M&A Market Review
Information Technology

GAMBIT CORPORATE FINANCE

Q3 2014

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Content Summary:

Key Observations	Significant levels of funding remain available within the IT sector from both private equity and acquisitive corporates. UK businesses contemplating an exit should consider the current market as providing significant opportunities.
Industry Overview	The UK IT sector maintained its momentum in Q3 with both M&A activity and EV/EBITDA multiples remaining buoyant for both Software and Services, with multiples in Services increasing for the fifth successive quarter.
Feature Article	This edition: Raj Shroff, Managing Director of Indian M&A specialist Aarayaa Advisory Services, examines the interaction between India and the UK in the IT sector. Mark Waite, Managing Director of Cohesive Communications discusses how technology companies need to captivate their markets.
Public Comparables	The IT sector public companies tracked by Gambit outperformed the FTSE All-Share by 6.1% in the third quarter of 2014.

Key Observations From Q3 2014:

There was a reversal for global stock markets reflecting increased nervousness amongst investors following a downgrading of global growth forecasts by the IMF. However, tech stocks outperformed the market, with the S&P Global 1200 IT Index up 2.2%, and robust performance seen in the Software and Consultants/Infrastructure sub-sectors of Gambit's IT Index.

The total value of global technology M&A activity in the opening three quarters of 2014 was 28% higher than for the same period of 2013. UK Software transaction volumes have continued to increase each quarter since the turn of the year, and UK IT Services M&A activity in Q3 remained broadly consistent with the Q2 level with valuations having increased for the fifth consecutive quarter.

M&A activity in 2014 has been dominated by corporates rather than private equity, with 76% of UK acquisitions being led by corporates, due to increasing valuations and buoyant stock markets for the majority of 2014. Corrections in listed equity prices may provide an advantage to private equity in the mid and upper-mid market in the next two quarters. Private equity has taken advantage of improving valuations by increasing the number of exits by 24% versus 2013.

In the lower mid-market, private equity investors remain very active, with cloud-related investments being a key area of focus. During the quarter, Node4 completed a cloud infrastructure bolt-on acquisition and Albion Ventures invested in a cloud-based customer management platform business.

UK businesses contemplating an exit should consider the current market as providing a significant opportunity. Well-positioned and scalable companies will achieve good valuations as a result of increased risk appetite and ongoing flight-to-quality. This is supported by a significant number of public and private companies with access to capital and ambitious growth plans against which to deliver.

Summary: Favourable M&A conditions in place for mid-market IT companies

To sell: With valuations having improved and volumes stabilised, combined with a greater level of funding currently available than in recent years, those considering a sale should act now.

Private equity: *Private equity investors remain focussed on the IT sector, given the potential* consolidation opportunities in fragmented sub-sectors, with intense competition for quality assets. A number of existing private equity managed services platforms in the sector are anticipated to seek an exit in the next 18 months.

Financing: Whilst raising debt capital remains challenging in many sectors, the underlying fundamentals of mid-market IT companies are more attractive to banks, resulting in increased availability, margins at their lowest and maturities longest since Q3 2008.

Information Technology Industry Overview –

How private equity can back SaaS valuations, and FinTech consolidation

Simon Williams
Director, Information Technology

Global Tech M&A maintained its momentum in Q3, with transaction values for the first three quarters 28% ahead of 2013 and European M&A (all sectors) 64% higher in Q3 than for the same period of 2013. Global equity markets witnessed significant volatility at the end of the quarter and into Q4 due to downgraded growth forecasts and renewed concern over certain European economies, although IT companies in general were resilient.

The UK continues to be an attractive destination for overseas buyers in the IT sector, particularly for US companies, which accounted for 53% of cross-border M&A into the UK. This was demonstrated in the UK IT sector with large acquisitions by both PTC and eGain. Significant cross-border transactions in the quarter from non-US buyers included Hexagon acquiring Vero for €350m and Feesa being acquired by KBC for £21.2m

Financial services technology (FinTech) remains an attractive segment of the IT sector, and insurance software was a particular focus during the quarter for both corporates and private equity, demonstrating consolidation opportunities in this sub-sector. Xchanging bought Agencyport Europe for £64m (3.2x revenue), HgCapital acquired Sequel Business Solutions and Montagu Private Equity acquired Open International.

The IT sector represents a significant area of focus for private equity. One challenge that they have faced in the last 12 months has been the ability to back SaaS companies, with their often stratospheric valuations, and they have often lost out to corporates. We believe that there is an opportunity for private equity to gain exposure to SaaS companies through backing established software companies to transition from a traditional licence to a SaaS model. Private equity can fund the working capital needed during the transitional period, allowing them to buy into a SaaS model at a lower valuation.

Gambit's view is that the M&A transaction activity and robust valuations in the IT sector will continue into 2015. Across the transaction spectrum, both corporates and private equity have significant funding available and are focussed on strategic transactions opportunities, whether that is to create a new platform, consolidate a fragmented segment or support disruptive technology. Weakening equity markets should provide private equity with a stronger position with which to bid against corporates.

IT Public Company Comparables			Share Price Changes		
	Enterprise Value (£m)	**EV/EBITDA**	**3 months**	**6 months**	**12 months**
FTSE All-Share			**(1.8%)**	**(0.6%)**	**2.6%**
S&P Global 1200 IT Index			**2.4%**	**8.0%**	**22.2%**
Datacentre/Managed Hosting					
Equinix	9,153	13.3	1.12%	13.0%	13.6%
Iomart	255	11.0	(1.2%)	(12.0%)	(31.8%)
Rackspace	2,710	7.5	(3.4%)	(0.8%)	(62.1%)
Telecity	1,819	10.9	(0.8%)	6.7%	(11.0%)
Sub-sector (weighted average)		**11.8**	**(0.1%)**	**9.0%**	**(5.2%)**
Consultants/Infrastructure					
Accenture	28,985	9.7	0.6%	2.0%	9.4%
Computacenter	822	6.9	4.9%	(4.5%)	15.2%
Cap Gemini	6,902	7.8	8.3%	3.3%	22.6%
CGI Group	7,131	7.3	6.2%	18.3%	4.7%
CSC	5,759	4.7	(3.4%)	0.5%	15.4%
Cognizant	14,240	11.1	(9.2%)	(13.0%)	8.3%
Hewlett Packard	44,381	5.3	5.0%	8.8%	40.8%
IBM	140,336	8.4	4.5%	(1.4%)	2.4%
Infosys	20,505	15.2	13.1%	12.4%	19.6%
Phoenix IT	150.3	5.0	22.2%	(8.4%)	(40.3%)
Tietoenator	1,181	7.3	(9.2%)	2.9%	21.0%
Sub-sector (weighted average)		**8.6**	**4.0%**	**1.7%**	**12.0%**
Software					
Dassault	9,397	15.1	7.6%	16.4%	3.0%
Micro Focus	1,644	14.6	18.1%	21.7%	28.5%
Microsoft	196,642	10.4	10.1%	11.6%	28.2%
Oracle	88,704	7.7	(5.9%)	(6.9%)	13.3%
Red Hat	6,010	22.3	1.6%	5.6%	17.8%
SAP	54,531	11.3	1.6%	(2.5%)	4.6%
Sub sector (weighted average)		**10.2**	**4.6%**	**4.9%**	**20.1%**

Source: CapIQ

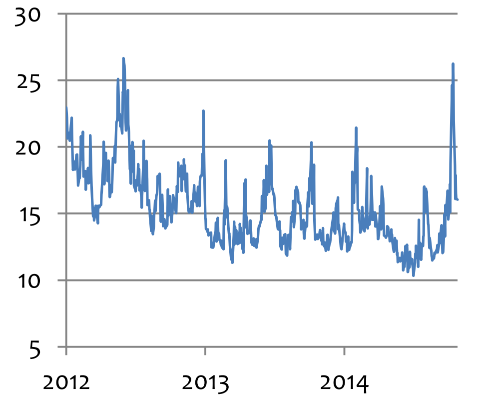
"Gambit's Global IT Index outperformed the FTSE All-Share by 6.1% in Q3"

Macro Outlook

The global macro outlook took an uncertain turn as Autumn began. The VIX Volatility Index, a measure of stock market volatility, reached its highest levels since 2012 as the International Monetary Fund (IMF) downgraded its global growth forecasts to 3.3%, 0.4% lower than their April World Economic Outlook. Growth has been slower than expected in the first half of 2014 and the IMF has also pointed towards increased downside risks to global growth, including financial and geopolitical. However, the IMF said the outlook was brighter in the US and the UK, which were "leaving the crisis behind and achieving decent growth".

The UK economy grew by 0.7% in the third quarter of 2014 according to the Office for National Statistics (ONS). This reflects a slowdown from 0.9% GDP growth in Q2 2014, but on a positive note the UK economy is now 3.5% larger than at its previous peak in January 2008. There are a number of risks that the UK economy still face, particularly with regards to the Eurozone, the UK's main trading partner.

VIX Volatility Index



Transaction Activity

The total value of global technology M&A activity was 28% ahead of the opening three quarters of 2013 (Mergermarket). Corporates are the key driver of this increase in activity with private equity starting to find it more difficult to compete with valuation inflation. Private equity has taken advantage of improved valuations, with private equity exits across all sectors in the first three quarters of 2014 being 24% higher than the same period for 2013.

Across all sectors US acquirers represented 53% of UK cross-border M&A in the first three quarters of 2014. Significant transactions by US acquirers in UK tech companies in Q3 2014 include the acquisition of OTC by Atego for $50 million and the acquisition of eGain by Exony for a consideration of $16 million.

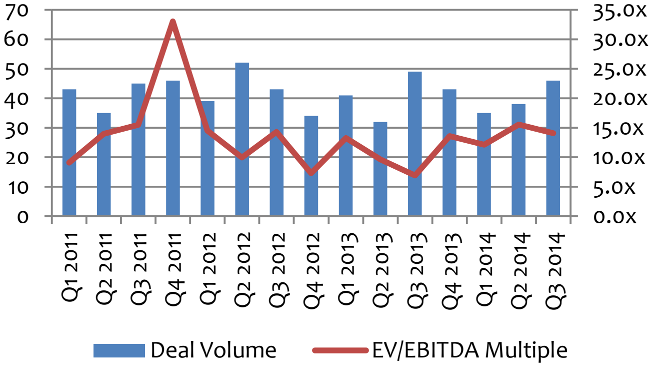
After a strong start to the first half of 2014 global technology IPO activity slowed in Q3 2014, with 18 IPOs completed in the quarter compared to 40 in Q2 2014. The recent downgrading of the global growth forecast and increased stock market volatility has led to a nervousness amongst owners and investors with a number of IPOs having recently been postponed. However, the technology sector remains at the forefront of global IPO activity, particularly with the recent record breaking $21.8 billion Alibaba IPO.

With rising business confidence and the continuing strength of the debt market we have confidence that M&A activity will strengthen into 2015 across the Information Technology sector. Potential sellers may find that now is a very good time to consider going to market.

Software

UK software transaction volumes increased by 21% in Q3 2014, with the mean EV/EBITDA multiple for disclosed transactions remaining relatively static at 14.1x.

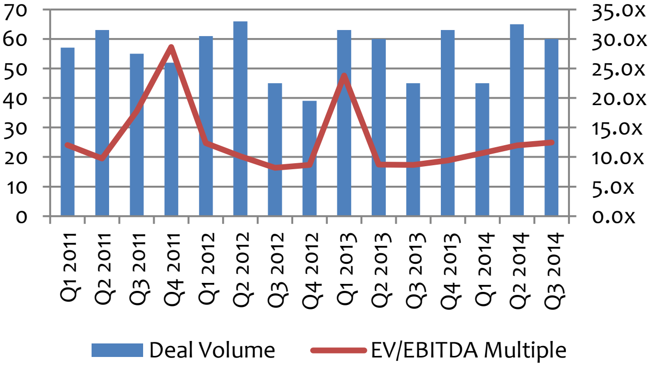
Xchanging completed two software acquisitions in Q3 2014, totalling more than £85 million in consideration. Capita plc also continued their software focus with the purchase of Eclispse Legal Systems.



Services

The volume of UK IT services transactions fell by almost 8% to 60 in Q3 2014, albeit a third higher than the Q3 2013 level. The average EV/EBITDA multiple improved marginally to 12.4x.

SCC's renewed focus on strategic M&A was highlighted in the £12m acquisition of a data centre from SSE, to follow their acquisition of M2 Digital earlier in the year. Capita demonstrated their desire to extend outside of the UK with their acquisition of Irish based BPO business South Western for a consideration of €35 million.



"Continuing momentum in IT valuations and transaction levels despite increased market volatility"

Indian IT Companies and UK Market Synergies

Raj Shroff
Founder Director,
Aarayaa Advisory Services

UK and India have a long association which is underpinned by a strong legacy in terms of language, culture, academia, bureaucracy and judiciary. This relationship is one of partnership and deep goodwill. The UK is one of the largest investor in India, and India invests more in the UK than in the rest of the European Union combined. In fact India is the fifth largest investor in the UK.

All major Indian IT and BPO companies are operating in the UK and for many Indian IT companies the UK is a key market. Predominantly these IT companies prefer an Onsite-Offshore model (local presence and offshore processing) which increases cost savings for the end customers. Recent research found that of the Top 41 fastest growing UK subsidiaries of Indian companies, subsidiaries operating in technology and telecom sector have registered the highest year on year growth of 32%.

Indian IT companies have acquired niche IT services firms in the UK to cater to local market as the UK is a mature market with a large number of mid-sized IT players catering to sectors such as healthcare, insurance, retail and logistics. Some of the notable transactions include HCL Tech's acquisition of Axon (Enterprise Applications Services / SAP Service provider) for $658m; Saksoft's acquisition of Acuma Solutions (Information value management solutions provider); Joint venture between Law Society and Mastek UK for managing a conveyancing portal; entry of Zomato, a technology driven company offering an online restaurant discovery guide in UK. Acquisition activity within the IT sector is also taking place in the opposite direction - Serco (UK government services firm) acquired Intelenet Global Services (BPO company) in 2011 for €446m; New Call Telecom, UK based ISP acquired Nimbuzz (an application providing cross platform for mobile instant messaging, VoIP and mobile ad service provider) in Oct 2014 for $250m.

As per National Association of Software and Services Companies, Social Media; Mobility; Analytics; Cloud ("SMAC") are reshaping the business, the consumers and all traditional approaches of the Indian IT industry. Indian IT vendors are expected to generate over $225bn by 2020 in SMAC related revenue. SMAC enables enterprises to leverage the cloud for storing huge volumes of multi-structured customer data, generated over mobile devices and social media and analyse these data sets for business advantage.

"India invests more in the UK than in the rest of the European Union combined"

To monetise the SMAC opportunities, top IT-BPO players are trying to venture in each of these technologies through both organic growth and acquisition/JV, and niche and pure-play operators are trying to build their expertise in one of the forms of the technology. SMAC technology provides an opportunity to move to higher-margin business by offering creative solutions and assisting businesses to grow dynamically instead of increasingly cutting margins for typical IT contracts. These verticals are likely to be strong focus areas for outward looking Indian enterprises attracted to UK knowhow, technology and market, where UK companies represent a key component in achieving this projected growth.

Why Disruptive Technology Alone Isn't Enough to Captivate Your Market

"Here's to the crazy ones. The rebels. The misfits. The troublemakers…"

Mark Waite
Managing Director,
Cohesive Communications

When Steve Jobs famously expressed the value of people to think different in order to innovate and change the world around them, the subtext of his argument was unquestionably the role of technology (namely, Apple's technology) in enabling that process. For all its present day success, lest we forget Apple is a brand that took its time captivating the market with promise and purpose, and very nearly missed the opportunity to be more than a company that just made fantastic products.

"If you're an innovative technology business then you must disrupt or die"

If you're an innovative technology business then you must disrupt or die. You care little for how it's always been done; driving change at incredible speed as if it's a race to make the previous generation of technology obsolete. But this isn't enough to really succeed. Without marketing purpose, isn't this innovation for innovation's sake?

You seldom see a market truly captivated on the strength of new intellectual property alone, yet good marketing – a good story - can turn heads and demand closer attention. Here are six fundamentals to any successful market captivation strategy:

- **Formulate** your strategy based on market insights to differentiate and position your brand
- **Articulate** your proposition and craft a simple and compelling story that creates an emotional connection with customers, partners and advocates
- **Influence** your publics through purposeful PR, analyst and industry relations, creating advocates to tell your story for you
- **Target** your audience through outbound marketing using web, email and direct marketing to nurture and generate sales opportunities
- **Attract** attention through inbound marketing that utilises valuable content, social media and web tools to interact and engage your market
- **Automate marketing systems and processes to maximise effectiveness and improve all aspects of your marketing operations**

So, think different. Be an upstart not a start-up. Challenge the status quo and be disruptive. Create a story that can be powerfully told, easily understood and emotionally connects with your audience. Now you're ready to captivate your market.

Contact us:

Gambit has a dedicated IT team with a significant track record in the sector. We have deep relationships with investors, vendors and acquirers in the sector. We understand the key issues and trends that drive M&A activity in the sector and how our clients' businesses are affected.

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Our team would be delighted to meet with you to discuss our experiences in the sector and to answer any questions you may have on the current M&A market.

Gambit Corporate Finance LLP

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. Gambit is widely recognised as a market leader in M&A advice in the IT industry having built up detailed industry knowledge and an enviable track record in deal origination and execution.

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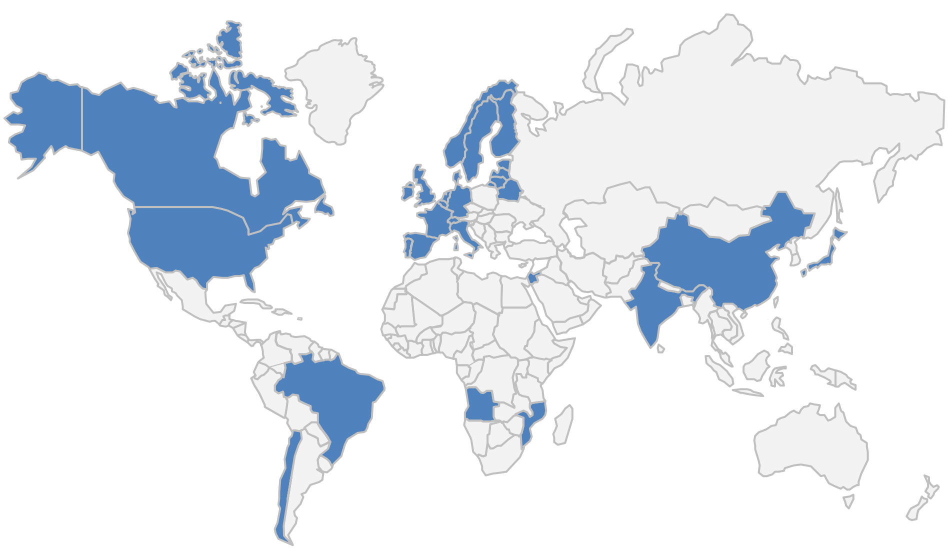

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