January 10 . . .

Inside Outsourcing ™

INTERVIEWED BY LARRY JANIS

Inside with:

Joe Vales, Senior Partner, Vales Advisors and Vales Consulting Group

Joe Vales is known as a pioneer in the outsourcing marketplace, at PwC, as Global Marketing Director, he helped shape the early days of the BPO market. At the Vales Consulting Group, he is a strategic business development advisor to many of the leading service providers and venture backed start-ups in the ITO, BPO, and software markets. But what really distinguishes Joe Vales is how so many CEO's and industry leaders consider him a trusted advisor and friend who passionately cares about their business.

LJ: For those who somehow do not know, you have expanded your business model to include consulting work on M&A in conjunction with Harry Feinberg, the Chairman & Chief Executive Officer of Sourcequest LLC. Why this aspect of consulting?

JV: We see Vales Advisors LLC as a very complimentary business to Vales Consulting Group LLC, our strategy and business consulting services firm. For many years, we had been asked by private equity firms for advice on what firms represent attractive acquisitions and we frequently did due diligence work for them so we had a very good understanding of the M&A process from an insider's perspective. At the same time, Harry Feinberg and Sourcequest LLC have been quietly involved in scores of license software transactions and advised on several PEO and ASO transactions in a very confidential manner for the past 12 years. We came together when we realized that we could monetize our thousands of industry contacts and the trust that we had developed with buyers and sellers in all segments of the outsourcing, software, and business services markets.

FROM THE EDITOR

Inside Outsourcing's goal is to provide you with articles of interest and with a forum for the exchange of information in this rapidly evolving industry.

Inside with:

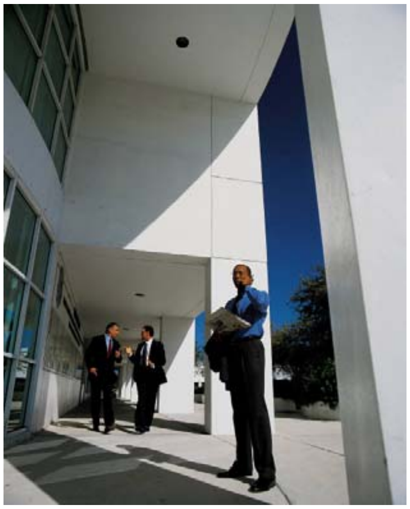
Joe Vales, Senior Partner, Vales Advisors and Vales Consulting Group

LJ: How would you define the difference between what you do as an advisor compared to that of an investment banker?

JV: We are advisors not investment bankers. A major reason that Harry and I came together was the problems we saw in the typical way investment bankers approached the M&A process from both a transactional and strategic focus. The typical investment banker will identify a market segment and then use a database service or research report to identify all the firms in the market. With this list, the dial for dollars approach starts as entry level bankers man the phones and start dialing with little knowledge of the firm they are calling. A typical mid-market CEO probably receives over 100 calls a year from scores of investment banking firms. They hate it and complain to us all the time that the callers have little knowledge of their business beyond a spread sheet of deal-oriented metrics.

"A major reason that Harry and I came together was the problems we saw in the typical way investment bankers approached the M&A process from both a transactional and strategic focus."

Moreover, the typical banker focuses on developing the book or investment memorandum that they will throw against the wall, sending it to well over a hundred investment groups and seeing what sticks. There is very little targeting or strategic thinking on which groups represent the best fit for the buyer or seller. It is simply a money game that often fails because of misunderstandings, lack of vision, culture issues and operational styles. This problem is emphasized when you look at the investment books themselves. There are scores of pages dealing with financial data but little information on the value proposition that the buyer or seller will bring to the table. It is similar to a typical outsourcing industry SLA where hundreds of metrics are described in great detail but the key metrics that will truly drive success or failure are lost in a pile of data.



In contrast, we take a very different approach. Harry and I have been in the middle of the outsourcing market for over 25 years. As such, we have a deep understanding of the needs of so many companies and have close relationships with the entrepreneurs and corporate executives driving so many firms. Instead of developing 100 page Information Memorandums, we distribute highly focused power point presentations and executive summaries.

(continues on next page)

Inside with:

Joe Vales, Senior Partner, Vales Advisors and Vales Consulting Group

We limit the distribution to approximately five to seven firms that represent the best strategic and financial fits and we emphasize the value propositions that make it a win/win for sellers and buyers. We do this for both buyers and sellers, as we represent either side of the transaction. We have formal relationships with a dozen private equity firms, close relationships with over 40 other PE/VC firms, leading angel investors, and family trusts, as well as, advisors to over a dozen market leading strategic buyers. So we can serve the entire spectrum of the market from one million dollar to several billion dollar, club-type transactions.

"where we focus and where there is the greatest need is in the SMB and mid market segments of the outsourcing and business services marketplace."

LJ: What segments of the M&A advisory market are your main focus?

JV: We have the relationships to serve all segments of the market. But where we focus and where there is the greatest need is in the SMB and mid market segments of the outsourcing and business services marketplace. These are the pre IPO firms with less than $100 million in revenue. This market segment is not very well serviced by the typical investment banker or broker. Within these segments our sweet spot is firms led by entrepreneurs with revenues ranging from $5 million to $50 million in both the US and Europe. These are the hidden gems in the market with great management teams, powerful value propositions, recurring revenue, positive cash flow/EBITDA (and some emerging firms with negative EBITDA), scalability, and strong intellectual capital/property to sustain growth and profitability. Few firms are able to meet this criteria, but we are fortunate that we know the market so well that we can identify these opportunities before others and can serve them very well as advisors and friends.

LJ: There has been a lot of M&A activity in the IT Services marketplace with deals like HP/EDS, Xerox/ACS and Dell/Perot. Do you see any shifts in 2010?

JV: We see in all segments of the outsourcing market an increase in M&A activity.   For example, in both the ITO and BPO markets, pick up a rock and you will find an investment banker or corporate development executive looking for the special opportunity to expand service offerings or even form a platform for rolling up companies.

(continues on next page)

Inside with:

Joe Vales, Senior Partner, Vales Advisors and Vales Consulting Group

There are also several companies looking to monetize their offshore captive shared service centers and we hear a lot about multi-sourcing/single point solutions in the marketplace. But when we look deeper, we see firms betting on clients, wanting one firm to choke and having difficulty managing multiple service providers. We see this driving market consolidation. In the BPO and ITO markets, mid market providers are adding to their service offering via both organic and inorganic growth, trying to grab a larger share of their clients spend/wallet. In the Fortune 1000 market, larger firms like Dell and Xerox are looking to bulk up their service business to provide a more integrated and innovative solution to their clients. This trend will continue to grow for at least the next two to three years. Nevertheless, all markets move in cycles so the breakthrough entrepreneur will always have a following, just look at what is happening with cloud computing and SaaS providers.

"But when we look deeper, we see firms betting on clients, wanting one firm to choke and having difficulty managing multiple service providers."

LJ: Are the seller needs and investment criteria driving the increase in M&A activity?

JV: There is no doubt that buying multiples are gradually increasing as the economy improves with EBITDA multiples ranging in the 5 to 7 range. But versus a few years back, buyers are almost exclusively focusing on EBITDA multiples and not revenue multiples. Firms with negative EBITDA are having difficulty finding suitors unless they have a very unique technology platform or value proposition. As one very successful PE firm said to us recently, we made several mistakes in 2000-2002, and have learned a lot about how to value outsourcing and business service firms. Sellers on the other hand still have the 2000-2006 expectations of 8 to 12 EBITDA valuations, so there is still a gap, but it is getting smaller and this had led to a number of new discussions in the market. The wild card is the strategic buyer who has a set of strategic needs that trump financial criteria such as: access to new markets, expanding their service offering, serving as a front end to an offshore operating base, gaining access to a new, important customer base, gaining experienced management team, or getting breakthrough technology that provides competitive advantage to their core business. That is why a seller needs to work with an advisor who understands these strategic issues and can make a powerful case for synergy and finding the right partner.

(continues on next page)

Inside with:

Joe Vales, Senior Partner, Vales Advisors and Vales Consulting Group

LJ: What advice would you and Harry give to a firm's management when considering whether to seek an investment partner or outside capital?

JV: Look at the investment criteria of the potential investor. In this economy, you need to meet or exceed the investment criteria just like you do in responding to an RFP. You have to move the discussion from a financial discussion to a strategic discussion. Articulate a very powerful value proposition don’t bury it in piles of reports, be serious about the process. Expect due diligence to be exhausting, make sure you have no surprises. We see too many deals break down in due diligence where the seller was not fully transparent in explaining their financials or technology or client satisfaction. All deals have warts, so open up sooner rather than later during due diligence. It is a deal killer to hold back information.

LJ: What has made you successful?

JV: TRUST, TRUST, AND TRUST. Our clients know that from start to finish they can trust we are on their side whether buyer or seller. We bet our reputation with every transaction and do our homework to bring together good strategic and financial partners. We know how to make a deal work so it is a win/win for both parties and will not stop until we do.