Staffing Industry Report

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Prepared for Staffing 360 Solutions, Inc. (OTC: STAF) – Third Quarter 2014

Staffing Industry Report:
Consolidation Opportunity

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<u>Sector Opportunity: Staffing Company Rollup</u>

The staffing industry, both in the U.S. and globally, has undergone extensive consolidation since the first quarter of 2008 as staffing companies have expanded their service offerings and geographical footprint through mergers and acquisitions. The transaction activity has been paced by the strong operating environment for many temporary staffing businesses, especially those specializing in higher-end IT staffing services. In the first quarter of 2014 there were 30 staffing industry M&A transactions, completed by 27 different buyers, according to Duff & Phelps, an 11% increase over the same period a year earlier.[1] Since 2009, 128 staffing firms reported completing a total of 238 acquisitions, according to Staffing Industry Analysts (SIA), a research firm that follows the sector.

However, the number of publicly-announced acquisitions of staffing firms in North America declined modestly in 2013 to 69 closed deals, according to SIA, a 7% decline from the 74 closed deals in 2012.[2]

Strategic buyers in the staffing industry, according to Duff & Phelps, are active because they have significant reserves of cash, have seen their company's share price rise and have specific growth objectives that need to be achieved.[3]

In fact, shares of staffing services and recruiting companies received a considerable boost from data indicating a big jump in hiring in June. Analyst Jeffrey Silber at BMO Capital Markets wrote in a note to clients that the June jobs data was a positive sign for the sector, given the continued strength in temporary hiring. He noted that temporary jobs as a percentage of the total workforce reached an all-time high of 2.068%.[4] With that tail wind, Robert Half International's stock price has climbed 16% in 2014 through early July and were on pace to close at an all-time high. Likewise, shares of Monster Worldwide, Manpower and Corporate Resource Services have rallied.[5]

In fact, labor statistics reveal a strong trend of temporary hiring in the first quarter of 2014. U.S. staffing companies employed an average of 2.96 million temporary and contract workers per week in the first quarter of 2014, up 3.2% from the same period in 2013, according to the American Staffing Association. Despite the extraordinary winter weather that adversely affected days worked in much of the U.S. in 2014, average weekly employment this January through March was higher than in any first quarter since 2006, when it was 3.10 million.

Industry executives consider the spike in temporary hiring to be a permanent change, not just a trend caused by a sluggish economy. The number of temp jobs has climbed almost 10% in the past year, the largest increase of any of the 150 categories tracked by the Labor Department. The

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[1] Industry Insights: Staffing Industry M&A Landscape, Duff & Phelps, April 2014.
[2] "2013 Staffing mergers and acquisitions activity and multiples," January 6, 2014, Ziv Tepman, Research Associate, Staffing Industry Analysts.
[3] Ibid.
[4] Tomi Kilgore, "Staffing stocks boosted by big jump in hiring," MarketWatch.com, July 3, 2014
[5] Ibid.

boost is fueled by companies that had reduced hiring amid the recession and learned to save money in wages and benefits, as well as increase their flexibility, by using fewer permanent workers — even as the economy grows. Jeffrey A. Joerres, chief executive of ManpowerGroup, one of the country's largest staffing firms, told the *Wall Street Journal* that "We do not see this as an indicator that we are at a 'peak' economy. Rather, we see it as more of a structural or secular change, that our industry will be absorbing more of the workforce than it did in the past."[6]

<u>Industry Consolidation: Factors Driving the Trend</u>

Acquisition activity continues to be primarily driven by privately held strategic buyers (many backed by private equity) as the larger publicly traded staffing companies account for only a handful of transactions each year. In the first quarter of 2014 nearly 77% of the transactions were completed by privately owned buyers, with only 23% acquired by publicly traded companies.[7]

The staffing industry is highly fragmented, with an estimated 15,000 staffing companies generating less than $20 million in annual sales in the United States alone. .[8] Likewise on a global scale, outside of the top 10 staffing firms in the world, no other company has greater than 1% market share.[9]

The U.S. personnel staffing industry includes about 32,000 companies[10] with revenues within the U.S. of $124 billion, according to SIA. The industry is divided into three major segments: temporary help services (about 50% of industry revenue), employer organizations (about 45%), and placement agencies (about 5%).[11] Major companies include ADP TotalSource, Insperity (formerly Administaff), Kelly Services, ManpowerGroup and the U.S. operations of Adecco.

SIA estimates that 124 firms generated at least $100 million in U.S. staffing and talent engagement revenue in 2013. Added together, these firms generated $74.1 billion in U.S. staffing and talent engagement revenue in 2013, which comprised 54.5% of the total market, according to their estimates. Industrial and IT staffing were the most commonly appearing largest segments (by revenue) for firms on the list, representing 29% and 27% of firms on SIA's list, respectively.

Globally, staffing companies generate about $416 billion in annual revenues. There are approximately 70,000 private employment services agencies around the world. Overall, the U.S. is the world's largest staffing market, with $124 billion of annual sales and more than double the size of the next largest country. Meanwhile, Europe remains the largest region, representing approximately 40% of global staffing revenues.[12]

Within Europe, the UK is the largest staffing market and is the third largest market worldwide, with 9% of global sales. Alongside the UK, the most important European markets are France, Germany and the Netherlands. The staffing industry is growing fastest among nations in the Asia-Pacific region. Major staffing services providers based outside the U.S. include Adecco (Switzerland) and

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[6] Damian Paletta, "Temp Jobs Surge as Firms Contain Expenses," *Wall Street Journal*, April 7, 2014.
[7] Ibid
[8] Meritus Capital corporate website.
[9] Staffing Industry Analysts (SIA)
[10] Industry Profile: "Staffing Services." First Research, November 19, 2012.
[11] Ibid.
[12] Staffing Industry Analysts (SIA), "Global Staffing Industry Size 2012."

Randstad (the Netherlands). The largest staffing services markets include Europe, the U.S., Japan and the UK.[13]

As a result of the fragmentation, growth through acquisition provides large staffing companies with opportunities such as the ability to be more competitive by capturing cost savings from back office operations and worker's comp, the advantage of serving national clients in multiple locations and generating economies of scale in advertising and marketing. For smaller staffing companies, being acquired by a larger operator can be an attractive proposition for similar reasons.

Information technology staffing companies continued to enjoy widespread demand and robust valuations throughout 2013 and in the first quarter of 2014, according to Duff & Phelps.[14] IT staffing was the single most attractive temporary staffing segment for acquirers with five transactions reported in the first quarter. In 2013, IT staffing was also the most active sector with 28 announced transactions while commercial staffing had 27.[15] Purchasers of staffing businesses continue to be selective; companies with a history of strong revenue growth, high profitability, diversified customer bases, and outstanding management teams committed to staying with the business post-transaction continued to fare well in the staffing M&A marketplace.[16]

The increasingly global business world is playing a major role in driving the consolidation as well. With offices located throughout the globe, large corporations want to hire service providers that can provide workers in those far-flung operations, according to industry analysts. As a result, temporary staffing providers have been pursuing geographic expansion through organic means or smaller acquisitions, or have expressed interest in being acquired by larger staffing companies with global reach.

Executives at client companies also report that they want to deal with fewer vendors. In a recent survey of IT executives by TEKsystems Inc., most of the respondents said that they want their IT vendors to have a wide range of services. The majority, 63%, of IT leaders who responded to the IT Executive Outlook Survey said that they would prefer to purchase more services from fewer vendors. Likely reasons include streamlining vendor management and leveraging vendors' institutional knowledge over time and across multiple initiatives.[17]

Even for large U.S. staffing firms, acquisitions can be a profitable method to expand into new U.S. markets. Consolidation is often driven mainly by the opportunity for large agencies to develop national relationships with big customers. Some firms expand by starting new offices in promising markets, but most prefer to buy established independent offices with proven staff and an existing rolodex of customers.[18]

With the advantages of scale, a larger staffing firm can enjoy significant leverage when pricing its services to corporate clients. Many bigger staffing companies mark up their services by as little as 12.5%, according to a recent *Globe and Mail* article about the industry.[19] In comparison, the

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[13] Ibid.
[14] Industry Insights: Staffing Industry M&A Landscape, Duff & Phelps, April 2014.
[15] Ibid.
[16] Ibid.
[17] "IT Executive Outlook Survey: First Quarter 2011.
[18] Industry Profile: "Staffing Services." First Research, August 22, 2011.
[19] Borzykowski, Bryan, "Small player feeling squeezed out by big ones," *The Globe and Mail*, July 13, 2011. http://www.theglobeandmail.com/report-on-business/small-business/sb-marketing/sales/small-player-feeling-squeezed-out-by-big-ones/article2095619/print/

owner of a smaller Canadian staffing company featured in the article stated that he can't afford to go lower than 16%, which is six percentage points less than what the firm charged in 2006.[20]

For future industry M&A transactions, William Blair & Co. stock analysts Timothy McHugh and Matt Hill write that after the three largest temporary staffing firms, companies such as Robert Half International Inc., Allegis Group Inc., and UK-based Hays plc and Michael Page International plc that generate $3 billion-$6 billion of annual revenues, but lack a truly global presence to match the scale of the big three firms could be potential targets.[21]

Some of these companies could make the same decision as SFN and sell to one of the three largest companies (i.e., there have been periodic, well-publicized rumors that Adecco and Hays have considered merging), although acquisitions of this size could be tough to complete. The ongoing industry consolidation and the preference for global service providers by a large corporate client could prompt some of these companies in the second tier of revenue to pursue a transformational acquisition.[22]

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[20] Ibid.

[21] "Temporary Staffing: Implications of SFN and Randstad Merger for Rest of Sector," July 22, 2011, William Blair & Co. Equity Research.

[22] Ibid.