Times Interest Earned ratio (EBIT or EBITDA divided by total interest payable) measures a company's ability to honor its debt payments.

**LEARNING OBJECTIVE**

- Use a company's index coverage ratio to evaluate its ability to meet its debt obligations

**KEY POINTS**

- **Times interest earned (TIE) or Interest Coverage ratio** is a measure of a company's ability to honor its debt payments. It may be calculated as either EBIT or EBITDA divided by the total interest payable.

- Interest Charges = Traditionally "charges" refers to interest expense found on the income statement.

- EBIT = Revenue – Operating expenses (OPEX) + Non-operating income.

- EBITDA = Earnings before interest, taxes, depreciation and amortization.

- Times Interest Earned or Interest Coverage is a great tool when measuring a company’s ability to meet its debt obligations.

**TERM**

- **Non-operating income**

  Non-operating income, in accounting and finance, is gains or losses from sources not related to the typical activities of the business or organization. Non-operating income can include gains or losses from investments, property or asset sales, currency exchange, and other atypical gains or losses.

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Times-Interest-Earned = EBIT or EBITDA / Interest charges

Interest rates of working capital financing can be largely affected by discount rate, WACC and cost of capital.

Times-Interest-Earned = EBIT or EBITDA / Interest charges
Interest Charges = Traditionally "charges" refers to interest expense found on the income statement.

EBIT = Earnings Before Interest and Taxes, also called operating profit or operating income. EBIT is a measure of a firm’s profit that excludes interest and income tax expenses. It is the difference between operating revenues and operating expenses. When a firm does not have non-operating income, then operating income is sometimes used as a synonym for EBIT and operating profit.

EBIT = Revenue – Operating Expenses (OPEX) + Non-operating income.

Operating income = Revenue – Operating expenses.

EBITDA = Earnings Before Interest, Taxes, Depreciation and Amortization. The EBITDA of a company provides insight on the operational profitability of the business. It shows the profitability of a company regarding its present assets and operations with the products it produces and sells, taking into account possible provisions that need to be done.

If EBITDA is negative, then the business has serious issues. A positive EBITDA, however, does not automatically imply that the business generates cash. EBITDA ignores changes in Working Capital (usually needed when growing a business), capital expenditures (needed to replace assets that have broken down), taxes, and interest.

Times Interest Earned or Interest Coverage is a great tool when measuring a company’s ability to meet its debt obligations. When the interest coverage ratio is smaller than 1, the company is not generating enough cash from its operations EBIT to meet its interest obligations. The Company would then have to either use cash on hand to make up the difference or borrow funds. Typically, it is a warning sign when interest coverage falls below 2.5x.