

Dear Staffing Owner / Executive:

Welcome to our first in a series of newsletters designed to provide staffing owners and executives in the **Staffing Industry** with some valuable insights into the many facets of M&A and Financial Management, including tips and insights on wide range of M&A and financial management topics. We hope that you find some useful information that you can apply to help you both run and enhance the value of your staffing business - especially in today's challenging economic environment.

Sincerely,
Stephen J. Sorrentino
Principal

Building Enterprise Value for Staffing Firms in Today's Challenging Economic Environment

It's a basic fact of our economic and business environments that every business will ultimately be sold or cease to exist. According to author Arie deGeus, who wrote *The Living Company*, a study conducted in conjunction with the Harvard Business School, the following were notable findings in his study:

- a) The average life expectancy of a Fortune 500 company was just over 40 years;
- b) One-third of the Fortune 500 companies in 1970 had vanished by 1983;
- c) The average life expectancy of all businesses, regardless of size, is 12.5 years

With the foregoing business life-cycle statistics in mind, business owners are well advised to consider whether to let their business run its course, or whether to prepare for the inevitable sale of the business. Whether it's motivated by a planned exit strategy that leads to retirement, planned succession, or perhaps professional burn-out, thinking long and hard about the possible future sale of your business, along with how to maximize the future value of your business, is time well spent.

That said, and with the effects of the lingering recession having hit staffing revenues and net profits hard over the past year, now more than ever is a crucial time to watch your firm's financial performance, especially your firm's coveted "bottom line" - as a fundamental pre-cursor to protecting your firm's underlying enterprise value.

So how do we define Enterprise Value?

The concept of enterprise value for private (non-public) businesses has multiple layers, taking into account such things as the size of the business, more specifically, its size in annual revenues and net profitability. But take note that

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The M&A Market Update

The Staffing Industry's M&A activity is starting to show signs of recovery in the first quarter of 2010 after a year of very sluggish activity. This rise in activity is directly correlated to the rise in Staffing Industry hiring for the fourth quarter of 2009 and the first quarter of 2010. This is especially evident in the IT, Professional, Technical, Healthcare and Light Industrial staffing sectors.

We are expecting to see continued improvement in Light Industrial M&A activity during 2010 as the sector slowly recovers this year.

Market valuations and multiples are holding steady by and large from 2009 levels, as total market value calculations

what supports 'value' is the underlying *quality* of those revenues and net profits - which for the most part is determined by the future *predictability and certainty* for the continuation of those revenues and profits - factors that influence a well known value-killer - called **risk**.

As a quick aside, no discussion of value is complete without a brief look at how staffing firms are traditionally valued in the Staffing Industry - that of applying some multiple to the firm's adjusted earnings known as EBITDA (earnings before interest, taxes, depreciation and amortization) - and then adjusting for any positive or negative shareholder equity. Bear in mind, though, that this is simply the **value calculation** which only speaks to the quantitative side of the equation and not the qualitative side - which as noted earlier, is all about the underlying quality of the revenues and resulting net profits, factors that will support the case for maximizing your firm's value.

So, to the degree that we can demonstrate and build a prospective buyer's confidence about the underlying quality of your firm's revenues and net profits (i.e. the *predictability and certainty* of your firm's future viability and sound financial performance), thereby reducing a buyer's perceived risk of ownership, the more solidly we can support and maximize the enterprise value. That said, in preparing your staffing business for any ownership transition, *your central objective is to reduce perceived operational and financial uncertainty and risk of ownership - while supporting future performance predictability for prospective buyers.*

How to start building Enterprise Value - Now

I have put together a list of four key steps a staffing business owner can take now to help improve the underlying qualitative factors that support and enhance enterprise value:

1) Maintain consistent financial performance that is on par or better than Industry standards. Clearly, one of the key things any buyer will want to see is historical financial performance that shows growth in both revenues and profits. In the Staffing Industry, buyers will want to see strong, consistent gross profit margins - this tells them how well you manage your service pricing, along with how well you manage the cost of your temp employees and other direct payroll related costs.

Every Staffing Sector has its standard Industry norms for financial performance, including acceptable ranges for gross profit margin and net operating margin performance (net earnings) - which is essentially a measurement of the firm's ability to produce cash flow - which is ultimately what a buyer wants to buy. Buyer's will also want to review your SG&A overhead costs, as with any industry experiencing margin pressure, how well you manage your other overhead determines the quality of your bottom line (net) earnings.

2) Diversify and grow in your customer base. Buyers want to see good customer diversity, which means that you are not reliant on one or a few top customers. As a good rule of thumb, try to keep single customer concentration to below 15% of your total sales revenues. Buyers also want to see longstanding, stable relationships with customers - as well diversity in the industries that they serve. Further, the consistent addition of new customers demonstrates your firm's ability to support new business development - a key to future business growth. In short, the more you can demonstrate stability, diversity and consistency with your customers, as well the ability to add new customers, the more a buyer will foresee sustainable value in your business.

3) Invest in human capital - develop a team that can grow your business. Hiring industry experienced staff that possess a strong work ethic - and investing in the training and development of strong managers and talented employees - is critical to building enterprise value. I strongly suggest that you evaluate the strengths and weaknesses of each of your firm's functional managers and staff members. If you have significant weaknesses, correct them. If you have underperforming employees, let them know and try your best to help them improve their performance. You cannot afford to maintain underperforming staff, certainly not in today's competitive environment. Bear in mind the old adage that "your team is as strong as its weakest link".

You might also think about instituting an employee performance feedback and control system (especially for recruiters and sales staff) if you do not already have such a monitoring system in place. A sound performance measurement system

are self-adjusted due to lower net earnings and adjusted EBITDA.

Finally, while buyer financing remains somewhat of a challenge, we're seeing a host of both first time buyers and private equity buyers enter the market - which in many cases has increased transaction cycle time (6-9 months) resulting from more cautious due diligence.

Our Principal



Steve Sorrentino has been actively involved as a senior financial and M&A executive and consultant in the Staffing Industry for over 17 years.

Prior to establishing MergeQuest in 1999, he was the Vice President of Finance and Corporate Development for an International IT and Technical Staffing firm.

Read more about:

Steve's Biography

About Our Company

MergeQuest offers a full range of M&A and financial consulting services & solutions on a national and international basis - specializing in the **Staffing Industry**.

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will provide vital information about your employee's daily activities - sometimes referred to as a "production" measurement system - one that measures the key activities and daily production of your functional staff, such as a recruiter's daily phone time, number of resumes submitted to clients, number of candidate interviews arranged and ultimately, the number of actual "fills" that your recruiter realized.

In short, constantly review the performance of your team. Get them all working from the same sheet of music while moving in unison towards the same goal - that of profitable revenue growth. Stay close to your staff and be sure to have a competitive compensation plan and commission structure in place, ones that are on par or better than Industry norms. Also, "re-recruit" your best players - let them know they are valued. The key is to strengthen the team, and to eliminate any uncertainty that a prospective buyer may have about the long-term viability, loyalty and commitment of your key players - as well the balance of all other team members.

4) Plan for Growth.

A key driver of any business value is the expected growth rate for revenue, profitability and ultimately, cash flow.

I strongly recommend that you develop a clear strategy for how your business will be successful in the future - in the form of a written business plan. I would also encourage you to prepare an annual financial budget - which demonstrates your commitment to establishing financial performance goals guided by a sound feedback and control mechanism.

According to business sale statistics, privately owned companies that have a written business plan that cover financial, marketing, operational and succession planning realize greater value in the long run. In short, *document your plans*. Ask yourself, "can I clearly explain why my business is successful now, and how it will continue to be successful in the future? A prospective buyer will want to hear a clear answer to this very important question.

Questions about this newsletter or any of its content?

Contact Steve directly at ssorrentino@mergequest.com

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MergeQuest
Stephen Sorrentino
Principal

Phone:
(781) 334-7184

Email:
[ssorrentino@
mergequest.com](mailto:ssorrentino@mergequest.com)

Website:
MergeQuest.com