M&A For Staffing Services: Let's Talk About Buyers

By Steve Sorrentino, President, MergeQuest

I thought to myself recently that much has been written about selling a staffing business but not much has been written about the other important side of the buy-sell equation, that is, about the *buyers* who complete the transaction. Over the years in my M&A practice, I have come to understand and appreciate the many characteristics, attributes and nuances of buyers along with their multi-faceted styles and motivations. With this in mind, I thought perhaps an important part of any seller's orientation in dealing with buyers should encompass a basic understanding of the dynamic and diverse nature of buyer profiles and motivations.

BUYERS CAN BE CATEGORIZED IN A NUMBER OF WAYS

Over the years I have developed my own unique classifications of buyers, and have categorized them as ***active***, ***inactive***, ***dormant***, ***opportunistic***, ***financial***, ***non-industry*** and ***strategic***.

Active buyers are out in the marketplace actively looking to make acquisitions. Active buyers today will run their course, generally within a year's timeframe, make one or a few acquisitions and then will become inactive.

Dormant buyers have not typically made acquisitions in the past but would if the "right" opportunity came along. They don't necessarily go looking for acquisitions so they're not easy to identify or locate. Although typically inexperienced as a buyer, if an acquisition opportunity happens to come along that appeals to them, they may get into the game. Dormant buyer inexperience can be an asset to a seller, as the inexperienced buyer often does not have a strong understanding of both market valuations and deal structures – so they can be persuaded more readily in pricing and deal structure negotiations.

Opportunistic buyers are commonly looking to buy either distressed companies or are looking for acquisitions that they can buy cheaply. Opportunistic buyers can be very useful allies if a seller's company is financially distressed, or perhaps in need of a "turnaround" investor.

Financial buyers are "number-crunchers", that is, they are very interested in making the numbers work. After reviewing a firm's earnings stream (or free cash flow), they will make an offer that is carefully calculated to give them a pre-determined Return on Investment.

Non-industry buyers are not "operators" within the Staffing Services Industry per se, such as Private Equity firms or companies with some distant connection to the Staffing Industry. Private Equity firms typically have a "platform" Staffing business within their portfolio of companies that they are looking to grow, enhance or diversify.

Strategic buyers are the cream of the crop in my view, they are rare birds and there are very few of them out there. Strategic buyers are typically run by entrepreneurs who are *highly motivated to grow their business*, as they want to grow rapidly or they want to expand into a new Staffing discipline (or "niche") - or want to have a presence in a particular geographic market. Strategic buyers can also be foreign buyers looking to enter the United States. Strategic buyers, in my experience, generally tend to be small to mid-size players, with revenues in the $25 to $80 million dollar range (although larger firms can be strategic buyers as well).

Strategic buyers have a “hot-buying-streak” that lasts for a given span of time – so it’s important to catch them when they early on within the buying streak. As such, given their drive to obtain some strategic objective, *they will typically pay a premium on market values to get what they want.*

PUBLIC VS. PRIVATE BUYERS

Buyers can also be identified as public or private. The key difference between a public and private buyer is that public buyers have another, often effective, source of acquisition “currency” at their disposal: that of public stock. The use of public stock to make acquisitions is not always a useable tool however, especially if the stock’s value is depressed or down from it’s trading highs of the past year. Public companies also face the issue of stock “dilution”, that is, the shareholders of the public corporation will experience a reduced percentage of ownership when additional stock is issued to acquire companies. Bear in mind that these factors are not necessarily negative factors for the buyer (or the seller), it’s just that public buyers face a few more hurdles vs. their private counterparts.

Private buyers, while they lack the use of public stock as currency, do not have many of the “restrictions” that public companies face - and in certain instances, have a bit more flexibility when making acquisitions. Private buyers will generally use cash as their acquisition currency (as will public companies either with or without the use of their stock), and in some cases, either may use private debt instruments such as notes payable to guarantee future payments to a seller. The risk in accepting corporate notes, warrants or guarantees for future payments is directly correlated to the financial strength and future viability of the corporate entity – an area where larger public companies with a strong financial foundation definitely have an edge.

At the end of the day, prospective sellers simply have to weigh the pros and cons of whether a particular public or private buyer’s offer is desirable. If there’s public stock in the deal, there could be terrific upside potential in terms of possible future, rising value of the stock, a risk that needs to be considered in light of a seller’s risk-tolerance level. Or, in many cases, the offers from public vs. private buyers may be very similar, in which case a seller needs to decide if they want to become part of a public company or simply remain part of a private enterprise.

THE STAFFING SERVICES INDUSTRY HAS A LIMITED NUMBER OF ACTIVE BUYERS AT ANY GIVEN POINT IN TIME

The “population” of active buyers in the Staffing Industry rises and falls during the course of any given year due to any number of reasons, many of which are tied to economic trends or specific industry trends. I estimate that there are currently under 100 active buyers in the (U.S.) Staffing Services Industry today. Of those active buyers, about half may have an interest in a particular staffing sector or labor niche. Of those, fewer have an interest in a particular geography. Of those, even fewer are capable of acquiring a business in a higher revenue size range (Over say $25MM). In the end, perhaps less than twenty buyers will express an interest in a particular staffing firm that is up for sale. Of those buyers, perhaps only 5-10 may make offers.

With the foregoing numbers in mind, it is my view that the more prospective buyers your M&A advisor brings to the table, the higher your chances to maximize the value paid for your staffing firm – this is called “buyer-leveraging” – much like what happens in an auction, i.e. the more players making offers, the higher the likelihood you will maximize the price paid for your business.

BUYERS MAKE ACQUISITIONS FOR A NUMBER OF IDENTIFIABLE REASONS

Here are some of the key reasons that buyers look to make acquisitions:

a. Grow revenues and profits. Many buyers have a time frame and revenue size objective they are trying to attain – after which they plan to sell the company – or go public;
b. Expand geographically;
c. Expand or diversify staffing / labor skill or other staffing service offerings;
d. Reduce overhead costs through consolidation and cost-absorption. That is, staffing companies realize that their margins today are constantly being squeezed, and so the only way to maintain acceptable levels of profit is to reduce overhead costs – which making acquisitions can offer by allowing larger staffing firms to "spread" their SG&A (backroom / infrastructure costs) over more profit-generating operations or branches to absorb the total corporate overhead. This is also known as "leveraging infrastructure".

Having an understanding of why a particular buyer is motivated to buy becomes an important part of negotiating, as it is typically useful knowledge that can be leveraged to help get what any seller will want, namely, *maximum value for their business and the best deal structure*.

TIMING AND SYNERGY ARE IMPORTANT FACTORS WHEN IT COMES TO BUYERS

It is important to bear in mind that "timing" is a very important factor when dealing with prospective buyers. Since the business world changes so rapidly, so do the reasons that influence a particular buyer's motives. Buyers can be hot today and cold tomorrow. I have had buyers "go the distance" in a deal and then back out at the eleventh hour – due to some internal issue that arose within their business. That said, it is very important that once a buyer expresses interest in your firm, that you stick with them and answer their questions promptly, or provide them with follow up materials or information expeditiously, so that you can get them to meet with you and your advisor and then get to the negotiations and offer as quickly as possible. This will also help you as the seller determine if a prospective buyer is truly sincere about buying your business.

The term "synergy" is a two-way street (synergy meaning the apparent similarities and "fit" between company profiles). Buyers look for synergies with a seller and vice versa. While seller synergy is a factor in considering prospective buyers, it's important to also consider buyer *motivation* and not to eliminate a buyer from consideration altogether until after speaking or meeting with them directly. Buyer synergy may not always be evident to a seller based on a buyer's initial profile, as there may in fact be less obvious synergy's below the surface – such as a growing firm's motivation to expand and diversify its offerings into new staffing skills.

It's also understandable that sellers want to maintain confidentiality and so not contacting close competitors (prospective buyers) in the marketplace may appear to make sense – especially if the competitor is not a "friendly" competitor or someone that you know. However, a seller should also consider that a close competitor may in fact be a strategic buyer in waiting, *one who may be willing to pay a market value premium for a business with close proximity*, *one that is familiar to them* and *one that can help maximize their market share and potentially be consolidated to help reduce their SG&A overhead.* All very solid motivations for a buyer.

BUYERS AND MARKET VALUE

Perhaps the most sensitive area of any acquisition discussion, be it with seller or buyer, is the subject of market value – as it is the most challenging and controversial part of any deal. Without judging either party's view, I will say that the most common complaint I receive from the buyers I have dealt with over the years is that there is a "disconnect" between what a buyer sees as a "reasonable" market value for a particular staffing business and what a seller sees as a reasonable market value for their particular business. Conversely, my seller clients have in the past expressed the view that buyer's, in general, are not willing to pay a fair and reasonable price for their business.

There is of course a generally accepted valuation methodology in the Staffing Industry and for the most part, seems to work well when both buyers and sellers are willing to work together within the parameters of that methodology.

In this regard, perhaps the most challenging aspect of any valuation discussion or exchange between two parties is the willingness of the parties to stay in the game and to continue to communicate with each other. My favorite adage that I have developed over the years addresses this issue as follows: *seller's have strong expectations and buyer's have strong motivations, which when met head-on and without compromise create confrontations*. The ideal scenario, in my view, is to try to reconcile the two, to try to work together and negotiate in search of some middle ground that is acceptable to both parties. Perhaps even use a "quid pro quo" approach (a Latin term meaning *something for something*). With this view in mind, both parties, if willing, can dramatically improve this part of the transaction through *compromise*, and by working towards a "win-win" outcome for the benefit of all concerned.

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Steve Sorrentino is the founder and President of MergeQuest, a trusted and experienced M&A Advisory & Brokerage Services firm serving the Staffing Services industry. Steve can be reached at (781) 334-7184, or by email at sjsorrentino@mergequest.com, (website: www.mergequest.com)

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