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## Business Reference Guide Online

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### Service Businesses

**SIC:** Unavailable**NAICS:** 81**Number of Businesses / Units:**  
Unavailable

#### The Sector as a Whole

The Other Services (except Public Administration) sector comprises establishments engaged in providing services not specifically provided for elsewhere in the classification system. Establishments in this sector are primarily engaged in activities, such as equipment and machinery repairing, promoting or administering religious activities, grantmaking, advocacy, and providing drycleaning and laundry services, personal care services, death care services, pet care services, photofinishing services, temporary parking services, and dating services.

Private households that engage in employing workers on or about the premises in activities primarily concerned with the operation of the household are included in this sector.

Excluded from this sector are establishments primarily engaged in retailing new equipment and also performing repairs and general maintenance on equipment. These establishments are classified in Sector 44-45, Retail Trade.

#### Rules of Thumb

50 percent of annual revenues [sales] plus inventory; however it is not unusual for service businesses to sell for a much higher figure

72 percent of annual sales plus inventory

2 times SDE

#### General Information

#### Expert Ratings

|                           |     |                            |
|---------------------------|-----|----------------------------|
| ▶ Competition             | 2.8 | (1=Lot of : 4= Not Much)   |
| ▶ Amount of Risk          | 2   | (1=Very : 4= Not Much)     |
| ▶ Historical Profit Trend | 2.8 | (1=Down : 4= Up)           |
| ▶ Location & Facilities   | 2   | (1=Poor : 4= Excellent)    |
| ▶ Marketability           | 2   | (1=Low : 4= High)          |
| ▶ Industry Trend          | 2.8 | (1=Declining : 4= Growing) |
| ▶ Ease of Replication     | 2.4 | (1=Easy : 4= Difficult)    |

#### Pricing Tips

"Consider the last 3 to 5 years—is it an up or down trend? Is the business expandable or is it at its peak?"

#### Valuation Issues for Service Companies

"On the plus side, almost all service companies have recurring revenue. Some, like funeral homes, have very little, while others, like Paychex (payroll service), Cintas (uniform rental) and Dun & Bradstreet (credit reports) have a lot of recurring revenue with each customer. Another plus is that service companies usually have modest capital equipment requirements resulting in a high return on assets. Expansion and geographic roll-outs like retail and restaurant chains can be readily expedited. Additionally, service companies are less impacted by foreign competition. From a macro-economic view, the U.S. had a \$65 billion service trade surplus in 2002 while the U.S. had a large manufactured goods deficit in 2002. And, from a competitive point of view, large service companies can source services off-shore just as manufacturing companies have done in order to reduce costs. For example, the annual cost for a computer-related employee in the U.S. is \$61,600 compared to India at \$5,800.

"On the minus side, service companies are largely dependent on their management team and employees. They are, by and large, the assets of the company... so imagine what would happen to the value of an architectural firm or a law firm if the people walked off their job. Since labor is the major expense of

**Expert Comments**

"Competition and the industry trends (growing or constant) are important for calculating the ROI on the intangible part."

service companies, they are more difficult to substantially increase sales (or scale-up) compared to manufacturing companies where labor might only represent 20% of sales.

"From a service owner's perspective, rarely can they fully cash-out at closing or rarely can they walk away from the business at closing, as service companies are highly relationship driven... not only with the customers but with the employees. Further, unlike some small niche manufacturers, many service companies need to reach a higher revenue threshold of \$10+ million to prove the company's viability of not being dependent on just a few key people or a few key customers.

"The valuation multiples vary widely across the various sectors and equally divergent are the various structures of the transactions. Of course, the critical issues in the valuation of service companies include the extent of their profitability, relative size, proprietary nature of the service firm's capabilities and the potential growth. Conventional wisdom dictates that service firms are valued between .5 x to 1.0 x revenues, but a closer look at the following sectors shows a wide differential of valuation metrics based on Last Twelve Months (LTM) of revenues and EBITDA."

**Service Businesses**

| Sectors                     | LTM Revenue | LTM EBITDA |
|-----------------------------|-------------|------------|
| IT Services                 | 1.0x        | 9.1x       |
| Outsource Business Services | 3.8x        | 15.5x      |
| Professional Employer Org.  | 0.4x        | 8.5x       |
| Healthcare Services         | 1.6x        | 10.0x      |
| Consulting Firms            | 2.2x        | 14.9x      |
| Advertising/Marketing       | 1.4x        | 12.8x      |

Note; LTM is Last Twelve Months

Source: "Selling Service Companies," *M&A Today*, April 2004

The information and data contained above and in the article above was furnished by Susan Pravda, a transaction attorney with Epstein Becker & Green (spravda@ebglaw.com) and Robert Cronin of Stonebridge Technology Associates, an investment banker (rcronin@stonebrtech.com), and appeared in *M&A Today*, April 2004. LTM is Last Twelve Months.

**Disadvantages**

- ▶ "Good help is hard to find—even at fair compensation."