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Size Matters

Among many factors that affect value when selling your business

By Bob Cohen and Sam Sacco

Most profitable staffing businesses are sold on the basis of a multiple of *adjusted* EBITDA (Earnings before Interest, Taxes, Depreciation and Amortization). The key word is often adjusted. Adjustments are used to normalize or add back those expenses that would be eliminated as a result of a sale of the business.

Typically these are items involving excess owners' compensation and truly non-recurring items. Since adjustments are always scrutinized by the buyer during due diligence a wise seller can create trust and credibility by not pushing the adjustment envelope too far.

We began by saying that size matters. It really does. The reason for this is merely supply and demand. As reported in Staffing Industry Report the U.S. Census Bureau 2002 Economic Census data showed there were 9,124 temporary staffing firms operating for at least one year in the U.S. In addition there were 5,253 search/employment placement services and 3,436 PEO's (Employee Leasing) firms in the U.S.

Temporary Help/Staffing Firms

In terms of annual revenue over 82% of the 9,124 temporary staffing firms were doing less than $5 Million dollars in annual sales and over 91% were selling less than $10 Million dollars per year in services. Almost 97% of these firms were doing less than $25 Million dollars in revenue per year. So if your firm is doing more than $25 Million in sales per year-**Congratulations- you are in the top 3% in terms of annual sales revenue in our industry.**

While some of this information is four years dated, the trends are clear. The staffing industry remains highly fragmented and many small firm owners' are able to create a living for themselves and their family as long as they operate the business. What about when it is time to move on?

Larger Staffing firms will attract more buyers and buyers who are willing to spend more money and resources for the sheer rarity of the larger firm. As importantly, a business with $10 Million or more in annual sales is more likely to be dependent on several individuals for driving the business, whereas a smaller firm is often perceived to be driven by the energy and talents of the owner/operator.

Buyers fear that once owner/operators attain a degree of financial security they will find it difficult to stay on with the business as an employee. Since most deals today involve an earn out as a part of the total consideration in the deal, the owner/seller wants to remain to maximize their earn out payments since they are often depending upon the total proceeds of the deal to assist in funding their retirement or next career.

If growing your business to a size that would attract a larger pool of buyers and possibly higher caliber buyers seem unlikely or daunting?

What can you do?

Since there are other factors besides size that matter perhaps you can focus on some of the other drivers of staffing firm value.

1. High Gross Margins- over 25% -are also a rarity, margins over 30% are truly precious in today's marketplace. Higher margins allow a buyer a greater proportionate return per dollar invested. High margins are an indication of your capability:

a. To deliver quality service to customers,
b. To properly value and price your services,
c. To serve customers who will value your services with less regard for pricing pressure;

2. High Annual Year over Year Growth Rates-above industry average growth rates shows your ability to expand your business and as a buyer this growth creates an opportunity to get a top return on their invested capital and speeds up and increases the likelihood of a satisfactory return. Just because you are small, it shouldn't preclude solid growth.

3. Specialty or Niche Service Offerings- are often able to both obtain higher gross margins and grow faster than the industry on the whole. In addition, you probably have expertise and knowledge that may be new to the buyer and that can be duplicated in some or all of the buyers' other locations.

4. A Diverse Customer Base-regardless of size it is helpful to have customers who represent no more than 10% of your total annual volume. It is not unusual for a staffing firm to have one or two customers that really anchor their business; however, if each of those customers represents say 20% of your total volume, the loss of one of those customers will be difficult to replace. Constantly try to broaden your base so you are less dependent on one or two key accounts.

5. Sub-Chapter "S" Corps or LLC's-allows buyers' to acquire assets rather than stock. In smaller acquisitions buyers prefer to acquire selected assets as due diligence is less complex and far less costly and the acquired assets can often be written off more quickly than in a stock transaction. Selling assets of an "S" Corp or LLC has no adverse tax consequences for the seller as the proceeds of the transaction are only taxed once (at favorable capital gains rates) in the hands of the seller. If one has a C Corp the proceeds of an asset sale are taxed when the proceeds come into the company and a second time when the shareholders take the proceeds out of the business. C Corp owners prefer to sell the stock to avoid this double taxation. However, buyers particularly of small staffing firms prefer to buy assets.

There are other factors that impact value however if as you grow your business you can increase your gross margins, quicken your growth rate, add specialties or niche services that are less commonly offered by others and diversify and broaden your customer base you can obtain a better valuation and more bidders (which always helps) when it becomes time for you to sell your business.

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