

2008 BUSINESS SERVICES M&A CONFERENCE

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Lincoln International's 2008 Business Services M&A Conference Report



CONFERENCE REPORT

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Executive Summary

The service sector, which continues to innovate and expand in important areas such as healthcare, financial services, engineering and insurance, is perhaps better positioned than many other areas of the economy to withstand fall-out from tightening credit markets, government bailouts and volatility in the stock market.

That was the key message that middle-market company executives, bankers, private equity investors and other financiers took away from market experts at the 2008 Business Services M&A Conference hosted jointly by Lincoln International and Reed Smith in Chicago.

"Anybody who thinks that somehow de-leveraging and the loss of all these financial institutions are going to take the economy down, I don't think they're looking at history very well," said Brian Wesbury, Chief Economist with First Trust Advisors L.P, in a keynote address designed to counter the belief that the U.S. economy has entered a recession.

The U.S. economy continues to be resilient, he said, adding that there will be many opportunities for the service sector amid continued productivity gains and entrepreneurial developments in industries ranging from computer services to cutting-edge pharmaceutical research.

"You can find it if you look for it," Mr. Wesbury said. "Underneath all this stuff, great, great things are going on."

After the speech, panelists presented contrasting views on topics ranging from the challenges of selling a mid-sized services company to the current environment for deal financing and the outlook for cross-border transactions, both into and out of the United States.

Even as they sounded a note of caution over the current state of the U.S. economy, panelists maintained that service-sector deals would continue to go forward in 2009, albeit at a slower pace than in prior years. The difficult economy will weed out the stronger companies from the weak, ensuring that the quality of transactions will be high.

"We're looking for the best deals," said Richard Michalik, Managing Director, Bank of Ireland. "We don't feel the pressure to do a marginal deal or an average deal."

The first of three panels highlighted the perspectives of executives at privately-held companies who orchestrated successful sale processes while continuing to lead their companies. They stressed the importance of preserving human capital during any service sector deal, especially when companies are faced with the volatility of a challenging economy.

“Particularly prevalent in a business services deal is preserving the value once you’ve decide to go down the sale path,” said panel moderator Seth Hemming, a Partner in Reed Smith’s Chicago office who specializes in M&A and private equity transactions.

Bankers concluded that valuations for solid companies in the service sector are holding steady, but cautious lenders are seeking deal structures that call for more equity and signs that management is willing to take on more of the financing risk.

“If business services companies continue to get high multiples – you might start to see bigger equity checks that need to be written on those deals,” said Curt Tatham, a Lincoln International Director and moderator.

Mezzanine financing and other alternatives are once again entering the fray to make up for shrinking liquidity in the market place, the lenders said.

Meanwhile, the appetite for cross-border transactions remains healthy, as U.S. and international buyers look to consolidate fragmented markets and continue their push toward globalization. But despite attractive trends such as favorable foreign exchange rates, many service sector companies take a long-term view of acquisitions, giving priority to strategic goals such as synergies and overall fit.

“At the end of the day, it will be strategic fit that will lead a foreign buyer into an acquisition,” said Dr. Michael Drill, a Lincoln International Managing Director and Chief Executive Officer of the firm’s German operations.

And that theme seemed to indeed to carry the day. Regardless of the headwinds in the economy, it seems that service sector companies, especially those with major investments in systems and well-defined value propositions, are apt to take a very exacting approach to their acquisition strategy.

“We are long-term investors,” stressed Barry Malkin, Vice President and Head of Corporate Development for educational services provider Apollo Group Inc.



Brian Wesbury, Chief Economist for First Trust Advisors L.P. gives the keynote address

Keynote Address

Recession, or Not.

Economist Brian Wesbury Sees Continued Growth in U.S. Economy

In his keynote address, economist Brian Wesbury set out to dispel the prevailing notion that the United States economy has entered or will be soon entering a recession. The economy will continue to grow, he said, despite a crisis in the sub-prime mortgage sector that has triggered a housing slowdown, the failure of prominent investment banks, government bailouts and sharp declines in the stock market.



Brian Wesbury

Productivity – the U.S. economy’s driving force – remains healthy, Mr. Wesbury said. Real gross domestic product rose 3.3 percent in the second quarter and is up 2.2 percent over the past 12 months; Mr. Wesbury forecasts GDP will rise 2.5 percent in the third quarter. Business investment is steady, tax rates remain low and the Federal Reserve is keeping monetary policy loose. Meanwhile, examples of innovation and entrepreneurship abound.

“If you want to call this a recession, it’s the shallowest and least negative recession we have ever, ever, had in our history,” said Mr. Wesbury. “Enough of this talk of the Great Depression.”

Even so, Mr. Wesbury noted that public sentiment about the economy remains negative, fueled in part by Wall Street’s dominance in the news and the government’s scramble to prop up troubled banks. Ongoing political discussions over the state of the economy in the run-up to the November presidential election may also be having an effect, he said.

“We have a culture of pessimism today that I have never seen before,” Mr. Wesbury told a room

filled with top executives from business service companies, private equity investors and other deal professionals at Chicago’s historic Union League Club. “It’s mind-boggling to me how people can believe that right now is the worst time since the Great Depression.”

Singling out Fargo, North Dakota as an example of Main Street America, Mr. Wesbury illustrated how public worry is defying signs of improvements in the economy. Despite a boom in oil and agriculture, the advent of multiple Starbucks coffeehouses, a newly remodeled Ramada Inn, the biggest Microsoft facility outside the state of Washington and bullish trends such as low unemployment, the majority of North Dakotans believe the United States is suffering from a recession, he said.

“Fourteen dollars an hour at McDonald’s with two weeks paid vacation,” joked Mr. Wesbury. “That’s North Dakota right now.”

Speaking just two days after the Dow Jones industrial average had posted its worst decline since the Sept. 11, 2001 attacks on the United States, Mr. Wesbury held to his argument that the U.S. economy, bolstered by ongoing productivity gains, will continue to weather economic headwinds that include rising unemployment rates, high energy prices and inflation.

“The model that I used to predict whether the Fed is tight or not predicted a recession in 2001,” said Mr. Wesbury, recalling that he was the leading contrarian voice who accurately foretold the 2001 recession out of 54 forecasters polled by the *Wall Street Journal*. “The model is saying ‘no recession.’”

A fall-off in consumer confidence will not derail the economy, Mr. Wesbury said, highlighting ongoing reports of failing consumer sentiment in the past year. The real catalyst behind a recession, he stressed, is a slowdown in business investment, which has not yet occurred.

“Consumer spending never went negative, not once, in the recession of 2001,” he said, adding that



today's purchases remain relatively healthy, despite the slowdown in housing starts and the steady decline in home prices.

"We're losing trillions of dollars in the value of homes and it's not driving spending down," he said. "Because the business side is what drives the economy."

Citing examples ranging from advances in fuel cells to cutting-edge pharmaceuticals and sophisticated computers that deliver advanced services, Mr. Wesbury characterized a current period of sustained innovation in the United States that surpasses that of the Industrial Revolution at the turn of the 20th Century.

"Right now, we are having the biggest boom in productivity ever in our history," he said. "That's why you all are here; that's what you look for. What's new, what's hot, what's innovative – how are we going to use technology to squeeze out costs, get more efficient, more productive."

Even as the U.S. has reported fewer hours worked, manufacturing output is healthy, Mr. Wesbury said. Automobile production in Detroit has remained strong despite a steady overall reduction in factory labor. Hourly output from non-farm labor is up nearly 3 percent over the year-ago period.

GDP – which tracks the total output of goods and services – does not paint a full picture of the economy's productivity, Mr. Wesbury said. The making of a car, for example, involves a host of intermediate value-added transactions that range from mining to metalworking.

Mr. Wesbury also attempted to debunk comparisons between today's economic environment and that of the Great Depression. Contrary to popular belief, he said, the economic crisis of the 1930s and early '40s did not result from the stock market crash of 1929, but from heavy-handed government policy that led to an extended period of deflation. The money supply was collapsing by 15 percent a year, he noted; in



Bradley Schmarak, Partner, Reed Smith LLP; Brian Wesbury; Robert Brown, Managing Director, Lincoln International

the U.S. economy of recent months, it has been "exploding to the upside."

"We had a man-made Great Depression, because of bad monetary policy, tax hikes, trade protectionism and government intervention in the economy," he said, adding that the period was marked by the extensive regulation of the New Deal.

According to Mr. Wesbury, today's economic trends are not responsible for the blowup of bulge bracket investment banks. Instead, poor lending standards and the excessive use of leverage are the culprits, he said, recalling excessively low interest rates of the 1980s and 1990s as the beginning of a pattern of amassing unreasonable amounts of debt.

"And we've got Lehman and Bear Stearns and Fannie and Freddie to prove it," he said.

Furthermore, the ensuing federal bailouts of troubled U.S. investment banks will not unhinge the U.S. economy, said Mr. Wesbury, noting no major

economic backlash after the government's asset management company, Resolution Trust Corporation, was charged with liquidating failed banking assets from 1989 to 1995.

"We lost almost 3,000 banks in the '80s and '90s and it didn't hurt the economy," he said, noting that between 1983 and 1994 the United States posted average annual growth of 3.5 percent. "We're going to continue to grow right through this."

Mr. Wesbury sounded a cautionary note over inflation, which results when the Federal Reserve holds interest rates too low. The U.S. inflation rate is running at roughly 3.5 percent to 4 percent, he said, predicting that it will rise above 4.5 percent in the next year or two, unless the Fed raises rates. Commodities such as gold have already priced in too much inflation at their current trading levels.

"Inflation...is one of the most damaging things we can ever have in an economy and we've got it running pretty well right now," Mr. Wesbury said. "Everybody thinks it's over because oil prices have come down. But it's not. What causes inflation is too much money, and interest rates today are too low."

In summation, Mr. Wesbury stressed that the U.S. economy has been resilient for an extended period of time. Besides the savings-and-loan crisis, it has weathered the rapid decline in oil prices of the 1980s, the increase in oil prices of the past decade and the flood of cheaper imports from surging Asian economies such as China.

"You've got a good current and I believe we're not having a recession right now," said Mr. Wesbury, "because tax rates are still low, the Fed is easy and productivity is strong. We have never had a recession when those three things are true."



Panel 1 (l-r): Robert Brown; George Rusu, Captive Resources LLC; Thad Fortin, Haas TCM; Seth Hemming, Reed Smith LLP; Marc Simon, HALO Branded Solutions, Inc

Panel 1

CEO Perspectives: Selling Your Business Services Company

The first panel of executives brought the perspective of senior management who had orchestrated proactive buyouts of their companies and were retained following the acquisition and subsequent changes in corporate structure. Valuation, while important, was not always the overriding factor in the final selection of a suitor, they said, noting that risk, speed to closing, synergies and overall strategic fit also had significant weight.



Thad Fortin of Haas TCM



Seth Hemming of Reed Smith

Among the many hurdles in closing a deal, the executives stressed the importance of disseminating accurate information as the transaction ensued to ensure a smooth transition of ownership and to offset concern by customers and employees regarding the company's continuity.

The panel was moderated by Robert Brown, a Lincoln International Managing Director and Co-Head of the firm's business services group, and Seth Hemming, a Partner specializing in M&A with the international law firm Reed Smith LLP.

Transition of Ownership: When Management Stays

HALO Branded Solutions CEO Marc Simon steered the country's leading provider of corporate gifts through a bankruptcy restructuring and two subsequent takeovers by private equity firms: first to H.I.G. Capital in 2003 and later to Compass Group in 2007.

Remaining indifferent about whether existing management would play a role in the newly structured company was essential during both transactions, Mr. Simon said, in order to uphold fiduciary responsibility. "If you don't do that, my concern would be that you make the deal too much about you, and you become a principal in the transaction," he said.

Mr. Simon said he was surprised when asked to stay on after the first deal; then, after establishing a post-bankruptcy track record of success for Sterling, Illinois-based HALO, it seemed natural for him to continue his leadership role after the most recent buyout.

Indeed, private equity buyers often see the benefit of retaining a team with industry expertise and a proven history, said Thad Fortin, CEO of West Chester, Pennsylvania-based Haas TCM, the world's largest chemical management company.

Mr. Fortin successfully merged Haas with rival Radian TCM in October of 2002; in 2007 he sought a capital infusion through a private equity partner. When the company ultimately selected Jordan Co. to put together a deal that combined Haas with ICMS Holdings Inc., management rolled over significant equity into the new entity controlled by Jordan, he said.

"We were the leader in our field, growing at double digits, a lot of the valuation was driven by business we already had in the backlog," said Mr. Fortin, who had built the family-run business purchased by his father in 1975 into a major supplier to the automotive, aerospace and defense industries. "Since it was a private equity company, we thought it was essential that, as a management team, we all stay in."

George Rusu, Chairman and CEO of Schaumburg, Illinois-based Captive Resources, the largest advisor to member-owned group captive insurance



companies in the United States, brought the unique perspective of selling the company he founded to a strategic buyer in the late 1990s and buying it back several years later.

The first transaction was driven by several factors: his partner wanted to retire and the company sought a means to build scale and offer management an ownership stake; the subsequent repurchase was motivated by the need to regain control after absorption by a public company proved to be a poor fit.

“We were looking for a strategic buyer who would have vision, in order for us to take the company to the next level, and I would stay involved,” he said. “The public company that we sold to had great plan, but they really couldn’t execute – which forced us to really take ourselves back in a short period of time.”

He said he would be wary of selling to a publicly-traded firm in the future. “We were increasing their earnings, and it helped their multiple, and their stock did well, and that’s all they really cared about.”

Beyond Valuation: Other Factors Driving the Sale

When faced with three high quality suitors, HALO’s Mr. Simon said he chose Compass, a private equity firm that is also a public company trust, because of its ability to speedily close the deal with minimal risk.

“The model Compass had made a lot of sense for us – we were able to close a transaction in less time than other people needed,” he said, later adding: “So many things can go wrong during the process; so many people poke their nose into the tent that shouldn’t.”

Mr. Fortin of Haas conceded that he did take the highest offer on the table, but was also motivated by the promise of a swift close amid a fast-approaching year-end deadline. In addition, he wanted to steer clear of private equity buyers that had stakes in rival companies in what he characterized as a relatively small market of competitors.

“When we looked at synergies and things like that, they were fairly significant,” he said.

Synergy was a driving force behind Captive Resource’s initial sale, said Mr. Rusu, emphasizing that his company sought a buyer that could fill in the gaps for services that had previously been outsourced. “We actively sought out a strategic buyer who had that, and also, to give us more credibility,” he said. “We really wanted to get it to the next level.”

But he cautioned that the transition from private company to one scrutinized by the public markets was painful. “If I had to do a transaction again, I think I would look for probably more of a private equity player



Marc Simon of HALO Branded Solutions



Robert Brown of Lincoln International

who has a big enough purse," he said, adding that his company's increased obligations for financial reporting and Sarbanes-Oxley compliance were burdensome.

All three executives emphasized a need to have a strong team of investment bankers and lawyers, but they cautioned that management must be ready to intervene if the specialists get hung on up minor issues that could slow or derail the transaction.

Said Mr. Simon: "It's very important to be sure you only fight for what you ought to be fighting for."

Preserving Value in the Business Services Company

The value of business services firms is largely tied to human capital and intellectual property, often making retention of staff following a merger critical to ongoing success, the executives said.

Mr. Simon stressed the importance of bringing senior members of his management and accounting teams into the deal fold early on, rather than risk leaks or misinformation that could damage company morale.

"We displayed our trust in them, and we impressed on them the importance of retaining the secret among the 25 of us," Mr. Simon said. "And in fact, they did."

Mr. Fortin explained that he allowed his managers to control the flow of information during the transaction

process through Web casts and emails designed to keep his entire work force in the loop.

"We thought it would be important that once the rumor mill started we would be the ones to control it," he said. Because the deal was with a private equity firm, he also said it was important to get the word out that another transaction might be coming down the pike in the future when the private equity group eventually exits.

"We've let them know long term, there will be another event, that the company needs to get to another level," he said



Panel 2 (l-r): Richard Michalik, Bank of Ireland; Tom Beck, GE Antares Capital; Joseph Romic, American Capital; Curt Tatham, Lincoln International; Bradley Schmarak, Reed Smith LLP

Panel 2

Lenders' Perspectives on Business Services Transactions

During the second panel, three leveraged lenders specializing in the service sector discussed the current lending environment. While the flow of deals has indeed been slowing amid the crisis in the credit markets and shrinking liquidity of the past 12 to 18 months, lenders stressed that transaction opportunities still exist for companies with strong underlying fundamentals.



Tom Beck of GE Antares Capital



Richard Michalik of Bank of Ireland

Valuations for solid performers have remained fairly stable, the panelists said, while those companies with spotty track records have seen their multiples drop.

Deal structures now require a higher percentage of equity than in recent years; meanwhile, debt multiples have gone down. The panelists noted that equity components of 40 percent or more have become common in service-sector transactions.

In addition, the panelists pointed out that the appetite for rollover equity from existing management has increased as lenders seek assurances that ongoing leadership has a vested interest in a company's long-term operational performance and sustained growth.

More club deals are taking place in today's market, as lenders seek to lower hold-sizes and to spread their risk without the benefit of a functioning CLO market.

Finally, the panelists said that deal participants should expect higher levels of due diligence from their lenders, who will thoroughly probe the company's operations to evaluate the customer retention, proprietary technology and other distinguishing characteristics in competitive service markets.

The panel was moderated by Curt Tatham, a Lincoln International Director and senior member

of the firm's business services group, and Bradley Schmarak, Co-chairman of Reed Smith's private equity group in Chicago.

The Environment

Joseph Romic, a Principal with American Capital, characterized the current lending environment as a "flight to quality," as institutions seek solid performers in the service sector with established patterns of recurring revenue.

"I think the bar has definitely gone up," Mr. Romic said. "The marginal deals that got done in the old market really just aren't getting done these days."

The best service companies are continuing to fetch valuations of roughly eight times cash earnings and higher, said Richard Michalik, Managing Director of the Bank of Ireland.

"It's really a bifurcation of the strong versus the weak," he said.

Mid-sized firms appear to be well suited to the current lending environment, as deals requiring more than \$100 million to \$125 million of senior debt are becoming more difficult to accomplish.



Senior debt multiples have fallen to 2.5 to 3 times EBITDA from 4 to 4.5 times EBITDA a year ago, said Mr. Romic, later adding that many borrowers are seeking flexible terms that give them the opportunity to lower their cost of capital in the future.

Mezzanine financing has returned as an alternative, panelists said, largely supplanting the second lien alternative that had become ubiquitous in the most recent up-cycle.

"A lot of mezzanine investors have got dedicated capital," said Mr. Michalik. "They've got a fund that hasn't gone away because the credit market has dried up."

He advised sponsors to focus on deals calling for \$100 million in financing or less, where they can seek "club" loans from a pool of three or four banks.

However, transactions below the \$10 million EBITDA threshold are also seeing substantial headwinds, said Tom Beck, a Senior Vice President with GE Antares Capital, noting, "a lot of people start struggling with single-digit EBITDA."

Mr. Beck noted that more regional banks are stepping up to provide capital for companies with less than \$10 million in cash earnings.

Despite difficult market conditions, the panelists stressed that qualified service companies should not hesitate to approach their lenders, as the sector is proving to be a bit more resilient in a down economy than heavy industry.

"We're open for business, no doubt," said Mr. Beck. "And we're finding partners to join us."

Stricter Due Diligence

When valuing service companies, lenders are paying closer attention to a company's competitive advantage, including the quality and tenure of its customers, the value of its proprietary technology and the stability of its ongoing revenue amid downturns in the economic cycle, panelists said.

People and intellectual property account for the lion's share of value in most service companies, the panelists noted, cautioning that red flags may go up if a company in this sector logs unusually high capital expenditures.

"If you have a service company that's got 50 percent of its EBITDA that has to be spent on cap ex, you've got to scratch your head – what exactly are they



Curt Tatbam of Lincoln International



Joseph Romic of American Capital

doing that requires that much capital expenditure,” said Mr. Michalik. “It’s really a people business.”

The due diligence process has become more thorough in recent months as lenders more closely scrutinize the company’s financials and overall operations. Because key competitive advantage resides in their people, service companies, it would appear, often have fewer variable costs than their financial disclosures may seem to indicate, making cost-cutting difficult, the lenders said.

For example, even if a company’s revenue stream temporarily suffers in a weakening economy, a service provider frequently cannot afford to cut staff in order to preserve profits, as its employees are highly trained, privy to sophisticated practices and procedures and costly to replace when the business climate again turns positive.

“There’s an argument that you’ve got to keep some of these people in as a fixed cost, because if you have to fire them, it’s going to cost a lot more to train people; it’s going to cost a lot more to bring them back to the table,” Mr. Michalik said.

Lenders will scrutinize customer contracts as well, the panelists said, noting that many which are classified as long-term could prove to be expendable.

“Do you really have five-year contracts or do you have 30-day contracts,” said Mr. Romic.

Standing Out in the Market

Panelists noted a host of factors that make service providers attractive candidates for financing, ranging from a stable base of business to proprietary technology and a strong management team.

Considered a sign of quality of service and barriers to exit, a diverse and long-tenured customer base is among the most valued attributes of service-sector companies; though, a high concentration of business among a few customers is considered a risk factor.

“If it’s too few customers, then it’s a difficult story,” Mr. Michalik stressed.

Lenders will likely spend more time than in past years contacting a business’s existing customers to evaluate the overall value of the company’s service and determining whether business is driven by quality, price or other factors.

“It often gives you a better understanding of exactly what’s going on in the business,” Mr. Michalik said.



Bradley Schmarak of Reed Smith

Provisions to attract and retain top talent are also important, the lenders said, noting that they pay close attention to non-compete agreements and related materials.

Of particular importance with non-competes are assurances that when top executives or senior staff leave the company they can not take their “book of business” with them, said Mr. Romic, citing the insurance brokerage industry as a business that is vulnerable to this pattern.

“Generally service companies don’t have a lot of assets to fall back on,” added Mr. Beck.

Proprietary technologies such as software or systems that would create a barrier to entry in the market by competition are also seen as favorable, according to the panel.

“Clearly technology can be an important factor,” said Mr. Michalik.

Mr. Beck sounded a note of caution over service providers whose earnings jump too quickly in a short period of time, because they may signal growth tied to an unsustainable trend.

“You always ask the question, what have you been doing for 30 years that all of a sudden, something clicked, now you’re taking off,” he said.

The panelists agreed that the most critical factor when determining investment worthiness of a service company is the quality of senior management, its long-term vision and the strength of its bench.

“After we get through all of our diligence, talking about customers and systems – it generally comes down to, 99 percent of the time, management, the quality of the management team,” Mr. Michalik stressed.



Panel 3 (l-r): Pranjal Srivastava, ICICI Securities Inc.; Barry Malkin, Apollo Group, Inc.; John Kenny, Iron Mountain Incorporated; Michelle Moore, Reed Smith LLP; Michael Iannelli, Lincoln International; Dr. Michael Drill, Lincoln International-Germany

Panel 3

The Global Perspective: Trends in Cross-Border Business Services M&A

The third panel, which featured specialists in cross-border transactions, focused on the emerging challenges U.S. and international companies face as they use acquisitions to meet globalization objectives.



Strategic goals are the overriding factors when evaluating potential foreign acquisitions, the panelists said, ultimately carrying more weight than favorable foreign exchange rates or regulatory and legal barriers.

Gaining familiarity with the target company is essential, they stressed, noting that extra efforts are required to offset inherent disadvantages overseas suitors may have with respect to timing of the deal or local market knowledge. Joint ventures and partnerships continue to be methods to mitigate risk.

Services companies will continue to be ripe for cross-border consolidation in the near-term, the panelists said, naming financial services, banking, insurance, engineering, healthcare and pharmaceutical research as some of the attractive end markets for service providers.

The panel was moderated by Michael Iannelli, a Lincoln International Managing Director and co-head of the firm's North American business services industry group, and Michelle Moore, a Partner in Reed Smith's Chicago office who specializes in domestic and cross-border M&A.

Foreign Currency Impact

During the past three years, the United States has dominated cross-border deals, said Dr. Michael Drill, CEO and Managing Director of Lincoln International - Germany. In Europe alone, American companies have acquired some 300 businesses, compared to Europe's takeover of 150 U.S. concerns during the same time period.

While it might be logical to assume that sustained weakness in the U.S. dollar would tip the scale in favor of more purchases of U.S. companies by non-U.S. buyers, panelists agreed that foreign exchange rates would continue to have a marginal bearing on their acquisition decisions.

"We believe currency itself has only a minor impact on cross-border and trans-Atlantic deal flow," Drill said.

U.S. services companies are expected to continue to do the bulk of the acquiring, primarily due to structural reasons, including the larger scale of U.S. buyers and their access to financing, said Drill. Many U.S. firms trade on public markets or have the backing of private equity funds. European companies, by comparison, are largely family owned and face financing challenges.



Dr. Michael Drill of Lincoln International-Germany



Pranjal Srivastava of ICICI Securities

"The U.S. is a service economy," he said, "whereas in Europe it's less developed and we have more fragmented players."

Mr. Drill doesn't expect many large transformative deals in the current environment, but instead foresees smaller, less risky "add-on" acquisitions that are less difficult to integrate.

India's buyers, too, are less swayed by attractive foreign exchange rates than by the long-term prospects of successful deals, said Pranjal Srivastava, a Vice President with ICICI Securities, Inc.

"Indian buyers prefer to evaluate deals on their own business merits, rather than a pure currency bet," he said.

The tightening U.S. regulatory environment, characterized by increased scrutiny from government regulators such as the Committee on Foreign Investment in the United States (CFIUS), is less of a deterrent to Indian buyers than the relative weakness in the U.S. economy, he said. Even so, Indian companies are beginning to shift their interests away from the U.S. and Europe to markets such as Australia and Japan.

"Currently more than 50 percent of the revenues of Indian technology companies come from the U.S. and they need to diversify," he said.

Strategic Objectives

Barry Malkin, Vice President and Head of Corporate Development for educational services provider Apollo Group, noted that his firm, like those of the other panelists, is taking a longer-term view of the acquisitions it is making around the world.

"We're buying these businesses to hold for a very, very long time," he said. "We have no intention of flipping them."

Indeed, strategic objectives seem to be the dominant factors when weighing international acquisitions. Even though the U.S. market has a reputation for being more litigious than other major world economies, the benefits of doing business in the U.S. have often outweighed that risk, Mr. Srivastava said.

Added Mr. Drill: "I think foreign buyers are willing to cope with corporate governance issues. At the end of the day, it will be the strategic fit that will lead a foreign buyer into an acquisition."



Barry Malkin of Apollo Group



Michelle Moore of Reed Smith

John Kenny, Executive Vice President of Iron Mountain, a global information services firm, said that his company is wary of doing business with countries that maintain a protectionist grip over the local work force, such as France, where labor unions are dominant.

“When we do a roll up, we are in the business of driving synergies,” Mr. Kenny said.

Indeed, thorough due diligence regarding the regulatory environment of a foreign government is essential, said Mr. Malkin, noting that it frequently increases the complexity of overseas acquisitions.

“The regulatory scheme is important to how we look at an acquisition – making sure that we fully understand the implications of operations in the country, but also of exporting our technology and processes to a new location, is something that we’re very, very sensitive to,” he said.

Building and maintaining a local team in the foreign country is essential, Mr. Malkin stressed, because local experts can guide the acquiring company through the in’s and out’s of government policy.

Gaining Local Expertise

Foreign buyers of U.S. companies are sometimes operating at a disadvantage to local suitors, Mr. Drill and Mr. Srivastava said, stressing that it is essential to spend time on the ground with the target company and become fluent in the market dynamics at the outset of the bidding.

A foreign buyer “needs to get familiar with not only the company – the target – but as well, the market, his competitors, market drivers,” Mr. Drill said. “And he needs to get familiar with tax implications – how the acquisition will impact his tax position, his financials, and so on.”

“Indian buyers are familiar with the business environment in the U.S. as they have operating companies or clients in the U.S. They are able to move quickly when they identify a U.S. target,” said Mr. Srivastava. Comparing the Indian economy to China, he said India may have an advantage in service sector deals, as its economy is based on British Common Law, is technology-driven, has a high percentage of graduates with advanced degrees and has no English-language barrier.



John Kenny of Iron Mountain



Michael Iannelli of Lincoln International

Joint ventures, rather than outright buyouts, are one of the best ways to mitigate risk when entering a new non-U.S. market, said Mr. Kenny. Iron Mountain has completed some 20 joint ventures outside the United States, he said, including half in which the firm has eventually increased ownership to a majority stake.

"It's been a very successful approach," he said. "The smaller the potential joint venture target, the more likely we are to start below the accounting hurdle at 19.9 (percent), and then move up consolidation at 50.1, and then eventually take them out."

Mr. Malkin pointed out that a partnership formed between Apollo Group and private equity firm Carlyle Group serves a similar purpose, giving Apollo the benefit of Carlyle's international presence. Carlyle owns a 20 percent stake in the entity, he said, while Apollo controls 80 percent.

"The objective is simply to acquire and build up an international, educational services practice," he said. "Having the breadth and reach of the Carlyle Group around the world to help us source transactions, help us executive transactions, find the right professional services partners overseas, etc., has been very important to us."

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