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UK's Serco Group Buys Out Intelenet for £385 M

One of the biggest BPO deals in India & first exit by Blackstone from its investments here

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UK-based Serco Group has bought out private equity firm Blackstone and other shareholders in Intelenet Global Services, a provider of back-office services, in an all-cash deal valued up to £385 million, or ₹2,861 crore, signalling continuing investor interest in the Indian BPO sector.

Blackstone could be paid £254 million, or $418 million, for its 66% stake, providing a return which is more than double its original investment in absolute terms. Blackstone has not publicly disclosed its initial investment, though a figure of $200 million, which was for an 80% stake in 2007, has been widely reported.

On Tuesday, Akhil Gupta, chairman of Blackstone India, said the transaction had yielded an internal rate of return, or IRR, of 26%. This assumes that the deal, which will be routed through Mauritius, will not face tax demands from Indian authorities, who have been fierce in their attempts to tax cross-border transactions. The deal will be consummated after receiving regulatory approvals.

The Intelenet management team led by CEO Susir Kumar, which will stay in place, will receive around 55 million pound for its 16% stake in the BPO provider. The transaction gives Serco, which provides business services to sectors such as transport and healthcare in the UK and other countries, a presence in back-office services and a sizeable offshore footprint in India. Intelenet figures among the top 15 exporters of BPO services from India.

ET was the first to report that Serco was in talks with Blackstone to acquire Intelenet in its May 9 edition. Intelenet is one of Blackstone's earliest investments in India and among its more profitable ones. This is the private equity firm's first exit from an Indian investment, which includes Gokaldas Exports, Nagarjuna Construction and Moser Baer Energy.

The Intelenet transaction involves an upfront payment of £335 million while the remaining £50 million will be paid as so-called earn-outs over two years up to December 2013.

Blackstone's First Sellout in India

Other Top PE Exits in India

YEAR	INVESTOR	INVESTED CO	EXIT VALUE ($ M)
Dec '10	Actis-Sequoia	Paras Pharma	726
Nov '10	ChrysCapital	Infosys Tech	400
Aug '10	Sequoia	SKS Microfinance	354
Feb '10	Siva Ventures	Amby Valley	323
Jun '10	SAIF & Others	Intelligroup	199
Jan '11	General Atlantic	Patni Computers	160

Shareholding Pattern*
*Approximate %

Blackstone	Intelenet	Barclays	HDFC
66.25%	16.25%	12.75%	4.50%

Ownership Changes ▶▶ 22

Repeated Ownership Changes

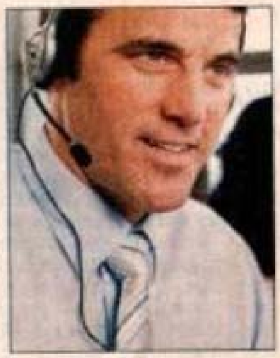
»» From Page 1

The earn-outs are linked to business coming from Blackstone's portfolio of companies and also from Barclays Bank, which together contribute close to 45-50% of Intelenet's revenues. For Serco, which is listed on the London Stock Exchange and part of the FTSE-100, this is the largest acquisition to date. The acquisition is in line with our strategy, which is focused on organic growth, supplemented by strategic acquisitions for new markets and sectors, particularly which enhance our growth and margins," said Tom Riall, a Serco official who will take over as executive chairman, Intelenet Global Services and Serco Global BPO, its India BPO unit. Riall is chief executive, civil government, in Serco.

Avendus and Barclays Capital were advisors to the deal.

The existing Intelenet management led by Kumar will continue to be at the helm. "Serco has given us the independence to run the business but will depute a senior person to help us integrate and grow strategically," said Kumar. Riall said Serco spoke to Intelenet's top 20 customers before deciding to continue with the same management team. Kumar and his team were instrumental in enticing Blackstone to invest in 2007 in a management-led buyout. Intelenet started as an equal joint venture between Tata Consultancy Services (TCS) and HDFC. The first ownership change happened when TCS exited and Intelenet became a 50:50 joint venture between Barclays and HDFC. In 2007, Barclays and HDFC exited through the management-led buyout, and Blackstone came in.

Blackstone currently holds 66% in Intelenet after the BPO firm recently broad-based its investor base by



bringing back HDFC and Barclays Bank as shareholders. The UK's Barclays currently holds a 12.75% stake in Intelenet and HDFC a little under 5%. The management holds about 16% after HDFC and Barclays returned.

"So far, we've had three investor changes. Now there will be no more changes," added Kumar.

Blackstone's Akhil Gupta termed the returns from its investment in the BPO provider as 'very satisfying'. "Since the time we invested, valuation multiples for the BPO industry have actually compressed. Despite that, we were able to get a good return because of the value we were able to create in Intelenet," he said. Blackstone, the world's largest PE firm, was able to add value by helping Intelenet in acquisitions that helped it diversify into providing services for the healthcare and travel industries. It also introduced six firms that are part of its global portfolio to Intelenet, which now contribute about a quarter of Intelenet's revenues, Gupta said. For the year ended March 2011, Intelenet had revenues of around £170 million ($279 million) and an adjusted operating profit (operating profit or EBIT before amortisation) of £19 million, or $31 million. The deal values Intelenet at about 10.5-12 times its FY11 EBIDTA of £32 million ($52.6 million) and over 2 times its revenues.

"The Intelenet deal is a win-win for both the existing shareholders and Serco. Serco was trying to get an offshore platform for long," said Nikhil Rajpal, partner (M&A and private equity), Everest Group. "What Serco is paying for Intelenet is line with the current valuations in the sector. But overall, valuations of BPO providers are on the higher side at 12 times EBIDTA. At these valuations, you have already built in 20% growth," he added.

"There will be more consolidation in the sector. But because valuations are stretched they are taking time to happen. Eventually, there will be a few large BPO providers instead of 20-30 small providers," Rajpal said. Intelenet is growing its revenues at 10-15% annually. Serco expects the acquisition to be accretive to its earnings in the first full year with returns meeting its cost of capital in the third full year of ownership. It is financing the acquisition through debt and expects the funding cost of the acquisition to be around 5%.

Intelenet currently employs 32,000 people. In all, along with Infovision, an acquisition Serco made in 2008, the British company will employ a total of 40,000 people in India once the deal is done. Infovision, now known as Serco BPO, was focused only on the domestic market while Intelenet gets about 75% of its revenues from overseas.

According to Everest Research Institute, the size of the global BPO market is estimated to be $350-500 billion, with around $200 billion being outsourced. The domestic BPO market is forecast to grow around 20% per annum to $2.5 billion in 2014, according to technology research firm Gartner.