

Software & IT Services

Market in Focus – Cyber Security



Cyber security solutions have become increasingly important in the ever evolving technological landscape. Robust, yet flexible cyber security software, products and services are highly sought after, requiring investors to execute M&A strategies in order to maintain competitive advantage and enhance their suite of security capabilities.

- The fourth industrial revolution is making the world more digitally connected. While this has fostered a feeling of the world becoming smaller, the cyber landscape has simultaneously expanded. This development has elevated cyber security from being an IT issue, to being an unavoidable threat that almost all organisations need to deal with effectively.
- Cyber security M&A activity has remained elevated throughout the pandemic across both software and service delivery models, in line with the wider Software & IT Services industry. The cyber security sector witnessed a 70% increase in deal volumes from H120 to H121, supported by investors with reformed risk appetite seeking to gain exposure to pandemic resilient business models and industry verticals.
- Strong performance from publicly listed cyber security companies has bolstered investor sentiment and fuelled M&A activity. Publicly listed cyber companies from Gambit's valuation index witnessed a 49.5% increase in EV/EBITDA multiples from Q120 to Q221.
- Covid-19 has accelerated the technological transition and adoption of cyber security resources. Strategic investors are bolstering their cyber capabilities with the likes of Deloitte which acquired aeCyberSolutions in order to offer technology-enabled tools for industrial control systems and operational technology (ICS/OT) security. Increased technological adoption is driving M&A volumes and enhancing exit valuations of pioneering cyber security companies able to mitigate the data vulnerabilities arising from the pandemic.
- Cyber security companies have capitalised on the opportunities presented by the pandemic by devising M&A strategies focused on augmentation of technologies, ease of scalability and expansion of market share. In turn, shareholders have benefitted from elevated valuations, with well capitalised acquirers willing to pay substantial premiums in order to maintain competitive advantage and access new technologies.
- The attractiveness of the cyber security sector to investors will continue to advance post-pandemic as strategic investors look to integrate cyber security into their product offerings. Microsoft's double acquisition of RiskIQ & CloudKnox was underpinned by cyber security's evolving use cases, growing demand, extensive innovation and technological disruption.
- The resilience of the cyber security sector has played a pivotal role in stimulating new growth within the industry. Subsequently, market sentiment remains elevated, underpinned by strong industry growth forecasts (10.9% CAGR to 2028), presenting a highly attractive investment proposition for well prepared acquirers and providers of capital.
- The ongoing technological transition and sophistication of cyber threats provides cyber security firms with the opportunity to realise substantial growth, supplemented by consolidation strategies and ample access to capital.
- Cyber security companies with a dominant presence in niche markets are attracting considerable interest from both strategic and financial investors, affording expansion opportunities within less-explored industry verticals.

Selected transactions

Date	Target	Acquirer/ Investor
Aug 2021	aeCyberSolutions	Deloitte
Jul 2021	RiskIQ & CloudKnox Security	Microsoft
Jul 2021	Marclay	BlueVoyant (Temasek)
Jul 2021	Ignition Technology	Exclusive Networks (Permira)
Jul 2021	Cyphra	Pixel (Chiltern Capital)
Jun 2021	Aquilai	Ergress (Albion Capital)
Jun 2021	Deep Secure	Forcepoint (Francisco Partners)
June 2021	Integrity360	August Equity
March 2021	Bridwell Consulting	Growth Capital Partners

The cyber security market is very active. H121 M&A volumes were up 70% with competing interest from strategic buyers and financial buyers looking to deploy excess dry powder into quality assets benefitting from a fast growing sector. This is providing an ideal window for shareholders and management teams to take advantage of high valuations and exploit strategic opportunities.



Market Adoption

- The use case for cyber security software and services has evolved substantially in recent years with the average cost of data breaches reaching \$3.86m according to IBM. This is driving technological adoption, as cyber security threats become increasingly sophisticated and costly, while data protection regulations such as GDPR rapidly evolve.
- The implementation of GDPR has resulted in mandatory reporting requirements of cyber security breaches, with potential fines for poor risk management. WhatsApp is currently facing a \$267m fine for breaching Europe's GDPR regulations for example. Subsequently, there has been a significant uptake in demand for cyber security solutions and services, with forecasts predicting continued exponential growth and technological adoption.
- Elevated market adoption has resulted in historically high growth forecasts, deal volumes & values, burgeoning investor confidence and appetite to increase exposure to the cyber security sector.

The number of businesses outsourcing cyber security has increased from 30% to 40%

Source: Ipsos MORI



Technology Transition

- Heightened pressure and demand for online security has become increasingly prevalent in recent years with the emergence of new technologies, fuelling accelerated growth in the cyber security industry.
- Cyber security solutions are proving to be an integral part of modern business operations, even within sectors with historically low levels of technological adoption. It is estimated that over 50% of Britain's manufacturing sector has been a victim of cyber crime in the last twelve months, with many of these companies now employing a designated board director to oversee for cyber protection.
- Reliance on traditional authentication methods and low preparedness are stimulating market growth as security professionals increasingly recommend cyber security solutions as a matter of urgency.
- Technological advancements and the increased breadth of service offering amongst cyber security has enabled companies to deploy highly tailored solutions to address customer's requirements, from SME's to global corporations, across multiple industry verticals.

4 in 10 businesses and a 1 in 4 charities report having cyber security breaches or attacks in the last 12 months

Source: Gov.UK Cyber Security Breaches Survey 2021



Role of the Public Sector

- Across the public sector, cyber security solutions are becoming increasingly utilised with government-backed initiatives to support cyber start-ups such as HutZero, CyberASAP and Cyber101 also gaining traction. These initiatives provide substantial support to early-stage companies and founders seeking to scale their businesses.
- On average, public bodies in the UK award £60m of cyber security contracts every quarter, highlighting a considerable growth opportunity for companies to explore to further supplement their earnings pipeline.
- Additionally, the National Cyber Security Centre's budget has continued to appreciate in recent years, currently set at £1.9bn annually to 2021. The NCSC's budget provides extensive capital to the sector, underpinning growth plans and cementing the UK as a market leader in the cyber security industry.

30% of UK cyber security companies' revenue is driven from the public sector and government bodies

Source: National Cyber Security Centre



International Reach

- A fundamental contributor to revenue growth for the cyber security sector in recent years has been cross-border trade. US-headquartered BlueVoyant's recent acquisition of UK-based Marclay's demonstrates the elevated appetite for cross border M&A activity in the industry, as firms seek to capitalise on advantageous sectoral characteristics such as ease of scalability, access to new and emerging markets and additional growth potential.
- The UK's cyber security sector receives international acclaim and recognition for stringent regulations and prudent practices. Subsequently, driving demand for UK cyber security solutions as global companies alternate to UK based assets for their cyber security solutions.
- The international reach of UK based Cyber Security resulted in substantial M&A activity being sustained in the sector as larger strategic acquirers look to capitalise on the fragmented market to consolidate market share. Demand for UK based services and solutions has resulted in elevated valuation multiples being realised within the sector.

Annual UK Cyber exports amount to £3.9bn – a 90% increase from 2018

Source: UK defence and security export statistics (2019-2020)



Covid-19 responsiveness

- Stimulated by the cyber security sector's resilience and responsiveness to the pandemic, strategic and financial acquirers are now enacting comprehensive M&A strategies and considering how to diversify current portfolios to suit the market demands of the post-pandemic landscape.
- The cyber security software & services industry has witnessed an appreciation in share prices in the last twelve months, reflective of private company exit valuations, driven by increased demand for economic and pandemic resilient assets.
- The combination of increased demand for emerging cyber security software solutions in response to the pandemic, the prolonged transition to remote working, heightened M&A activity and investor sentiment have enabled cyber security providers to benefit from an associated uplift in company valuations and access to capital.



Recurring revenues

- Cyber security as service business models have become an industry favourite of recent, underpinned by ease of scalability, low capex intensity and visibility of recurring revenues - further demonstrating resilience to the pandemic.
- Underpinned by high margins and strong operating cash conversion, cyber security companies present an attractive investment proposition for both strategic and financial acquirers seeking to identify risk averse investments in the face of economic instability.
- Cyber security companies demonstrating sustained visibility of recurring and re-occurring revenues have greater valuation multiples than business models reliant on solitary and project related sales.



Scalability

- The proliferation of IoT devices has highlighted the scalability opportunity of cyber security solutions, with studies suggesting there will be 18 billion IoT connected devices globally by 2022, each containing various personal and confidential data which will need to be protected.
- The inherent scalability characteristics, on an international scale, coupled with the influx of capital from both financial and strategic acquirers has enabled the sector to achieve amplified deal volumes and valuation multiples.
- Scaling via acquisition can substantially elevate shareholder value, as demonstrated by the ShearWater Group which has implemented successive buy and build strategies in recent years, helping to support 3.5x EBITDA growth over a three-year period.



Differentiation

- Greater exposure and knowledge to emerging cyber risks affords pioneering companies with elevated valuation prospects driven by substantial acquirer appetite for intellectual property and access to new technologies.
- Acquirers have sought to diversify their existing portfolios and expand the scope of their acquisition criteria into emerging verticals, rather than purely scaling existing cyber security capabilities.
- The propensity to adopt earlier stage cyber software technologies in the pursuit of speed and agility has led acquirers to consider smaller-scale transactions to supplement buy-and-build strategies and leverage the fast-growing nature of more agile companies.

Gambit's cyber security software & services valuation index witnessed an appreciation in EV/EBITDA multiples to achieve record valuations in Q2'21, stimulated by the industry's responsiveness to Covid-19 and favourable market sentiment from investors.

Cyber Security Software & Services - Valuation Index



Key points in focus:

- The sophistication of technologies and implementation of cyber security solutions has undergone considerable growth, accelerated by the Covid-19 pandemic and the transition to remote and flexible working. The adoption of cyber security solutions is rapidly increasing, boding well for sustained market growth, product development and investor appetite.
- Innovation in technologies and adaptation in delivery models will continue to support positive market growth and trading performance of cyber security companies.
- We expect to see a mixture of continued pricing growth, increased aggregate demand, and the creation of new market niches for cyber security software and solutions providers to explore.
- Across the cyber security landscape there is increasing appetite for development capital, with 45% of active firms citing a 'lack of finance' as their most significant barrier to growth. (IPSOS, MORI survey). Understanding the appropriate sources of capital to support their business' needs will enable shareholders and management teams to unlock additional growth potential, enter new markets and appreciate shareholder value.
- Acquirers will continue to demonstrate their growing appetite to incorporate cyber security assets within their portfolios in order to access new technologies in an industry that is rapidly evolving. Simultaneously, investors are deploying substantial levels of development capital to support these companies in reaching the next stage of their growth plans, creating substantial competition for market leading businesses.
- Acquirers have widened the scope of their acquisition strategy to identify disruptive, smaller, and more agile cyber security software companies to help facilitate the transition towards digitisation and interconnectivity. Opportunity exists for these companies to accelerate succession planning and shareholder exit processes to crystallise capital gains during a period of heightened M&A activity and corporate valuations.
- The recent wave of consolidation reflects the recognition that quality assets within fast growing and pandemic-resilient sectors such as cyber security are highly sought after and provides an opportunity for shareholders to exit at historically strong valuations.
- Deal making has changed during the pandemic, but M&A participants have remained persistent and flexible, adapting to remote due diligence and negotiations and completing transactions despite this unique situation.
- If you would like to arrange a call to discuss the opportunities facing your business or to understand the most appropriate solutions to support your shareholders' needs and ambitions, please contact a member of the team.



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Gambit Corporate Finance

Established in 1992, Gambit is an independent corporate finance advisory firm specialising in advising private and public companies on mid-market transactions in the UK and overseas. With offices in London and Cardiff, Gambit is widely recognised as a market leader in M&A advice in the Software & IT Services sector having built up detailed industry knowledge and an enviable track record in deal origination and execution.

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