long-term profitability potential**, especially in early-stage companies where earnings are volatile [29].

Figure 3 demonstrates that average EBITDA margins in technology tend to exceed those in capital-intensive sectors, largely due to lower fixed costs and limited asset maintenance requirements. Many firms also report **adjusted EBITDA** to normalize for stock-based compensation or development expenses—though these adjustments must be scrutinized for consistency [30].

However, over-reliance on EBITDA in this sector can still obscure investment needs in talent, innovation, and platform security. Thus, while highly relevant, EBITDA in technology firms should be paired with **growth metrics**, **customer lifetime value (CLTV)**, and **burn rate analyses** to assess full economic resilience [31].

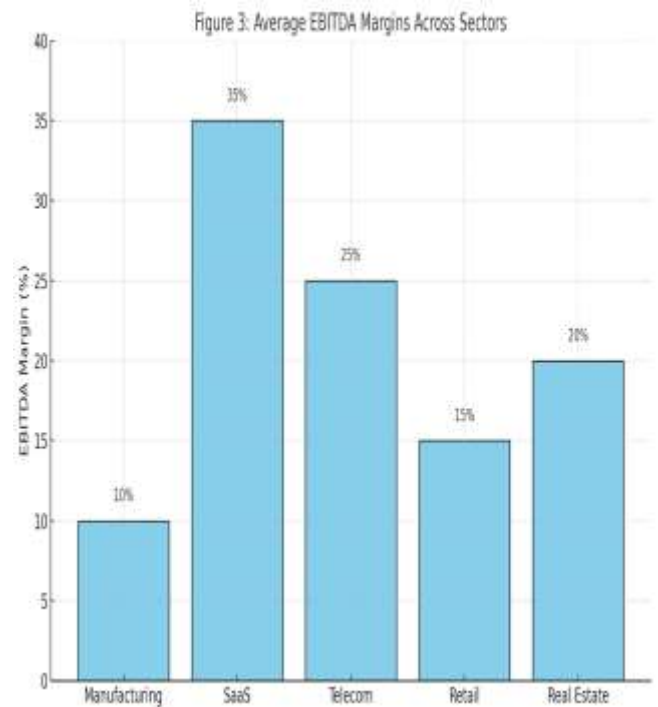


Figure 3: Average EBITDA Margins Across Sectors

7.3 Financial Services and Real Estate

In **financial services**, EBITDA is less commonly used as a primary performance metric due to the sector's unique structure. Financial institutions such as banks, insurance companies, and asset managers operate with fundamentally different financial models, where **interest income**, **regulatory capital**, and **risk-weighted assets** define performance more than operating earnings alone [32].

Unlike industrial or service firms, financial institutions do not typically incur depreciation in the same way. Their profitability hinges on **net interest margin (NIM)**, **fee income**, and **capital adequacy**, making **net income**, **ROE**, and **Tier 1 capital ratios** more appropriate for evaluation. As such, EBITDA often fails to capture the regulatory and credit risk dynamics intrinsic to financial entities [33].

However, in certain **non-bank financial institutions (NBFIs)**—such as leasing firms, fintech lenders, and credit bureaus—EBITDA may still hold relevance for comparing cost structures or operational efficiency. Even then, analysts must isolate EBITDA contributions from financial revenues to ensure meaningful interpretation [34].

In **real estate**, particularly among Real Estate Investment Trusts (REITs), EBITDA is more useful but still insufficient without key sectoral adaptations. Many REITs rely on **EBITDAre** (EBITDA for real estate), which adjusts for gains or losses on asset sales, impairments, and acquisition expenses [38]. This modified metric better reflects cash-generating capacity of real estate portfolios under fair value accounting standards [35].

Additionally, EBITDA may not fully reflect property-specific metrics such as **Net Operating Income (NOI)**, **Funds from Operations (FFO)**, or **Adjusted Funds from Operations (AFFO)**, all of which are more tailored to real estate performance. These metrics capture rental income stability, occupancy rates, and property-level expenses—factors that significantly impact cash flow sustainability and dividend capacity [36].

Table 3 below compares the effectiveness of EBITDA across sectors, identifying contexts where it offers high, moderate, or low interpretive value based on asset structure, revenue model, and reinvestment needs [37].

Table 3: Effectiveness of EBITDA by Industry

Sector	EBITDA Relevance	Key Considerations
Capital-Intensive Manufacturing	Moderate	Must adjust for CapEx and depreciation
Technology (SaaS)	High	Closely aligned with cash flows; consider R&D expensing
Financial Services	Low	Better alternatives include ROE, NIM, and Tier 1 Capital
Real Estate (REITs)	Moderate–High	Use sector-specific variants like EBITDAre and FFO
Telecommunications	High	EBITDA useful due to long asset lives and regulated pricing
Retail	Moderate	Seasonality and working capital impact EBITDA–cash alignment

8. STRATEGIC AND REGULATORY PERSPECTIVES

8.1 EBITDA in Executive Compensation and Strategic KPIs

EBITDA has increasingly become a cornerstone of **executive compensation frameworks** and strategic performance measurement. Many public companies now tie annual bonuses and long-term incentive plans to EBITDA targets, positioning it as a key performance indicator (KPI) for operational success [25]. This trend is driven by EBITDA’s perceived

alignment with core earnings, cash flow generation, and shareholder value creation.

Unlike net income, which can fluctuate due to tax effects or capital structure decisions, EBITDA provides a smoother earnings trajectory, offering executives more consistent performance benchmarks. For growth-focused firms—particularly in technology, infrastructure, and private equity—EBITDA-linked bonuses are designed to reward managers for improving operational efficiency and cost control [26].

However, this reliance on EBITDA for incentive structuring introduces risks. Executives may be incentivized to pursue short-term EBITDA growth at the expense of long-term investment, product development, or capital maintenance. Furthermore, because EBITDA excludes depreciation, amortization, and financing costs, it may encourage aggressive capital expansion or debt-financed growth that inflates short-term results while undermining long-term sustainability [27].

To mitigate these risks, some organizations adopt **adjusted EBITDA** targets, which normalize for one-off items and reduce volatility. Others use a blend of metrics—combining EBITDA with revenue growth, return on invested capital (ROIC), and total shareholder return (TSR)—to balance operational performance with strategic outcomes [28].

Overall, while EBITDA offers measurable clarity in performance-based compensation, governance bodies must ensure it is contextualized within a **multi-metric framework** that aligns with broader corporate objectives and shareholder interests [29].

8.2 Regulatory Scrutiny and Non-GAAP Reporting Standards

8.2.1 SEC and IFRS Views

Given its exclusion from GAAP and IFRS, EBITDA has drawn growing **regulatory attention**, particularly concerning its use in earnings releases and investor presentations. The **U.S. Securities and Exchange Commission (SEC)** permits the disclosure of non-GAAP measures such as EBITDA but mandates that they be presented **alongside the most directly comparable GAAP figures**, such as net income or operating profit [30]. Moreover, companies must explain the rationale behind using such metrics and provide reconciliations to ensure transparency.

The **SEC has expressed concern** about the increasing reliance on adjusted or “tailored” EBITDA figures that exclude recurring costs or reclassify standard expenses. These practices can mislead investors by portraying an inflated picture of profitability. The agency has issued comment letters and enforcement actions where disclosures were found to be inconsistent or lacking adequate explanation [31].

Similarly, under **IFRS**, EBITDA is not a defined performance metric. The International Accounting Standards Board (IASB) discourages overreliance on non-IFRS measures in financial

reporting without clear contextual support. Companies reporting under IFRS are expected to exercise caution when promoting EBITDA figures and must disclose reconciliation with standard income metrics [32].

8.2.2 Disclosure Guidance

To guide issuers, the SEC issued Regulation G and Item 10(e) of Regulation S-K, which govern the use of non-GAAP disclosures. These rules emphasize that non-GAAP metrics like EBITDA must not be given undue prominence over GAAP numbers, and any adjustments must be clearly described and consistently applied [33].

Best practices include transparent labeling, reconciliation tables, and footnotes explaining each adjustment. Companies are also encouraged to avoid using EBITDA in performance narratives unless supported by balanced discussion of its limitations and appropriate GAAP references [34].

In an era of increasing investor activism and regulatory scrutiny, disciplined reporting and disclosure around EBITDA remain central to maintaining credibility and ensuring compliance with evolving financial governance standards [35].

9. EMERGING TRENDS AND FUTURE ALTERNATIVES

9.1 Rise of Adjusted Metrics and ESG Considerations

The increasing complexity of corporate performance has led to the **proliferation of adjusted financial metrics**, often customized to better reflect company-specific realities. Adjusted EBITDA—commonly tailored to exclude non-recurring costs, stock-based compensation, and restructuring charges—is now widely adopted in earnings releases, investor decks, and credit analyses [28]. These metrics allow firms to present a “normalized” view of profitability, particularly during transitional phases such as M&A, market entry, or strategic realignment.

However, this evolution has also been shaped by the **emergence of Environmental, Social, and Governance (ESG)** considerations. Investors are now evaluating company performance not only through financial lenses but also by examining sustainability, ethical governance, and stakeholder engagement. As a result, non-GAAP metrics are increasingly being blended with **ESG performance indicators**, prompting the rise of integrated dashboards that combine adjusted EBITDA with carbon intensity, employee turnover, and supply chain diversity metrics [29].

Rating agencies, institutional investors, and proxy advisors are beginning to require **adjusted performance disclosures that incorporate ESG materiality**. For instance, a company’s carbon-adjusted EBITDA or “green EBITDA” may exclude revenues from non-sustainable activities or integrate penalties for high emissions. These hybrid metrics

seek to align financial outcomes with long-term societal value creation [30].

While these trends expand the performance narrative, they also present challenges in standardization, assurance, and interpretation. As such, companies are encouraged to **disclose adjustment criteria transparently**, articulate ESG relevance to financial outcomes, and avoid overstating ESG contributions in pursuit of valuation premiums [31].

9.2 Role of Technology and AI in Metric Evolution

Technology is transforming how performance metrics are calculated, interpreted, and applied. In particular, **Artificial Intelligence (AI)** and machine learning models are enabling a new generation of **predictive financial analytics**, including “**Predictive EBITDA**”—the forward-looking estimation of operational earnings using real-time data, behavioral trends, and macroeconomic inputs [32].

Unlike traditional static projections, predictive EBITDA incorporates AI-driven insights derived from customer churn models, production efficiency metrics, sales pipeline data, and industry sentiment analysis. These models dynamically update forecasts, allowing firms and investors to anticipate performance fluctuations with greater precision [33]. This capability is especially useful in volatile sectors such as retail, logistics, and energy, where external variables significantly influence financial outcomes.

AI is also facilitating the **integration of sustainability data into financial modeling**. Through natural language processing (NLP), image recognition, and satellite data analysis, companies can quantify ESG factors and correlate them with financial indicators. For instance, AI can assess how improvements in energy efficiency correlate with EBITDA margins or how workforce diversity influences productivity ratios [34].

Moreover, blockchain and cloud-based reporting platforms are enhancing **data transparency and auditability**, allowing adjusted and predictive metrics to be traced, verified, and contextualized across stakeholder groups. These technologies are expected to underpin the next generation of financial dashboards—offering real-time, interactive, and stakeholder-aligned analytics [35].

As performance measurement evolves, firms that embrace **technological integration and ESG alignment** will be better positioned to meet investor expectations and sustain long-term valuation advantages in increasingly data-driven capital markets [36].

10. CONCLUSION

10.1 Summary of Key Findings

This article has explored the multifaceted role of EBITDA as a financial performance metric across a wide range of applications and industries. Initially developed as a tool to isolate operational earnings from financing, tax, and non-cash

factors, EBITDA has become a cornerstone in corporate valuation, debt analysis, and executive compensation. Its popularity stems from its simplicity, consistency, and comparative flexibility, especially in sectors with predictable cash flows or asset-light models.

However, the analysis also highlighted EBITDA's limitations—most notably its exclusion of capital expenditures, working capital changes, and financing costs. These omissions can misrepresent liquidity, sustainability, and capital efficiency, particularly in asset-heavy or regulated sectors. Furthermore, the increasing use of adjusted EBITDA and pro forma estimates introduces subjectivity and potential for manipulation.

Industry-specific insights demonstrate that EBITDA is highly useful in technology and service sectors but less informative in banking or capital-intensive manufacturing without supplemental analysis. The integration of ESG metrics and technological tools like predictive analytics is also reshaping how EBITDA is interpreted, adding new dimensions of value and risk assessment.

Ultimately, while EBITDA remains a valuable financial lens, it should be part of a broader, context-aware performance measurement framework.

10.2 Balanced Interpretation and Best Practices

To maximize the utility of EBITDA in financial decision-making, practitioners must interpret the metric within the right strategic and operational context. Rather than relying on EBITDA in isolation, analysts and investors should use it alongside complementary indicators such as free cash flow, net income, return on invested capital, and sector-specific metrics.

Best practices for EBITDA application include clear disclosure of adjustments, reconciliation to GAAP or IFRS figures, and consistency in calculation methodology across reporting periods. Transparency in what is included or excluded from adjusted EBITDA builds investor confidence and strengthens internal governance. Companies should avoid overuse of discretionary add-backs that inflate perceived earnings strength.

For executive compensation, EBITDA-based targets should be supplemented with long-term strategic KPIs to align managerial incentives with sustainable value creation. Similarly, in M&A or leveraged finance, EBITDA should be stress-tested under various scenarios to ensure reliable debt service projections.

As financial reporting evolves, integrating non-financial indicators—such as ESG performance or operational resilience—will enhance the interpretive value of EBITDA. A balanced, multidimensional approach supports more accurate valuation, risk assessment, and strategic planning in today's increasingly complex financial landscape.

10.3 Final Thoughts and Recommendations

EBITDA remains a relevant and powerful tool in modern finance, but its effectiveness depends on **how thoughtfully and transparently it is applied**. Companies should treat EBITDA not as a replacement for comprehensive analysis but as a starting point for understanding operational health.

Moving forward, organizations should invest in analytical systems that contextualize EBITDA within a broader narrative of value creation—blending financial, operational, and ESG data. Regulators, boards, and investors should continue advocating for **responsible use and clear disclosure**, ensuring EBITDA evolves in tandem with global expectations for financial integrity and sustainable performance.

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