



Technology Sector M&A – Half Year Review 2011



Déjà vu all over again

1. A MACRO VIEW

Last year saw recovery in the value of many asset classes, but so far this year equity markets are broadly flat, as are exchange rates, interest rates and many forecasts of economic growth! Yet amongst all this uncertainty, the technology sector has outperformed in both the UK and the US with NASDAQ and Techmark indices rising this year and both are near recent highs.

The mergers and acquisition market usually dances to the tune of the equity markets and this year has been no different with technology M&A activity holding up well, with the number of deals in the first half of 2011 up 8%. Although there weren't as many mega deals, so the overall value is down.

Much of the headlines and excitement in the last 6-9 months has been in a small number of social network related businesses in the US, such as LinkedIn and Groupon. But while social media is spreading rapidly, a bubble is forming in some of the valuations. However, only a small number of companies have been invited to the party; the reality is that the broader technology sector, both in the UK and the US, trades on a PE valuation (price earnings ratio) that is only slightly higher than the market and overall it looks in good shape.

Key statistics for 2011 so far:

| Key Statistics | 31 Dec 2010 | 30 June 2011 | Change |
|--|-------------|--------------|--------|
| FTSE | 5,900 | 5,946 | +1% |
| FTSE Techmark 100 | 2,040 | 2,202 | +8% |
| NASDAQ | 2,653 | 2,774 | +5% |
| US\$ / £ exchange rate | 1.56 | 1.60 | +3% |
| Technology M&A deals Val.(\$bn) – last 6months | \$80.8bn | \$45.1bn | -44% |
| Technology M&A deals Vol. (No.) – last 6months | 1,715 | 1,854 | +8% |
| Price to revenue (x) | 1.5x | 1.7 | |

2. GLOBAL TECHNOLOGY M&A

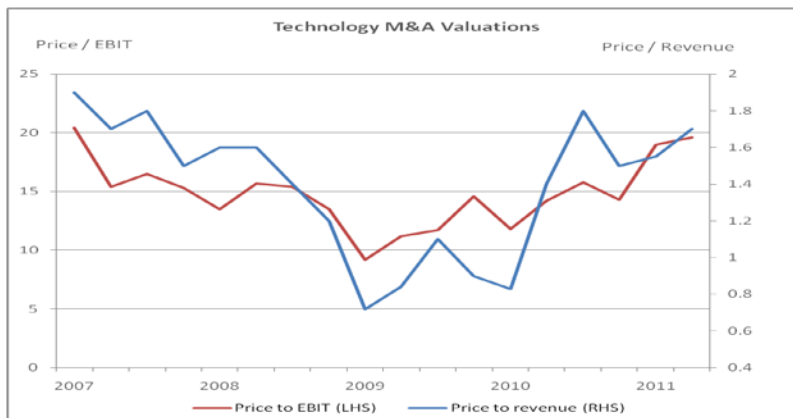
The Balance Sheet of the technology sector remains very strong, the Top 10 have over \$230bn in cash. It is therefore well positioned to fund M&A activity.

This year has seen some interesting IPOs in the US with Yandex the Russian search engine, Renren a Chinese social network operator and LinkedIn the professional services network all listing. In particular, the appetite for the LinkedIn listing is encouraging other companies to look at the IPO options.



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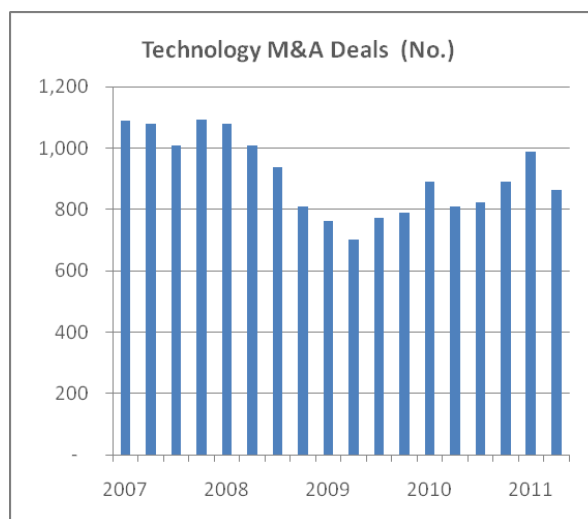
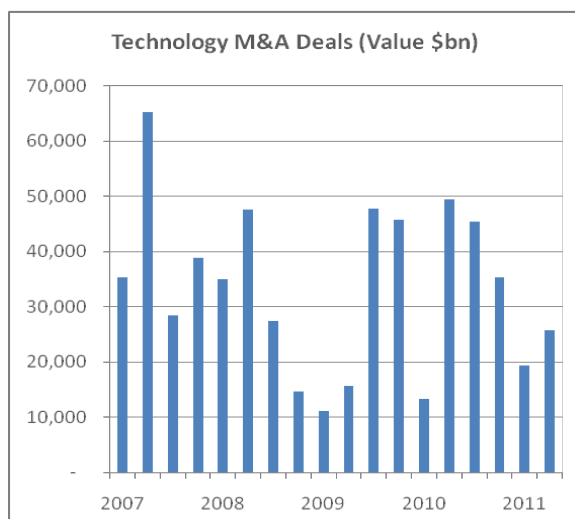
In the UK, the IPO market remains quieter albeit showing signs of a come back with the recent listings of the sports data provider, Perform, and Ubisense the real time location solutions company. However, for UK shareholders looking to realise their equity stakes, the M&A route still remains the only real option.



Global IT valuations, as shown on the chart above, are broadly back to the sort of range that they were in 2008 before the credit crunch.

By the end of 2010, the average price to trailing revenue had risen to 1.5 x and the average price to EBIT was 14.4 x both of these have risen this year. Reasons for this increase are a combination of factors including a smaller number of transactions during the period being “distressed” but also, there has been a gradual rebuilding of confidence after the downturn of 2008/9.

So far this year the number of technology deals continues to increase with 1,854 deals in the first half of 2011, which is 8% more than in the second half of 2010 and 9% more than in the same period last year. So activity levels continue to rise steadily, showing a healthy market.



Last year saw an absolute feast of mega deals – particularly in the US. For example, the largest 20 deals in 2010 had a combined value of \$53bn (and were all worth more than \$1bn each). By way of comparison in 2011, so far the Top 20 deals have a value of only \$26bn (and only 7 were over \$1bn), a drop of 50%. So that is still a lot of large deals, just not as many as last year.



Technology Sector M&A – Half Year Review 2011

3. THE US MARKET

Each year there seems to be a stand out deal that sets it apart from its peers. In the past few years we have seen mega deals such as Oracle buying Sun for \$7.4bn, Xerox acquiring outsourcer ACS for \$7.6bn and HP acquiring EDS for \$13bn. In 2010, the stand out deals have to be the \$7.7bn acquisition of McAfee by Intel and SAP acquiring Sybase for \$5.8bn. In 2011 the stand out deal is clearly Microsoft's acquisition of Skype.

The Biggest Deals in 2011 so far

| Date | Purchaser | Target | Ent. Val (\$) | EV / T/o (x) | Activity of target |
|--------|---------------|------------------|---------------|--------------|-----------------------------------|
| May-11 | Microsoft | Skype | 8,500,000 | 10.0 | Internet telephony. |
| May-11 | CenturyLink | Savvis | 2,500,000 | 1.5 | Cloud computing services |
| Mar-11 | eBay Inc. | GSI | 2,400,000 | 1.8 | Online marketing. Ecommerce |
| Apr-11 | GGC Software | Lawson Software | 1,841,000 | 2.5 | ERP software |
| Jan-11 | Verizon | Terremark | 1,400,000 | 5.0 | Managed IT infrastructure. |
| Jun-11 | Stanley B&D | Niscaya | 1,167,000 | 49.0 | Security technology |
| Apr-11 | Apax Partners | Activant | 1,024,000 | 11.0 | ERP software |
| Apr-11 | Apax Partners | Epicor Software | 976,000 | 2.2 | Enterprise and e-comm software |
| Jan-11 | iGATE Global | Patni | 921,000 | 2.0 | IT consultancy |
| Feb-11 | Axa | Opodo | 652,000 | 4.4 | Online travel |
| Jun-11 | Lenovo | Medion | 624,000 | 0.3 | Low cost computers |
| Apr-11 | Genpact | Headstrong | 550,000 | 3.1 | IT consulting. Financial services |
| Apr-11 | Solera | Explore Info Sys | 520,000 | 6.9 | Insurance data and analytics |

Microsoft announced the acquisition of **Skype** for \$8.5bn in May 2011. Clearly Microsoft sees something of value that eBay could not extract in its five years of ownership. Skype has an interesting story; it was launched in 2003 and was acquired by eBay in 2005 for \$2.6bn. However, eBay ended up selling 70% of it back to its founders again in 2009 at a similar price. By selling it on again the founders have made a staggering profit. Skype is a business with \$860m of revenues and made a loss of \$7m last year, so one has to wonder how such a valuation can be justified (10 x sales for a business that doesn't make a profit). Well it does help if the buyer is Microsoft with over \$50bn in cash just sitting on their balance sheet earning a very modest amount in the bank.

Clearly part of the answer on the Skype valuation is that Skype has a huge 660m users, yet has only \$860m in revenue which equates to a mere \$1.30 of revenue for each customer. The trick that Microsoft clearly needs to achieve is to monetise this massive client base and increase revenue per customer from its current modest base.

At the other end of the scale from the Skype deal is the fate of **Myspace**. It has also had an interesting history, but how the mighty have fallen. In the period 2006 until 2008 Myspace was the most popular social networking website in the US. Having been acquired by News Corporation for \$580m in 2005 they tried to take advantage of its popularity when in 2007 they tried to merge it with Yahoo, in a deal that would have valued it at \$12bn. Fortunately for Yahoo that deal never happened and now after several years of decline News Corp have ended up selling it for just \$35m! Ouch. Clearly a major blow for the owners and a clear example of the dominance that Facebook has in that market.

Much of the excitement/hype in the US at the end of 2010 centred on the implied valuations from the private shareholder financing of **Facebook** and online coupon business, **Groupon**. This year it has moved on to **LinkedIn** - the business version of Facebook, whose shares listed at \$45 each and went to \$122 per share on the first day before settling at a valuation of \$8.5bn or 600 x profits! It is not likely to be the last IPO in the US, with any number of others such as Facebook, Twitter, Groupon and Zynga all keeping a close eye on market conditions after fund raising last year.



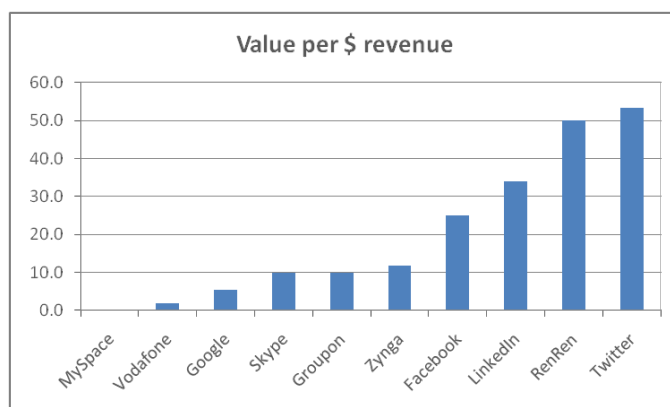
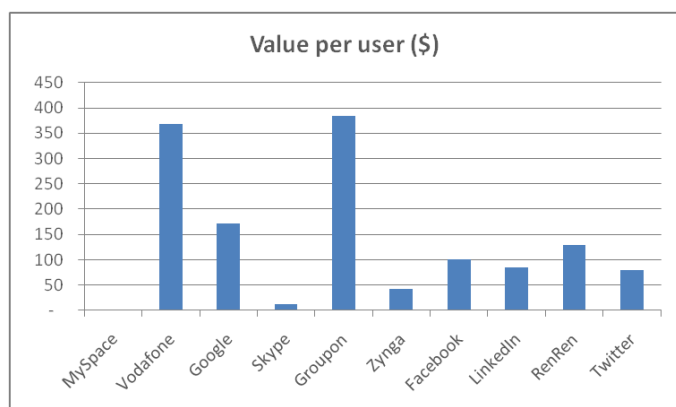
Technology Sector M&A – Half Year Review 2011

With so many large numbers being attributed to these social media related businesses, we thought it would be interesting to look at some comparative valuations and how they stack up against some established brands.

| | Valuation \$m | Users (m) | Revenue (\$m) | Value / User (\$) | Value / Revenue (x) |
|----------|------------------|--------------|------------------|----------------------|------------------------|
| MySpace | 35 | 65 | 109 | 1 | 0.3 |
| Vodafone | 136,000 | 370 | 75,000 | 368 | 1.8 |
| Google | 171,000 | 1,000 | 31,000 | 171 | 5.5 |
| Skype | 8,500 | 660 | 860 | 13 | 9.9 |
| Groupon | 25,000 | 65 | 2,500 | 385 | 10.0 |
| Zynga | 10,000 | 238 | 850 | 42 | 11.8 |
| Facebook | 50,000 | 500 | 2,000 | 100 | 25.0 |
| LinkedIn | 8,500 | 100 | 250 | 85 | 34.0 |
| RenRen | 4,000 | 31 | 80 | 129 | 50.0 |
| Twitter | 8,000 | 100 | 150 | 80 | 53.3 |

Source the information in this table is from a range of sources and includes estimates and so no guarantee can be made as to its accuracy. It has been prepared for illustrative comparison and should be treated accordingly.

As can be seen in the charts below, the multiple of revenues of many of these businesses is pretty stratospheric in relation to both their current revenues and relative to established companies such as Vodafone and Google. However, if one looks at the valuation relative to the number of users, then the numbers start to make some sense. In fact the valuation of Skype starts to look cheap at \$13 a user. The trick is to turn those users into revenues and profits.



Other interesting deals that were outside the list of very largest deals, includes the purchase of **Huffington Post**, the online news aggregator for \$315m or 5 x revenues by AOL. Elsewhere, Symantec acquired e-discovery and litigation support specialist **Clearwell Systems** for \$390m or over 7 x revenues. In the same sector, Autonomy acquired the online backup and e-discovery assets of **Iron Mountain** for \$380m or 3 x sales. Also interesting to see that amongst some of the larger deals, there are a number of service based companies including several cloud based service offerings (**Savvis** and **Terremark**) and outsourcers and IT services such as **Headstrong**, **Patni** and **Tellenet**, all at attractive looking multiples

4. UK TECHNOLOGY M&A

Capita remains by far the busiest acquirer of UK technology companies. Capita bought 11 companies in 2009 and 12 in 2010 and have acquired 9 at a cost of £120m so far in 2011. Having bought the likes of SunGard Public Sector, Ramesys and McKeon last year they have continued in 2011 with the acquisition of Right Document Solutions (print management), Team 24 (healthcare recruitment), Talis (library management), Call Centre Technology (which does what it says on the tin) and Tribal's health division. The focus is on value rather than chasing prices, they consistently appear to buy profitable businesses and pay what appear sensible prices of 6-9 x EBIT.



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All the activity at Capita seems to have awoken **Serco** which is not renowned for its M&A activity; they paid £55m for telecoms services The Listening Company in March and then in May acquired Indian outsourcer Intelient at a hefty 2.2 x revenues.

System C added to the number of listed companies that have been privatised in the past few years. The company originally listed in 2005 at 54p a share has succumbed to a 70p per share offer from \$20bn McKesson. It's hardly an exciting return for IPO investors, but at least it's a positive one. McKesson paid 16 x earnings or 2.3 x revenues for the health and social care software provider

Amazon acquired **Lovefilm** for an estimated £200m, although it already owned 42% of the company following the earlier sale just three years ago of its DVD rental business. Lovefilm is pushing hard to move from a DVD rental company to an online delivery model, but is currently not fully online like Netflix is in the US. The price at 2 x revenues isn't headline grabbing and no doubt partly reflects the fact it lost money in their last accounts.

We have seen a noticeable increase in e-commerce transactions with numerous high profile dotcom/online business sales so far in 2011. They range from gambling, health, finance and baby products. Kiddicare.com was the largest deal at £70m (or 2 x sales) surprisingly bought by supermarket group Morrisons. Google paid £38m for Beatthatquote.com, a financial comparison website. Kax Media acquired gambling.com for £1.5m. The HUT Group also boosted its online retail presence with the acquisition of health site myprotein.com, ahead of its rumoured £100m IPO and fund raising later in 2011.

Two of the biggest UK technology players **Misys** (£1.4bn market cap) and **MicroFocus** (£700m) seem set to be taken over soon. Misys is in takeover discussions with Fidelity National Information Services (FNIS) who acquired Metavante last year and **MicroFocus** is in discussions with two private equity buyers (Bain and Advent).

Top UK Technology M&A Targets – 2011 so far

| Date | Purchaser | Target | Ent. Val (\$m) | EV / T/o (x) | Activity of target |
|--------|----------------|---------------------|----------------|--------------|--------------------------------------|
| Feb-11 | Axa | Opodo | 652,000 | 4.4 | Online travel |
| May-11 | Nvidia | Icera | 245,000 | 4.9 | Mobile semi-conductor chip |
| Jan-11 | Amazon | Lovefilm | 200,000 | 2.0 | Online film rental |
| Mar-11 | VerlinVest SA | ToLuna | 161,700 | 3.2 | Online market research. |
| Mar-11 | Mckesson | System C | 87,000 | 2.3 | UK healthcare software |
| Feb-11 | Morrisons | Kiddicare | 70,000 | 2.0 | Online baby products |
| Mar-11 | Serco | The Listening Co | 55,900 | 0.7 | Telecoms services |
| Apr-11 | KIT Digital | ioko 365 | 55,900 | 1.5 | IP video management software |
| Mar-11 | Lyceum Capital | Access UK | 50,000 | 1.8 | ERP business and accounting software |
| Mar-11 | Eci (MBO) | Fourth | 50,000 | 3.9 | Hospitality software |
| Jan-11 | BSkyB | The Cloud | 48,000 | | Internet access via wifi |
| Apr-11 | Capita | Right Doc Solutions | 40,000 | 3.3 | Print managed services |
| Mar-11 | Google | Beatthatquote | 37,700 | 4.7 | Price comparison website |
| Mar-11 | HTC | Saffron Media | 30,000 | 4.6 | Digital multimedia platform |
| May-11 | Capita | Team24 | 26,000 | 0.8 | Healthcare recruitment |
| Apr-11 | Emailvision | SmartFocus | 25,300 | 1.8 | Email marketing |
| May-11 | Twitter | Tweetdeck | 25,000 | | Software app for using Twitter |



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It is quite noticeable that a number of larger overseas corporates are active in UK M&A again after the market correction in 2009. In particular, major corporates such as Amazon, McKesson, HTC, SunGard, Xerox and OpenText have all been acquisitive in 2011. Other deals from overseas corporates that caught the eye include the acquisition of Tweetdeck by Twitter for £25m and Sony's acquisition of HawkEye Technologies (of tennis fame).

One investor taking full advantage of the healthy market conditions is DFJ Esprit who have sold 7 portfolio companies in the past year, with 4 of those in 2011, namely, Lovefilm, The Listening Company, Icera and The Cloud.

5. OUTLOOK

For those that remember the dotcom bubble, the current party going on in the social media space is very much a case of déjà vu all over again. While this has grabbed a lot of headlines, most of the excitement has been contained within a few transactions in the US; although the ripples have reached these shores too with Tweetdeck and others.

Of more relevance to most UK technology businesses is that the sector remains fundamentally strong with good growth, sound balance sheets and active buyers; so we would expect to continue to see healthy M&A activity going forward. Matching that demand, we are also seeing an increasing supply in the number of technology owners exploring the market for exit opportunities.

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