DE BELLAS & CO.

INVESTMENT BANKING

WHY IS ONE STAFFING COMPANY WORTH MORE THAN ANOTHER?

Two companies generating annual revenues of $10 million sell in separate transactions. The total consideration paid for one company is 25% higher than the amount paid for the other company. Why?

Why do purchase prices differ so significantly from one transaction to the next? What factors impact the value of these companies?

Typically, buyers of temporary staffing and IT consulting businesses determine value by applying a multiple to an earnings figure which we will refer to as Base Earnings. The Base Earnings used in this calculation, as well as the multiple actually applied to those earnings need to be examined to understand the variation.

Base Earnings

Base Earnings may consist of profits after expense adjustments for the last fiscal or calendar year, the last twelve months, or projected results. In some situations, a buyer may look at several scenarios in determining value, and apply different multiples to historical and projected earnings. A lower multiple is applied to projections compared to historical results.

Indicators of Value

The actual multiple applied to Base Earnings is a function of a number of quantitative and qualitative factors specific to the company. These factors and their significance will vary for each transaction and for each buyer. However, the items discussed below always impact value to some degree, regardless of the buyer.

Growth rates - Among the critical determinants of value are the historical and current growth rates of revenues and profitability in comparison to past company performance and industry standards. A buyer will frequently pay more for a business exhibiting strong growth trends that are deemed to be sustainable and are in line with or exceeding industry norms. An exception could include a situation where sales are increasing at the expense of gross profit percentages and profitability.

Size - In general, larger companies command a higher relative value. A greater market presence, historical earnings stability, a more diverse customer base and increased opportunities are generally associated with larger companies.

Gross profit percentage - In most cases, the higher the gross profit percentage, the better. If a company's gross profit percentage is perceived to be unrealistically high, a buyer may question if it is sustainable.

Markets, Position and Reputation - The value of a business is impacted by the markets it serves, including their size and growth potential. Multiple branches, if effectively managed, can also add value. A company that is recognized as a leader in its market(s) typically commands additional value. In addition, the company's reputation can add or detract from the purchase price that a buyer is willing to pay.

Services - The multiples that buyers apply to the earnings of temporary staffing and IT consulting services companies can range depending on the type of services provided. In general, information technology consulting businesses generate high profit margins and command higher multiples, clerical and specialty staffing have higher markups than industrial staffing, and buyers frequently apply higher multiples to the earnings of those companies when determining value. Payrolling services command a lower value than other temporary staffing services, as their markups are even lower. Contracts with customers and vendor-on-premise relationships can result in additional value for a seller.

Customers - A diverse customer base frequently commands a higher value than a concentrated client base. The characteristics of the client base are also important, such as the industries represented, the type of skills required, the history, and the relationships with clients. For example, is there direct contact with clients or is there a master vendor?

Management and Staff - Breadth and depth of management is key to a strategic buyer. The value of a company is impacted by the buyer's belief that management will be motivated to continue the company's success after a sale. Retention of a competent staff is essential.

Recruiting and Retention - A company's skill in recruiting and retaining temporary employees can add value in a sale. Although recruiting is difficult for most companies in today's environment, any edge that a company has over its competitors can enhance value. The quality of an IT consulting companies database is very important.

Workers' Compensation - In staffing companies where workers' compensation costs are a significant component of providing temporary employees, those costs can have a large impact on value. A company's loss experience and risk management programs are extremely important to a buyer in such instances.

Transaction Structure - The price paid by a buyer is dependent on the transaction structure, such as whether or not the seller retains working capital and how much of the total value is structured as an earnout. Additionally, the corporate structure of a company (C-corp versus S-corp), and the structure of the purchase (assets versus stock) can impact the price paid for the business. If a buyer acquires the stock of a C-corp, the price is generally reduced by 10% to 15% because the buyer loses the tax benefits of amortizing goodwill. This is typically not an issue in the purchase of the stock of an S-corp. In that case, the buyer can amortize the goodwill if both parties take a Section 338(h)(10) election where the transaction is treated as an asset sale allowing for the amortization of goodwill.

The above factors represent items that temporary staffing and IT consulting company owners can control to some degree. Additionally, there are certain external items which affect value that are out of an owner's control. They include the general economic conditions of the nation, the region and the industry, as well as legislative issues which impact the company's operations. Although these items cannot be directly controlled by an owner, in certain instances it is possible to offset the impact that they have on a business. For instance, expansion into new market areas may offset regional economic cycles.

In summary - Why can prices differ significantly between companies of an equal revenue size? Differences in the above characteristics unique to each company strongly influence a buyer's price thinking. Knowledge of these factors is a key requirement to developing effective strategies for increasing value and, if acted upon, will ensure that the highest price possible is achieved by the seller.

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