How Recruitment Businesses are Valued

How Recruitment Businesses are Valued

The most frequently asked question by recruitment business owners is "what is my business worth?". There is never a simple answer to this as many factors influence value and a deep understanding of a business is needed in order to value it, but here we set out to give some guidance on how recruitment businesses are valued.

The formula for calculating the value is:

EBITDA x Multiple = Enterprise Value

Enterprise Value + cash – debt +/- Normalised Working Capital adjustment = Equity Value

Definitions

EBITDA

Earnings Before Interest, Tax, Depreciation and Amortisation

Debt

May include factoring or Invoice Discounting Borrowings.
This is a key issue we address below

Equity Value is the price an acquirer pays to buy a business.

EBITDA

EBITDA is used to measure the maintainable profit which can be generated by a business (i.e. how much profit the business can continue to generate for the new owner), excluding variable items such as interest and tax which can vary from one company to another depending upon their funding structures and rate of corporate tax they pay. The exclusion of these items enables the operating performance of businesses to be easily compared.

An EBITDA figure can include adjustments to the profit shown in the company's accounts to ensure it properly reflects maintainable profits. Examples of common adjustments are:

a. Directors' remuneration. Directors may pay themselves by dividend or salaries which are not in line with market rate (might be higher or lower). An adjustment would be made to ensure that the market rate cost of a person fulfilling the role carried out by an exiting shareholder is properly reflected.

b. Directors may incur certain travel, entertaining or other costs which would not necessarily be recurring when the business is under new ownership. Suitable adjustments would be needed to reflect this.

c. Other non-recurring costs can arise at any time, such as legal fees in the event of a dispute. Adjustments would be made if they are truly one-off items.

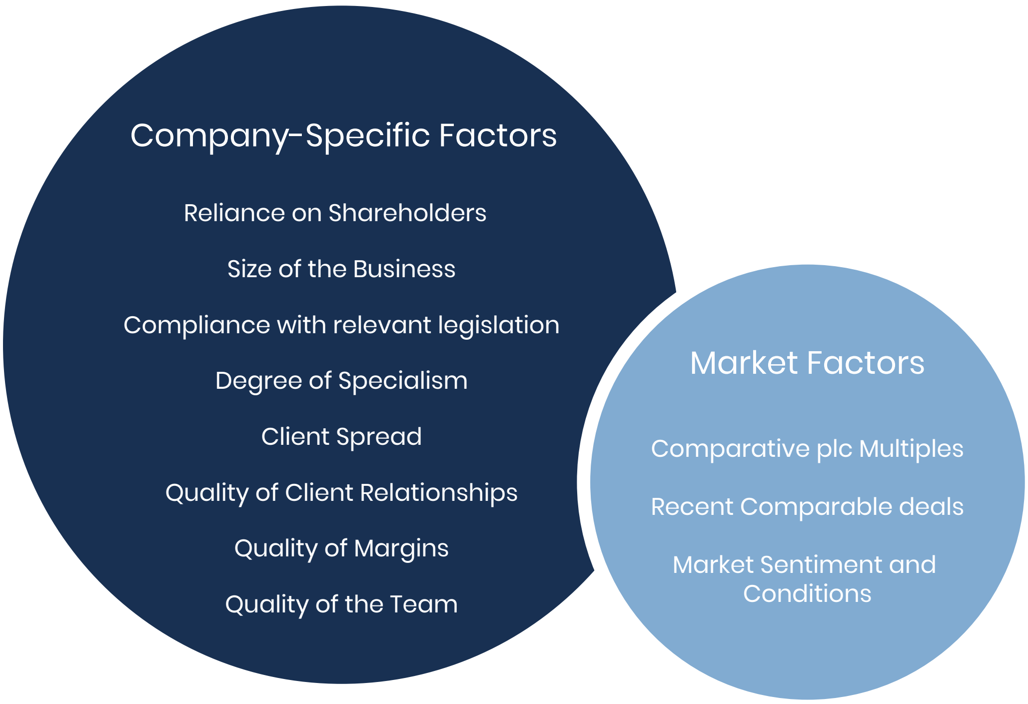
Negotiation is sometimes required to agree which period the EBITDA should be taken for. It could be:

- the last full year
- the current financial year (which may include projections)
- an average of these two periods
- a weighted average of the two periods
- any other combination depending upon circumstances

The Multiple

Having established the EBITDA figure, the key question is what multiple to use. Every business is different and there is no scientific method of determining a suitable multiple. A business has different values to different people depending upon the value they can derive from it. Below are a number of factors which will influence the multiple:

Factors which Influence the Multiple



Any business also has a number of specific matters which will affect its valuation. The above lists are not intended to be exhaustive.

The multiple will also be determined partly in relation to the deal structure adopted. If an owner wants an outright sale, this increases the risk to the purchaser which will therefore be reflected in the price paid, but acquiring the same business if the shareholders remain involved through an earnout for say 2 years after completion will give the purchaser greater comfort and they will therefore be prepared to ultimately pay more for the business.

The strategic fit of a business with a potential acquirer will impact on its value. Examples of value enhancing matters are:

Complementary disciplines	Access to key clients
New territories	Presence on valuable contracts

A business cannot easily plan which of these matters will be of value, but advisors ought to consider who would consider paying the highest price for a business as part of the preparation for marketing a business for sale.

Cash, Debt and Working Capital

As explained above, cash and debt balances are taken into account when calculating the Equity Value. This is sometimes referred to as valuing a business on a cash-free and debt-free basis. This is not a simple calculation. Over the course of a period of months, cash and debt balances fluctuate and an average position needs to be established.

It must be recognised that factoring or invoice discounting borrowings may be treated as debt by an acquirer and therefore could be deducted from the Enterprise Value. This can have a material impact on value, which business owners sometimes fail to appreciate.

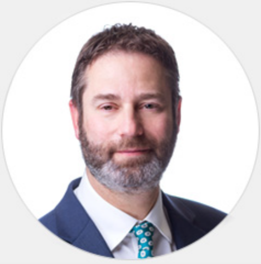
Different acquirers will adopt different approaches to what is classified as debt, so advice is needed when negotiating these matters. Treatement should be established early in negotiations to avoid any nasty surprises later in the process.

The overriding factor when considering this aspect of the valuation process is that an acquirer paying a multiple of profits for a business will regard the business as a going concern which must therefore have sufficient working capital to continue to operate. An acquirer will not expect to have to inject additional funding on top of the purchase price to keep an acquired business running.

Negotiating a normalised working capital figure is a technical negotiation and can result in material changes in overall valuation, so again advice should be taken.

As with any asset, a business is ultimately worth what an acquirer is prepared to pay for it. The valuation methodology in this paper offers guidance as to how to determine a market value for a business against which offers can be benchmarked.

Author



Philip Ellis
Director
philip@optimacf.com
M: +44 (0) 7973 625 211

About us

Optima Corporate Finance is a UK-based M&A consultancy focused exclusively on the recruitment and human capital sector, with expertise stretching more than 20 years. Clients range from owner managers who may sell a business once in their life to public companies who may be serial acquirers. We are equally comfortable at either end of this spectrum and are able to add value to each transaction on which we advise.

We are practical, hands-on advisors who seek to add value in each and every transaction on which we advise and are proud to have been awarded "Best Corporate Finance / M&A Provider" at the 2019 TALiNT International Supplier Awards.

www.optimacf.com