Mixed Signals

The staffing industry continues to benefit from a positive operating environment, with every major segment of the industry producing moderate to strong growth. The M&A environment for staffing companies also continues to see increasing activity, as more owners seek to capitalize on improving profitability and realize value through a sale. However, the staffing M&A market is becoming increasingly discriminating, offering very aggressive valuations for the most attractive companies, but providing only opportunistic interest for many sellers.

M&A Environment

Staffing industry M&A activity has continued to increase with the overall strengthening operating environment. There has been a significant increase in seller interest across most segments of the industry. This growth in seller interest is being spurred by many factors, including:

- Improved operating results, making reasonable valuation targets achievable;
- The growing realization that the current recovery is likely to continue to produce only moderate growth and limited margin improvement for most companies; and
- The desire by many owners to avoid the risk of holding a business too long and missing an open window for sellers before an economic slowdown.

In short, to many industry participants the perceived risk of a medium-term slowdown is beginning to outweigh the modest potential growth in valuation offered by the current recovery.

As seller interest has broadened, the M&A market has become increasingly crowded, particularly for small to mid-sized businesses. While buyer interest remains strong, sellers are now competing with other opportunities for buyer attention. In this environment, buyers have had the ability to assume a highly selective posture and to maintain pricing discipline.

The result is a bifurcation of the staffing M&A market. Companies that have the right combination of attractive growth and margins, a differentiated business model or niche focus, and “sticky” relationships with a diverse set of customers have been able to command attractive valuations. On the other hand, undifferentiated companies and companies that are not outperforming the industry are facing limited, opportunistic buyer interest.

Buyers appear to have particular interest in companies that have developed differentiated business models that enable more highly-integrated customer relationships and recurring revenue. Examples include companies with a heavy focus on managed service offerings, “functional outsourcing” solutions, and recruitment process outsourcing. There is also a heavy focus, driven as usual by demands of the public equity markets, on the gross margin impact of potential acquisitions.

By segment, staffing M&A interest remains the strongest in niche markets. There continues to be a shortage of sellers of attractive businesses in the major professional segments, such as F&A and legal. We also are sensing a greater demand for medical staffing companies, particularly companies with strong, defined focuses in a niche allied market. IT staffing companies with strong gross margin profiles and an attractive, diverse customer base are of interest. In commercial staffing, the key to generating interest is scale and having an element of differentiation in your business model.

In terms of buyer categories, we are continuing to see interest from a diverse group. Private companies and international buyers continue to be very active. There is selective interest among public companies, particularly in professional staffing segments. Private equity interest in the staffing industry continues to be very targeted.
Operating Environment

Over the first half of 2006 every segment of the staffing industry experienced positive year-over-year growth. This marks the first sustained period of widespread gains in the industry since early 2001. The consensus of industry analysts is that the recovery will continue through 2007, as Wall Street expects similar growth in 2007 as 2006. Beyond 2007, the outlook is less clear, and the recent volatility among staffing stock prices reflects the growing nervousness about length of the current growth cycle.

While there are clearly pockets of strength, the overall staffing industry recovery continues to be a moderate one. Temporary jobs, as tracked by the Bureau of Labor Statistics (“BLS”) have been relatively flat in 2006, and still remain below the peak level from April 2000. However, we are increasingly hearing from executives that tightness is returning to many segments of the labor market, pointing to pockets of high demand.

One of the more disappointing aspects of the current staffing recovery has been the general lack of improvement in industry gross margins. Industry gross margins declined 2%-4%, depending on the segment, during the downturn. However, the core commercial and IT segments have recovered very little of this lost margin. This obviously reflects the changes in the competitive landscape and greater sophistication among staffing purchasers. This ongoing pricing and margin pressure has had a major impact on the staffing M&A market, as buyers seek to grow their presence in higher margin niche segments and to develop higher-value, higher-margin service offerings.
Commercial Staffing
The commercial staffing segment continued to experience moderate, but sustained growth through the first half of 2006. This fall represents the completion of the 3rd full year of the current recovery for light industrial and clerical/admin staffing. After experiencing relatively strong growth rates during the early stage of the recovery in 2004, the segment has settled into a mid-cycle growth pattern characterized by consistent 2%-3% year-over-year growth. Commercial staffing gross margins have been stable for the past two years, although they do not appear to be experiencing significant improvement in this recovery.

IT Staffing
The IT staffing segment has produced significantly improved growth in the first half of 2006, with year-over-year growth averaging 7% for the public IT staffing companies. The segment has followed a pattern of inconsistent recovery over the past 10 quarters. IT staffing gross margins continued to experience pressure, with year-over-year declines in the public company average for 3 of the past 4 quarters. However, IT staffing companies appear to be adapting to the new pricing reality and adjusting their cost structures, as operating margins have shown consistent improvement since 2001-2002.

Medical Staffing
The medical staffing market continued to experience highly mixed results. Overall, the segment has produced five consecutive quarters of modest growth, averaging 6.5% over this period. However, the results by individual company have varied significantly, with companies that have a strong presence in certain markets, particularly the locum tenens niche, experiencing strong growth, while demand in the per diem nursing market remained relatively flat. Revenue growth and gross margins have benefited from an improving pricing environment, especially in the travel nurse segment.

Professional Staffing
The professional staffing segment continued to lead the industry in the first half of 2006. The segment has experienced 11 consecutive quarters of very strong growth, averaging 15% on a year-over-year basis during that span. However, the growth rates appear to be moderating, partially reflecting that the early gains in F&A staffing from Sarbanes-Oxley have abated. The professional segment also has shown solid improvement in gross margins, as permanent placement revenue continues to rise and higher margin service lines experience strong growth. This has resulted in sharp increases in operating margins which have returned to pre-recession levels in recent quarters.
**Selected Capital Markets Activity**

**October 2006**: J.W. Childs & Associates, a private equity group, announced the acquisition of Employbridge Holdings, a provider of commercial, logistics & transportation, and accounting and finance staffing services.

**October 2006**: TEKsystems, Inc., a provider of IT staffing, announced the acquisition of TSG IT Resources, an IT staffing company based in Massachusetts. Terms of the transaction were not disclosed.

**October 2006**: Kforce Inc. (NASDAQ: KFRC), a provider of IT, finance & accounting, and scientific staffing solutions, announced the acquisition of Bradion Corp., a provider of finance & accounting staffing services to the federal government. The enterprise value of $73.0 million represents a multiple of 6.0x projected 2006 EBITDA.

**September 2006**: Heidrick & Struggles International, Inc., a human resource and leadership consulting provider, announced the acquisition of Highland Partners, an executive search and staffing services provider. The enterprise value of $51.6 million represents a multiple of 0.9x revenue.

**September 2006**: Headway Corporate Resources Inc. completed a recapitalization with an investor group affiliated with management. Ewing Bemiss & Co. advised Headway on this transaction.

**August 2006**: Cross Country Healthcare, Inc., a healthcare staffing provider, acquired Metropolitan Research Associates, a contract research and clinical staffing provider. The enterprise value of $18.6 million represents a multiple of 7.1x EBITDA.

**August 2006**: Terra Nova Acquisition Corporation, a specified purpose acquisition corporation, agreed to acquire ClearPoint Business Resources, Inc., a workforce management solutions provider, in a reverse merger transaction. The enterprise value of $43.6 million represents a multiple of 6.2x EBITDA.

**June 2006**: SELECT Personnel Services, a diversified staffing provider, acquired Remedytemp Inc., a commercial and specialty staffing provider. The enterprise value of $124.8 million represents a multiple of 11.8x EBITDA and 0.2x revenue.

**May 2006**: Sentinal Capital Partners, an Ontario-based private equity firm, said it would acquire Interim Healthcare, Inc., a healthcare staffing provider.

**May 2006**: Vedior NV’ (ENXTAM: VDOR), a diversified staffing firm, acquired CNC Global Limited, an IT staffing and solutions provider.

**May 2006**: Jackson Healthcare Solutions, Inc., a healthcare staffing services provider, acquired World Health Alternatives, Inc., a nursing and healthcare staffing provider. The enterprise value of $43.0 million represents a multiple of 6.8x EBITDA and 0.5x revenue.

**March 2006**: Global Employment Holdings, Inc., a public shell company, acquired Global Employment Solutions, a diversified staffing provider. The enterprise value of $87.5 million represents a multiple of 8.3x EBITDA and 0.8x revenue. Ewing Bemiss & Co. advised Global Employment Solutions on this transaction.

**January 2006**: Kforce Inc. (NASDAQ: KFRC), an IT, finance & accounting, and scientific staffing solutions provider, acquired Pinkerton Computer Consultants, an IT services provider. The enterprise value of $60 million represents a multiple of 0.6x Pinkerton’s revenue.

**EB&Co. Index Notes:**

Sources: SEC documents and EB&Co. estimates. All indices are pro formas for any material acquisitions and adjusted for foreign currency fluctuations.

- **Commercial Staffing Index** includes: ADO (North America only), AHI, BBFI (Staffing division only), CDI (Today’s Staffing Division only), KELYA (US Commercial only), LRIW, MAN (US only), Randstad (North America only), REMX, SFN, (Recruitment Division only), VOL (Commercial Division only), WSTP.
- **IT Staffing Index** includes: ADO (Ajilon only), ANLY, CDI (IT/technical divisions only), HHGP (staffing division only), KEA, KFRC (IT Division only), MPS (IT divisions only), CITP, VOL (IT division only), CHRC (IT division only), TSRI.
- **Medical Staffing Index** includes: AHS, CCRN, MRN, ASGN (Healthcare staffing only), AHN, TSSF (Staffing only), SUGN (Staffing only), KFRC, CHG.
- **Professional Staffing Index** includes: BUTL, CT5 (Staff augmentation only), KFRC (Accounting & finance only), HHGP (staffing division only), MPS (Professional staffing only), RECN, RHI, KELYA, (PTSA adjusted), ASGN (non-healthcare), Vedior (US only), SFN (professional services), MAN (Jefferson Wells only), MSXI (human capital only), CDI (Business Solutions except IT/technical), }

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