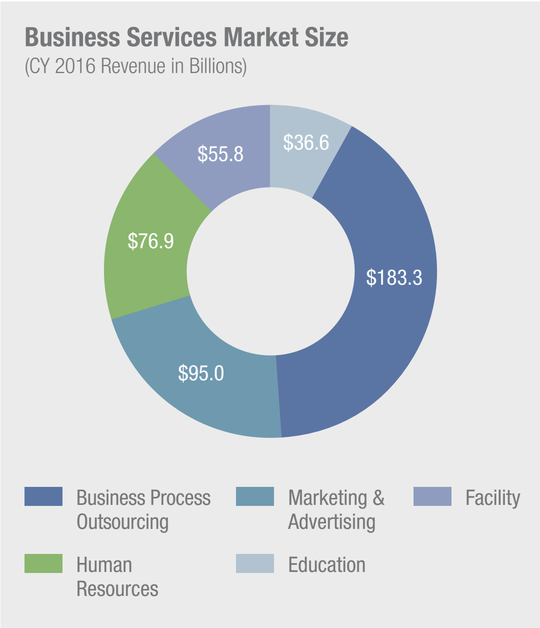
Business Services
Strategy

The Business Services industry consists of companies that provide business-to-business services, including segments such as human resource services, business process outsourcing, facility services, marketing and advertising services, and education services.

Business Services represents a large, $448 billion industry in the United States, as measured by 2016 revenues.

Segments within the Business Services Strategy generally align well with GPB Capital's acquisition criteria in that they may demonstrate strong and consistent cash flows, recession resiliency, and defined barriers to entry. GPB Capital launched its Business Services Strategy with an acquisition in the human resource ("HR") services segment (specifically the Professional Employer Organization or "PEO" industry).



*Please refer to page 3 for source information for the chart above.

Professional Employer Organization (PEO) Segment

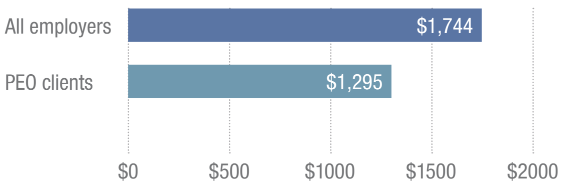
Overview

The PEO industry represents a segment of Human Resource Services that is attractive to GPB Capital. PEOs specialize in providing HR management and administrative services primarily to small and medium-sized businesses ("SMB") through a co-employment relationship. PEO industry operators engage with clients through a contractual agreement which transfers payroll, workers' compensation, health and retirement benefits, and most other employee-level responsibilities to the PEO. The client retains decision making power over directing its employees (clients' employees are referred to as worksite employees or "WSE") and responsibility for company-specific compliance, such as federal Occupational Safety and Health Administration and United States Environmental Protection Agency regulations. In other words, PEOs serve as the legal co-employers of clients' employees, while the client continues to oversee their day-to-day operations and can focus on the core operations of the business.[1] The PEO industry is moderately fragmented, with the four large national operators accounting for approximately 60% of industry revenue in 2017. The rest of the PEO market is controlled by hundreds of smaller operators that operate regionally or locally.[2]

The PEO industry is estimated to have generated approximately $23 billion in net revenue in 2016. With PEO penetration of U.S. firms with 0-99 employees remaining low (~3%) there is ample room for growth.[3] The industry experienced an estimated annualized growth rate of 8.7% from 2012 to 2017. The annual growth rate over the next five years is expected to be more modest, at 2.6%, but still anticipated to outpace GDP growth as a whole.[4] In addition to the broad based economic expansion over the past five years, industry growth has been driven by a few key industry-specific factors, including increased labor-related regulation and increased outsourcing by small and medium sized businesses due to cost and service advantages provided by PEOs. New labor regulations at the state and federal level, such as those associated with workers' compensation and health insurance coverage, have increased the complexity and cost of compliance. For example, the Affordable Care Act ("ACA") represented one of the most extensive overhauls to the U.S. healthcare system in decades. The ACA has added significant regulatory complexity to the healthcare industry for which businesses with 50 or more employees must comply.[5] Recent efforts to repeal and replace the ACA has led to more uncertainty in healthcare compliance for businesses. Many small and midsize businesses with limited resources have chosen to outsource labor-related compliance duties to PEOs, rather than attempting to navigate the ever-changing regulatory framework themselves.

1 IBISWorld, *IBISWorld Industry Report 56133: Professional Employer Organizations* in the US, April 2017.
2 Ibid.
3 NAPEO, *The State of the PEO Industry 2016: Markets, Value, and Trends*, September 2016.
4 IBISWorld, *IBISWorld Industry Report 56133: Professional Employer Organizations* in the US, April 2017.
5 NAPEO, *The State of the PEO Industry 2016: Markets, Value, and Trends*, September 2016.

HR Administration Costs Per Employee



Source: NAPEO, *The State of the PEO Industry 2016: Markets, Value, and Trends*, September 2016.

With approximately 880 PEO firms providing service to around 3.1 million WSEs, the average PEO firm oversees around 3,400 WSEs.[6] This scale gives PEO providers more leverage when negotiating benefits, such as health insurance and retirement plans, which leads to a reduction in overall cost per employee. PEO clients pay, on average, approximately $1,300 per WSE for HR administration and all other services provided by their PEOs. The average cost per employee for HR administration across all employers is around $1,740, meaning PEO clients spend approximately 25% less on HR administration per employee.[7] PEO clients are able to offer a more complete benefits package compared to firms that manage their own HR administration, while spending the same per employee. A complete benefits package is a key way businesses can attract and retain employees. A survey by Towers Watson found that 33% of employees cited a company's healthcare program as an important factor in deciding to work for the company initially and 47% cited the healthcare program as an important factor in staying with the company.[8]

The main competition to the PEO industry comes from internal HR departments and companies that provide similar services to PEO operators, such as outsourced payroll and benefit services. Internal HR departments can provide many of the same services PEO firms offer. However, PEO operators primarily target SMBs, which generally do not have the resources to support a full-time internal HR staff.[9] Potential clients that wish to utilize specific external services can typically choose to outsource only certain responsibilities, rather than transfer the entire employee administration process to PEO providers. To mitigate this risk, many full service PEO firms offer standalone services, such as payroll or benefit services, without entering into a co-employment relationship with the client.

The same industry-specific factors that have driven rapid growth over the previous five years, namely increased labor-related regulation and cost advantages, are expected to drive growth going forward, albeit at a more moderate pace. Despite the projected steady growth in the industry, the number of PEO enterprises is expected to rise at a marginal annualized rate of 0.1% over the next five years. This is primarily due to an increase in merger and acquisition activity by major industry players and rising barriers to entry, as stated in further detail below.[10]

GPB Capital Acquisition Strategy

GPB Capital will seek to acquire 20+ profitable PEO companies and provide capital, as well as operational assistance, to these companies. GPB Capital will aim to drive operational efficiencies by consolidating back-office functions, such as accounting, advertising, and insurance, of multiple PEO enterprises. GPB Capital seeks to acquire companies in the 4 – 8x EBITDA range and work to create value through increased operational efficiency as well as an aggregation premium.

6 Ibid.
7 Ibid.
8 Towers Watson, *Attracting and Keeping Employees: The Strategic Value of Employee Benefits*, May 2014.
9 Ibid.
10 Ibid.

Why Professional Employment Organizations?

GPB Capital's overarching philosophy is to seek to acquire companies with strong, consistent cash flows and proven management teams that operate in recession resilient industries with defined barriers to entry. GPB Capital has targeted the PEO industry because it demonstrates certain qualities that are consistent with the four fundamental criteria laid out below:

Strong, Consistent Cash Flows

PEO companies engage with clients through client service agreements ("CSA"), which tend to be one-year contracts. While CSAs are generally one-year commitments, PEO operators are estimated to have an 80% to 90% client retention rate across the industry.[11] Once a client joins a PEO, they are unlikely to end the relationship, as it is difficult to move to a self-managed HR department. This "sticky" relationship is due to the high amount of information and processes managed by the PEO, strong customer service relationships, and moderately high switching costs. A high client retention rate helps to provide stable cash flows from year to year, even as contracts with clients expire.

Recession Resilient

In seeking to provide consistent cash flow throughout the economic cycle, GPB Capital targets industries that have historically demonstrated recession resilient traits. As noted previously, PEO operators benefit from one-year contracts and a high rate of customer retention. Both these factors help to provide a buffer during recessionary periods. From 2007 to 2010, industry revenue grew by 1.6%, including only one year of declining revenue.[12] During this same period, U.S. GDP declined by 0.6%, including two years of declining GDP.[13] In periods of recession, SMBs have historically turned to outsourcing in order to lower expenses, further protecting PEOs in downturns.

Defined Barriers to Entry

By focusing on industries with defined barriers to entry, GPB Capital is able to target companies that have a certain level of protection from revenue and profit erosion by new competitors. Increasing government regulation of the PEO industry has created meaningful barriers to entry. Currently, 42 states require licensing, registration, and certification for PEO operators and this number is expected to rise over the coming years.[14] At the federal level, the Small Business Efficiency Act ("SBEA"), passed in 2014, created a standardized regulatory framework for the PEO industry. The SBEA included a certification process for licensed PEOs and minimum capital requirements, among other standards.[15] These increased standards are likely to discourage new operators from quickly entering the PEO industry.

Proven Management Teams

In most cases, GPB Capital will seek to acquire a majority interest in a company, generally seeking to acquire 70% to 80% of the target company, while keeping existing owners and management in place to run the operations. Given the increasing level of government regulation and oversight of the PEO industry, it is of the utmost importance to partner with proven and capable operators. GPB Capital will focus on partnering with management teams and operators that have demonstrated an ability to operate profitable companies throughout the economic cycle. GPB Capital will aim to provide these operators with the guidance and capital needed to execute on our shared objectives.

11 PEO Spectrum, Regional Professional Employer Organization Providers, March 2015.
12 Ibid.
13 Bureau of Economic Analysis, *Current-Dollar and "Real" Gross Domestic Product*, December 2017.
14 NAPEO, *The State of the PEO Industry 2016: Markets, Value, and Trends*, September 2016.
15 Ibid.

*IDC, "Worldwide and US Business Process Outsourcing Services 2015-2020 Forecast by Vertical and Company Size Update", February 2017.
*Dun & Bradstreet, "Advertising & Marketing Services Industry Profile", June 2017.
*Global Industry Analysts, "The Global Human Resource Outsourcing Market", January 2016.
*BGL, "Business Services Spotlight: The PEO Industry Pulse", August 2017.
*IBIS, "Janitorial Services in the US", June 2017.
*IBIS, "For-Profit Universities in the US", November 2016.
*IBIS, "Business Certification & IT Schools in the US", April 2017.
*IBIS, "Business Coaching in the US", August 2017

GPB Capital

GPB Capital is a New York-based alternative asset management firm focusing on acquiring income-producing private companies. GPB Capital provides their portfolio companies with the strategic planning, managerial insight and capital needed to enable strong businesses to work towards the next level of growth and profitability. GPB Capital seeks to take advantage of the large opportunity in the private U.S. middle-market by investing in companies that have a track record of current and sustainable yield, are recession resilient, have proven operating partners/ management teams and are in industries which have high barriers to entry. GPB Capital's strategies include, but are not limited to, Automotive Retail, Technology-Enabled Services, Debt Strategies, Waste Management, and Special Situations.

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