A GUIDE TO SELLING A RECRUITMENT BUSINESS

evolution complete business sales

SELLING YOUR BUSINESS FOR ALL IT'S WORTH

The recruitment sector has been very active, in terms of sales and acquisitions, since 2014 and, shows no sign of slowing down overall, although some are more active than others.

Like many service based sectors, Recruitment has distinguishing features; it is asset light and people heavy. In other words, recruitment is essentially a people business and the skills of the fee earning consultants are a critical element of any acquisition.

Strategic acquisitions, although not without risk, offer an attractive route to growth – by moving into a different sector or geographic area or expanding the range of services on offer.

In order to maximise value before a sale, recruitment business owners can deploy a number of core value builders.

This guide provides an overview of what's involved in preparing a recruitment business for sale.

Rob Goddard

Managing Director

Evolution CBS Ltd

2014 saw the UK recruitment industry recover to pre-recession levels and the REC recently reported that a 2015 study by BDO found that "More than four-out-of-10 (46%) of recruitment consultants surveyed believe that M&A was on the cards for their business within the next three years as a way of achieving growth ambitions and expanding their service portfolios. Whereas 41% also think that their business is likely to be sold or go through an exit in the next five years."

Valuing a recruitment business

"The underlying value of a recruitment business is in the individuals involved, their client relationships and the level of requirements, i.e. the prospects for those clients' businesses. These can never be truly reflected in a balance sheet".

James Monjack

Evolution CBS Ltd

Whilst it's not uncommon for business owners expectations to be higher than those of acquirers, I suspect that the recruitment sector is more susceptible to misconception because of the various valuation methods used in the past. I've come across statements like "Ten times profit, that's the standard valuation in the recruitment industry" and "Net Fee Income is the best way to value a recruitment business."

As a general principle, scale and liquidity are the key determinants of valuation

The valuation methodology used depends on a number of factors, chiefly the mix of temp/perm and who the acquirer is. A company with a high number of temps is most likely to be valued on a multiple of Earnings Before Interest and Tax. Whereas a company with a heavy perm focus being acquired by another recruitment business may well be valued on a multiple of NFI as the target company's cost base is potentially of little relevance.

Arriving at a full valuation depends on a number of factors, financial and otherwise. It's also worth bearing in mind the effect of the performance of publicly listed firms. Unlikely as it seems, the performance of these companies does impact the valuation multiples for smaller private businesses because of the effect on market sentiment.

It's also important not to be swayed by large multiples in listed company transactions – these do not apply to private business transactions which carry a higher element of risk to the buyer which is reflected in lower multiples.

But there are many factors that influence value that recruitment business owners can use to increase business value in the run up to a sale.

Russell Bell, Senior Partner at asb law LLP notes that *"Any buyer interested in purchasing your company, will typically calculate it's value using a multiple of the current operating profits, potential savings, cross-selling opportunities, intellectual property, brand and perception of risk."*

That is why it's vital to consider strategic ways of increasing your company's worth, not through profits alone, but by also addressing the multiple factors influencing the value of your business, such as; minimising the perception of risk, ensuring steady, recurring and foreseeable income, guaranteeing solid operating systems are in place, employing star staff, having strategic long-term growth plans, being up-to-date on the latest technology and owning a niche marketplace, if possible.

Getting the timing right

With M&A activity rising it's wise to consider an acquirer's perspective when deciding on the time to exit.

In the case of private companies deploying a mid to long term growth by acquisition strategy, particularly if funded by external growth capital, any acquisition will need to be fully integrated and delivering a return on the investment in order to comply with their own exit plans.

As that is likely to be at least 3 years down the line such buyers will want to take advantage of the current "window of opportunity" before market conditions change again.

For acquirers deploying a "buy and build" strategy with a view to listing the company, market conditions are even more important and they will need to ensure a faster integration and ROI in order to list whilst there is still growth in the market.

It's important to understand acquisition criteria – is your buyer taking a short or long term view with the acquisition. If it's short term, as in a "buy and build" example above, your primary focus will be on your financial performance and meeting your forecasts. If it's longer term, there are a number of value builders that can be adopted in conjunction with financial performance.

Ultimately a successful sale is achieved when profits are rising and can offer an acquirer a realistic prospect of continued growth. This is why it is so important to manage financial performance right through to the end of the sale process.

Leaving a sale until the business performance plateaus will impact value; to improve performance will require investment – either from the owner or from the buyer, who will, understandably, take that into account when making an offer.

So what can business owners do to make their companies a more attractive and valuable acquisition prospect?

Reduce owner dependence

You must be able to prove that the business has a future without you at the helm

Would you pay a premium price for a car without an engine?

Unless it was an extremely rare item, probably not. So unless your business has something so unique and valuable that a buyer will pay more for it, make sure your business does not depend on you.

Build a strong and reliable management team that can handle the operational aspects of the business and to whom you can transfer key business relationships. That might mean investing in training for existing employees or hiring from outside the business but your investment will be repaid several times over. Why? Because acquirers buy a business that they expect to function successfully and, just as important, grow under their ownership.

Focus on key staff

It is very difficult for an acquirer to consider a high value for your business if you are the main decision maker in the company and the business depends largely on your skill set.

Well-trained and motivated staff are a major asset and will be at the top of a buyer's criteria. They will gain comfort from length of service of your key staff, particularly those that demonstrate strong and consistent performance.

Losing key employees can have a significant impact on the value of a business. Incentive and share option schemes are common methods of attracting and retaining key employees, which are generally looked upon favourably by an acquirer.

If you are concerned about any key employees (i.e. those whose departure would be detrimental to the business) leaving, you might consider incentivising them.

"Because it's a people business, the issues that arise on sales do rotate largely around how secure the management team is and how reliant the business might be on a small number of directors."

Russell Bell

Senior Partner

"The best leader is the one who has sense enough to pick good men to do what he wants done, and the self-restraint to keep from meddling with them while they do it."

Theodore Roosevelt

However, it's important do take legal advice before you decide how best to do this as there are tax considerations to take into account.

Russell Bell of asb Law LLP comments that *"Building and retaining secondary management is key to establishing and realising value and will be one of the first things a buyer will look at to ensure he's getting a sustainable business capable of further growth."*

If possible, start working on staff related issues at least a year before you plan to start the sales process.

Confidentiality is always a key concern regardless of what industry you're in. But in a people business it is even more important. Whether its employees finding out or a competitor, its vital to maintain confidentiality and that is best achieved by running a carefully controlled process.

One of the benefits of early preparation is that you can put reward structures in place and promote them in a positive light without them being associated with a sale

Diversify your customer base

Would you buy a business where a high percentage of revenue comes from just a few customers? Probably not so diversify your customer base so that no single client contributes more than 10% of your revenues.

When preparing for a sale you will need to segment your customer base. How many clients do you work with? What are they worth to the business?

Segment your client base by size and by sector. If you have framework agreements in place with large companies this will increase the overall value of your business.

An acquirer will prefer to see long term client relationships; they help to demonstrate the value of your service. Whilst numerous short-term clients may produce a similar financial result they do little to establish the quality of your business.

Do you recruit for positions across a range of industries, or do you specialise in one or more sectors? Specialists tend to achieve higher multiples than generalist firms because they provide strategic "bolt-on" opportunities.

This data needs to feed your financial forecasts and a degree of pragmatism is required here. Can you really be certain that your key clients will remain loyal for the forecast period?

In such a competitive market there is nothing to stop clients looking elsewhere so its essential to have a strong key account management strategy in place to protect your revenues.

Do ensure that you don't hold the key to key client relationships. Transition these to your management team because if you choose to sell without doing so you should be prepared to accept an "earn out" as part of the transaction value, possibly having to stay on in the business for a period. Consider very carefully whether you could actually work for someone else in the business that you founded?

Forecast realistically

When selling any business you will need to produce 3 years accounts and a forecast for the current and following year.

Your published results are what they are but you must be able to substantiate your current and future forecasts.

You will also need to produce monthly management accounts that demonstrate the business is on track to meet its forecasts but just as important you need to be able to explain the assumptions you have made and the basis on which you have made them – for example sales and marketing initiatives, forward order book, recently renewed contracts, competitive intelligence etc.

A buyer will calculate the return on investment to be achieved by buying your business above another, so make sure you have a robust financial argument that demonstrates your company's growth potential.

Look after your cash

This may sound obvious as you will be doing this anyway but in a sale situation cash management has other implications.

Rather than slashing costs to improve profitability, work towards long term sustainable improvement.

Don't make cash savings to the detriment of productivity, thereby threatening your financial forecasts.

If you suddenly stop hiring staff, cut advertising and reduce expenditure to maximise profitability, a buyer or his advisors will spot it, and consider such short-term measures as potentially damaging to the business.

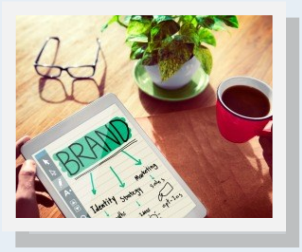
This will then reflect on your long term forecasts, making a buyer suspicious and more likely to end negotiations.

Take professional advice before you make any drastic cuts. Acquirers will be very suspicious about sudden short-term changes in cash flow and will start to doubt your credibility – resulting in valuation changes to offset the perceived risk.

Branding

Having a recognisable name and good quality reputation helps make a business more attractive to an acquirer. Associate your reputation to your brand; make it visible and consistent.

Ensure your marketing and business collateral supports your brand.



Your online presence, advertising, correspondence, candidate CVs and office signage should all be in line with your chosen brand and should clearly demonstrate your company's quality and professionalism.

If you use a company logo, particularly if it was designed specifically for you, consider protecting it with a trademark. These intangible assets can make a real difference to the saleability of your business.

Barriers to Entry

A major reason a buyer would pay more is to break down the barriers preventing his business achieving success in a particular location or in a particular sector. Framework contracts with key clients can be very attractive to certain buyers, providing an affordable entry route into a key area.

Documented processes

These give acquirers comfort that the business is well run and that it is not completely owner-reliant. Good financial records demonstrate that you are in control of your business and will be of great help to you during due diligence.

"Anything that is measured and watched, improves."

Bob Parsons,

GoDaddy founder

Also, knowing your numbers and how you will achieve them is essential during negotiation meetings.

The reverse is also true as acquirers will be highly suspicious of your forecasts and will be less likely to make a good offer for your business.

Compliance

In the recruitment industry compliance is a major factor and when it comes to selling a business any failures can make it unsaleable. Robust compliance procedures are a sign of a quality business and serious buyers will examine them thoroughly as any failures may make an acquisition too risky. This will at the very least, result in warranty clauses in the Share Purchase Agreement should a deal be agreed.

Don't max it out

When you're selling a business a buyer will want to identify areas where they can add value and speed up return on investment. If your business is perfect you deny them that opportunity and will consequently reduce the value and saleability of your business. This is a matter for your business strategy and planning as you need to identify areas of your business that can receive less focus or investment without risking achieving your targets.

In Conclusion

There are several factors that influence the value of your recruitment business and I hope that this guide will help you.

As with everything, the better you plan the more successful you are likely to achieve the results you want.

We are made wise not by the recollection of our past, but by the responsibility for our future.

George Bernard Shaw

Remember that whilst EBITDA is important it isn't everything; it's the starting point for negotiation. By taking the time to prepare your business for sale you can maximise its value and saleability—something that will improve your business whether or not you proceed to market.

For more information about exit planning and preparing a business for sale please come along to one of our regular free educational events.

Full details are on our website – www.evolutioncbs.co.uk/events

"Our thanks to Russell Bell, Senior Partner at asb law LLP for his valuable contributions to this guide. asb law LLP is a full-service UK law firm, providing a range of commercial legal services to a broad client base including UK companies and global businesses."

About Us

Evolution CBS is a boutique M&A advisory company comprising 3 integrated divisions: Business Sales, Business Acquisitions and Business Growth.

Delivering excellent service combined with the highest degree of professional integrity, Evolution CBS helps business owners to maximise the value of their companies so that they realise the best price and the best exit terms when they sell.

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SELLING YOUR BUSINESS FOR ALL IT'S WORTH

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