Answers

1. Financial analysis of Steria

Steria is a fast growing group (+13% p.a.), this growth is apparently both organic and external (acquisition of Mummert in 2005).

Thanks to this growth, Steria benefits from economies of scale, its EBITDA margin increases therefore over the period. The EBIT margin increases even more as depreciations remain stable: EBIT margin almost doubles in 3 years. Overall, EBIT is multiplied by 2.5.

Steria benefits from a reduced tax rate in 2004 and 2005, which is back to normal in 2006 (30%).

Working capital increases faster than turnover this is therefore a burden for cashflows.

Steria makes a very strong investment in 2005 (acquisition of Mummert). In 2004 and 2006 capex are low (1% of turnover), this is justified by the low level of capex needed in the service sector (mainly IT investments).

In 2004, Steria is almost exclusively financed with equity; net debt is below 0,4x EBITDA. In 2005, the acquisition is financed with operating cash flows and by debt (Steria does not issue equity at that time). Net debt becomes material (2x EBITDA), in particular due to the fact that the sector is relatively risky (see beta of Steria). In 2006, free cash flows generated allow to reduce significantly the level of debt which become much more acceptable (below 1x l'EBITDA).

Average ROCE becomes superior to the WACC of the firm in 2006. ROE benefits from a positive leverage effect (in particular in 2005).

2. Stock market analysis

Steria share price seems very volatile which reflects the risk of the company perceived by investors.

Yield and pay out ratio are very low, which does not seem surprising given the high growth rate of the company and of the sector. Nevertheless, we can mention that this policy is justified only by external growth opportunities as capex are largely self financed.

2004 P/E is high which seems justified by the growth of the company in 2005/2006. P/E decreases over time to become under the market P/E level. This can only be explained by the high level of risk perceived by investors (beta of 1.9), and most likely by a reduction in growth opportunities in the future.

Return required by shareholders (c. 11%) is below ROE. The group is therefore creating value. This is confirmed by the fact that the market cap. Is above the book value of equity (PBR of 2x).

3. Compute the control premium (in M€) paid by Stéria for purchasing 100% of Xansa.

The amount of the acquisition is € 660m incluant with a 69,9% premium to market price. This translates in a € 272m premium (compared to a market cap. of de € 388m).

4. Compute the Weighted Average Cost of Capital for Steria assuming a 5% cost of debt before taxes at 35%

keq = 4.15% + 3.67% x 1.86 = 10.98%

kd = 5 % (before tax)

WACC = 10.98% x 637 / (637+80) + 5% x 80 / (637 + 80) x (1-35%) = 10.11%

5. Compute the value of synergies, net of the initial investment sustained by the company to this regard and assuming that synergies are perpetually constant at 53 M€/year.

Synergies before:

2008	€ 24m
2009	€ 49m
2010	€ 53m
...	

NPV (after tax) = € 321m

Taking into account the implementation costs (€ 48m spread over 2 years)

NPV (after tax) = € 294m

6. Assuming that the stock price of Xansa before the announcement is fair (efficient markets), does this acquisition create value for Steria? Why?

This transaction creates value for Steria as the value of synergies is above the premium paid. There should theoretically be c. € 12m of value created.

But given the change in share price following the announcement, the market does not seem to believe that the firm will deliver the synergies announced...

Financing of the acquisition of Xansa

7. What is the amount of the investment made by Steria in Xansa (equity value and enterprise value) assuming the purchase of 100% of the shares of the company?

Equity value: € 660m

Enterprise value: € 731m (Xansa has € 71m of net debt)

8. Stéria initially financed the purchase of Xansa with a new bank facility. Could this situation be sustainable? What are the long term financing options Steria could have?

Proforma EBITDA is € 154m pre-synergies and € 178m taking into account 2008 synergies

Net debt before refinancing is = 80 + 731 = 811

Net debt / EBITDA is in the range of 4.5x – 5.2x. This level is way to high in particular for a risky business.

An issue of share seems therefore necessary.

9. How Steria wanted originally to finance the acquisition in the long term (detail the proportion of each product)?

Steria initially scheduled an issue of shares for an amount of c. € 330m (50% of the acquisition amount)

10. How Steria finally financed this acquisition, considering the refinancing occurred in November? Why did they (partially) change their idea about the refinancing of the bridge loan?

Financing:

Issue of shares: € 201m
Convertible bonds: € 152m
Financial debt: € 307m

A part of the capital increase initially planned was replaced by an issue of convertibles. The drop in share price between announcement of the transaction and its refinancing led shareholders to try to reduce the capital increase ...

11. Generally speaking, do you think that Steria should finance itself with equity or debt? Why?

Equity given the high economic risk of the firm and its sector.

Analysis of the convertible bond

12. What is the stock price level Steria must reach for considering the conversion convenient? What is the (percentage) premium considering the most recent stock price?

€ 37,36 i.e. a 18,6% premium to share price (€ 31,49). This premium does not seem very high given the relatively high cost of equity of Steria (11%), its low yield (1%) and the maturity of the conversion option (5 years).

13. What are the characteristics that the convertible bond has that makes it an equity-like financial instrument?

- No firm commitment to pay interests (if the company does not pay dividends).
- No commitment to reimburse
- In case of liquidation, junior to other creditors in the reimbursement (subordinated)
- Accounted for equity in IFRS!

14. What are the characteristics that the convertible bond has that makes it a debt-like financial instrument?

- Fixed interests
- In case of liquidation, senior to equity
- Likely reimbursement in 5 years (see below)

15. Based on an EURIBOR of 4.72%, the interest rate of the convertible after 2013 would increase to 12.72%. How would you characterize that rate? What could be an intelligent financial decision of the company after 2013?

Cost of convertible becomes prohibitive after 2013 (above cost of equity !)

The company should better pay back the bonds even if it is not compulsory.

16. Is the accounting treatment suggested by the company justified (see the November press release)?

It does not seem so as we have demonstrated that the repayment is highly likely, therefore it should be considered as debt. The treatment as equity does not reflect the actual financial situation of the group.

Share issue

17. What is the theoretical value of the subscription right?

(31.49 – 23.20) / (1 + 9/4) = 2.55 €

18. What is the theoretical stock price after issue of the subscription right?

31.49 – 2.55 = 28.94 €

19. How do you interpret the intention of Jean Carteron regarding the capital increase? Is your answer influenced by the fact that Jean Carteron is a private individual investor and that most of its wealth is represented by the shares he owns in Steria?

The signal is mixed (negative or neutral) : Jean Carteron will be diluted through this transaction (he does not subscribe up to its present participation), nevertheless he does not monetize its rights.

The fact that he is an individual who has most of his wealth invested in the company is a mitigant to the negative signal as he does not probably have the financial means to subscribe to the capital increase. In addition financial theory should guide him to diversify its investments.

20. Assuming that the acquisition of Xansa and its financing occured the 01/01/2007, what would the EPS 2007 of Steria be, considering 24 M€ de synergies before taxes in 2007, a net result 2007 of Xansa of 16 M€ (and not considering the cost needed for exploiting the synergies)? What do you think of the result?

NI 07 = 19.5 x 2,9 =	€ 56 m
+ Xansa	€ 16 m
+ Synergies post tax	€ 15.6 m
- interests debt	€ 10 m (307 x 5% x 65%)
- interests convertible	€ 5.6 (152 x 5.7% x 65%)

NI 07 PF = 72 m

shares = 28.2

EPS PF = 2.6 €

Dilution: -11%