

Mergers & Acquisitions Update

Where is the Market Headed?

March 24, 2002

It is no secret that the number of staffing industry firms changing ownership has declined substantially over the past few years.

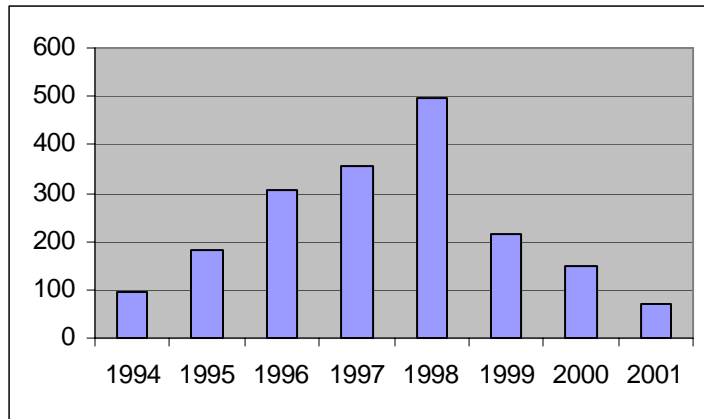
However, most industry analysts believe that there will inevitably be increased consolidation in the Staffing industry. The industry is still highly fragmented with over 7,000 firms in the US alone. To see where we are going it may be helpful to look back at our recent history.

The Mergers & Acquisitions market for staffing firms has been traveling on an 8-year roller coaster. We started out slowly in 1994, began to gain momentum in 1995-96, peaked in 1997-98, began to slow down in 1999-2000 and returned to almost, but not quite where we began in 1994. The chart below illustrates our adventurous ride.

Sales of Staffing Firms 1994-2001

	Number of Transactions
1994	95
1995	183
1996	306
1997	356
1998	495
1999	216
2000	151
2001	72

Source: Staff Facts, Staffing Industry Analysts, R.A.. Cohen Consulting, SEC Filings



As the chart above shows there is almost a perfect “Bell Curve” over the last 8 years. Many public companies that were very active consolidators from 1995-98 have since seen their stock receive significantly lower market valuations and are no longer as active in the North American acquisition market.

This has been the case virtually across all service sectors in the staffing/contract and Professional Services arena. However there are some notable exceptions such as non-government subsidized Health Care, particularly nurse and allied health staffing as well as accounting/finance and scientific staffing.

Many of the most active acquirers a few years ago are hardly recognizable today having morphed into new names or new entities.

The busiest acquiring publicly owned staffing firms just 5 years ago in 1997 were:

Accustaff split off its’ commercial services business into Strategix, which it sold to Randstad NA and became Modis Professional Services, then Modis Communication Services, and now MPS.

Romac became Kforce.com and is now Kforce Inc.

Metamor (nee Corestaff) became Comsys

Select Appointments (nee New Boston) became Select Appointments NA owned by Vedior

Interim acquired Norrell and became Spherion

Outsource International (nee Labor World) became Tandem went public, subsequently seeking Bankruptcy protection and has recently sold its' business operations to a private company.

How much has changed in five short years.

In 2001, the top five publicly owned acquiring staffing firms were:

TMP Worldwide, Inc.

CIBER, Inc.

CGI Group

Kforce, Inc. (the only returnee from our 1997 list) and

Manpower, Inc.

Private acquirers continued to be more active than their public counterparts, accounting for almost 60% of all staffing industry transactions in 2001.

The cost of borrowing for acquisitions for private firms was equaled once the publicly owned staffing stock valuations declined.

Today's low M & A activity level is more **an issue of credit availability** than the cost of borrowing. With a soft economy, missed earnings forecasts and violations of loan covenants, **banks are less willing to finance acquisitions** at previous multiples of cash flow.

In addition, **the Fed is requiring banks to reclassify their loan portfolios to reflect the higher risk levels** resulting from the slowing economy. This has caused a reduction of bank financing multiples that in turn has caused middle market acquirers and some financial buyers to defer transactions until multiples recover and adequate ROI's can be obtained.

We are beginning to see this trend poised for reversal. Industry analysts feel that with what now appears will be an improving economic environment, staffing firms' earnings will also slowly begin to rise. This will inevitably lead to a loosening of Bank loan restrictions as earnings for staffing and professional service firms return to their earlier higher growth levels.

What can we expect during 2002?

An improving economy and gradually a stronger, more vigorous M & A market for well run staffing firms. We are already seeing an increased number of buyers that have capital to invest seeking quality acquisitions and are requesting our assistance in identifying suitable acquisition targets.

Buyers today are looking for sellers to share some of the risk going forward. Whether a seller is continuing on for several years with the acquirer or leaving after a transition period, buyers are using earn outs to ensure the seller has a strong continuing financial interest in growing the business after selling.

In years past initial cash payments were such a large part of the transaction (often 75-90%) that sellers had little financial motivation for helping their former business grow and these sellers had enough financial security to allow them a low tolerance level for any changes.

The difficulty in completing transactions today has been caused by a significant difference in value expectations between buyers and sellers.

Some sellers have unrealistic ideas about the true market value of their business today. Values have declined significantly since the heady days of early 1998.

Buyers today believe they will have to invest significant resources to get the business where it needs to be. Some sellers seeing their business continuing in decline want to remove their company from the selling market, as no seller wants to “give their business away”.

However, many of these sellers return to us 6-9 months later with their business in dire straits as they did not have an aggressive recovery plan but were hoping the rising market tide would lift them up. Sadly, many sunk deeper and their businesses were now suitable only for fire sales.

Increasingly we are being asked to help sellers get their business growing again, so they can return to the M & A market with stronger prospects for a successful sale.

Some buyers believe they can buy formerly good companies that have fallen on hard times for very low valuations and fix them up. Their results have

been mixed at best. They too need an aggressive plan to turn these businesses around.

Most staffing firms have already trimmed their expenses (the easier part) to fit their lower sales levels but few have been able to increase their sales and profit performance in this tough market (the harder part of recovery) with fewer staff. This is why some owners are turning to us for advice on how to strengthen their business.

What can you do?

Continue to watch your fundamentals, particularly your margins on hard to fill positions. Achieving good margins are often a “mindset” and/or a training issue. If we continue to commoditize our service, we can expect more downward margin pressure. If we don’t believe our services are worth what we are asking for them, why should our client? Once we drop our margins it is hard to raise them with the same customer in a reasonable timeframe.

Find out why your customers use your services and focus your efforts on emphasizing your perceived market edge. Show how using your service will provide greater value. Sell value not price. Someone can always come along and beat your price, so make your service unbeatable.

Educate your clients; it’s your job to show why they get better value dealing with your firm. It is not the client’s job to figure it out. Show them by delivering service that exceeds their expectations, which is impossible to do if you are unaware of their expectations and what they value most. You want to know what your clients’ value about your service.

Choose clients who will appreciate your service level. Be ready to fire clients who are unwilling to pay fair value for your services. Don’t expect a Chevy buyer to pay Cadillac prices. Find a Cadillac buyer or become a Chevy supplier. Make your client shine and your future will be prosperous. Help them achieve their goals in every way you can.

Some Suggestions

- Lead your staff, by example if possible
- Develop a straightforward, proactive recovery plan

- Communicate your plan clearly and allow your staff to buy-in
- Re-recruit your key performers' and weed out negativity
- Ensure everyone knows how to contribute to the plan's success
- Explain WIIFM- What's in it for me, to each employee
- Measure each customer's true profitability and cost to service
- Measure each employee's total contributions to your firm's success
- Terminate unproductive customer and employee relationships
- Solicit and act on feedback from customers and employees
- You must be positive and project hope to your staff
- We all know what to do, the winners' do it, execute your plan

Most of the sellers we meet come in two broad categories, those who have planned and prepared their company for sale and those forced by the owner's poor health or their business failing and must sell. Ideally, we would like you to come to the M & A market with the greatest chance for success. Winning that game can provide you and your family lifetime security. It is never too early to start planning.

When you are ready to enter the M & A market be realistic about the value of your business. Buyers have virtually unlimited choices to invest their capital. Try to make a deal where both you and the buyer can succeed if together as partners going forward you can build the business so all can benefit.

If you are not ready for the M & A market, you can still benefit by strengthening your business. We want to see you succeed.

Bob Cohen, Sam Sacco operate R. A. Cohen Consulting a trusted M & A Advisory firm. Together they have completed more than 100 successful staffing industry transactions. They can be reached at:

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