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The Death of EBITDA

Increasingly "deal value" is driven by Intellectual Capital. Intellectual Capital includes a wide range of intangibles: Talented Workforce, Ability to Innovate, Leadership, Loyal Customers, or Brand Recognition. These intellectual assets are flipping the traditional EBITDA model on its head. This is evident by acquisitions driven by intellectual capital (IC). Take for example a valuation of $ 10 Billion assigned to SnapShot which has no sales revenues. How can this company be valued at $ 10 Billion with no EBITDA? SnapShot is a social application now used by 9% of all Smart Phone owners. These types of examples are becoming common place. Take for example the acquisitions of highly innovative companies such as FlipKart, Dropbox, Square and WhatsApp. All of these deals were IC driven and not guided by EBITDA.

What makes this interesting is how traditional EBITDA multiples have been thrown out the window. This is due in part to the absence of measurable EBITDA associated with IC. Just look at companies such as Apple which hit a $ 500 billion market capitalization in 2013 or Google which hit a market capitalization of $ 400 billion in 2014. As one Analyst explained it – the market place is rewarding these companies for their ability to innovate going forward.

In order to wrap your arms around this Non-EBITDA IC world, you have to ask some rather subjective type questions:

- What are the industry wide uses and applications of the intellectual assets
- What development opportunities exist for these intellectual assets
- How do the intellectual assets integrate with our company's strategy for growth

Google seems to execute well on this strategy. Since 2001, Google has acquired over 100 companies; mostly startups that help Google reduce the development life cycle in a wide range of areas – online advertising, mobile apps, data mapping tools and cloud computing. It's worth noting that over 60% of the founders for these startups are still with Google. So the intellectual assets do not walk out the door. Not only does Google retain intellectual capital, but it leverages the IC for further acquisitions. As Neal Mahan, founder of DoubleClick (acquired by Google in 2007 for $ 3.1 Billion) explains, I am directly involved in evaluating new acquisitions for Google. Google has a culture that rewards risk takers. According to Ramsey Allington, Head of M&A Integration for Google: "Larry and Sergey (who founded Google) are scientists and they believe in allowing people to fail. Yes, it costs time and money, but that kind of exploration is what makes us who we are."

A final observation about Intellectual Capital – it’s not confined to startups or high tech companies. Almost every industry is now driven predominately by IC. So this begs a simple question – are we witnessing the death of EBITDA? Many experts, including IP (Intellectual Property) attorneys, think so. And judging by the market values for many of these companies, EBITDA no longer fits. Are you ready for this new world of valuations?

“America's economy has been transformed from a twentieth-century materials-based economy to the Age of the Conceptual-Based Economy—and the currency of this realm is ideas and knowledge. Today's corporations must prepare to seize the advantages of this new age, or watch as others that are more ready and willing to do so replace them.” – Mind Over Matter: Why Intellectual Capital is the Chief Source of Wealth by Ronald J. Baker