Conflicting Views in Staffing Mergers & Acquisitions

Buyers and Sellers can view the same action very differently!

by Bob Cohen and Sam Sacco

When most profitable Staffing firms are sold, they are sold on a formula based on a multiple of adjusted EBITDA, Earnings Before Income Taxes, Depreciation and Amortization. The multiple applied will vary based on a variety of factors including but not limited to:

- **Staffing Sector**
- **Gross Margins**
- **Rate of year-over-year Growth**
- **Size -measured in annual revenues and number of offices.**
- **Management Depth**
- **Infrastructure**
- **Earnings History and several other variable factors.**

Making a Move

While most Buyers acknowledge that the Seller should continue to run their business as if they own it, (because they do) until a transaction closes, they will sometimes see a business move by a firm that is considering the sale of their company, i.e. closing an unprofitable branch, as short-term thinking by the owner.

Buyers will acknowledge that closing an unprofitable branch may make sense for the owner for many reasons including that it raises the EBITDA level of the Seller's company; it could lessen the Buyer's interest since it can be seen as a short term gain (in EBITDA) with a risk of losing a longer term return from that territory.

Leaving aside for the moment that there can be several totally legitimate reasons for closing a branch office; let's just focus on the fact that the owner has decided to cut their losses at the present time while still reserving the right to re-enter that territory under better conditions at some time in the future.

Certainly staffing firms open and close offices all the time for various reasons such as: a poor or changed local economy, lack of qualified staff, inability to assemble or retain a solid team, financial losses that require operating expenses to be lowered to stop the current financial bleeding so one can live to fight another day, and consolidating limited resources and assets in fewer locations. Isn't it better to have four or five successful and profitable operations rather than seven weak branches with several losing money?

(cont'd)

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If a staffing company is considering a sale of its business, which scenario would offer greater benefits to a Buyer?

A company with fewer branches and good profitability from each operation, or a firm with more branches with a couple making money, a couple losing money and the others barely breaking even.

A Seller may wonder if the Buyer just wants to lower their cost of acquiring their business. Possibly after a few more months of losses, the Buyer would close those questionable branches as well. After all, it is not good business to sustain losses indefinitely.

The Seller may be thinking what is their upside in keeping a losing branch open? Will it help their earn out?

What assurances can the Buyer give that they will continue to operate at a loss (for the long term gain) if they cannot turn that branch around in relatively short order?

Is the Buyer happy to take over the operation after the Seller has sustained much of the start-up investment and before the Seller has had time to get a good return? It certainly will keep their acquisition costs down, but does it really help either party?

Even if the Seller's earn out is based on gross profit dollars generated, what good is generating gross profit dollars that does not result in operational profits?

If it is good business to close a branch at a particular point, it should be good business for the Buyer as well as the Seller.

If the Buyer thinks the branch should remain open for the long term good then why penalize the Seller by deducting that branch's losses from the overall company EBITDA? Isn't it enough to get that operation for nothing?

If it is worth less than nothing, perhaps it should be closed.

How about the Buyer sharing some of that risk with the Seller? Is this reasonable?

Responses from both Buyers and Sellers are welcome.

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