

# Can PEOs Afford a Cyclical Economy?

*Evolving Cultural Trends Call for Workforce Change*



**BUSINESS-TO-BUSINESS SERVICES**

Carleton McKenna & Co



## TABLE OF CONTENTS

Professional Employer Organization Sector Trends	3
Key Factors Driving Performance	4
Industry Constraints Put a Hold on Potential Growth	4
Competitive Landscape Varied Across Markets	5
How Can PEOs Overcome Industry Volatility	7
Select Transactions & Industry Multiples	8
Carleton McKenna Team & Track Record	9

## CARLETON MCKENNA BUSINESS-TO-BUSINESS SERVICES BANKERS



**Paul H. Carleton**  
Managing Partner  
[phc@carletonmckenna.com](mailto:phc@carletonmckenna.com)



**Nora T. Mahoney**  
Managing Director  
[ntm@carletonmckenna.com](mailto:ntm@carletonmckenna.com)



# Can PEOs Afford a Cyclical Economy?

## *Evolving Cultural Trends Call for Workforce Change*

### KEY TAKEAWAYS

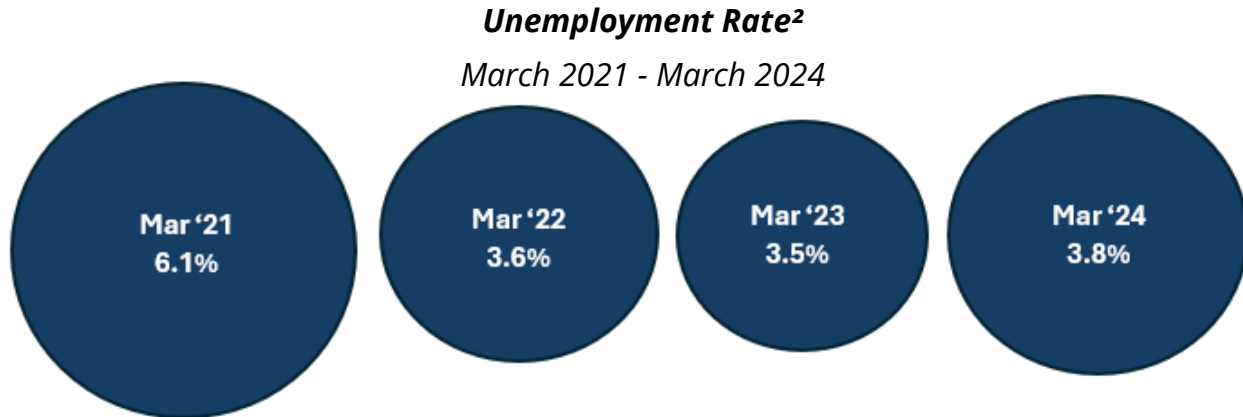
Carleton McKenna is pleased to share its 2Q24 PEO report following [PEOs At a Glance](#). In this report, Carleton McKenna explores the strategic marketplace, consolidation trends, noteworthy transactions, as well as what the future deal-making landscape may look like for PEO service businesses to help sector participants shape their strategies for the near- to medium-term.

1. **Increasing Demand:** Small and medium-sized businesses are increasingly recognizing the benefits of outsourcing HR and administrative tasks, driving growing demand for PEO services.
2. **Regulatory Changes:** Evolving labor laws and regulations are creating new compliance challenges for PEOs that they need to address.
3. **Technology Disruption:** PEOs are leveraging new software tools and platforms to offer more customized and streamlined services to their clients, automating processes and improving efficiency.
4. **PEO Consolidation:** The industry is consolidating, with larger PEO players acquiring smaller ones to increase market share and expand service offerings.
5. **Cost Pressures:** PEOs are facing rising costs, including healthcare, compliance, and competitive pressures, leading to a greater focus on efficiency and cost optimization.
6. **Agile Business Models:** PEOs are adopting more agile business models, leveraging technology and partnerships to offer flexible and customized services to their clients.
7. **Focus on Employee Engagement:** PEOs are placing a greater emphasis on employee engagement, recognizing that engaged employees are more productive and contribute more to their clients' bottom lines.
8. **Expansion of Service Offerings:** PEOs are broadening the range of services they offer, such as employee immigration, global recruitment, and international HR support, to provide more comprehensive solutions to their clients.
9. **Revenue Volatility:** The pandemic more than doubled the national unemployment rate, but rising production recovery has brought a jump in revenue.

Carleton McKenna has meaningful experience in the PEO industry, with an interest in cutting edge, tech-enabled businesses and a diverse mix of PEO clientele. To learn more about Carleton McKenna's wide range of transaction experiences, strategies for growth or exit, and current PEO industry trends, please [contact us](#).

## Key Factors Driving Performance

The labor market has played a vital role in overall industry revenue volatility. Pandemic losses and post-pandemic recovery in the PEO (professional employer organization) industry has reinforced the risk associated with layoffs and cost savings during recessions, though directly impacted lower unemployment, a higher labor force participation rate and strong population growth during times of economic prosperity. All factors have led to a boost in demand for professional employment organizations. However, historical investment in PEOs following the 2008 recession and the corresponding consumer spending surge came to a screeching halt at the onset of the pandemic in 2020.



Overall business expansion and employment growth over the prior 12 years reversed completely as unemployment rates doubled and the labor market deteriorated exponentially. In the aftermath of the pandemic, revenues surged in accordance with the economic rebound.

Based on prior economic downturns, PEOs are closely tied to overall economic performance, so any additional shifts in factors including the labor force participation rate, inflation and consumer spending will dictate industry health and profitability.

### ***External Factors Rescued the Industry Post-Pandemic<sup>1</sup>***

The pandemic forced many companies to downsize, pause or shut down operations, leading to a drop in revenue. Not long into the recovery period, many businesses looked to PEOs amidst the virus' effects on health insurance, paid leave and workers compensation complexities. Similarly, corporations that continued to work with PEOs through the pandemic increased their operating use of PEOs to stay ahead of the economic rebound curve.

On the same side of the coin, PEOs benefited significantly from the proliferation of Paycheck Protection Program (PPP) loans, leading to companies investing more in PEOs and less on internal expenses. Overall, the nature of the virus and government aid kept industry revenue from plummeting drastically.

### **Industry Constraints Put a Hold on Potential Growth**

Employment rates can fluctuate on their own accord relative to the number of people entering the workforce or retiring, however scarcity of top talent is generating significant concern for HR professionals according to NAPEO's iSolved report for 2023. To provide further clarity, the cultural trend inciting young adults to pursue non-traditional educations has translated itself into a "lack of talent" entering the corporate workforce. The top five challenges providers faced when running their business was reported as (i) operating cost, (ii) securing talent, (iii) attaining revenue goals, (iv) effectively training employees and (v) possible security breaches.<sup>3</sup> These concerns run parallel to the need for PEOs to adapt with their client's needs and must ensure that their human capital management technology partners are poised handle evolving client sentiments.



# COMPETITIVE LANDSCAPE VARIED ACROSS MARKETS

Labor law regulatory changes have created a separate issue for PEOs related to the Affordable Care Act and the PRO Act.

## **Affordable Care Act | Increased Compliance Challenges**

Flexible business models have run rampant in the post-pandemic economy, but legislation is just catching up to the ever-changing workplace trends. Work from home brings forth a new number of compliance issues related to productivity, employee engagement and compensation management. PEOs should be prepared to recenter their business models to compete with the younger generation's ideal workforce conditions to find and keep top industry talent.

## **The PRO Act | Liability Expansion, Arbitration Restrictions and Information Disclosure**

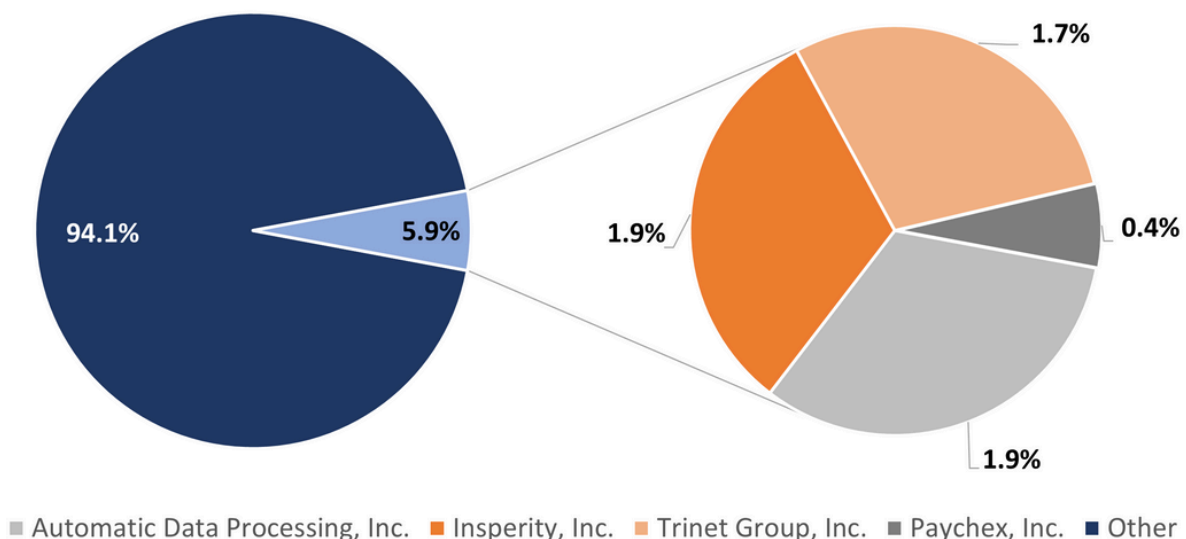
Meant to expand upon current labor protections related to employee rights, the PRO Act (i) broadens the scope of individuals covered by the fair labor standards, (ii) permits labor organizations to encourages union member participation during strikes initiated by employees of other labor organizations (i.e., secondary strikes) and (iii) prohibits claims to be brought against unions conducting secondary strikes. Though it was passed in 2021, more power has been placed in the hands of the employees and has become increasingly apparent in the rise of strikes and outcries for workplace equality and fairness. This bill will remain catalyst for the workforce as House Representatives begin the process of introducing resolutions inclusive of various racial or gender specific demographics.

On a state-wide basis, legislation for licensing agreements has constrained business growth across state lines for those PEOs that are unfamiliar with local legislation. Hawaii, California, Minnesota, and New Jersey are among the few states that have created 2,400 new pieces of legislation related to the pandemic.<sup>1</sup> In general, it's more difficult for small establishments to comply with these regulatory requirements, so many non-employers and smaller PEOs have left the industry further increasing market share concentration.

## **Competitive Landscape Varied Across Markets**

The PEO industry is characterized by a moderate level of market share concentration, with the top four companies generating around 50% of total industry revenue.<sup>1,4</sup> However, total industry revenues from the top four companies has continued to grow in accordance with the acquisition of smaller PEOs with greater regional concentrations.

**2023 Industry Market Share Concentration<sup>1</sup>**



# COMPETITIVE LANDSCAPE VARIED ACROSS MARKETS

ADP has been most active in the industry regarding mergers and acquisitions. In January 2023, the company acquired SecurAX. SecurAX is the proprietor of SecurTime, a platform that provides a single, accurate, real-time view of attendance, performance, productivity, cost and compliance of the client's workforce. In a similar move, ADP went on to acquire Honu HR, Inc. BDA Sora in August 2023. Sora is a low-code intelligent workflow automation and data integration tool that unifies disparate business applications such as HR, IT and other systems and data sets to create a smarter, easier-to-use experience for employees, business owners and HR professionals.<sup>5</sup>

## Notable Acquisitions in 2023<sup>5</sup>



was acquired by



### ***SecurAX Acquired by ADP TotalSource***

SecurAX was founded in 2012 and serves more than 500 customers across multiple countries. The company offers robust, scalable cloud-based enterprise workforce management software that will provide access to emerging sectors in India and APAC such as Logistics, Healthcare, and E-Commerce.



was acquired by



### ***Honu HR, Inc. DBA Sora Acquired by ADP TotalSource***

Founded in 2018, Sora's acquisition by ADP further solidifies ADP's long-standing strategy to simplify complex HR processes through automation. ADP will be able to provide clients' HR teams with the ability to build and iterate existing workflows, automating many key processes including communication, data collection and more.

ADP has continued to acquire niche service businesses within the PEO industry and is forecast to continue generating momentum with mergers and acquisition activity. The outstanding 94% of market share is spread across about 6,300 businesses in the United States. As a highly fragmented industry, small and medium-sized PEOs can expect increasing competition as direct competitors look to expand beyond local boundaries.

While the locality of smaller PEO business may work to limit the dispersion of market share to national companies, those smaller businesses become limited in revenue growth opportunities and must understand the higher likelihood that company growth will plateau over time. In a cyclical pattern, national PEOs like ADP will acquire those local, plateaued companies and market share will shift further in favor of the top four PEOs. Current multiples in the industry offer a better idea of what PEOs could expect during a transaction, should they choose to sell in the coming year.



## How Can PEOs Overcome Industry Volatility?

### ***Diversify the Client Base<sup>6</sup>***

Small- and medium-sized businesses (“SMBs”) should avoid over concentration within any one industry vertical that may be highly cyclical, as it could contribute to greater volatility. For example, if a PEO is heavily focused on new construction clientele, they may feel a greater impact in economic shifts. When the economy is booming, new construction is flourishing, and the PEO reaps the benefits. Conversely, an economic downturn typically indicates mass layoffs and a reported revenue loss for PEOs. Though the PEO can rebound over time, it may be a slower curve for its competitors that have greater diversity in their client mix.

### ***Focus on High-Growth Sectors<sup>7</sup>***

Target industries and clients that are less prone to inflationary pressures, such as professional services, technology companies or medical practices. Although continued federal policies are expected to be put into action and relieve inflationary pressures, it is critical for PEOs to be mindful of these risks if they want to remain profitable and competitive.

### ***Emphasize Operational Efficiency<sup>8</sup>***

Optimization of internal processes and the leveraging of economies of scale have lent a hand to competitive pricing and profitability for PEOs willing to integrate new software and services that reduce time spent on repetitive or mundane tasks. Technology is an essential function within the PEO industry and business model. With innovation and advancements consistently occurring in the tech space, a PEO must remain abreast of developments that could positively or negatively impact their end-users and internal efficiency.

### ***Enhance Service Offerings<sup>8,9</sup>***

Economies of scale enhance the overall value proposition for PEOs such as HR technology, employee benefits, and compliance support. As a PEO grows, it will scale its operations. How the PEO scales will play a role in determining its operational efficiency and net profit as a percentage of revenue. The other benefit to scale is purchasing leverage to negotiate insurance, technology TPAs, etc. In accordance with operational efficiency, scaling service offerings combined with purchasing leverage will allow a PEO to drop more profit to the bottom-line.

### ***Maintain Strong Client Relationships<sup>6</sup>***

Focus on client retention through excellent service and responsiveness to customers’ evolving needs. As noted in the report, now more than ever will businesses be shifting their models in favor of cultural trends. PEOs should be no stranger to these shifts and work to openly strategize with and for their clients resulting in mutual success and business longevity.

### ***Prepare for Cyclical Shifts<sup>6,7</sup>***

Anticipate and plan for potential economic downturns with applicable recovery strategies and cost structures to ensure financial stability. Similarly, leverage the ability to quickly add new clients during a recession to offset any declines or include the diversification of customers in strategies to mitigate further volatility.

Though these factors relate heavily to PEOs remaining profitable and competitive in the industry, mergers and acquisitions can present both opportunities and complexities for PEOs, underscoring the potential value of partnering with a global PEO to provide services to a greater mix of clients across multiple sectors.

# SELECT TRANSACTIONS & INDUSTRY MULTIPLES

## Professional Employer Organizations<sup>12</sup>

(2013 - Present)

TEV Range	TEV \$	Revenues \$	TTM Rev Growth %	EBITDA Margin %	TEV/Revs	TEV / EBITDA	N
10 - 50	\$ 23.4	\$ 51.9	10.0%	11.8%	0.7x	5.8x	3
Total	\$ 23.4	\$ 51.9	10.0%	11.8%	0.7x	5.8x	3

## Business Support Services<sup>12</sup>

(2013 - Present)

TEV Range	TEV \$	Revenues \$	TTM Rev Growth %	EBITDA Margin %	TEV/Revs	TEV / EBITDA	N
10 - 25	\$ 16.2	\$ 22.5	12.6%	21.3%	1.2x	5.6x	30
25 - 50	\$ 34.7	\$ 21.7	25.3%	29.2%	2.2x	7.5x	19
50 - 100	\$ 76.8	\$ 75.4	10.7%	21.3%	1.6x	7.1x	9
100 - 250	\$ 130.9	\$ 66.0	11.5%	29.9%	2.6x	8.3x	4
Total	\$ 38.1	\$ 32.8	16.2%	24.3%	1.7x	6.6x	62

## Administrative and Support Services<sup>12</sup>

(2013 - Present)

TEV Range	TEV \$	Revenues \$	TTM Rev Growth %	EBITDA Margin %	TEV/Revs	TEV / EBITDA	N
10 - 25	\$ 16.5	\$ 22.4	11.8%	19.2%	1.1x	5.9x	103
25 - 50	\$ 34.7	\$ 37.0	17.7%	20.7%	1.5x	7.0x	74
50 - 100	\$ 73.6	\$ 72.1	14.0%	18.0%	1.5x	8.0x	50
100 - 250	\$ 134.7	\$ 119.2	9.8%	21.4%	2.1x	9.4x	23
Total	\$ 44.1	\$ 45.6	13.8%	19.6%	1.4x	7.0x	250

## Select M&A Transactions<sup>10,11</sup>



has acquired



TPG's investment in G&A Partners will help the company continue to provide comprehensive services across HR management software, payroll administration, health insurance and benefits, risk management and compliance, and outsourced accounting for more than 3,000 SMBs nationwide.



and

STONE POINT CAPITAL

have acquired



MarathonHR Services, LLC was acquired by Vensure Employer Solutions, via its financial sponsor Stone Street Capital. Through an LBO in February 2024, the acquisition broadens the reach for professional employer organizations, administrative services organizations and payroll services in Georgia and surrounding states.





**Paul H. Carleton**  
Managing Partner

Paul is founder and Managing Partner of Carleton McKenna & Company. He has more than 40 years of experience in corporate and investment banking focusing on mergers and acquisitions and capital raising activities for both private and public corporations. Prior to establishing Carleton McKenna, Paul was founder and Senior Managing Director of Carleton, McCreary, Holmes & Company, which was acquired by KeyCorp. Paul was previously Senior Managing Director and Head of Corporate Finance at the regional investment banking firm of McDonald & Company.

Paul has extensive corporate governance experience serving on corporate boards and not-for-profit boards. He has served on over 15 private company boards and currently sits on the Boards of E & H Family Group, Inc. and Breuer Premium Pet Food, Inc. Paul earned his bachelor's degree from Baldwin Wallace University and his master's in business administration from Northwestern University. He also received an honorary doctorate degree from Baldwin Wallace University.



**Christopher J. McKenna**  
Managing Partner

Christopher McKenna is Managing Partner at Carleton McKenna & Company. Before joining Carleton McKenna, Chris partnered with a private equity firm to buy a Cleveland manufacturing business where he was President and CEO. Previously, Chris was the Director of Financial Analysis with the MacLean-Fogg Company in Chicago where he executed on financial transactions and acquisitions and also managed a business unit.

Chris was an Associate with the investment banking firm of Rodman & Renshaw in New York, where he was involved with private and public transactions to raise equity, subordinated and senior debt. He began his career in commercial banking in New York with Manufacturers Hanover Trust and Security Pacific Business Credit. Chris received his B.A. in Economics from Dartmouth College and his M.B.A. with High Distinction from the University of Michigan Business School.



**Nora T. Mahoney**  
Managing Director

Nora T. Mahoney has experience with securities regulation, corporate governance, commercial litigation and broker dealer registrations. Nora is primarily responsible for the execution of capital raisings and private placement assignments across a variety of industries, as well as M&A advisory for business owners, specifically focused in B2B Services and Manufacturing.

Prior to joining Carleton McKenna, Nora worked for Attorney General Mike DeWine and then practiced Commercial Litigation with a national law firm where she was involved in pre-trial practice for securities litigation.

Nora was awarded her Juris Doctor and Masters from Vermont Law School and serves as a Board Member for First Federal of Lakewood and as an executive Board Member for the Union Club of Cleveland. She also serves on the Board of Trustees for Baldwin Wallace University, from which she received her Bachelors in Biology and Sustainability.



## **Alexis M. Becker**

Vice President

Alexis is a Vice President at Carleton McKenna & Company. As part of Carleton McKenna's senior management team, Alexis manages M&A and capital raise transactions, guiding clients from preparation and marketing stages through negotiation and close. As part of transaction processing, Alexis reviews and develops marketing materials, conducts financial and valuation analysis, identifies strategic and financial partners for clients and facilitates due diligence processes. Alexis is also actively involved in building and maintaining client and partner relationships for Carleton McKenna.

Alexis completed her M.B.A. in Business Administration from Baldwin Wallace University in May 2018. She received her B.S. in Business Administration with a concentration in Marketing and a minor in Spanish from the Honors Program at Edinboro University of Pennsylvania, where she graduated top of her class.



## **David T. Jeziorowski**

Analyst

David is an Analyst at Carleton McKenna & Company. His current job responsibilities include industry and sell-side flow research, as well as creation of buyers lists, pitches and other transaction documents.

Before joining Carleton McKenna, David worked as a research and investment intern at Praetorian Holdings Group, a Cleveland-based private equity firm. During his internship, David performed extensive research on Industrial and Renewable Energy industries, communicated directly with sell-side M&A advisors and executed business and financial analysis utilized by members of the firm's investment committee.

David graduated from the University of Dayton in May 2022 where he received his B.S. in Business Administration with a concentration in Finance.



## **Emily A. Kuznik**

Marketing Analyst

Emily is a Marketing Analyst at Carleton McKenna & Company. Her primary responsibilities include researching and developing marketing content and industry reports, enacting website development, maintaining a social media strategy and regulating web-based management services.

Prior to joining Carleton McKenna, Emily worked as a Leadership Development Fellow for Baldwin Wallace University's Carmel Boyer School of Business. As a member of the pilot program, she coordinated a variety of marketing initiatives for both graduate and undergraduate programs including social media and email marketing campaigns, advertising, event planning, and recruiting.

She graduated magna cum laude from Baldwin Wallace University in 2021 where she earned a B.A. in Digital Marketing and in 2022 with an M.B.A. in Management.





has been acquired by



CM&Co



has been acquired by



CM&Co



has been acquired by



CM&Co



has been acquired by



CM&Co



has acquired



CM&Co



Fully-integrated architectural design, facilities engineering, and specialty services

CM&Co



has acquired



CM&Co



has been acquired by



CM&Co



National Group Purchasing Organization providing members with account management, sales and contracting services

CM&Co



has been acquired by



CM&Co



has been acquired by



CM&Co



Consulting firm providing sustainability solutions for built environments

CM&Co



Provider of outsourced facilities maintenance solutions

CM&Co



has been acquired by



CM&Co



has successfully closed on the sale of equity financing

CM&Co



has been acquired by



CM&Co

# ENDNOTES

1. <https://www.ibisworld.com/>
2. <https://data.bls.gov/cgi-bin/surveymost>
3. <https://hrtechcube.com/2023-2024-peo-aso-payroll-service-provider-insight-survey/>
4. <https://straitresearch.com/report/professional-employer-organization-market>
5. <https://mediacenter.adp.com/latest-news>
6. <https://netprofitgrowth.com/cyclicality-within-the-peo-industry/>
7. <https://www.prismhr.com/best-practices/what-can-peos-do-to-prepare-should-we-head-into-a-recession/>
8. <https://netprofitgrowth.com/creating-and-driving-a-successful-peo-model/>
9. <https://www.keka.com/peo-professional-employer-organization>
10. <https://www.pitchbook.com/>
11. <https://www.tpg.com/news-and-insights/tpg-to-invest-in-ga-partners/>
12. <https://www.gfdata.com/>