

BUSINESS TRENDS

PEO MEGATRENDS:
THE WAVE OF CONSOLIDATION
AND ITS IMPACT



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It has been a historic year for the PEO industry with the completion of the two largest transactions in the history of the industry. The two blockbuster transactions were the Paychex (NASDAQ: NYSE) acquisition of Oasis Outsourcing, Inc., which was announced in the fourth quarter of 2018, a deal purportedly valued at \$1.2 billion, and the Aquiline Capital Partners acquisition of CoAdvantage from Morgan Stanley in a third quarter 2019 transaction, expected to be valued near \$800 million, although that information was unavailable at the time of this writing.

So, how large has the wave of consolidation been over the last several years? The PEO market is filled each year with a large number of transactions from players large and small across the country. Let's take a look at some of the largest PEO players in the industry by worksite employee (WSE) count. Those in Table 1 below have completed PEO transactions within the last decade.

WHAT MAY NOT BE EVIDENT IS THE INDIVIDUAL STORY THAT EACH TRANSACTION HOLDS. MANY TIMES, THE ASSETS TRANSACTED ARE THE RESULT OF A CAREER'S WORTH OF WORK.

The impact of consolidation in the PEO industry could be viewed as positive or negative. Some of the positive impact consolidation has had on the PEO industry includes:

- The successful completion and monetization of an entrepreneur's life work;
- Increased sophistication in the PEO value proposition and evolution to better insulate the industry from encroaching business service models (such as Namely and BambooHR);
- Additional innovations in technology and automation;
- Greater interest from private equity and the capital markets, bringing more professionals into the industry with more diverse backgrounds and experience;
- Greater market awareness of the PEO model by the business community and, more importantly, small and mid-size businesses;
- An offsetting number of new entrants filling the vacuum created by consolidation, even though the speed of consolidation has accelerated; and
- Rising gross profit per WSE among all participants in recent years;

Some of the negative impact consolidation has had on the PEO industry includes:

- A reduction of NAPEO revenue to support the mission and lobbying efforts of the PEO industry due to its graduated dues structure;
- A reduction of accredited PEOs and the corresponding Employer Services Assurance Corporation (ESAC) revenue to support the mission of accrediting PEOs; and
- As a byproduct of consolidation and the process of synergizing the combined entities, the potential loss of jobs (although acquiring entities often desire highly skilled personnel to bring within the transaction).

THE IMPACT OF A FEW COMPANIES ON THE INDUSTRY

In sports, a coach's success is often measured based on how many head coaches are produced from his stable of assistant coaches. In the same vein, we

TABLE 1. SOME OF THE LARGEST PEOs BY ESTIMATED WSE COUNT.

	PEO	Ownership	Estimated WSEs
1	ADP TotalSource Inc.	NASDAQ: ADP	500,000+
2	Paychex Business Solutions, LLC (including Oasis acquisition)	NASDAQ: PAYX	400,000+
3	TriNet Group, Inc.	NYSE: TNET	300,000+
4	Insperty, Inc	NYSE: NSP	200,000+
5	Vensure Employer Services, Inc	Private: Solamere Capital	200,000+
6	Barrett Business Services, Inc.	NASDAQ: BBSI	200,000+
7	Southeast Personnel	Private	100,000+
8	CoAdvantage	Private: Aquiline Capital Partners	90,000+
	Total of the listed PEOs		2,000,000+
	Estimated total of PEO industry		4,000,000
	Marketshare of the listed PEOs		50%+

FIGURE 1. THE PAYCHEX PEO CONSOLIDATION TREE.

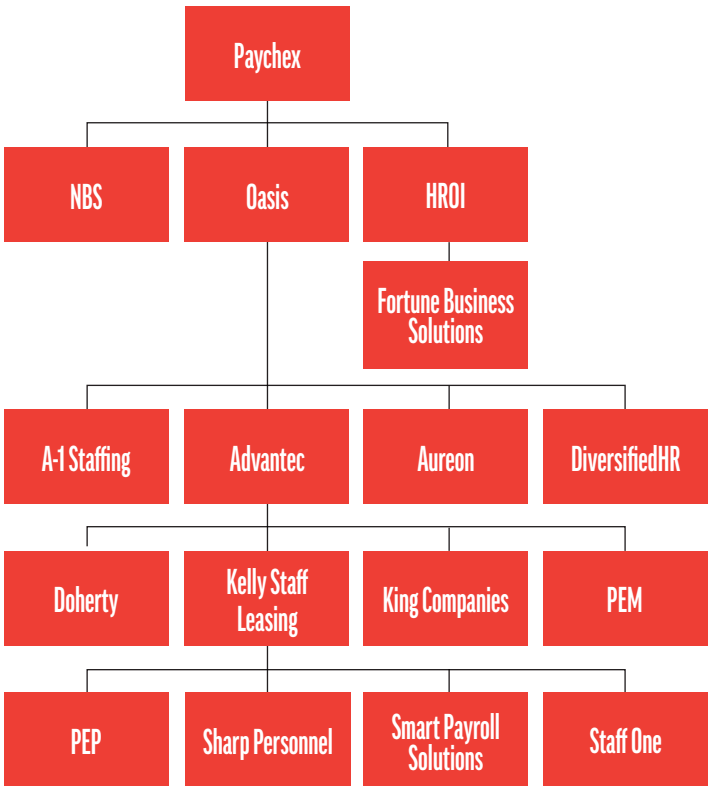


FIGURE 2. THE TRINET PEO CONSOLIDATION TREE.

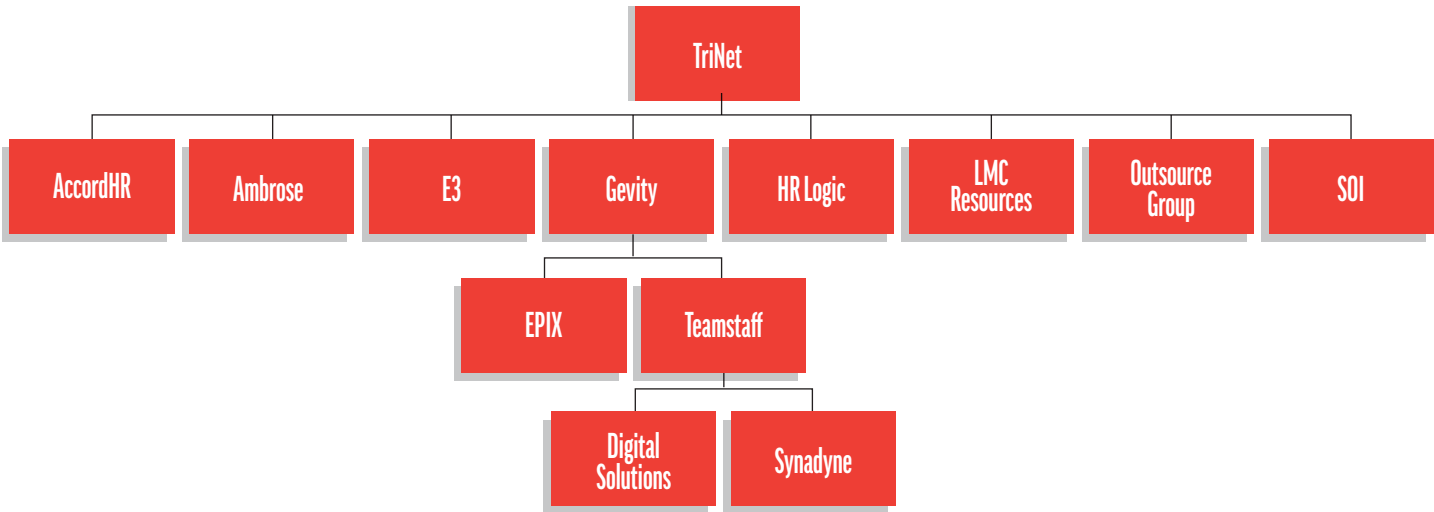


FIGURE 3. THE VENSURE EMPLOYER SERVICES PEO CONSOLIDATION TREE.

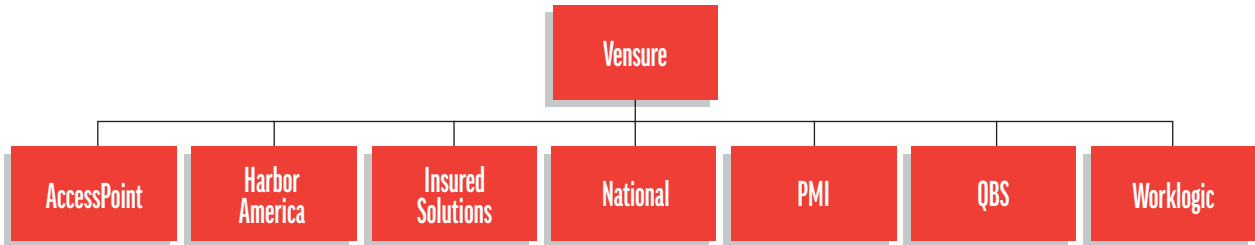
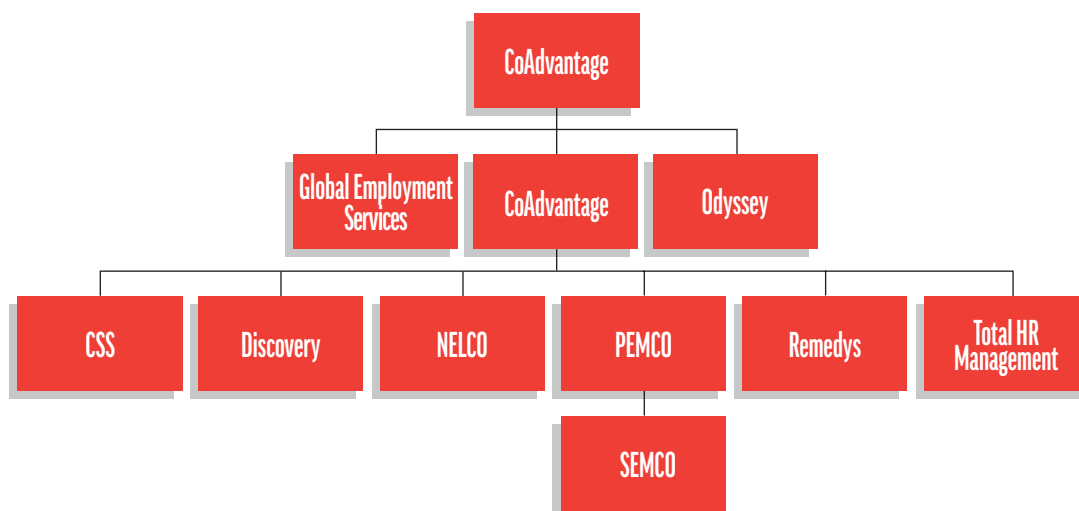


FIGURE 4. THE COADVANTAGE PEO CONSOLIDATION TREE.



DEMOGRAPHICS, TECHNOLOGY, COMPETITIVE INNOVATION, AND MANY OTHER FACTORS WILL DRIVE THIS ACTIVITY.

introduce the concept of the “PEO Consolidation Tree” for four of the consolidators we highlight in Table 1.

Please keep in mind that we may miss some of the historical acquisitions of these groups in our review of our archives, but the Consolidation Tree is only meant to give you a visualization of the impact that a few companies can have on the landscape of an industry. These only represent the activity of four consolidators. There are also many regional, middle market, and even local PEOs that have been active mergers and acquisition (M&A) transactors in the PEO space.

Those considering adopting an acquisition strategy to supplement their organic growth strategy must develop and refine a simple, smooth, and efficient process of finding, closing, and integrating these

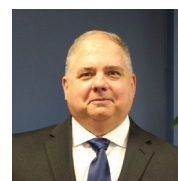
PEO properties. This must include the ability to:

- Retain the clients of the acquired entity;
- Protect the culture of the acquirer; and
- Have a scalable human resources information system (HRIS) platform that has the capacity to accommodate the additional scale.

From the above perspective, it is interesting to see how many entities are impacted by M&A activity. What may not be evident is the individual story that each transaction holds. Many times, the assets transacted are the result of a career’s worth of work. These are true life-changing events for the human beings involved.

It is most likely that the activity level relating to M&A will continue and these life-changing events will continue. Demographics, technology, competitive innovation, and many other factors will drive this activity.

When considering entering into this activity (either buying or selling), it is important to choose wisely, as it is someone’s career culmination (possibly yours). A multitude of considerations can make or break the process for your specific event. As we have said in other published articles, “Measure twice and cut once.” It will pay dividends (literally and figuratively)! ■



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