

What are "Discretionary Earnings"?

The term "Discretionary Earnings" has been defined by the International Business Brokers Association (IBBA) as a substitute for terms such as Owner's Discretionary Cash and Owner's Cash Flow. It is a critical component of establishing the value of a business.

The IBBA defines discretionary earnings as the earnings of a business prior to (or "adding back") the following items:

- Income taxes
- Nonrecurring income and expenses
- Non-operating income and expenses
- Depreciation and amortization
- Interest expense or income
- Owner's total compensation for one owner/operator, after adjusting the total compensation of all other owners to market value
- Prerequisites -- Expenses incurred at the discretion of the owner, which are unnecessary to the continued operation of the business. Once the actual owner's Discretionary Earnings have been established, a multiple can be applied to that number to arrive at a valuation. One potential modification of this concept would be to deduct capital expenditures necessary to maintain the fixed assets of a business.