# 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:

1. EBITDA x Multiple = Enterprise Value
2. Enterprise Value + cash – debt = Equity Value

**Definitions**

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| EBITDA | Earnings Before Interest, Tax, Depreciation and Amortisation |
| Debt | Includes factoring and invoice discounting borrowings |

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:

- 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
- 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
- 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:

A. Company-Specific Factors:

- Size of the business
- Compliance with relevant legislation
- Degree of specialism
- Client spread
- Quality of client relationships
- Quality of margins
- Quality of the team

B. Market Factors

- Comparative plc multiples
- Recent comparable deals
- Market sentiment and conditions

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
- New territories
- Access to key clients
- 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 will be treated as debt by an acquirer and therefore will be deducted from the Enterprise Value. This can have a material impact on value, which business owners sometimes fail to appreciate.

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.

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.

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