



Overview

Global Business Process Outsourcing (“BPO”) transaction activity returned to more normal levels in Q1 2017 following a depressed Q4 2016. Deal activity jumped from 291 closings in Q4 2016 to 381 closings in Q1 2017. While the longer-term trend still points to a modest decline in transaction volume, it’s worth noting this was the first year-over-year (“YoY”) increase since 2Q 2015. Quarterly BPO transactions from 2014 through Q1 2017 are depicted in the graph below.

What was once a cost-optimization strategy focused on noncore and back-office functions, BPO is now engrained in all business operations—and expanding. This creates opportunity for smaller niche providers to carve out market share. However, customers are shifting to fewer vendors with more diverse service offerings. This drives BPOs to diversify their offerings through acquisitions to increase customer wallet share.

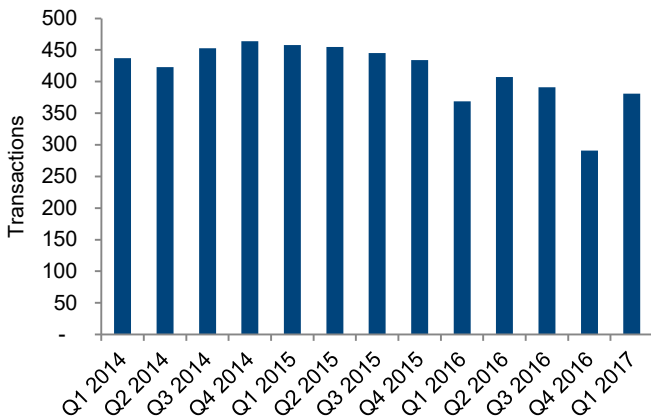
Meanwhile, the middle market is garnering much of the attention. During the quarter, middle-market companies accounted for 88% of total deal volume (with published financials), which is up from 80% last quarter. Middle-market companies offer attractive return profiles, which command attention from both financial and strategic investors.

A key industry trend is BPO service modernization through new technologies. Lines are increasingly blurred between traditional BPO companies and traditional tech or software companies as technology-enabled services and software-as-a-service models become more prevalent in the BPO sector. This drives cross-industry combinations domestically and internationally.

This trend also pushes more deal volume to developed nations with technological expertise. During the quarter, North America captured 48% of deal volume, up from 41% last quarter and 39% last year. In contrast, deal volume in Asia-Pacific dropped to 13% from 28% last quarter and 34% last year.

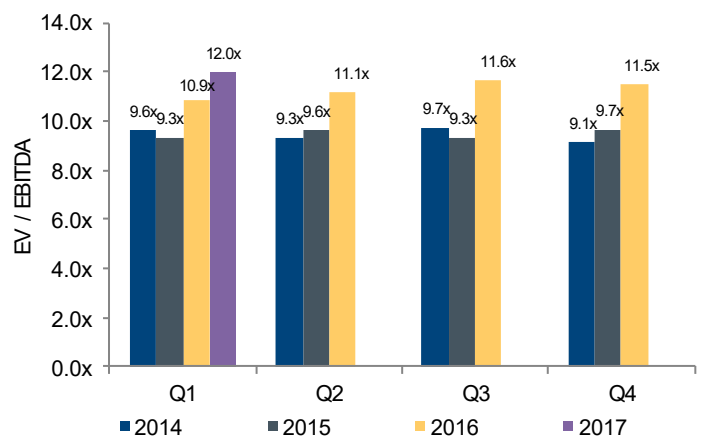
Despite the modest downward trend in overall BPO M&A activity over the last several years, valuation metrics continue climbing higher. The current 12.0x median valuation is the highest in the last three years. The increase in valuation multiples indicates still-healthy fundamentals for BPO companies and a favorable outlook.

Transactions by Quarter



Source: CapIQ

Valuation Metrics by Quarter



Source: CapIQ

Reported M&A Activity

Transactions in the quarter highlight continued interest for both middle-market and large businesses, and from both strategic and financial acquirers. Trends include gaining access to stronger growth by buttressing established core businesses, and by expanding into new markets and technologies. We highlighted certain technology-enabled BPO transactions to reveal how technology advances are shaping the industry.

Transactions by strategic acquirers dominated the industry in Q1 2017, representing 90%+ of the mix. This industry consolidation is primarily driven by companies seeking additional capabilities and technologies to expand into new markets. Customers of all sizes are trimming their vendor lists and choosing BPO providers that are one-stop-shops for their outsourcing needs. To win and keep business, BPO companies must expand their offerings, which creates opportunity for small and mid-sized businesses with niche market strongholds.

Although financial buyers were relatively quiet during the quarter, strong interest in this growing segment remains. Key attributes for increased deal activity include: a longer-term trend for outsourcing business functions, recurring revenue, long-term contracts, scalable business models, fragmented global markets, technological barriers to entry, low capex requirements, and strong cash flow. These characteristics make a convincing case for BPO buy-and-build platforms, where much of the middle-market activity occurs.

EdgePoint expects M&A activity in the BPO sector to accelerate during the coming quarters as favorable industry fundamentals combine with strong investor interest. Valuation-multiple ranges are likely to be rather wide with traditional call-center-like businesses on the low end and high-growth or scalable technology companies on the high end.

Noteworthy Business Process Outsourcing Transactions | Q1 2017

M&A Closed Date	Target/Issuer	Buyers/Investors	Target Business Description	Price (\$USDmm)	Target Country
1/1/2017	Personnel Management Systems, Inc.	Asure Software, Inc. (NasdaqCM:ASUR)	Provides HR outsourcing solutions for small and medium-sized companies	5	United States
1/2/2017	Ulixes Consulting, LLC	Bridge Partners, LLC	Offers management consulting services	-	United States
1/4/2017	Gruppo Marcucci, LLC	Arthur J. Gallagher & Co. (NYSE:AJG)	Provides outsourcing services for benefits and human resources	-	United States
1/6/2017	DirectCash Payments Inc.	Cardtronics Holdings Limited	Engages in payments service business	480	Canada
1/6/2017	Datalink Corporation	Insight Enterprises, Inc. (NasdaqGS:NSIT)	Provides consulting, managed services, and data center services	298	United States
1/9/2017	MSX International, Inc.	Bain Capital Private Equity, LP	Provides technology-based human capital solutions	-	United States
1/15/2017	GDFC Services Limited	Aurium Capital Markets LLP	Offers administration services for the financial industry	52	United Kingdom
1/17/2017	The Marcus Buckingham Company, Inc	Automatic Data Processing, Inc. (NasdaqGS:ADP)	Provides leadership development solutions to organizations	-	United States
1/23/2017	SRID Informatique Societe De Realisation S Informatiques Diverses	Groupe Infodis S.A.	Provides IT outsourcing services	-	France
1/25/2017	DCM Services, LLC	WILsquare Capital LLC	Provides deceased and probate account recovery services	-	United States
1/30/2017	Compliance Solutions Strategies	CIP Capital	Provides technology-enabled regulatory and compliance solutions	-	United States
1/31/2017	Denali Sourcing Services, Inc.	WNS (Holdings) Ltd. (NYSE:WNS)	Provides strategic procurement solutions	40	United States
1/31/2017	Denali Sourcing Services, Inc.	WNS (Holdings) Ltd. (NYSE:WNS)	Provides strategic procurement BPM solutions	40	United States
2/1/2017	TriNet Group, Inc. (NYSE:TNET)	Atairos Group, Inc.	Human resources solutions for small and midsize businesses	442	United States
2/3/2017	Northeast Retirement Services, LLC	Benefit Plans Administrative Services, Inc.	Provides administration and processing solutions for retirement and charitable programs	145	United States
2/10/2017	ServicePower Technologies plc	Diversis Capital UK Limited	Engages in the implementation of field service management software	19	United States
2/14/2017	Comtel Solutions Pte. Ltd.	Quesscorp Holdings Pte. Ltd.	Provides technology and knowledge processes outsourcing services	20	Singapore
3/1/2017	Innosight LLC	Huron Consulting Group Inc. (NasdaqGS:HURN)	Offers strategy and growth consulting services	135	United States
3/1/2017	Wipro Ecoenergy	Chubb Alba Control Systems Limited	Provides solutions for enterprise-wide energy operations and efficiency management	70	United States
3/10/2017	Seabury Consulting LLC	Accenture plc (NYSE:ACN)	Provides business strategic planning and consulting services	-	United States
3/27/2017	International Financial Data Services Ltd.	DST Systems, Inc. (NYSE:DST)	Provides outsourced administration and technology solutions	175	United Kingdom
3/31/2017	Everett Spinco, Inc.	DXC Technology Company (NYSE:DXC)	Provides technology consulting, outsourcing, and support services	8,859	United States

Notable BPO Transactions

Accenture Is Acquiring New Capabilities

Accenture continues to be one of the most active acquirers in the BPO space. With \$1 billion earmarked for acquisitions in 2017, it has already completed nine acquisitions in Q1 2017 and seven Q2. This adds to 20 completed deals in 2016 and 25 in 2015. Its investments are targeted to help customers transform legacy processes to new and evolved digital variants.



While Accenture's recent M&A activity has a technology-based slant, it illustrates large multinational company growth of core competencies—in this case consulting and outsourced services. Seven of its nine Q1 transactions were companies with consulting aspects to their businesses. The other two were service and IT focused.

Like the overarching theme for the BPO industry, all of Accenture's recent M&A transactions occurred in developed countries (primarily the U.S. and Europe) and with a technology component. The strategy is clear. They seek talent, differentiated services, and technological competitive advantages.

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Arthur J. Gallagher Continues to Roll Up the Market With Tuck-In Acquisitions

Like Accenture, Arthur J. Gallagher is taking advantage of the fragmented market by being highly active in global M&A. With 13 transactions completed in Q1 and an additional four finalized in Q2, the Company has now completed 81 transactions in the last two-and-a-half years (33 in 2016 and 31 in 2015).

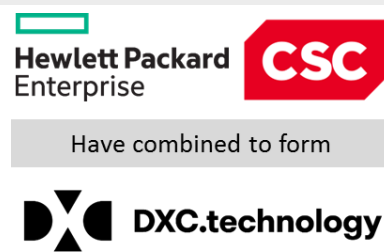


While Arthur J. Gallagher is primarily known as an insurance broker and risk management company, a big piece of its business is related to back office, administration, HR, and benefits outsourcing. In fact, six of its 13 acquisitions in Q1 had elements of BPO (the other seven were insurance brokers).

The Company is primarily pursuing a tuck-in acquisition strategy with companies that are close to its core competency. It is purchasing companies to acquire new customers, fortify existing strongholds, and expand into new geographies. Post acquisition, it generates cross-selling opportunities by rolling out Arthur J. Gallagher's comprehensive suite of products and services. While most recent acquisitions have been tuck-ins, the Company notes it is also interested in acquiring new capabilities and technologies.

The Largest Quarterly Transaction Blurs the Line Between BPO and IT

On March 31, Hewlett Packard Enterprises ("HPE") completed the spin-off merger of its Enterprise Services business with Computer Sciences Corporation ("CSC") to form DXC Technology ("DXC"). Valued at \$8.9 billion, the deal was the largest transaction in Q1 2017 by over \$6 billion.



The transaction demonstrates the blurring lines between traditional BPO companies and IT companies. HPE's Enterprise Services arm was more of a technology business focused on making IT more efficient. CSC was more of a services business providing multinational customers IT and professional services. The marriage creates a high-tech services company with a strong BPE value proposition. This "best of both worlds" approach is likely to continue as BPO providers strive to compete in a technology-heavy world and IT companies look to add customers and recurring monthly revenue through monthly services.

Bain Buys Into a Technology-Enabled BPO Business

During the quarter, Bain Private Equity bought into the automotive BPO market with its acquisition of MSX International ("MSXI"). MSXI is a fitting example of a traditional BPO business enhanced with technology. MSXI is a global business-process-outsourcing company providing specialized technology-based services primarily to the automotive industry.

Bain highlighted the following investment considerations in its acquisition of MSXI: consistently strong growth, unique competitive position, broad geography and service capabilities, strong recurring revenue based on long-term customer contracts, and a trend for automotive companies to outsource more of their business processes. This will likely be the play-book for other financial buyers in coming quarters.



Now that Bain has a foothold in the global automotive BPO market, it is likely to enhance its investment with bolt-on acquisitions. An attractive business is a company with complimentary services that Bain can cross-sell to its automotive customer base. Another opportunity is a business with similar product lines and a different manufacturing customer base. Bain's buy-and-build strategy will become evident shortly.

Conclusion / Final Thoughts

While overall global M&A activity for BPO companies slowed in recent quarters, the outlook for the domestic middle-market is positive, based on current and developing trends.

On a global level, the landscape is painted with opportunity and challenge as diverging longer-term trends divide the BPO industry. Traditional offshore human-capital-intensive BPO companies like call-centers should continue to face tighter markets and contracting multiples—primarily in emerging markets with inexpensive labor. On the other hand, BPOs in developed countries, particularly those with a specialized service or unique technology, should benefit from robust demand and interest from a variety of buyers.



Specialized BPO service providers should have plenty of interest from both strategic and financial acquirers as industry consolidation of a fragmented market continues. On the strategic side, this is exhibited by the flurry of activity from large multinational firms such as Accenture and Arthur J. Gallagher who show a continued appetite to diversify their offering. On the financial side, activity from large private equity groups like Bain and The Blackstone Group, as well as middle-market firms like CIP Capital and Diversis Capital, point to robust buy-and-build platform opportunities for companies of all sizes.

Core industry growth drivers like outsourcing for cost reductions will continue to influence the market. However, increased value is placed on BPO companies that leverage technologies for efficiency and scalability. Key areas of interest are process automation, big-data analytics, software-as-a-service (“SaaS”), and cloud services. We expect the lines to increasingly blur between BPO and IT companies, while tech-enabled BPO transactions gain more industry M&A activity.

This trend is demonstrated in a recent transaction in which EdgePoint served as exclusive financial advisor to Comstar Technologies in its recapitalization to Wincove Private Holdings. Comstar provides telephony, IT, managed, cloud-based, business infrastructure, and other technology services. Wincove was attracted to the longer-term industry trend toward outsourcing, strong cash flow, and acquisition growth strategy.

Based on the fragmented nature of the industry, longer-term demand growth trends, interest from both financial and strategic buyers, EdgePoint expects BPO to remain an attractive industry for M&A near term. This is particularly evident for domestic middle-market companies, which are attracting the majority of demand.

Representative EdgePoint Transactions

<p>Sell-Side Advisory</p>  <p>Comstar Technologies has been recapitalized by Wincove Private Holdings</p>	<p>Sell-Side Advisory</p>  <p>Nationwide Property & Appraisal Services, LLC has been recapitalized by Corridor Capital, LLC</p>	<p>Sell-Side Advisory</p>  <p>PeopleShare, Inc. has been recapitalized with Trivest Partners</p>	<p>Sell-Side Advisory</p>  <p>InfoAccess.net LLC has sold to Corcentric</p>	<p>Sell-Side Advisory</p>  <p>Smart Solutions has sold to Blue Technologies, Inc.</p>
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Service Offerings

Sell-Side Advisory

- Third-Party Sale
- Sale to Management
- Recapitalization
- ESOP

Buy-Side Advisory

- Buy-Side Search
- Buy-Side Diligence & Financing
- Targeted Buy-Side
- Management Buyout

Financing Advisory

- Senior & Sub Debt
- Asset Based Lending
- Mezzanine Debt
- Private Placements



EdgePoint is an **independent, advisory-focused, investment banking** firm serving the **middle market**.

