Steria case study

Yann Le Fur (HEC) December 2007

This document cannot be used, reproduced or sold without the Authors authorization.

Les éléments présentés dans ce cas sont inspirés d'opérations réelles, il convient néanmoins de souligner que certains faits et certaines données ont été modifiés par rapport à la réalité à des fins pédagogiques.

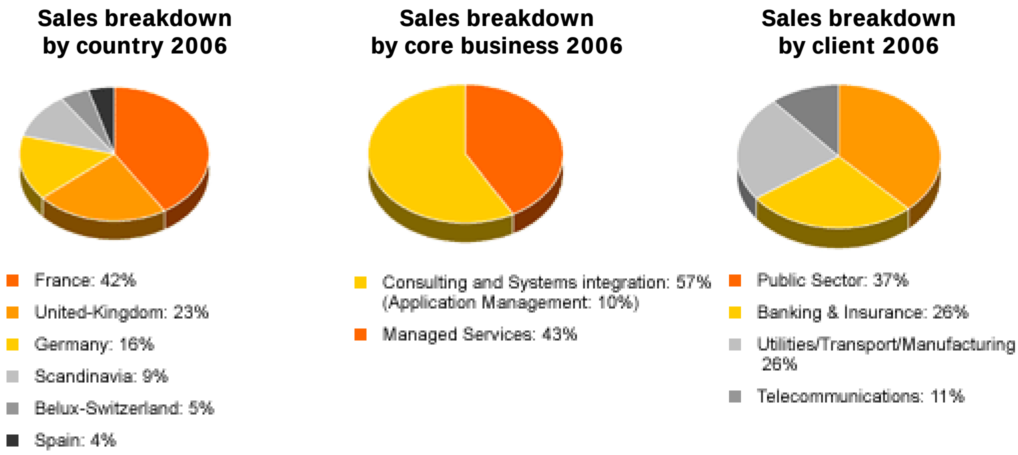
Description of STERIA

Stéria is a global IT service provider for corporates and European public administrations. With sales of €1,3 billion in 2006 and more than 10 000 employees, Stéria ranks among the top 10 groups of IT services in Europe.

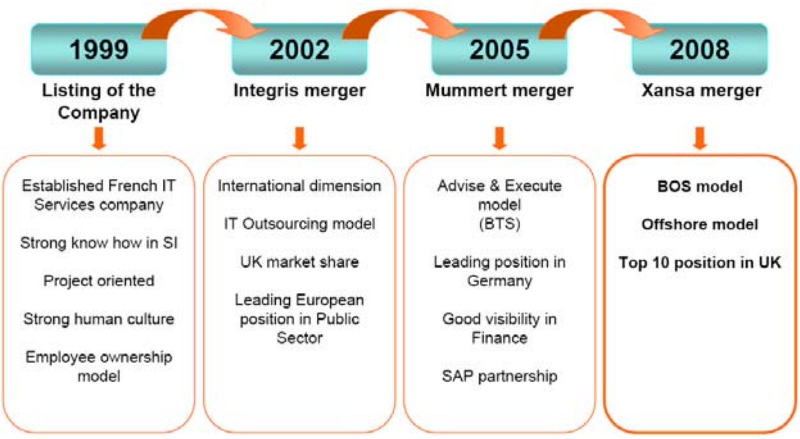
A good understanding of clients needs allows Stéria to offer high value added services – public and health care, bank-insurance, telecommunications, energy-transportation-production – as well as innovative technological solutions.

With an experience of more than 35 years in big scale project management, Stéria has also developed a strong culture of results by focusing the attention on client satisfaction.

Concentrated around few corporate values – simplicity, creativity, independence, respect, the employees of Stéria – owning 24% of the shares – are highly oriented toward a continuous improvement of techonologies in innovative services.



The recent growth of Steria has been realized also thanks to 3 external transactions, occurred in 2002, 2005 and 2007.



Press release 30 July 2007

A new reference in the European IT services

Recommended offering

Group Stéria, one of the 10 biggest european actors of IT services and Xansa Plc, an IT British operator specialized in *Business Process Outsourcing* have announced today their integration project through a friendly bid of Xansa made by Stéria.

Encouraged by the employees of the two companies, anticipated by the clients with which the company successfully cooperate, the integration of the two companies represent one of the strongest alliances in the european IT service industry. The integration:

- Is strategically relevant
- Reinforces the Group
- Is attractive for the shareholders of both companies.

Commenting on the Acquisition, Francois Enaud, General Manager and CEO of Steria, said:
"This transaction constitutes a major step in the implementation of our strategic plan. Focused on the fastest growing market segments, the new group will be one of the most attractive in the ITS sector, both through the value of its service offerings (Business Transformation and Business Operation) and its exceptional industrial delivery model. I am sure that such an alliance represents an exciting opportunity for all of our employees."

Commenting on the Acquisition, Jean Carteron, founder of Steria, said:
"As for the acquisition of Mummert three years ago, I am delighted to support a transaction that fits so well with the strategy defined by the Executive Management of Steria. I am even more enthusiasted by the cultural fit of the two companies."

Commenting on the Acquisition, Bill Alexander, Chairman and acting Chief Executive of Xansa, said:
"On behalf of the Board of Directors of Xansa, I am pleased to recommend Steria's offer. We are confident that our recommendation is in the best interests of Xansa shareholders and offers an opportunity for our employees to be part of a culturally-aligned, pan-European company able to leverage our integrated onshore/offshore mode. The combination of our two businesses will create a leading European IT Services provider able to offer our clients a broader range of market-leading services."

A Capital employed of excellent quality

Xansa is an outsourcing and technology company with operations in the UK and India. It is committed to the delivery of guaranteed business outcomes for its clients through the provision of IT Services and Business Process Outsourcing (BPO). Xansa is built around the core principle of bringing its technology, process and industry expertise together to enable its clients to do more with their own businesses. It has over 8,000 employees, over 5,000 of whom are located in India, with approximately 3,000 in the UK. Its onshore/offshore integrated business delivery platform provides a key differentiating factor for its business. It is one of the largest independent UK-based suppliers of offshore services into the UK market. For the year ended 30 April 2007, Xansa reported revenue of £379.7 million, operating profit of £25.2 million and profit before tax of £16.4 million.

An integration that creates value

The Directors of Steria believe that there is a compelling strategic rationale for combining the two businesses:

1. Steria expects to accelerate the implementation of its strategic plan, namely the development of one of the most advanced business models in the European IT Services sector, bringing together: (1) complementary business transformation and business operation services; and (2) an approach that is highly customised to the client with a highly industrialised delivery model;
2. Steria will strengthen its position in the UK IT Services market, increasing its visibility and aligning its UK business lines (Application/Infrastructure) and its UK vertical services lines (Public Sector/Private Sector) with those of the Group;
3. Steria will implement one of the most advanced Global Delivery Models among its European peers, incorporating an established, integrated UK-India delivery platform;
4. The combination of Steria and Xansa will create a leading European IT Services company. Post-Acquisition, Steria is expected to be amon the top 10 IT Service providers in both Europe and the UK (by revenue), with a particularly significant presence in the public services and financial services sectors. Its increased scale and reach would also enable it to compete more effectively for business with larger customers;
5. The Enlarged Group would benefit from a combined client base that is focused on attractive vertical business segments and that would give rise to significant cross-selling opportunities within the UK and Europe;
6. Both companies are founded upon a common culture of entrepreneurship, innovation and client focus. The close cultural fit between Steria and Xansa is expected to facilitate their integration;
7. Both Steria and Xansa are committed to the shared success of their employees. Steria will seek to integrate Xansa employees into the Steria employee shareholding programme shortly after completion of the Acquisition;

The Steria Directors expect the Acquisition to deliver pre-tax synergies of approximately €24 million in 2008, €49 million in 2009 and €53 million from 2010 onwards. The costs to achieve these synergies are estimated at approximately €49 million over two years (50 % in 2008 and 50 % in 2009).

These synergies will derive from three principal areas: cost synergies in the UK and offshore and delivery synergies across the group as a whole. Cost synergy opportunities, which will make up the majority of these savings, are expected to arise from benefits of scale, notably head office costs, delivery costs and procurement systems.

Description of the transaction

The terms of the Acquisition represent:

1. For each Xansa share will be offered 130 pence in cash;
2. a premium of 69.9% to 76.5 pence, being the Closing Price per Xansa Share on 26 July 2007, the last Business Day prior to the date on which Xansa announced that it was in advanced talks regarding a possible offer;
3. Xansa Shareholders on the register on 6 July 2007 will be entitled to receive the 2007 dividend of 2.16p announced in respect of the financial year ended 30 April 2007 which will be paid on 27 September 2007.
4. The total purchase price of 100% of the equity of Xansa is € 660 millions (market capitalization before the transaction is €388 millions).
5. The acquisition will be financed from a new bank facility provided by BNP Paribas, approximately 50 per cent of which will be in the form of bridge financing, to be repaid from the proceeds of a subsequent rights offering.

Press release 13 November 2007

Simultaneous launch of a hybrid subordinated convertible bond and a rights issue totalling €352 million to partially refinance the Xansa acquisition.

Groupe Steria announces the simultaneous launch of a hybrid subordinated convertible bond for €152 million and a €201 million rights issue for existing shareholders in order to refinance the bridge loan used to finance the acquisition of Xansa plc, which was completed on 17 October 2007. This refinancing is the final step in the successful completion of the acquisition of Xansa and allows the Group to develop one of the most advanced business models in the European IT Services sector.

Hybrid subordinated convertible bonds

The hybrid subordinated convertible bond issue of €152 million is launched today. There will be a coupon step-up from 1 January 2013, should the bonds have not been converted by that date. Settlement of the hybrid subordinated convertible bond is expected to take place on 20 November 2007. The key terms and conditions of the hybrid subordinated convertible bonds are described in Schedule A.
The hybrid subordinated convertible bonds will be accounted as equity under IFRS.

Rights issue

The subscription period for the rights issue will begin on 15 November 2007 and will end on 28 November 2007. Every Steria shareholder will receive a preferential subscription right for every share held as of the closing of the stock market trading session on 14 November, 2007. During the subscription period, preferential subscription rights will be listed and traded on the Eurolist by Euronext Paris.

9 preferential subscription rights will entitle their holder to subscribe for 4 new shares, at a price of €23.20 per new share. The key terms and conditions of the rights issue are described in Schedule B.

Financial results of Stéria (millions of euros)

BALANCE SHEET	2004	2005	2006
Intangible fixed assets	162	253	256
Tangible fixed assets	58	66	68
Financial fixed assets	10	13	6
Other LT assets	0	42	37
Fixed assets	**230**	**374**	**367**
Inventories	6	6	12
Trade receivables	306	400	420
Other operating ST assets	32	17	18
Trade payables	-120	-127	-135
Other current liabilities	-213	-275	-279
Working capital	**11**	**21**	**36**
Capital employed	**241**	**395**	**403**
Shareholders equity	220	261	323
Minority interest	0	0	0
Total group equity	**220**	**261**	**323**
Medium and long term debt	87	160	130
Current debt	15	40	8
Cash and cash equivalents	81	66	58
Net debt	**21**	**134**	**80**
Invested capital	**241**	**395**	**403**

RATIOS			
EBIT margin	2,2%	2,5%	4,2%
Asset turnover	4,1	3,0	3,1
ROCE	**8,9%**	**7,4%**	**13,1%**
Net cost of debt (%)	9,3%	3,9%	2,4%
Net debt / Equity	0,1	0,5	0,2
ROE	**10,5%**	**13,8%**	**16,7%**
WC/Sales	1,1%	1,8%	2,9%
EV /EBITDA	14,4	15,1	6,8
Net debt / EBITDA	0,4	1,9	0,8

tax rate 35%

INCOME STATEMENT	2004	2005	2006
Sales	983	1175	1262
Monetary operating costs	-923	-1106	-1157
EBITDA	**60**	**69**	**105**
Amortizations	-27	-24	-24
EBIT	**33**	**45**	**81**
Net financial result	-3	-8	-3
Corporate income tax	-7	-1	-24
Net earnings	**23**	**36**	**54**

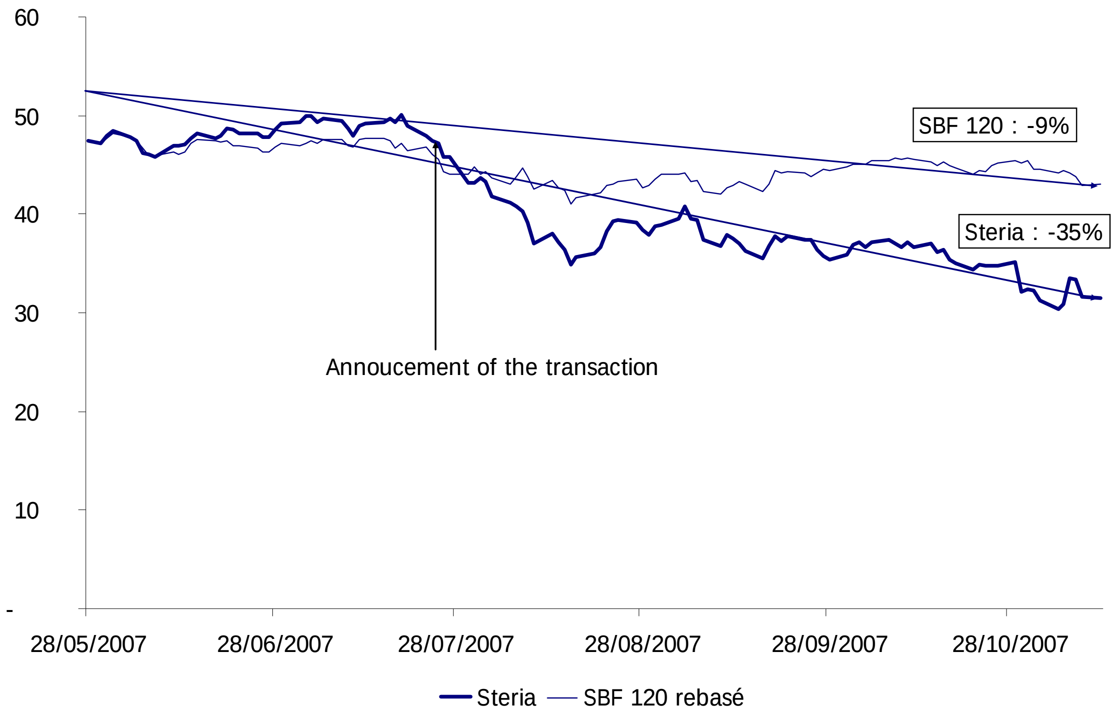
CASH FLOW STATEMENT			
Net earnings	23	36	54
Depreciation	27	24	24
Cash flow	**50**	**60**	**78**
Change in OWC	15	-10	-15
Other non cash charges	-1	4	3
Cash flow from operations	**64**	**54**	**66**
Capex	**17**	**167**	**18**
Equity issue	4	3	12
Dividends	-4	-5	-6
Change in net debt	**47**	**-115**	**54**

Stock market information (millions of euros)

Shareholders composition before the transaction

Ownership structure	
Employees	16%
Jean Carteron	6%
Financier de l'Echiquier	5%
Public	73%

Stock market price and key market figures of Steria



STOCK MARKET FIGURES	2005	2006	2007
Stock price			
Highest	45,9	50,6	52,0
Lowest	28,6	32,2	30,4
Last	42	45,4	31,5
Shares outstanding (millions)	20	20	20
EPS	1,9	2,7	2,9
P/E	22,1	16,8	10,9
1 / PE	4,5%	5,9%	9,2%
Dividend per share	0,3	0,42	0,40
Dividend growth rate		40%	-5%
Dividend yield	0,71%	0,93%	1,27%
Payout ratio	16%	16%	14%
Stock market capitalization	840	908	630
β **Shareholders' equity (share of group)**	261	323	
ROE	13,8%	16,7%	
BETA			1,86
Free risk rate			4,15%
Market risk premium			3,67%

Key figures of Xansa (converted in Euros)

BALANCE SHEET	2006	2007
Intangible fixed assets	120,3	116,9
Tangible fixed assets	34,9	32,9
Other LT assets	31,8	19,3
Fixed assets	**187**	**169,1**
Working capital	**-21,7**	**-21,8**
Capital employed	**165,3**	**147,3**
Total group equity	**8,3**	**75,9**
Net debt	**156,9**	**71,4**
Invested capital	**165,2**	**147,3**

INCOME STATEMENT	2006	2007
Sales	500,2	531,6
EBITDA	**42,3**	**49,4**
EBIT	**32,6**	**35,3**
Net earnings	**9,7**	**14,1**

RATIOS		
EBIT margin	4,2%	4,3%
Asset turnover	3,0	3,6
ROCE	**12,8%**	**15,6%**
Net debt / Equity	Nm	0,9
ROE	Nm	**18,6%**
WC/Sales	-4,3%	-4,1%
Net debt / EBITDA	3,7	1,4

tax rate 35%

Questions

Financial analysis

1. Prepare a financial analysis of Stéria.

2. Prepare a stock market analysis of Stéria.

Acquisition of Xansa

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

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

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.

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

Acquisition financing 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?

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?

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

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

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

Convertible bond analysis

11. 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?

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

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

14. 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?

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

Capital increase

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

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

20. 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?

21. 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?

ANNEX A

Key terms and conditions of the hybrid subordinated convertible bonds

Nominal value of bonds – Issue price

The nominal value of bonds is €37.36. The bonds will be issued at par value.

Principal amount of the issue

Total principal initial amount of 152 449 310 euros represented by 4 080 549 bonds.

Settlement date of the bonds

20 November 2007.

Annual interest

From November 20, 2007 to December 31, 2012 (the "Option expiry date")

The bonds will bear interest at an annual rate of 5.70%.

In the event of change of control of Steria, the bonds will bear interest at a rate of 10.70%.

Should the bonds be converted into shares, they will cease to bear interest as of January preceding the date of conversion.

Beginning on January 1, 2013 and for the entire term of the issuance

Beginning on January 1, 2013, the bonds not converted into shares or not reimbursed will no longer be convertible. The will bear a periodical 3 months Euribor 3 mois + 8%.

In the event of change of control of Steria, the bonds will bear floating interest rate plus 500 basis points.

Duration and redemption

The bonds are perpetual securities. Subject to early redemption at the option of the company, the Bonds will be redeemable only if the Company is liquidated or upon expiry of the corporate life stated in the Company's by-laws (unless extended as provided pursuant to the applicable legislation). In both cases, the Bonds will be redeemed at par.

Early Redemption at the Option of the Company

The Company may, at its sole option, redeem the Bonds, subject to prior payment of Deferred Interest and Additional Interest:

1. In full or in part, at any time, without limitation on price by repurchases on the market or by way of off market transactions or by way of public offerings.
2. Effective from January 1, 2011 and until December 31, 2012, for all the bonds at par value if the arithmetic average of (i) the opening prices of the Steria shares and (ii) the current Conversion/Exchange Ratio, exceeds 130% of the principal amount of the bonds.
3. From December 31, 2012, and for the first time on December 31, 2012 for all the Bonds at par value.
4. At any time, for all of the Bonds still outstanding, if fewer than 15% of Bonds issued are still outstanding.

5. If there is a change of control of Steria.

Redemption at bondholders option

None.

Conversion and/or exchange of the bonds

At any time from December 30, 2007 until the Option Expiry Date, at the ratio of ONE share for ONE Bond, subject to any further adjustments.

The Company may elect to deliver new and/or existing shares..

Ranking – Subordination

In the event of liquidation, payment of accrued interest (and deferred interest and additional interest, if any) and redemption of the principal due in respect of the Bonds is entirely subordinated to prior payment of the Company's unsubordinated debt.

Intention of the Principal Shareholders

The Company is not aware of whether its principal shareholders intend to participate in this issue, with the exception of Mr. Jean Carteron, who has incidated that he does not intend to participate in the offering.

ANNEX B

Key terms and conditions of the rights issue

Based on the outstanding capital stock of Group Steria at 31 October 2007, or 19 492 215 euros represented by 19 492 215 shares, the capital increase would amount to 200 986 333 euros through the issuance of 8 663 204 shares, corresponding to 44% of the capital stock and 37.2% of the voting rights of the Company.

Origin of the securities being offered

Capital increase with retention of preferential subscription rights.

Subscription price

23.20 euros per share

Date of effectiveness of new shares

January 1, 2007.

Gross proceeds of the issuance

€200 986 333.

Subscription terms

Preferential subscription rights: subscription is reserved, in priority, for holders of existing shares held at the close of trading on 14 November 2007 or for transferees of their preferential subscription rights at the rate of 4 new shares of €1 nominal value for 9 existing shares held (9 preferential subscription rights will allow holders thereof to subscribe for 4 shares at a price of €23.20 per share).

Theoretical value

Based on a trading price of €31.49:

- value of preferential subscription right: TBD
- value of a Group Steria share ex rights: TBD

Objectives of the rights issue

Partial reimbursement of one the two tranches of the bridge financing raised for the acquisition of Xansa.

Intention of the Principal Shareholders

The Company is not aware of whether its principal shareholders intend to participate in this issue, with the exception of Mr. Jean Carteron, who has indicated that he intends to participate by subscribing the rights he is entitled to receive.