G4S dash for growth unsettles investors

SUPPORT SERVICES

News analysis

Analysts fear £5.2bn move for ISS might be a deal too far, write **Gill Plimmer** and **Clare MacCarthy**

As the supplier of security guards to the US government in Afghanistan and Iraq, G4S should have an eye for military precision. But the group's decision to raise £2bn from investors to fund its acquisition of Denmark's ISS, has left many questioning whether it has too big a target in its sights.

With 625,000 staff in 125 countries and generating £7.38bn in revenue last year, G4S was already the world's biggest security company.

The acquisition of ISS for an enterprise value of £5.2bn turns it into a support services powerhouse – providing cleaning, catering, security and property management to government and private sector business worldwide.

Revenues are expected to double from £7.4bn to £16bn a year; and employee numbers will also double to 1.2m, making G4S second only to Walmart as a private-sector employer and the biggest securities and facilities management company in the world by revenues and staff.

But is the deal a step too far? G4S shares fell 22 per cent to 220p on Monday as investors worried about the price, the integration risk and the impact of the 7-for-6 rights issue, which is priced at 122p.

> 'I don't see a big difference between security and cleaning'
>
> **Nick Buckles, chief executive of G4S**

G4S is paying £1.5bn in cash and shares for the equity and assuming £3.67bn of net debt. That puts ISS's enterprise value (equity plus net debt) at 8.5 times historic earnings before interest, tax, depreciation and amortisation. G4S's own enterprise value is now about 7 times its historic ebitda.

Kevin Lapwood at Seymour Pierce described the price as being at "the top end of expectations".

Much would depend on how well the deal was executed, he added.

"Although G4S has in the past proved effective at integrating large acquisitions this will double the size of the group and there is bound to be some transactional risks in the short term," he said.

Nick Buckles, chief executive of G4S, is more confident. After all, he says, he has done it before with the integration of Group 4 Falck and Securicor to create G4S in 2004.

"We've got the track record to make it work," Mr Buckles said, adding that the two groups had cultural similarities, not least shared roots in Denmark in the early 20th century.

Mr Buckles, who first joined the group as an accountant with Securicor in 1985, is banking on a boom in the £500bn a year facilities services market – its fastest growing business in Britain, where ISS is already a leading operator, cleaning hospitals and offices nationwide.

The private and public sector are increasingly looking for one-stop suppliers, says Mr Buckles, and that makes the merger a good fit.

"We've done our research. There's definitely a trend there based on consumer needs," he says pointing to a £6.9bn pipeline of deals on offer in the UK alone, where G4S already runs prisons, work programmes and security tagging for the government.

"I don't see a big difference between security and cleaning in terms of margins, sectors or growth rates," he says.

ISS generated £8.5bn in revenues in 2010 and £481m in profits before interest, tax and amortisation.

But G4S also expects the deal to create £100m in cost savings by 2014, to be achieved by melding back offices in the 45 countries where both companies operate.

About 2,000 jobs will be lost as the two are combined, with less than 10 per cent in Britain – though in the long run G4S says it is likely to expand by 4,000 to 5,000 jobs a year in the UK as government departments and corporations press ahead with outsourcing non-core tasks.

But the real aim is to push ahead with expansion in emerging markets, which account for just 29 per cent of G4S's group profit and have been growing fast. Multinationals are increasingly seeking the same level of service – and often the same provider – that they use in their home countries, fuelling the trend towards outsourcing in countries from Asia through the Middle East. G4S wants half of its revenues to come from emerging markets by 2019.

It will also enable the group to muscle in on the wider outsourcing market dominated by operators such as Serco, Capita and Compass, which compete for catering contracts with ISS, as well as encroaching on the markets occupied by property services companies such as Mitie, Carillion and Interserve.

In Copenhagen there was some chagrin that a giant of Danish industry was switching nationality. Such sentimentality, though, was overruled by the dynamics of the deal: "ISS's owners are getting around 25 per cent more than they would have in the abandoned IPO and that's excellent for them," said Martin Bo Hansen, an analyst at Jyske Bank.

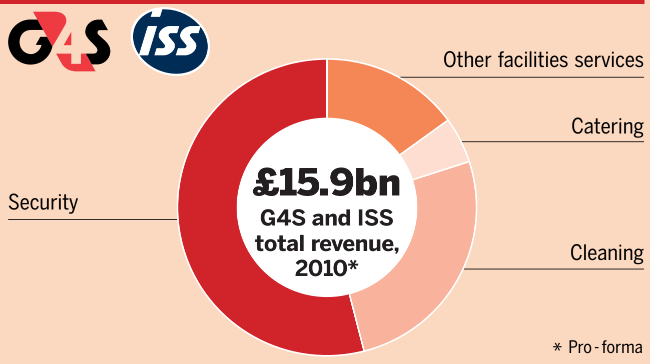
Waldemar Schmidt, a former ISS chief executive and author of a best-selling book on the services industry, also approved of the deal.

"The integration between the two companies should be extremely smooth because of their similar strategies – it's an excellent fit," he said.

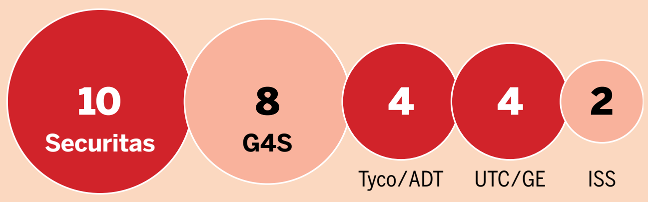
But as with all good military operations, much will depend on the execution.

See Lombard

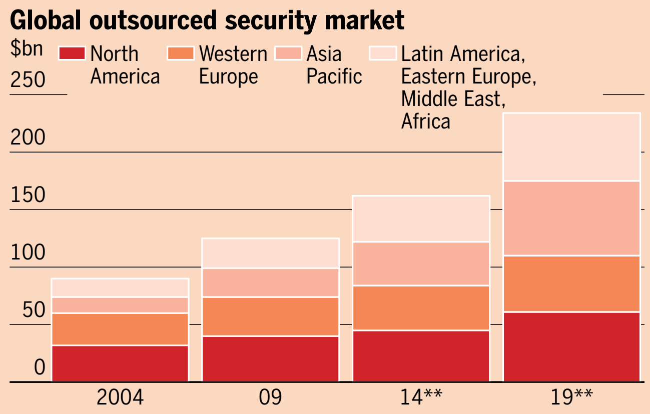
Expansion view



Manned security and security systems market
Market share, 2010 (%)



Global outsourced security market



Sources: company; Espirito Santo

** Forecast

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● A boom in **corporate litigation** is expected in the US and UK because of increased regulation and whistleblower complaints, a survey of top in-house lawyers by the law firm Fulbright & Jaworski has found. More than 90 per cent of US companies and 85 per cent of UK companies are expecting lawsuits to stay the same or rise next year, and stricter regulation was the top reason for the predicted increase

● Sir Richard Sykes, the veteran pharmaceutical executive, is to chair a venture fund designed to invest in fledgling British biotechnology businesses spun out of academia. **Deepbridge Innovation Fund**, which has just obtained registration in Luxembourg, plans to raise up to $250m by the spring to invest in European, and predominantly UK-based, life science, energy and software companies

● **Canopius** has entered an updated bid for **Omega Insurance**, its listed Lloyd's of London rival, but instead of the full cash offer indicated in September the company is asking some shareholders to take its own unlisted stock