SunCoast
MERGERS AND ACQUISITION CONSULTANTS

UNDERSTANDING ADJUSTED EBITDA

Why Normalized Earnings Can Be One of the Most Important Numbers in an Insurance Agency Transaction.



EBITDA Is the Starting Point



When an insurance agency owner begins preparing for a potential sale, EBITDA often becomes one of the first financial measurements discussed. EBITDA - Earnings Before Interest, Taxes, Depreciation, and Amortization - helps buyers evaluate operating performance before certain financing, tax, and non-cash accounting items.

For a privately held agency, however, reported EBITDA may not tell the entire story. The business may include owner-related, discretionary, unusual, or non-recurring expenses that do not accurately represent normalized operations under new ownership. That is where **Adjusted EBITDA** enters the discussion.

What Is Adjusted EBITDA?

Adjusted EBITDA begins with reported EBITDA and makes appropriate adjustments intended to present a more representative view of the agency's ongoing earning capacity.

The objective is not to artificially increase earnings. It is to identify legitimate differences between the way the business is currently operated and the way a rational new owner would expect it to operate after a transaction.

A useful principle is: **Adjusted EBITDA isn't about making your earnings look better. It's about making them more representative.**

A Simple Example

Assume an insurance agency reports $500,000 of EBITDA. A review identifies $30,000 of excess owner compensation above a reasonable replacement cost, $20,000 of documented personal or discretionary expenses, and a $25,000 legitimate one-time expense.

Those proposed adjustments total $75,000, producing proposed Adjusted EBITDA of $575,000. The word proposed matters because the buyer will generally review the adjustments rather than automatically accepting them.

Three EBITDA Numbers an Owner May Encounter

During a transaction, an owner may effectively encounter three numbers: **reported EBITDA** from the financial statements; **seller-proposed Adjusted EBITDA** based on identified and supported adjustments; and **buyer-accepted Adjusted EBITDA** after diligence and negotiation.

The bridge between those numbers can be extremely important. A buyer may accept some adjustments, modify others, or reject them entirely depending on the facts and supporting evidence.



Replacement Owner Compensation

Owner compensation is a common area of analysis. If an owner receives $250,000 but performs duties that would require a replacement executive or producer costing $150,000, it would generally be misleading to simply add back the entire $250,000 and assume the business can operate without replacing the owner's work.
The analysis should focus on the reasonable cost of replacing the responsibilities that must continue. In this simplified example, the potential adjustment would be the difference - $100,000 - rather than the full amount of owner compensation.



What Makes an Adjustment Supportable?

A buyer will typically want to understand whether the expense is truly non-recurring, whether it will actually disappear after closing, whether another expense will replace it, whether it is connected to generating the revenue being valued, and whether the seller can document the amount.

Strong adjustments usually have a clear explanation and a clear financial trail. Weak adjustments often depend on assumptions about future savings or attempt to remove normal operating costs while keeping all of the revenue those costs helped produce.

What Should Not Automatically Be Adjusted?

Necessary employees, recurring marketing, normal technology costs, compliance expenses, and other costs required to operate the agency should not simply be removed because a seller believes a buyer might manage them differently.

Likewise, projected post-closing cost savings can receive buyer pushback when the savings have not actually been realized. Adjusted EBITDA should reflect normalized economics, not an optimistic future budget created solely for the transaction.



Documentation Creates Credibility

A well-prepared Adjusted EBITDA bridge should identify each adjustment, show where it appears in the financial statements or general ledger, state the amount, explain the rationale, and include supporting documentation when appropriate.

This preparation helps buyers follow the seller's logic and can be particularly valuable during due diligence or a Quality of Earnings review. A shorter list of defensible adjustments can be more persuasive than a long list of aggressive ones.

Why Adjusted EBITDA Can Affect Valuation

If a buyer applies an EBITDA multiple as part of its valuation methodology, changes in accepted Adjusted EBITDA can have a multiplied effect on enterprise value.

Using the simplified example above, $500,000 of EBITDA at an illustrative 7x multiple implies $3.5 million of enterprise value. $575,000 at the same multiple implies $4.025 million - a $525,000 difference. Actual valuation methods, multiples, accepted adjustments, and deal terms vary, but the example demonstrates why the EBITDA bridge deserves attention before an agency goes to market.

Prepare the Number
Before the Buyer Does



Agency owners should not wait until an LOI arrives or diligence begins to understand Adjusted EBITDA. Reviewing the financials in advance provides time to identify potential adjustments, eliminate weak assumptions, gather documentation, and understand how a buyer may challenge the presentation.

At **SunCoast Consulting Group**, we help health, life, Medicare, and employee benefits agency owners understand the bridge from reported EBITDA to Adjusted EBITDA and prepare a financial presentation they can explain, support, and defend.

Understand the number. Document the bridge. Defend the value.



SunCoast Consulting Group

Helping Agency owners understand their true value, prepare for transactions, and make informed decisions.

Educational content only. Illustrative examples are not valuations or guarantees of transaction value.
Actual deal terms and valuations vary.