

# EXL's Disciplined M&A Drive

A conservative approach to buyouts is helping the BPO firm grow faster & perform better than some peers. At \$91 million, the OPI acquisition is EXL's largest buy till date.

## EXL Growth Strategy

### Banking on Buyouts but cautiously

A conservative approach to buyouts is helping EXL Services grow faster and perform better than some of its peers

#### EXL's Past Acquisitions

PDMA Inc	\$14 m
American Express travel captive	\$30m
Schnieder Logistics Business Process Services	\$6 m
Inductis	\$20 m

#### Largest BPO Acquisitions

WNS largest acquisition: Aviva Global Services	\$228 m
FirstSource largest acquisition: MedAssist	\$330 m
EXL's largest acquisition: OPI	\$91 m

FIGURES INDICATE DEAL SIZE \* SOURCE: COMPANIES. DEAL SIZES ARE APPROXIMATE

### Growth in F&A services

Technology researcher Gartner says the F&A BPO market is growing at a compound rate of 8%



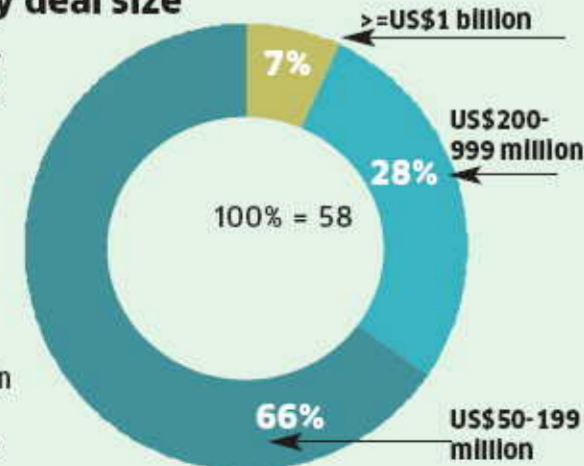
### Outsourcing Deals: The Q1 Picture

Key contribution came from BFSI, manufacturing and healthcare verticals. BPO market transactions grew 25% in Q1

#### Distribution by deal size

There were 58 major deals (contract value exceeding US\$50 million) reported in Q1 2011, compared to 69 in Q4 2011

Four mega deals (contract value exceeding US\$1 billion) were reported in Q1, compared to eight in the previous quarter



TOTAL CONTRACT VALUE (TCV) GREATER THAN US\$50 MILLION, INCLUDES TRANSACTIONS WHERE THE SIGNING REGION OF THE TRANSACTION WAS NOT PUBLICLY DISCLOSED. SOURCE: EVEREST RESEARCH INSTITUTE TRANSACTION INTELLIGENCE DATABASE

NSHIVAPRIYA  
MUMBAI

Rohit Kapoor, president and CEO of EXL Services, looks a happy man. Last month EXL Services Holdings, a provider of back-office services, clinched a deal to acquire a former KPMG captive and a dedicated provider of finance and accounting services, Outsource Partners International (OPI).

The deal will make EXL one of the leading players in the finance and accounting (F&A) segment, the largest category of outsourced services after voice-based services. The acquisition could not have been more timely with outsourcing of call centre services to India becoming highly sensitive and also moving to locations such as Philippines, which are culturally closer to the US market.

#### F&A FOCUS

Finance and accounting services provide an opportunity to scale up to higher value services, which fits well with EXL's goals. Three years ago, Raman Roy's Quattro BPO Solutions bought out the captive accounting unit of RSM McGladrey -- a global tax and accounting firm -- for the same reason. Technology researcher Gartner says the F&A BPO market is growing at a compound rate of 8% and total revenues will be \$17.4 billion in calendar 2011, rising to \$18.8 billion in 2012 and \$20.3 billion in 2013.

The OPI acquisition adds \$76 million to EXL's revenues and takes its total F&A and risk management business to \$125 million. OPI's founders Clarence Schmitz and Kishore Mirchandani, professionals with experience in accounting firms KPMG and Deloitte & Touche, are expected to join EXL's management after the transaction.

Schmitz, Mirchandani and other shareholders -- Trident Capital (an early investor in IT firm, Cognizant), The Chatterjee Group and Cargill Ventures -- were said to be looking to sell out for \$150 million in 2009. EXL eventually clinched the deal for \$91 million in an all-cash payment in 2011.

At \$91 million, the transaction is valued at 1.2 times OPI's 2010 revenues and EXL will use the cash on its balance sheet and a working capital revolver (a credit line on its working capital which can paid back at any point) to finance it.

"We like the acquisition at first blush for three reason: F&A is a fast growing vertical, valuation looks reasonable (1.2x revenue), and it is accretive," said analysts

Acquisitions are an important part of our strategy. Our growth will be much faster. Our strategy is similar to that of Cognizant's. Five years ago, Cognizant was much smaller than the Big 3 of IT. Today, it is set to overtake Wipro

ROHIT KAPOOR  
CEO, EXL Services



Joseph D Foresti and Jeffrey Rosetti of brokerage, Janney Montgomery Scott, in a May 4 report after EXL's acquisition announcement.

#### DEBT DRAGS PEERS DOWN

Compared to peers, WNS Global Services and Firstsource Solutions, EXL has done fewer acquisitions and used debt sparingly. "You can evaluate how aggressive a company is on three counts -- total value of acquisitions, number of acquisitions and the debt taken. If you look at all these parameters -- Firstsource and WNS would be similar. EXL would have less number of acquisitions, least value, and least debt," says a banker. "Even when you take debt, it depends on much how much you are stretching your balance sheet," he adds. EXL, for instance, has cash of around \$115 million and a debt to equity ratio of 0.24 -- much much lower than WNS, which has cash of \$27 million and a debt-equity ratio of 40.

In the last one year, EXL's shares have appreciated over 40% as compared to its peers whose ADRs or shares have fallen. The ADRs of NYSE-listed WNS have dipped 15% and that of BSE-listed Firstsource Solutions have fallen over 30% in the same period.

But three years back, the outlook for EXL was hardly rosy. It had lost its largest client Aviva to rival WNS Global Services as also the opportunity to build on its expertise in insurance-related processes. Aviva, the world's fifth largest

insurance firm, had put its captive for sale. The work in the captive was not done directly by Aviva but outsourced to EXL, WNS and 24x7 BPO. The successful bidder for the captive would get the business being done all the three vendors.

Kapoor says EXL bid at around \$100 million but lost out to WNS, which won the deal at \$228 million and also the exclusive rights to all

We like the acquisition (of OPI by EXL) at first blush for three reason: Finance and accounting segment is a fast growing vertical, valuation looks reasonable (1.2x revenue), and it is accretive

JOSEPH D FORESTI & JEFFREY ROSETTI  
Analysts, International Brokerage

outsourcing contracts from Aviva UK and Aviva Canada. EXL lost a big chunk of its insurance back-office business, which contributed 40% to its revenues while Aviva alone contributed 25-30%. "We were nervous and scared of losing business but we stuck through to our principles. Today, we feel vindicated," says Kapoor.

WNS took a debt of \$200 million to finance the acquisition of Aviva's captive. The debt has con-

strained it from going after further acquisitions, and experts point out that companies also need cash flows for running day-to-day operations. "We do not see pre-payments as the best use of excess cash. We plan on reinvesting in the sales function of the business to support top and bottom line growth," WNS CFO Alok Misra told investors recently.

The global financial meltdown of 2008-09 has also changed how analysts and investors view leverage. "Post-meltdown, shareholders don't like a company taking too much leverage to do an acquisition. Everybody is worried about leverage. Once the overall economy slows down, organic growth suffers and as a result, cash flows can slow down," points out an executive who advises on outsourcing deals. Firstsource is also bogged down by the same problem -- a \$275 million debt it took to acquire MedAssist in 2007. Firstsource has done seven acquisitions so far of which MedAssist, a US-based back-office services provider to the healthcare industry, is the largest. MedAssist's revenues were \$99 million for the year to December 2006 and Firstsource paid \$330 million -- 12.5 times MedAssist's operating profit -- to acquire it in August 2007.

As on March 2011, Firstsource had FCCBs of around Rs 1,158 crore and other borrowings of Rs 3,34.7 crore. The company, which gobbled up several acquisitions since its inception, has not done any since MedAssist. Its FCCBs are coming up for conversion in FY13 but are unlikely to be converted to equity given that its share price is trading at significant discount to the conversion price, feel analysts.

"It's hard to say whether these companies (WNS and Firstsource) paid more for the acquisitions. What a company pays is ultimately dependent on the value they see being created over a period of time from the asset," says Rajesh Ranjan, research director, Everest Group. "For instance, Genpact paid \$550 million for Headstrong, which had \$217 million in annual revenues, because they wanted that capability."

#### ADVANTAGE EXL

But clearly, Firstsource's and WNS' lack of appetite for acquisitions has been EXL's gain. WNS, which also has sizeable F&A practice, may have otherwise been a potential competitor to EXL in its bid for OPI. Post OPI transaction, EXL's F&A revenues will increase from 16% of revenues to 35%, says Kapoor.

Since losing the Aviva captive, EXL has also made three other smaller acquisitions -- PDMA Inc for \$14.1 million last May, American Express' travel captive in India for \$30 million last March and Schneider Logistics in business process services in the Czech Republic for \$6 million in July 2009\*.

Through the PDMA acquisition, EXL gets LifePro, an insurance policy administration system that boosts its insurance capabilities and helps it move towards outcome-based pricing, which is the direction BPO contracts are moving towards. The acquisition of Schneider gives it a presence in Eastern Europe and multi-lingual capability in travel and logistics, one of its focus verticals. "Acquisitions are an important part of our growth strategy," says Kapoor, who also chairs the M&A committee at EXL.

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SENIOR EXECUTIVE  
Advisor, Outsourcing Services

The committee meets every week, indicating seriousness with which the management takes this exercise. "Our growth trajectory will be much faster. Our strategy is similar to that of Cognizant's. Five years ago, Cognizant was much smaller than the Big 3 of IT. Today, it set to overtake Wipro," he says. So far, the BPO industry has been growing at a slower pace than IT. While the IT industry has bounced back strongly, the BPO firms are yet to demonstrate the return to pre-recession growth rates, which Kapoor admits. There are some initial signs of a recovery in the sector as deal pipelines start to grow and clients move faster on outsourcing decisions, say experts. But it is still early days yet.

\*All acquisition amounts are approximate, where not disclosed by the company

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