Redefine your view

AN INTERVIEW WITH

Hannah Rock

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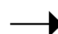
Welcome

to **Redefine Your View**. A thought-provoking series of personal interviews from recruitment leaders and industry specialists

We are delighted to feature Hannah Rock

in our first publication. Hannah sits within Deloitte's Corporate Finance Advisory practice in London and has over ten years' experience across Deloitte's UK and Australian firms. She specialises in providing advice to privately owned and private equity clients in relation to M&A transactions across the Human Capital Services sector.

Her early career included experience in audit, where she managed a diverse portfolio of cross-sector private and listed clients. She is a Chartered Accountant and holds a BSc in Physics from Bristol University.



Q Can you explain in more detail about the M&A division at Deloitte and the role you play when recruitment firms look to achieve a trade sale or gain external PE investment?

We believe we have the largest dedicated and most experienced team in the sector, with over 40 relevant deals completed in recent years. Our work covers a breadth of services from M&A execution, strategic advice, operational improvements and market relationships.

Where a company is looking to achieve a trade sale or is looking at approaching financial investors for a capital injection, we help them to prepare their business for a transaction, work with them to design a process to achieve a successful outcome, approach and negotiate with investors and then manage the transaction through to completion.

Our senior client service team is very hands-on. We have an in depth and real understanding of sector dynamics, value drivers, buyer dynamics, and how to shape strategy to optimise exit positioning and value. We have active and current insight into buyer and investor appetite through recent processes and strong direct relationships with key buyers. This is supplemented by unrivalled support from our global firm, including sector experts across a range of services and disciplines.

> *“We have active and current insight into buyer and investor appetite”*

Q I have often heard discussions regarding what EBITDA number attracts investment and the differing multiples that can be obtained by a recruitment firm who offers either permanent, interim or both recruitment solutions. Can you clarify some of the numbers for us?

It's true that increasing levels of EBITDA opens doors to different groups of investors and also impacts the average multiples paid. This is for a few different reasons. Larger businesses tend to be less dependent on a small group of fee earners or key members of the management team, meaning there is less risk for an investor. We'd therefore encourage recruiters to consider where they sit against a series of valuation metrics, rather than just size.

Trade buyers are often looking for access to a new geography or new market. They may see themselves as capable of achieving this growth organically at a smaller scale so be willing to pay only for a platform asset. Financial investors typically have a size range they operate within, so increasing scale will introduce new investors, but exclude others.

There are lots of multiples quoted in the market but the problem with that is two-fold: Firstly, they are often wrong. Multiples can only be used for comparison if they are multiples of a normalised EBITDA (which in itself can be calculated on a number of different bases). Data points are rarely put in the public domain that would enable you to calculate this accurately, so unless you were directly involved in valuation negotiations you are unlikely to know what the 'real' multiple is. Secondly, there are many different factors that influence valuation in addition to whether the NFI is generated predominantly from permanent or contract offerings.

> *“Unless you were directly involved in valuation negotiations you are unlikely to know what the ‘real’ multiple is”*

Some of these are internal factors but also valuations are also dependent on macro-economic dynamics.

When we first start working with a recruitment company, one of the first things we do with them is to work through key value drivers that may impact the multiple an investor is able to offer. A few of the key ones are:

Unique service proposition – this could be access to a unique candidate base or something more complex that moves a business away from being transactional in nature

Low fee earner concentration – key fee earners should be locked in to reduce the risk of them leaving

Strong management team – if key members are departing through a transaction, this would refer to the management team remaining post transaction

High visibility of earnings – often this comes with contract revenues

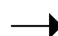
High cash generation – this can be driven by several factors, including high productivity of fee earners

Whilst I recognise I haven’t provided specific multiple ranges, it would be fair to say that contract NFI typically attracts a higher multiple than permanent NFI. However there are plenty of exceptions to this where permanent businesses display atypical characteristics or are otherwise truly unique.

From start to finish what is the typical timeline attached with a full sale and how long have you often worked behind the scenes?

Every process should be tailored to meet the objectives of the shareholders and they can vary dramatically, but there is certainly a ‘traditional’ auction process timetable of around 4-6 months. This would see a period of time dedicated to preparing the business for sale, followed by time spent actively speaking to potential investors. This time is often split into two rounds, each ending in the receipt of offers from interested parties, with more information given to a smaller group in the second round. We seek to reduce the amount of time spent in the market, as it can distract management from running the business.

Our preference is to work with a business for a longer period of time before a transaction so we have a chance to make recommendations that take some time to implement. Often we do that on an informal basis before being mandated, for example attending board meetings to input on strategic decisions and gradually educating the management team in the year before the shareholders are seeking an exit.



Q What areas of a recruitment business do you feel Boards and senior management teams often overlook but play a key role in negotiations for a trade sale?

Balance sheet management is often overlooked in the run up to a sale. Once a headline price is agreed, adjustments are negotiated to reflect cash and debt within the business and also to reflect a 'normal' level of working capital. It is most advantageous to the sellers if the actual level of working capital is higher than the 'normal' level of working capital, so activities such as focusing on reducing debtor days can add real value.

A little bit of knowledge is a dangerous thing when it comes to sales negotiations. I've seen many businesses where management teams have tried to increase their EBITDA in the year of transaction by reducing hiring at a junior level. Whilst new consultants often have a negative contribution to EBITDA for their first few months, taking this kind of action restricts the ability of the company to growth, so they are less likely to hit their forecasts and this would be reflected in the multiple a buyer would be likely to pay.

We spend a lot of time working with management teams to establish what really makes their company unique. In the recruitment sector this is not always as easy as it seems and management should dedicated time to evidencing their USPs. It is also important that the whole management team is on board with these key messages, so any potential buyers are continuously having the same points reinforced by everyone they interact with.

> *"Balance sheet management is often overlooked in the run up to a sale"*

The best thing a management team can do to assist in negotiations is remain focussed on running their business as though they are not in a sales process, although any material decisions such as material abnormal capex spend should be discussed with their advisers. If businesses start to fall behind forecasts during a sales process, this can reduce confidence in the management team's assertions and have an impact on both pricing and buyer appetite.

Q In the present climate, opening a physical overseas office could be considered a significant risk and one not worth taking. Does your geographical footprint impact your ability to sell? Or is it ok to have market presence in Germany without having a physical office in, eg, Frankfurt?

This can create a risk to the business' performance, particularly if you don't have previous experience of opening offices in new jurisdictions. If it goes well it's a fantastic story that demonstrates the ability of the business to scale, but if it is unsuccessful it can lose a material amount of money and create a point of negative focus during a transaction that was completely unavoidable.

Before establishing a physical presence in an overseas market, you should prove the business case for doing so to the board. In the recruitment sector, this is most commonly done through servicing the geography you are looking to enter from current office locations using multi-lingual consultants. If you have the ability to relocate current consultants once you are prepared to move to a physical presence, then you have the benefit of

> *“In the present climate, opening a physical overseas office would be a significant challenge”*

ready-made local leadership who already know how you like to operate.

In the present climate (as I write the UK is in lockdown in response to COVID-19), opening a physical overseas office would be a significant challenge as you would be unable to visit to resolve any teething problems and I can only imagine that international travel may be significantly impacted until there is wide-spread access to a successful vaccine. Personally, I have not spoken to any businesses in recent weeks who are considering opening a new overseas jurisdiction. For those businesses who are seeing increased demand in their current markets, typically they are finding there is plenty of opportunity they can focus on without looking further afield.

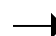
In 2017, Deloitte's UK Recruitment Index highlighted that the most significant barrier to entry to growth for recruitment firms was the need to up-skill employees. In light of COVID-19, what would you say is going to be the most significant barrier to growth as we enter the final part of 2020 and into 2021?

Our research has consistently shown that the ability to source high quality talent and the need to shorten the time required to bring new consultants 'up the curve' to reach full productivity are the two fundamental areas that drive growth.

In the current climate it is also crucially important that companies are proactive in assessing not only their capability to withstand disruption from both an operational and a financial standpoint, but the potential opportunities presented by the current environment. Actions that a company takes during this period can set the foundation for sustained growth and performance long after the pandemic is over.

Many of the recruitment companies we are speaking to have responded to the pandemic very quickly, starting early conversations with lenders, furloughing contractors and consultants. As companies come through this initial phase, we believe it is vitally important to move from short-term cash flow forecasting to longer term consideration of working capital requirements. Many recruitment businesses may see a big lag between the timing of revenue and associated costs as the economy stabilises and need to be prepared for that to take advantage of the uptick.

It is also worth considering the position of key consultants whose equity is currently underwater (without value). Careful consideration will need to be given to how to incentivise them as other recruiters look to expand their consultant base in a recovering economy.



Q Staff retention is absolutely critical in our industry, but especially smaller, privately owned recruitment companies. Increasingly, key employees are often incentivised by equity. What advice would you provide to a CEO who is currently looking at a share scheme but is unsure what route to take? What about key employees who have been offered equity and are unsure whether to take it?

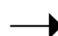
Our research has continuously shown that staff turnover tends to be higher in larger organisations, so whilst each individual leaver has a higher impact on a smaller business, this is an issue that is high on the agenda for recruiters (and other human capital services businesses) of all sizes.

Equity schemes are widespread in the industry now, being used as a tool to lock in key consultants. They can be completely vanilla or highly complex, depending on what is required, and this is often reflected in the cost of setting them up. The first question a CEO would need to ask themselves is: what am I trying to achieve? Are you looking to incentivise a senior member of the team to share your mind set, i.e. to grow the value of the business with less of a focus on short term billings? Are you simply looking to find a more tax efficient way of paying bonuses? Some of the more common concepts include shadow equity, growth shares and share options.

Once you know what your aim is, take professional advice – there are 3 key things to consider here: legal drafting, tax implications (for the business and the employee) and impact on any future transaction. If these schemes are not set up well they can have significant immediate and future tax implications. They can also have a significant impact on a future transaction if the legal drafting is not tight.

> ***"The first question a CEO would need to ask themselves is: what am I trying to achieve?"***

For employees who have been offered equity, assuming it has been structured in a tax efficient manner, there are rarely any downsides. However, the chances are you will lose the equity if you leave the company as the schemes are usually designed to tie you in. You should work through examples of what the scheme could mean for you in various scenarios and most importantly check that there is a point where you will realise value. For example, if you can only realise value from your equity when there is a transaction and the shareholders do not plan on selling until they are ready to retire in 30 years' time, it may be considerably less attractive than equity given to you where there is private equity investment and they are looking to exit in a 3-5 year time period.



Q If you were setting up a recruitment business tomorrow, what area would you specialise in and why?

I would look at some of the largest staffing companies and think about what kind of company they would want to buy. They will rarely turn down the opportunity to look at acquiring in a niche they have struggled to grow in organically. So I would pick a highly specialised niche, ideally in a market that is receptive to contractors. A good example of this could be one particular niche within the IT sector, where you could create a business with strong visibility of earnings through a contract base supplemented by a smaller proportion of permanent placements that naturally eases the cash flow strains of contract NFI. Staying focussed on your core offering can make a business more attractive and enables management to focus their investment in an area of proven capability.

“ I would pick a highly specialised niche, ideally in a market that is receptive to contractors ”

Dryden Search will be looking to host a breakfast seminar later this year and plan to invite Hannah Rock as our guest speaker.

To register your interest please contact
Daniel Close / dc@drydensearch.com
or **Daniel Flynn / df@drydensearch.com**

For more information on how Deloitte’s Corporate Finance Advisory function can assist your recruitment business please contact **Hannah Rock, harock@deloitte.co.uk**

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