Valuation for Sale

By Michael Neidle

It's been some ride for the past several years. Staffing and recruiting firms have had more business than they can handle. The biggest problem has been finding enough candidates to meet clients' needs, never mind internal staff. Now that the economy has slowed, more candidates are trickling onto the job market. At the same time, some employers are downsizing or deferring hiring of permanent staff, others are taking more time to hire permanent staff, and the demand for temporary help has slowed sharply.

Where does that leave staffing? That depends to a great extent on the sector. In a slowdown, perm falls hardest; clients only replace essential staff when they have turnover. Perm also stays down the longest, because when customers begin growing again they commonly begin by hiring temps, in case the recovery doesn't last. Temp, which typically declines first, can remain flat for the duration but tends to become counter-cyclical in a recession.

"The real question, of course, is 'Where are we now?'" says Optimal Management's Michael Neidle. "If you go back about 40 years, about every seven to nine years we go through a cycle of recession and recovery. In this last period, we went from the beginning of the recession in 1989 to reach a growth peak in 2000. That's 11 years, the longest period we've seen since we've been looking at the numbers, so we were probably overdue for a downturn. The next question is: 'How far is it going to go?'"

In the face of this uncertainty, staffing firm owners who've weathered slowdowns before are likely to consider selling and taking a well-deserved rest.

If the thought has crossed your mind, you've wondered what you could get for your firm. SI Review talked to experts in valuing, buying and selling staffing firms to learn how they value a firm, whether it's to sell or simply because the owner wants to identify weak points in the organization where he or she can build value and become more competitive.

BUSINESS MIX

Depending on who is buying, diding on wversification may add to or subtract from value. Margins and volume tend to be inversely related. Private investment groups, which were doing a lot of acquisitions last year, tended to want to keep doing whatever the acquiree was doing, to leave success "as is," says Neidle. But a large corporation doing just office staffing might look at your 80% clerical and 20% light industrial business and discount the light industrial portion heavily because it only wants the clerical portion. Or it could value the business as a whole and plan to sell off the light industrial segment.

"It's usually safer to stay in a single line of business and find a buyer that will appreciate that homogeneity," says Neidle. "You only need one buyer, so you want to find one that appreciates what you're doing. It's difficult to find a buyer that will appreciate diversity."

The Multiple Curve

Neidle explains that the multiple curve he uses is a function of dollar volume – earnings before interest, depreciation, non-recurring business expense (such as a serious accounting error that causes a one-time large loss) and excess owner's compensation (whatever profits the owner takes out of the firm above what he or she would pay a professional manager to do).

The curve shifts up or down depending on the line of business. The major areas that affect multiples in staffing, Neidle says, are the size of the company and its relative growth rate.

"You can look at it very simply as the value of compound interest," he explains. "When you're growing at 25% to 30% per year, which IT has been averaging in contracting, versus 10% to 12% on the light industrial side, and you compound that, you come up with very substantial differences in the future value of IT versus light industrial. This translates into a P/E curve that is basically the same as the [dollar] volume curve, with IT at the top, other sectors like legal and accounting next, office services farther down and light industrial at the lower end."

CUSTOMER BASE

The diversity of your customer base is a major value factor. Sacco says, "If any of your customers constitute more than 20% of your business -- and we really don't like more than 10% -- it will affect your pricing, because you'll have too many eggs in one basket." A prospective buyer will not be attracted to a business that is dependent on very few customers; if the firm loses that business, a large portion of its earnings will evaporate.

Other factors that can influence a staffing firm's value to a potential buyer are its geographic location, amount of bank debt, any litigation it's involved in, insurance coverage and efficiency. Paradoxically, Neidle notes, if your company has a structure in which a buyer can make efficiencies (e.g., you have too many managers, who can be replaced by a single regional manager at the buyer's firm), that may make your company more valuable to that buyer.

*Michael Neidle is president of Optimal Management (*http://www.optimal-mgt.com*), a leading-edge management consulting company for the staffing industry.*