

2010

Business Process Outsourcing

Moving Beyond Borders and Cost

Industry and M&A
Review and Outlook



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Introduction

Providers of Business Process Outsourcing (BPO) services continued to expand globally in 2009, meeting the traditional outsourcing needs of companies seeking to streamline costs in the front and back office in order to focus on their core businesses. BPO companies are realizing the need to have offshore, near-shore and onshore capabilities, what we term “all-shoring”, to best serve Global 1000 companies.

This all-shoring trend is driving increased M&A activity to capture onshore companies in the US, and near-shore companies in South America. Cost-efficient locations, such as Vietnam and Egypt are expanding operations and forcing more traditional locations, such as India, to move beyond cost and focus on higher value services such as Knowledge Process Outsourcing (KPO).

This report provides a short overview of the BPO industry, its latest trends, global M&A activity, notable deals and deal drivers, and the outlook for 2010.

2009 in Review

The year 2009 highlighted the following trends:

- **BPO M&A activity saw rapid growth, beginning in the second quarter:** Major deals included Stream Global Services merger with eTelecare, Xerox’s acquisition of ACS, and InfoSys’s acquisition of McCamish Systems.
- **Foreign BPO firms increased their U.S. presence:** European and Indian firms (including Aegis, TCS, Infosys, and others) expanded their American presence.
- **Several corporate firms relinquished captive service centers:** Cognizant acquired UBS India Service Centre, a unit of UBS that specializing in BPO services. AIG, General Electric and Monitor group also sold internal service centers to more focused, stand-alone BPO providers.
- **Providers delved further into emerging markets:** With developed nations mired in economic crises, firms looked overseas to emerging markets to fuel growth. While the U.S. remained the largest market additional for many BPO providers, they were also able to provide growing attention to

opportunities in Europe, Australia and the Asia Pacific regions.

- **Growth in certain market segments slowed:** Corporate layoffs and higher unemployment affected the growth of payroll services; similarly constrained corporate spending limited new customer acquisition, thereby affecting the growth in CRM services.

Market Analysis

BPO Service Trends by Function

BPO services comprise a variety of functions that encompass their own specific trends.

Human Resources: Major new HR deals disappeared in 2009 due the looming economic uncertainties created by recession across developed economies. Service architectures are migrating from customized to standardized solutions. A few services – such as benefits administration to manage employee downsizing – did see growth.

Finance and Accounting: The F&A sector shrank by 3.6% in 2009, according to Gartner. It will continue to grow as companies continue to cut costs even while starting to grow. India was the largest destination, though Central/South America continued to grow and add new staff.

Customer Relationship Management: Customer retention has come to the forefront in CRM BPO, especially as businesses face greater price pressures in the tough global economic environment. Demand in such destinations as India and the Philippines continued to run ahead of supply, and rates and transaction numbers continued to increase. Wage inflation tended to make alternate locations (e.g., Ireland, Latin America) more appealing to some customers. Work-at-home options received increasing attention - especially in North America and Western Europe - as did analytical services.

BPO Service Trends by Geography

BPO services have also evolved along different geographic markets, based on data from Gartner:

North America: The North American BPO market was expected to decline 4.8% in 2009. The U.S. is still the largest and most developed BPO market in the world; in addition, Canada is notable for work in the energy sector and having

a domestic provider market. Traditionally, use of BPO services in the region has been the province of large corporations, though mid-size corporations divested from larger parents have emerged as a new customer category since the mid-2000s. Key vertical markets anticipating future growth include utilities, retail, healthcare, and manufacturing.

Asia-Pacific: The Asia-Pacific BPO market is expected to see strong growth of 11.3% in 2010. Growth is expected to be particularly keen in India, Australia and China. Key factors influencing local adoption of BPO services include to increase scale, infuse best-of-breed processes/technologies, increasing time-to-market, and improving service quality. Shifting customer locations and increasing consumer wealth will make the region a strong growth story over the coming years.

Japan: While many Japanese firms have adopted BPO services to increase efficiencies and reduce costs, some services (especially HR and Finance and Accounting) have been hampered by a need to maintain employment levels. Certain service areas – such as demand and supply management – grew in 2009, and will continue thru 2010, albeit at slower rates than previous years.

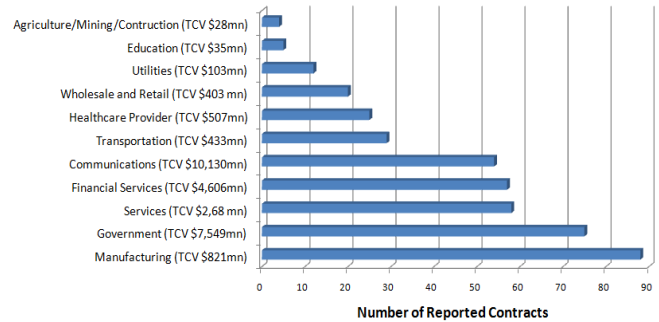
Western Europe: Demand for back-office and Finance and Accounting services is being driven largely by the United Kingdom, through it is beginning to grow in France and Scandinavia as well. Other services – such as payroll, contact center, banking, and tolling – are seeing growth across the Continental Europe. Unfortunately, challenges related to language, labor laws and trade union resistance is hampered broader growth of BPO services across the continents. However, specific countries like Spain and Italy are examining BPO projects to improve process rather than cut costs, thereby driving industry activity.

Latin America: The adoption of BPO services in Latin America is largely being driven by domestic companies as well as subsidiaries of multinational firms. Smaller service providers do exist in the region, especially in Brazil. Since labor costs in the region are still low, multinationals have been less dependent on BPO to reduce cost; rather, they have viewed it as a means to gain local knowledge and minimize

direct investment. Service providers continue to view the region as an offshore delivery location.

BPO Customers

Clients of BPO providers included a wide array of customer segments in 2009, as shown in Fig. 1. The leading presence of the government segment is particularly noteworthy.

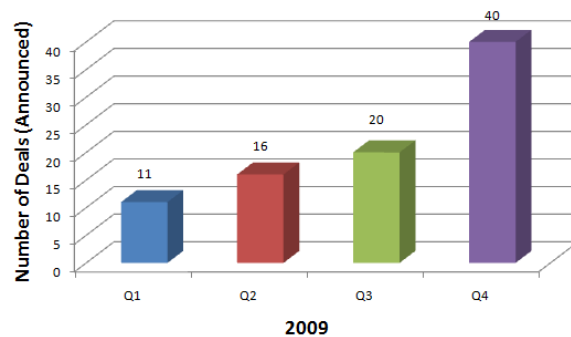


Source: Gartner
Note: TCV = Total Contract Value

Figure 1: Contracts by Customer Segment

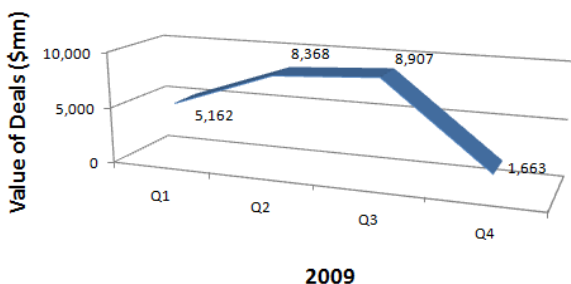
Global M&A Activity

Despite economic challenges in the first quarter of 2009, M&A activity rebounded, with fourth quarter performance powered in part by the psychology of the Xerox/ACS deal in the third quarter. Overall, approximately 87 publicly announced deals involving BPO and related outsourcing and services firms occurred during the year, with a combined value of over \$24 billion, as shown in Figs. 2 and 3.



Source: Standard & Poor's

Figure 2: BPO M&A Activity in 2009: Global Transaction Volume



Source: Standard & Poor's

Figure 3: BPO M&A Activity in 2009: Global Transaction Value

Notable Deals

M&A activity in the BPO space was highlighted by several notable deals, including the following:

April 12, 2009 Tech Mahindra Acquires Control of Satyam (\$354mn)

One of most public deals of the year involved Tech Mahindra Ltd.'s winning bid for Satyam Computer Services Ltd. Satyam, one of India's leading BPO and IT vendors, was embroiled in legal controversy after its founder, B. Ramalinga Raju, admitted in January of inflating the company's accounting results, including faking \$1 billion of cash. Indian investigators charged over a dozen other employees as being complicit to the fraud. The national government took control and arranged a sale process. Tech Mahindra's winning bid of \$354 million won it 31% of the firm. Tech Mahindra is a joint venture between British Telecom and the Indian conglomerate Mahindra & Mahindra, providing IT services and solutions to the global telecommunications industry. Satyam was eventually renamed Mahindra Satyam.

Tech Mahindra's bid was realized by a preferential issue of equity. It planned to make an offer for an additional 20% of existing Satyam shares, to win control of the former company.

July 17, 2009 Xerox to Acquire ACS (\$8.8bn)

Xerox Corp.'s intention to purchase Affiliated Computer Services Inc. was another example of a hardware-based vendor diversifying into higher-margin service businesses. The company hopes to energize the growth of its business in managing printing and document services; with the deal, Xerox's services revenue will increase to \$10 billion next year, from \$3.5 billion in 2008. ACS, based in Dallas, Texas, is a pioneer in back-office outsourcing. Approximately 40% of its

revenue comes from government business, including support of Medicare and Medicaid.

Xerox cash-and-stock deal assumed Xerox would pay \$18.60 in cash and 4.94 Xerox shares for each share of ACS. Xerox's initial value of the deal, at \$6.4 billion or \$63.11 a share, represented a 34% premium to ACS's closing stock price at the end of the previous week. The total transaction size is currently valued at \$8.8 billion. According to the Wall Street Journal, ACS Chairman Darwin Deason, who had been floating the company for several years, is expected to reap a \$800 million windfall in cash and Xerox stock and debt from the deal.

August 14, 2009 Stream Global Services Acquires eTelecare (\$141mn)

Stream Global Services Inc. acquired eTelecare Global Solutions Inc. in order to expand its reach into the Philippines, where EGS is already a market leader, and provide integrated BPO services on a worldwide basis. Stream provides relationship management and other business process outsourcing services to companies in the technology, software, consumer electronics, and communications industries. With the EGS acquisition, it will extend its reach into financial services, retail and consumer product segments. In addition, it will be able to offer a broader portfolio of services, including sales and revenue generation, warranty management, customer loyalty and brand management, customer care, technical support, and customer life cycle management. The combined company will have a global footprint, owning 50 contact centers solution centers across North America, Europe, the Philippines, Latin America, India, the Middle East, and Africa, and projects annual revenue of \$1 billion by the end of 2010.

The merger was a stock-for-stock deal, with Stream and EGS shareholders owning 57.5% and 42.5% of the new company, respectively.

November 12, 2009 InfoSys Acquires McCamish Systems (\$58mn)

InfoSys BPO Ltd. extended its reach in the U.S. and business platform customers through its acquisition of McCamish Systems Inc. McCamish, which is based in Atlanta, Georgia, provides BPO services to the life insurance and financial services industries. The company, in turn, will use the resources of its new parent company to expand its portfolio of transactions and expand globally. Gordon Beckham Jr.,

President and CEO, McCamish Systems said, "McCamish wakes up every day with one objective in mind - delivering world-class business solutions to our clients through continuous improvement. Our combination with Infosys is wholly consistent with this objective. Leveraging the domain expertise of our associates and platforms with Infosys' industry-leading technology and BPO capabilities will be a game changer for the insurance and financial services industries. We are ready to roll."

The deal was valued at \$58 million, involving an up-front cash payment of \$38 million, with a subsequent cash payment contingent on McCamish meeting specific financial targets.

M&A Drivers

Buyers and sellers in the BPO industry are being driven back to the market to seek deals based on a variety of factors.

For buyers, drivers include the following:

- Need for simultaneous onshore, near-shore and offshore presence (i.e., "all-shoring")
- Increasing number of industries open to outsourcing parts of their value chains
- Recovering stock price, enough to finance acquisitions
- Stronger balance sheets
- Limited organic growth options

For sellers, drivers include the following:

- Increased valuations, reflecting recovered growth opportunities
- Valuable process capabilities
- Attractive customer segments
- Increasing domestic competition
- Customers expanding globally

Emerging Evolution: KPO

Knowledge Process Outsourcing (KPO) is viewed as the next logical extension of BPO. However, whereas BPO today is based on third-party process expertise, KPO is focused on a third-party's domain and business expertise. Such expertise can relate to legal processes, intellectual property and patents, computer-aided-design and manufacturing, research and development, clinical and market research, and data analytics, just to name a few areas. According to NASSCOM, part of the Indian chamber of commerce, the KPO industry is expected to reach \$17 billion in 2010, with \$12

billion expected to be outsourced to India. Similar studies anticipated the KPO industry having a CAGR of 46%, growing from 1.2 billion in 2003 thru 2010. Beyond India, other countries such as Russia, China, the Czech Republic, Ireland, and Israel are also expected to join the industry. While many statistics and discussions still include KPO within the high-end of the BPO universe, it will be interesting to see in coming years, what type of BPO deals retain a KPO component, and how leading consulting firms in the developing world, in particular, will use KPO services to increase their value-add for established multinational firms in the developed world.

Expectations for 2010

Agile Equity predicts the following trends for 2010:

Growth in key verticals in the U.S. will drive the majority of business: Verticals such as healthcare, financial, legal, and the government sector will continue to present attractive opportunities to BPO providers in the largest market in the world. Increased IT spending by U.S. firms will also help drive additional outsourcing business.

India will continue to the star location for BPO firms: Despite increasing competition from the Philippines and other countries, India will remain the most attractive host country for providers to base and export services. With the Bombay stock exchange providing a staggering 81% return in 2009, and foreign funds investing over \$17 billion in Indian equities, major BPO providers will have the resources and confidence to expand their businesses, both domestically and overseas. The dollar-rupee exchange rate will affect firms' profitability, though such risks can be effectively hedged for the most part.

The pace of mergers and acquisitions will continue across several dimensions: Resurgent global economies will allow BPO providers to utilize M&A activities to increase their economies of scale and scope, as well as to expand their reach to present all-shoring capabilities that can attract multinational clients, diversifying their customer base. Similarly, smaller, less efficient BPO firms with niche capabilities or market share will leverage M&A to be subsumed by more resource-rich players.

Large BPO firms will continue to expand into KPO services: KPO services will allow the larger firms to address opportunities in key verticals like banking, insurance, manufacturing, and pharmaceuticals, to name just a few. Such clients will view such BPO firms less as cost-reducing agents and more as value-added business partners. That changing dynamic will help to further strengthen the brands of those firms which capture contracts for KPO work.

Providers will utilize the latest technologies to provide integrated platforms for service delivery: Client work – as well as M&A activity – will be driven by a need for firms to utilize the latest technologies to deliver services on a global basis. BPO firms will scrutinize Software as a Service (SaaS) companies and related suppliers to enhance their infrastructures, continuing a trend signified by WNS's acquisition of BizApps in 2008.

Conclusion

The global economic downturn spurred corporations around the world to emphasize cost reductions and strategic reprioritizations enabled by business process outsourcing. In turn, BPO providers continued to consolidate, enabling agile players to provide allshore services for increasingly global customers and forcing weaker players to exit the stage. For corporate dealmakers, the time is right to start examining how best to capture market opportunities in the U.S. and beyond, as well as progress up the value chain from cost to value arbitrage. A corporate strategy involving a M&A component will help leading firms achieve both aims.

REFERENCES

[1] Gartner, Inc. "Gartner on Outsourcing, 2009-2010." ID Number: G00173421. December 23, 2009.

[2] Standard & Poor's. Capital IQ.

Who We Are

Founded in 1996, Agile Equity is a leading M&A focused investment bank headquartered in New York City. We are led by a strong team of corporate finance professionals with extensive IT and IT-enabled M&A transaction experience, with an expertise and track record in executing cross-border M&A transactions.

We advise multinational public and private companies across the globe on a range of strategic M&A transactions including asset purchases, dispositions, restructurings, reorganizations and fairness opinions.







Our dedicated approach to client assignments is focused and highly personal, marked by superior service and creativity. We focus on building long-term relationships with clients. This often leads to multiple engagements with satisfied clients.

What We Do

Buy Side: Agile Equity advises companies seeking to expand distribution, enter new markets, or gain access to technology through acquisitions, mergers, joint ventures or minority investments. In each case, Agile Equity helps clients to define the strategic goals, identify and qualify target companies, handle target contact, conduct due diligence, and structure, negotiate and close the transaction.

Sell Side: Agile Equity advises companies seeking a partial divestiture or a complete sale to achieve broader economies of scale and market presence. Agile Equity helps clients define specific goals and positioning, preparing marketing materials, identify and qualify potential partners, build the valuation and structure, negotiate and close the transaction.

Selected Agile Equity Transactions

 <p>firstsource has acquired MEDASSIST for \$330,000,000</p> <p>India - USA</p>	 <p>firstsource has acquired bpm BUSINESS PROCESS MANAGEMENT for \$40,000,000</p> <p>India - USA</p>	 <p>Pelican Security has been acquired by Microsoft</p> <p>Israel - USA</p>	<p>BERTELSMANN</p> <p>VOCEL. has received an investment from</p>  <p>MOTOROLA</p> <p>Germany - USA</p>
<p>Annie Chun's</p> <p>has been acquired by</p>  <p>CJ</p> <p>USA - South Korea</p>	<p>PINAULT PRINTEMPS-REDOUTE</p> <p>has sold mobileplanet. to expansys</p> <p>France - USA - UK</p>	<p>JASTEC</p> <p>has acquired LTU technologies to LTU</p> <p>Japan - France</p>	 <p>infowave has acquired TELISPARK</p> <p>Canada - USA</p>

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