

Transformation of Business Process Outsourcing

Business Models, Technology Enablement and M&A Themes in the Growing and Fragmented BPO Sector



Kiran Paruchuru
Business Process Outsourcing
kparuchuru@rwbaird.com
+1.312.609.4926

Christopher Hildreth
Information & Marketing
childreth@rwbaird.com
+1.312.609.4937

Andrew Snow
Technology & Services
asnow@rwbaird.com
+1.312.609.4972

John Sun
Technology & Services
jysun@rwbaird.com
+44.20.7667.8224

David Silver
Head of European Investment Banking
dsilver@rwbaird.com
+44.20.7667.8216

Michael Magluilo
Software and Cloud Technologies
mmagluilo@rwbaird.com
+1.303.413.3818

Martin Luen
Technology & Services
mluen@rwbaird.com
+44.20.7667.8381

Peter Augar
Technology & Services
paugar@rwbaird.com
+44.20.7667.8263

Jonathan Harrison
Technology & Services
jjharrison@rwbaird.com
+44.20.7667.8414

Bret Schoch
Human Capital Services
bschoch@rwbaird.com
+1.312.609.4965

Howard Lanser
Head of Debt Capital Markets
hlanser@rwbaird.com
+1.312.609.5478

Jordan Klein
Technology & Services
jklein@rwbaird.com
+1.312.609.4978

Peter Kies
Head of Technology & Services
pkies@rwbaird.com
+1.414.765.7262

Brian Doyal
Co-Head of Global Investment Banking
bdoyal@rwbaird.com
+1.312.609.4916

Paul Bail
European Debt Advisory
pbail@rwbaird.com
+44.20.7667.8271

Tahseen Siddique
M&A Research
tsiddique@rwbaird.com
+44.20.7667.8402

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2. Subsector Overview

- 2.1. Finance & accounting (F&A) services, outsourced fund administration and fiduciary services
 - reducing the administrative burden for corporates and asset managers
- 2.2. Governance, risk and compliance (GRC) services
 - helping businesses comply with ever-increasing regulation
- 2.3. Human resource outsourcing (HRO)
 - a holistic approach to recruiting, talent management and HR administration
- 2.4. Outsourced customer care (OCC)
 - shifting focus from cost saving benefits to higher quality service
- 2.5. Legal process outsourcing (LPO)
 - specialist legal support services for corporations and law firms
- 2.6. Insurance related outsourcing
 - supporting insurance companies and their customers

3. Sector Trends and M&A Themes

- 3.1. Delivery of BPO via software
 - providing a more efficient service to customers while reducing the cost of delivery
- 3.2. Broader service offering and one-stop-shop solutions
 - fully outsourced solutions from fewer providers and buy-and-build platforms
- 3.3. Off-shoring, near-shoring, on-shoring and home-shoring
 - the latest preferences for best-shoring; balancing quality and cost
- 3.4. Public sector and education sector outsourcing
 - more privatisation, more opportunities and more responsibility
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 - how strong is the debt market for BPO providers

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1. Executive Summary

1.1. What is BPO and its subsectors?

A decade ago, business process outsourcing (BPO) was a term that many may have associated with an outsourced call centre, somewhere in India. The sector has come a long way since then and covers most white-collar functions in the value chain.

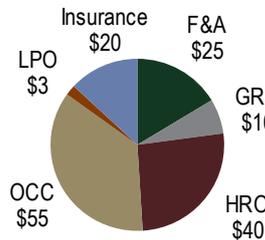
The transformation of BPO means that the sector now encompasses all types of business models, from back office administration to middle office international expansion services. Clients include small and medium sized enterprises (SMEs), not only large multinationals. Most SMEs do not have the resources in-house to manage their back office responsibilities efficiently.

BPO providers are actively seeking means of better serving their clients while reducing the cost of providing services. Advances in technology have facilitated the creation of new business models, often revolutionising the method of service delivery e.g. virtual contact centres where agents work from home or SaaS (Software as a Service).

The low growth environment since the economic downturn has forced client firms to focus on margin enhancement, resulting in a greater willingness to outsource non-revenue producing functions to outside providers offering cost savings through economies of scale.

Selected Global BPO Market

(represents ~\$150bn in annual revenue)



Kiran Paruchuru
Managing Director, BPO
Technology & Services

Nevertheless, lowering fixed costs and reducing in-house capital expenditure are no longer the only reasons for outsourcing. Clients are looking for value-added outsourced solutions to increase productivity and reduce complexity in their own core business. This shift in mentality continues, industry by industry.

For example, commercial terms in some outsourcing contracts are drafted to ensure that both the client and the BPO provider have “skin in the game” through risk and reward sharing. Clients see the benefits of “partnering”, incentivising their provider to deliver tangible added value.

Attractive acquisition targets typically have a differentiated value proposition. BPO providers that ‘own’ their proprietary work flow can command high profit margins and enjoy longstanding client relationships.

Information technology outsourcing (ITO) is seen by many as the largest BPO subsector. However, for the purposes of this report, Baird has chosen to discuss the six subsectors below with a focus on European and North American market trends:

- Finance & accounting (F&A) services, outsourced fund administration and fiduciary services
- Governance, risk and compliance (GRC) services
- Human resource outsourcing (HRO)
- Outsourced customer care (OCC)
- Legal process outsourcing (LPO)
- Insurance related outsourcing

EXAMPLE CLIENT FUNCTIONS THAT CAN BE OUTSOURCED

Back Office		Middle Office	Customer Facing
Analytics / Data Management	Employee Benefits	Risk and Compliance	Sales and Marketing
Finance and Accounting	Fund Administration	Supply Chain / Procurement	Technical / Customer Support
Payroll	Recruitment	International Expansion	Insurance Claims Management

1.2. How large is the global market for each subsector?

The global BPO industry is currently valued at almost \$1 trillion, where information technology outsourcing (ITO) and other IT services account for ~\$500 billion. For this report, we focus on the subsectors below, totalling ~\$150 billion in annual revenue. This represents revenue for BPO providers and also includes revenue generated from specialist services that were not necessarily conducted in-house before they were outsourced / purchased by clients.

BPO Subsector	Typical / Example Services	Global Outsourced Market / 5 Year Forecast CAGR	Outsourcing Penetration of Selected Functions
Finance & Accounting (F&A) Services, Outsourced Fund Administration and Fiduciary Services	Finance & accounting (F&A) services <ul style="list-style-type: none"> Financial reporting, payroll, accounting and tax services Fund administration, valuation, compliance with AIFMD International expansion services for corporates 	~\$25bn ~10%	 General Accounting
Governance, Risk and Compliance (GRC) Services	Governance, risk and compliance (GRC) services <ul style="list-style-type: none"> Third party / supply chain risk management Policy and procedure management Risk and compliance management software 	~\$10bn ~20%	 GRC Technology
Human Resource Outsourcing (HRO)	Human capital management services <ul style="list-style-type: none"> Payroll and benefits administration Managed services providers (MSP) Recruitment process outsourcing (RPO) 	~\$40bn ~10%	 Recruitment Process
Outsourced Customer Care (OCC)	Customer relationship management (CRM) services <ul style="list-style-type: none"> Contact centres (technical support, sales, marketing) Customer loyalty programmes / database management Order management, fulfilment and logistics 	~\$55bn ~5%	 Customer Interaction
Legal Process Outsourcing (LPO)	Specialist services for corporations and law firms <ul style="list-style-type: none"> Legal research / contract review eDiscovery and litigation case support Onsite data collection / document management 	~\$3bn ~20%	 LPO by Law Firms
Insurance Related Outsourcing	Support services to insurers and their customers <ul style="list-style-type: none"> Insurance claims management Telematics / fleet management Data analytics / electronic policy processing 	~\$20bn ~10%	 Telematics Insurance

Source: Baird, HFS Research, Sandler Research, IDC, Forrester Research, Thomson Reuters, Solera Holdings.
 Note: Some overlap in market sizes exist e.g. outsourcing of the payroll function is included in both F&A and HRO.

■ Outsourced ■ In-House

OVERALL MARKET GROWTH TRENDS

There are multiple drivers of growth for the overall BPO market. Growth still continues in standardised back office services where BPO providers are leveraging technology to reduce their cost of service delivery. The strongest growth rates, often double-digit, are being seen in subsectors representing higher value, transformational activities.

- **Secular trend to outsourcing** – over 70% of relevant services are performed in-house by clients, which translates to an outsourced penetration rate of under 30%; a large untapped opportunity for BPO providers, particularly in developed economies such as Germany where there is a relatively low level of outsourcing
- **Lower costs** – it is inefficient for clients to replicate specialised functions in-house that need significant fixed costs and capital expenditure; cheaper instead to transform the function into a variable expense by outsourcing
- **Focus on core business** – clients are continuing to restructure their non-core business operations since the economic downturn to free up internal resources and management time on achieving their core strategic goals
- **Scalability and labour flexibility** – outsourcing allows a company the ability to better match resources with demand, reducing the need for short term staffing and training and the costs associated with peak capacity
- **Increasingly complex regulatory environment** – rapid regulatory change in recent years has moved clients toward the use of third party service providers with specialist expertise to ensure compliance with new rules
- **Service offerings in their infancy** – much of the BPO services market is in its infancy relative to the OCC subsector, representing significant growth potential as clients begin to realise the value of other newer services
- **New public sector BPO** – inefficiencies and deficits in the public sector driving new outsourcing opportunities

1.3. What is driving M&A and consolidation in the sector?

The BPO sector has seen significant M&A volumes from both corporate acquirers and private equity firms. This is expected to continue given the fragmented nature of the global industry and increasing demand from multinational clients and SMEs for more sophisticated, value-added services across their entire value chain.

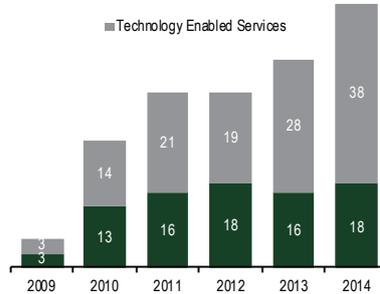
In addition, blue-chip clients that already outsource selected functions are continually looking to prune their vendor lists. This has pushed larger BPO providers towards a more diversified service offering, increasing their wallet share of major clients. M&A transactions can be the most effective way of enhancing capabilities to secure the larger, multisite contracts.

Large BPO corporates have been acquiring targets to gain:

- Additional capabilities for a broader service offering and / or one-stop-shop solution
- Exposure to higher growth end market verticals
- Wider geographic coverage to provide a more global service
- Economies of scale to reduce proportion of fixed costs
- New clients to reduce customer concentration

Selected BPO M&A Activity

(number of deals)



David Silver
Managing Director, Head of European Investment Banking

Private equity firms have been attracted to some of the following BPO sector attributes:

- Underlying market growth and secular trend to outsourcing
- Recurring revenue through multiyear client contracts
- High cash conversion and / or negative working capital with efficient service delivery
- Scalable business models leveraging technology
- Scope for buy-and-build and creation of global platforms

Corporate client spin-offs were the start for some of today's largest BPO providers. For example, off-shore BPO provider Genpact was spun off by General Electric to US private equity firms General Atlantic and Oak Hill in 2004 for \$500m.

We have analysed 220 M&A transactions, primarily in Europe and North America, since 2009 where the targets typically had an EBITDA over €5m. These companies had an average EBITDA margin of 22%.

The most notable trend coming out of our 5 year M&A analysis is that an increasing proportion of targets were technology enabled service providers or used a SaaS delivery model.

M&A valuation levels vary considerably depending on the subsector, business model and end market growth trends. EBITDA multiples for contact centres are typically single-digit while high growth BPO providers with a scalable technology offering and sustainable margins could see over 12x EBITDA.

ATTRACTIVE CHARACTERISTICS FOR POTENTIAL BPO TARGETS

Large, fast growing addressable market	High barriers to entry and low exposure to cyclicality	Demonstrable ROI proposition for clients / non-discretionary spend
Differentiated service offering / sustainable market leadership	Clearly discernable, metric-driven business model	Recurring revenue model providing forward visibility
Highly scalable technology enabled platform	Opportunity to leverage platform with bolt-on services / acquisitions	Strong revenue growth with attractive margin profile and cash generation

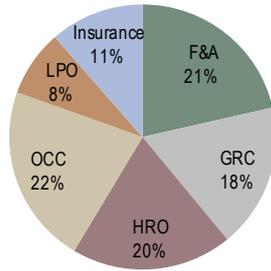
1.4. Summary M&A analysis

WHERE HAVE THE DEALS BEEN?

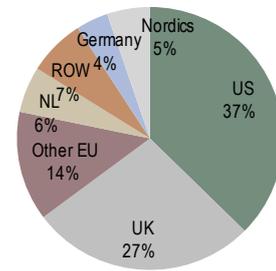
OCC has been the most active subsector for M&A, driven by geographic expansion, diversification of customers and need for scale

The **US and UK account for the majority of deals**, driven by higher relative outsourcing penetration

Deal volume by subsector

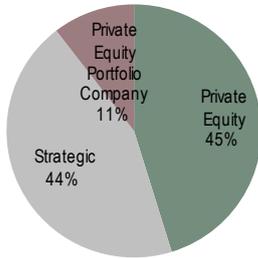


Deal volume by target geography



WHO HAS INVESTED?

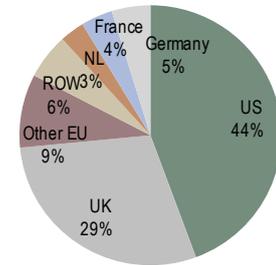
Deal volume by buyer category



Strategic and private equity buyers each accounted for half of deals, driven by **sector growth trends** and supported by the availability of **leveraged finance**

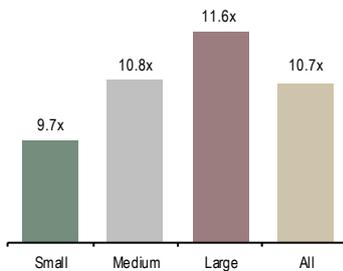
48% of deals were **cross-border**, reflecting **globalisation** of clients

Deal volume by buyer geography

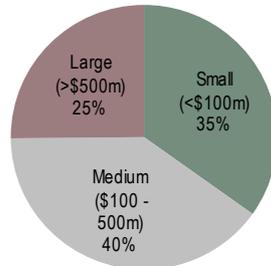


WHY SIZE AND SCALE MATTER?

EV / EBITDA by deal size ⁽¹⁾



Deal volume by target size



Larger BPO platforms attract premium valuations, reflecting economies of scale and higher barriers to entry

Substantial deal activity in the lower and middle-market reflects the **fragmented landscape** of the sector

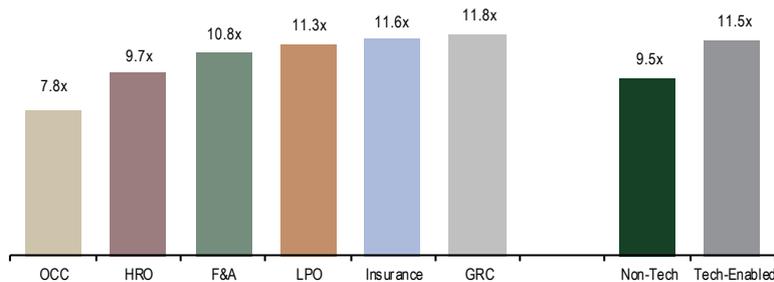
WHICH SUBSECTORS HAVE ATTRACTED HIGH VALUATIONS?

Both corporate and private equity buyers have paid **premium valuations** for BPO providers across the subsectors, particularly GRC

Key business attributes include:

- A compelling **growth strategy**
- **Technology** enablement / SaaS
- Attractive **financial** characteristics

EV / EBITDA by subsector and technology enablement ⁽¹⁾



Source: Baird analysis of selected M&A deals in the BPO sector: (i) from 2009 to April 2015; (ii) typically with EBITDA of over €5m.
 (1) Average EBITDA multiples, excluding sizeable SaaS deals over 20x EBITDA where revenue multiples are typically used.

4. Baird's BPO Practice

4.1. Global investment banking team

Baird's Global Investment Banking department comprises over 250 professionals across the United States, Europe and Asia. We operate in a fully integrated manner in order to leverage the collective strengths of our M&A advisory, equity financing and debt advisory capabilities through dedicated industry teams. Baird's Technology & Services team has a long track record in the industry, leveraging its BPO sector expertise and relationships with key corporate entities and financial sponsors around the globe. Since 2010, Baird has advised on over 340 M&A transactions, representing over \$83bn in transaction value. Selected members of Baird's team are listed below.



KIRAN PARUCHURU –
*MANAGING DIRECTOR,
 BUSINESS PROCESS OUTSOURCING*
 T: +1.312.609.4926
 E: kparuchuru@rwbaird.com



DAVID SILVER –
*MANAGING DIRECTOR, HEAD OF
 EUROPEAN INVESTMENT BANKING*
 T: +44.20.7667.8216
 E: dsilver@rwbaird.com



JONATHAN HARRISON –
*MANAGING DIRECTOR,
 TECHNOLOGY & SERVICES*
 T: +44.20.7667.8414
 E: jjharrison@rwbaird.com



PETER KIES –
*MANAGING DIRECTOR,
 HEAD OF TECHNOLOGY & SERVICES*
 T: +1.414.765.7262
 E: pkies@rwbaird.com



CHRISTOPHER HILDRETH –
*MANAGING DIRECTOR,
 INFORMATION & MARKETING*
 T: +1.312.609.4937
 E: childreth@rwbaird.com



MICHAEL MAGLUULO –
*MANAGING DIRECTOR, SOFTWARE
 AND CLOUD TECHNOLOGIES*
 T: +1.303.413.3818
 E: mmaglullo@rwbaird.com



BRET SCHOCH –
*MANAGING DIRECTOR,
 HUMAN CAPITAL SERVICES*
 T: +1.312.609.4965
 E: bschoch@rwbaird.com



BRIAN DOYAL –
*MANAGING DIRECTOR, CO-HEAD
 OF GLOBAL INVESTMENT BANKING*
 T: +1.312.609.4916
 E: bdooyal@rwbaird.com



ANDREW SNOW –
*MANAGING DIRECTOR,
 TECHNOLOGY & SERVICES*
 T: +1.312.609.4972
 E: asnow@rwbaird.com



MARTIN LUEN –
*DIRECTOR,
 TECHNOLOGY & SERVICES*
 T: +44.20.7667.8381
 E: mluen@rwbaird.com



HOWARD LANSER –
*MANAGING DIRECTOR,
 HEAD OF DEBT CAPITAL MARKETS*
 T: +1.312.609.5478
 E: hlanser@rwbaird.com



PAUL BAIL –
*MANAGING DIRECTOR
 EUROPEAN DEBT ADVISORY*
 T: +44.20.7667.8271
 E: pbail@rwbaird.com



JOHN SUN –
*DIRECTOR,
 TECHNOLOGY & SERVICES*
 T: +44.20.7667.8224
 E: jysun@rwbaird.com



PETER AUGAR –
*DIRECTOR,
 TECHNOLOGY & SERVICES*
 T: +44.20.7667.8263
 E: paugar@rwbaird.com



JORDAN KLEIN –
*DIRECTOR,
 TECHNOLOGY & SERVICES*
 T: +1.312.609.4978
 E: jklein@rwbaird.com



TAHSEEN SIDDIQUE –
*VICE PRESIDENT,
 M&A RESEARCH*
 T: +44.20.7667.8402
 E: tsiddique@rwbaird.com

4.2. M&A and ECM expertise

SELECTED BAIRD BPO M&A TRANSACTIONS

<p>€210,000,000</p> <p>avocis[®]</p> <p>A Portfolio Company of</p> <p>EQUISTONE</p> <p>Sale to</p> <p>CAPITA</p>	<p>\$820,000,000</p> <p>stream</p> <p>A Portfolio Company of</p> <p>ARES / LiveIt / PROGRESSIVITY</p> <p>Sale to</p> <p>CONVERGYS</p>	<p>Undisclosed Value</p> <p>endicia</p> <p>A Division of</p> <p>NewellRubbermaid</p> <p>Sale to</p> <p>stamps.com</p>	<p>\$220,000,000</p> <p>ENVIRON</p> <p>Sale to</p> <p>RAMBOLL</p>	<p>Undisclosed Value</p> <p>DTI</p> <p>A Portfolio Company of</p> <p>HARVEST CAPITAL</p> <p>Recapitalization by</p> <p>OMERS</p> <p>Private Equity</p>	<p>£260,000,000</p> <p>alexander mann</p> <p>A Portfolio Company of</p> <p>GRAPHITE CAPITAL</p> <p>Sale to</p> <p>NMC</p> <p>St. Michaels Capital LLC</p>
<p>\$310,000,000</p> <p>TRUEBLUE</p> <p>Acquisition of</p> <p>SeatonCorp</p>	<p>Undisclosed Value</p> <p>inflexion</p> <p>PRIVATE EQUITY</p> <p>Acquisition of</p> <p>CMO COMPLIANCE</p> <p>Private Equity</p>	<p>Undisclosed Value</p> <p>Access</p> <p>A Portfolio Company of</p> <p>SUMMIT PARTNERS</p> <p>Sale to</p> <p>Berkshire Partners</p>	<p>Undisclosed Value</p> <p>HSP</p> <p>HIGH STREET PARTNERS</p> <p>A Portfolio Company of</p> <p>Baird Capital</p> <p>Private Equity</p> <p>Sale to</p> <p>NAIR & CO. } HgCapital }</p>	<p>Undisclosed Value</p> <p>NAIR & CO.</p> <p>Sale to</p> <p>HgCapital</p>	<p>Undisclosed Value</p> <p>CCC</p> <p>A Portfolio Company of</p> <p>ARDIAN</p> <p>Sale to</p> <p>silverline capital</p>
<p>CAD\$650,000,000</p> <p>Maxxam</p> <p>A Portfolio Company of</p> <p>OMERS</p> <p>Sale to</p> <p>OMERS</p>	<p>Undisclosed Value</p> <p>thing5</p> <p>Acquisition of</p> <p>Sale to</p> <p>TZP</p>	<p>Undisclosed Value</p> <p>LYCEUM CAPITAL</p> <p>Acquisition of</p> <p>ISOTRAK</p> <p>A Portfolio Company of</p> <p>Saints Charmonix Private Equity</p>	<p>Undisclosed Value</p> <p>GLOBAL</p> <p>GLOBAL INVESTMENT MANAGEMENT</p> <p>A Portfolio Company of</p> <p>VICTORY PARK CAPITAL</p> <p>Acquired by</p> <p>TZP</p>	<p>Undisclosed Value</p> <p>WORKFORCELOGIC</p> <p>Sale to</p> <p>SNOW PHIPPS</p>	<p>Undisclosed Value</p> <p>IRTC</p> <p>IRTC Group Company</p> <p>A Portfolio Company of</p> <p>HEALAND CAPITAL</p> <p>Private Equity</p> <p>Sale to</p> <p>iqor</p>
<p>Undisclosed Value</p> <p>teletrac</p> <p>A Portfolio Company of</p> <p>VECTOR CAPITAL</p> <p>Sale to</p> <p>DANAHER</p>	<p>Undisclosed Value</p> <p>vestcom</p> <p>A Portfolio Company of</p> <p>The Strategic Group } LAKE CAPITAL }</p> <p>Sale to</p> <p>LAKE CAPITAL</p>	<p>Undisclosed Value</p> <p>D+S Europe</p> <p>the customer excellence group</p> <p>A Portfolio Company of</p> <p>Apax PARTNERS</p> <p>Sale of Customer Care Activities to</p> <p>CEP</p>	<p>Undisclosed Value</p> <p>MCS</p> <p>MCS GROUP</p> <p>A Portfolio Company of</p> <p>CEP Concentric Equity Partners</p> <p>Private Equity</p> <p>Sale to</p> <p>TDR Capital</p>	<p>Undisclosed Value</p> <p>THE BRIGHT THINGS</p> <p>Sale to</p> <p>ADP</p>	<p>\$190,833,000</p> <p>Comerstone</p> <p>COMERSTONE MANAGEMENT</p> <p>A Portfolio Company of</p> <p>STERLING PARTNERS</p> <p>Sale to</p> <p>IRON MOUNTAIN</p>
<p>Undisclosed Value</p> <p>ZENTA</p> <p>Sale to</p> <p>accenture</p> <p>High Performance. Delivered.</p>	<p>Undisclosed Value</p> <p>UL Underwriters Laboratories Inc.®</p> <p>Acquisition of</p> <p>PureSafety</p>	<p>\$185,000,000</p> <p>mpv</p> <p>A Portfolio Company of</p> <p>rho and CHERRYBENTURES</p> <p>Sale to</p> <p>Experian</p>	<p>Undisclosed Value</p> <p>zerochaos</p> <p>Sale to</p> <p>SNOW PHIPPS</p>	<p>\$300,000,000</p> <p>ARCHWAY</p> <p>ARCHWAY INVESTMENT MANAGEMENT</p> <p>A Portfolio Company of</p> <p>TAILWIND CAPITAL</p> <p>Sale to</p> <p>BLACK CANYON CAPITAL</p> <p>Sale to</p> <p>INVESTCORP</p>	<p>Undisclosed Value</p> <p>Tag:</p> <p>Sale to</p> <p>WILLIAMS LEA</p> <p>Private Equity</p>
<p>Undisclosed Value</p> <p>unamic HCN</p> <p>Sale to</p> <p>ACS</p> <p>A XEROX Company</p>	<p>Undisclosed Value</p> <p>motion</p> <p>RECRUITMENT PARTNERS</p> <p>Sale to</p> <p>GRIDIRON CAPITAL</p>	<p>\$260,000,000</p> <p>FD FINANCIAL DYNAMICS BUSINESS COMMUNICATIONS</p> <p>A Portfolio Company of</p> <p>Advent International</p> <p>Sale to</p> <p>FTI</p>	<p>Undisclosed Value</p> <p>OmniSYS</p> <p>OmniSYS Technology Solutions</p> <p>A Portfolio Company of</p> <p>CICPARTNERS</p> <p>Sale to</p> <p>MOELLS & COMPANY</p>	<p>Undisclosed Value</p> <p>PRC</p> <p>Sale to</p> <p>ALORICA</p> <p>The World's Best-Kept Secret</p>	<p>Undisclosed Value</p> <p>protocol</p> <p>Private Equity</p> <p>Sale to</p> <p>NCO</p> <p>Private Equity</p> <p>A Portfolio Company of</p> <p>One Equity Partners</p>

SELECTED BAIRD BPO EQUITY TRANSACTIONS

<p>inovalon</p> <p>\$684,849,681 Common Stock</p> <p>Initial Public Offering</p>	<p>DIST SYSTEMS</p> <p>\$472,505,040 Common Stock</p> <p>Follow-on Offering</p>	<p>QIWI</p> <p>\$229,054,736 American Depository Shares</p> <p>Initial Public Offering</p>	<p>west</p> <p>\$425,500,000 Common Stock</p> <p>Initial Public Offering</p>	<p>vantiv</p> <p>\$552,466,468 Common Stock</p> <p>Follow-on Offering</p>	<p>WNS</p> <p>\$185,119,086 American Depository Shares</p> <p>Follow-on Offering</p>	<p>ATENTO</p> <p>\$150,000,000 Common Stock</p> <p>Initial Public Offering</p>
<p>workiva</p> <p>\$100,800,000 Common Stock</p> <p>Initial Public Offering</p>	<p>PRGX</p> <p>\$39,900,000 Common Stock</p> <p>Follow-on Offering</p>	<p>Huron</p> <p>CONSULTING GROUP</p> <p>\$195,615,000 Common Stock</p> <p>Follow-on Offering</p>	<p>C.ncur</p> <p>\$488,750,000 0.50% Convertible Senior Secured Notes</p> <p>Initial Public Offering</p>	<p>XOOM</p> <p>\$116,380,000 Common Stock</p> <p>Initial Public Offering</p>	<p>INTERSECTIONS INC.</p> <p>\$106,250,000 Common Stock</p> <p>Initial Public Offering</p>	<p>HireRight</p> <p>\$65,625,000 Common Stock</p> <p>Initial Public Offering</p>
<p>QUALYS</p> <p>\$104,535,000 Common Stock</p> <p>Initial Public Offering</p>	<p>WNS</p> <p>\$255,274,000 Common Stock</p> <p>Initial Public Offering</p>	<p>EKL</p> <p>SECURITIES</p> <p>\$92,000,000 Common Stock</p> <p>Follow-On Offering</p>	<p>Inspirity</p> <p>\$50,000,000 Common Stock</p> <p>Dutch Auction Tender Offer</p>	<p>Hudson</p> <p>\$21,010,500 Common Stock</p> <p>Follow-on Offering</p>	<p>TOWERS WATSON</p> <p>\$226,366,046 Common Stock</p> <p>Follow-on Offering</p>	<p>channeladvisor</p> <p>\$195,500,000 Common Stock</p> <p>Follow-on Offering</p>

Note: Selected Baird transactions shown. Please visit rwbaird.com/investment-banking for a complete listing of transactions.

4.3. Equity research coverage

SECTORS	SELECTED PUBLIC COMPANIES
Business Process Outsourcing / Outsourced Customer Care / Financial Processing	
Human Resource Outsourcing / Technology and Staffing Companies	
Internet / e-commerce	
Software and SaaS	
Information Services	
Facility Services	

Note: Selected sectors and selected equity research coverage shown. Please visit rwbaird.com/research-insights/research/coverage/research-coverage.aspx for a complete listing of Baird's research coverage.

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