A QUARTERLY SUMMARY OF CORPORATE DEAL ACTIVITY IN THE TECHNOLOGY SECTOR

Q1: 2015

# TECHtalk

**THIS QUARTER:**
**AN EXCLUSIVE FEATURE ON DATA CENTRE & HOSTING SERVICES**

BDO

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# THE BDO VIEW

2015 has started with a rather mixed outlook: the UK's economy grew by 2.6% in 2014; the fastest pace since 2007 and up from 1.7% in 2013. Recent reports by the Centre for Economic and Business Research suggest that the UK is set to become the world's second most important economy, after the United States, within the next 15 years and unemployment now stands at 1.91 million – the lowest level for more than six years. With fuel prices pushing down inflation and earnings growth above inflation for the second month in a row, one could be led to believe the economy is booming. However, significant concerns still remain: construction is shrinking and manufacturing, which had been one of the best performing sectors since the recession, is close to flatlining. With Europe still remaining the UK's major trade partner, exporters are still facing significant headwinds from the turbulent economy of our European counterparts.

Despite the mixed picture, the technology sector continues to boom. A report by CB Insights for London & Partners in December 2014 showed that venture capital investment into London tech start-ups hit a record high in 2014 with investors putting £900m in tech start-ups – twice as much as 2013 and 20 times higher than in 2010. With Apple posting the highest ever quarterly profits in history in January, the outperformance of the sector is clearly impacting the top end of the sector as well.

This quarter's TECH*talk* report focuses on the data centre and hosting market. After suffering a relatively poor 2013, the industry has recovered in 2014 with the majority of share prices up on a three month view, and performance in the past month alone has seen an average rise of 11%, outpacing both the NASDAQ and FTSE indices. Furthermore, most public companies are also seeing double digit growth with EBITDA growing faster than revenues due to operational leverage. The London data centre market continues to thrive, with London hosting 31% of Europe's data centres – more than any other European city. IT budgets continue to be cut driving companies to outsource information storage and this, coupled with increasing confidence in the security of hosting information externally, means the prospects continue to look strong for data centres.

Interestingly, it is the managed services market which has underperformed over the course of the year: both Rackspace and Iomart have seen massive share price declines this year, whereas data centre focussed players have performed much better. This is also evident in the valuations of the relative groups: data centre companies have valuations between 8x and 16x, whereas managed hosting companies – which includes Rackspace and Iomart – are significantly lower at 8-9x.

Managed services performance has been hit by the bad performance of the subsector majors, Rackspace and Iomart and does not necessarily reflect the broader view of the industry. Both Rackspace and Iomart have been involved in failed M&A transactions this year which has had significant impact on shareprice, and Rackspace has also been hit by the negative impact of investment in the public cloud.

Whatever negativity surrounds the performance of Rackspace and Iomart, the M&A environment for the sector is buoyant, with both trade and private equity offering higher multiples than average. Host Europe changed private equity owners for around 11.5-12x current year EBITDA, and Oakhill's acquisition of Pulsant and LDC's acquisition of Node4 are both believed to be in the double-digit EBITDA multiples. In fact, private equity broke recent records in Q4, with seven deals completed by companies valued at an aggregate £3.2bn – the highest since 2009. Trade are also happy to pay high premiums for the right assets, with Alternative Networks paying £39.4m – or 18x run rate EBITDA – for the managed hosting company, Control Circle.

The largest deal of the year, Host Europe's acquisition of CDW Corp's investment in Kelway, achieved a valuation of just over 10x run rate EBITDA.

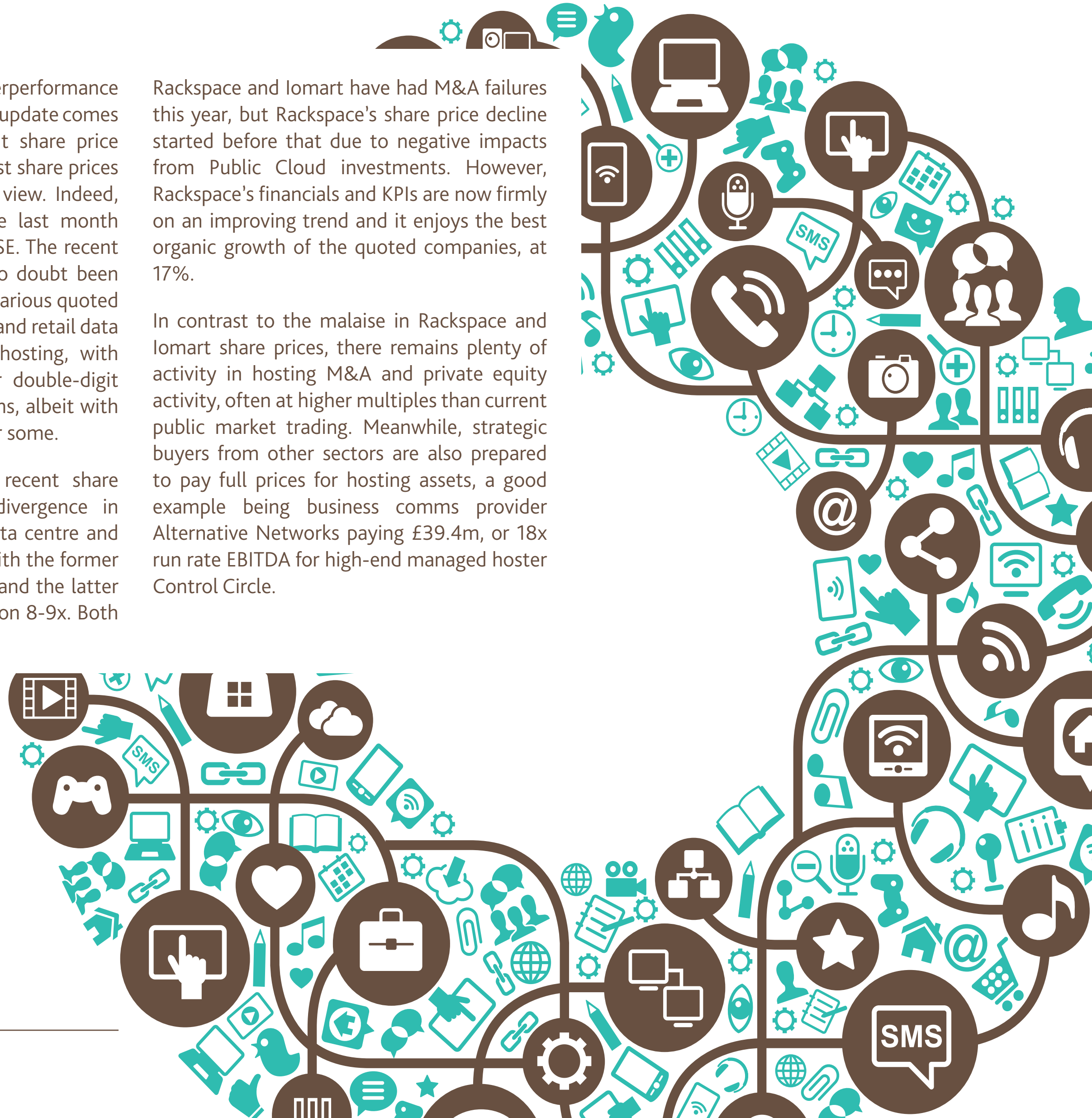
And whilst Iomart's shareprice may have been suffering, it has enjoyed the strongest headline revenue growth: it has grown 29% over the past 12 months and, whilst half of this has come from acquisitions, organic growth is still around 15%. The carrier neutral colocation providers, Interxion and Telecity, are growing at around 9% with Telecity peer Equinix seeing even stronger growth at 13%. Interestingly, Rackspace has trumped them all, with organic growth of 17% in the past 12 months.

The positivity has carried across into smaller companies, with data centre companies again exhibiting the strongest growth. Infinity posted a massive 363% growth over the course of the year thanks to the acquisition of two new high-revenue generating customers, whilst Next Generation Data's increase of 33% is still significant. M&A has helped to drive some growth, with Adapt Group growing at 62% after acquiring Sleek and eLINIA and Claranet benefitting from the acquisitions of Star and Typhon. Mass hosting companies, exposed to more mature market conditions, have seen sluggish growth this year, whilst even well-known names have also seen growth below that of their peers: Telehouse, for example, only saw 5% growth this year.

Data centre and hosting companies have clearly had a good year in 2014, boasting impressive organic growth boosted by intelligent, strategic acquisitions. The continually innovative nature of data centre and hosting companies' service portfolios together with a keen eye for the right acquisitions – albeit expensive – sets a strong foundation for continued growth into 2015.

**JULIAN FROST**
Head of Technology
at BDO

# SECTOR FOCUS: DATA CENTRE AND HOSTING SERVICES




In contrast to the significant underperformance through 2013, this latest annual update comes against the backdrop of recent share price strength for the group, with most share prices up on a one and three-month view. Indeed, the average 11% rise over the last month has outpaced NASDAQ and FTSE. The recent share price performance has no doubt been aided by solid results from the various quoted players ranging from wholesale and retail data centres through to managed hosting, with most enjoying double or near double-digit organic growth and solid margins, albeit with a continued heavy capex diet for some.

The most notable aspect of recent share price moves has been the divergence in public market valuations for data centre and managed hosting companies, with the former on 11-16x current year EBITDA and the latter (mainly Rackspace and Iomart) on 8-9x. Both Rackspace and Iomart have had M&A failures this year, but Rackspace's share price decline started before that due to negative impacts from Public Cloud investments. However, Rackspace's financials and KPIs are now firmly on an improving trend and it enjoys the best organic growth of the quoted companies, at 17%.

In contrast to the malaise in Rackspace and Iomart share prices, there remains plenty of activity in hosting M&A and private equity activity, often at higher multiples than current public market trading. Meanwhile, strategic buyers from other sectors are also prepared to pay full prices for hosting assets, a good example being business comms provider Alternative Networks paying £39.4m, or 18x run rate EBITDA for high-end managed hoster Control Circle.

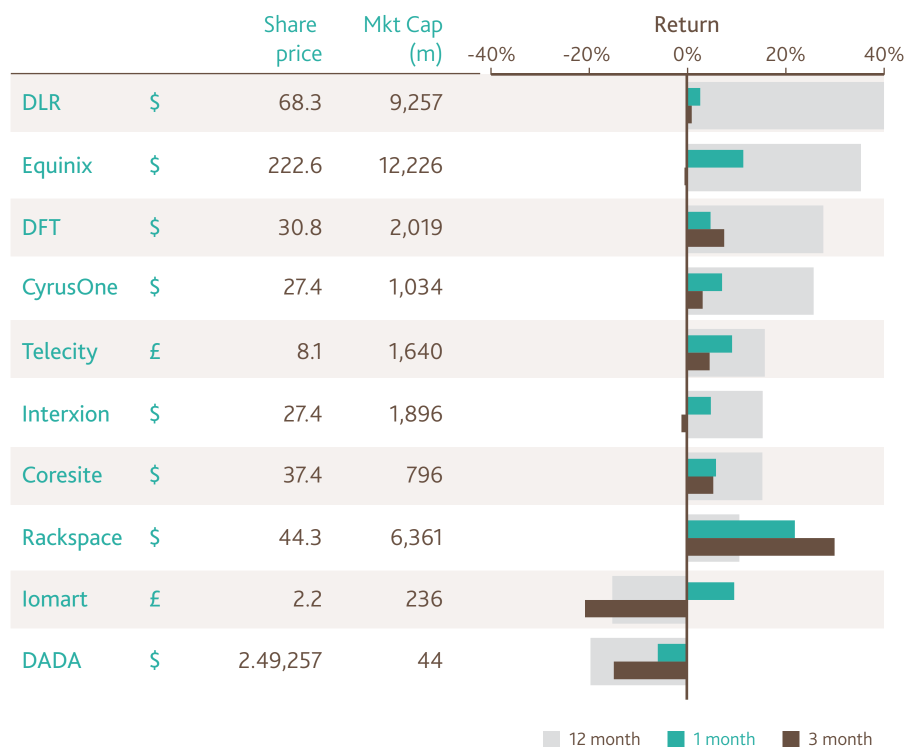
# SHARE PRICES LACKING DIRECTION

## SHARE PRICES LACKING DIRECTION

After a sustained share price outperformance, publicly listed DCH companies significantly underperformed through 2013, after the index peaked in January. Delving into the detail of the ongoing and expected financial performance of the ten or so tracked US and UK-listed companies spanning wholesale and retail data centres and managed hosting, we came to the conclusion that the share price weakness was not reflective of the broader market opportunity or dynamics, which are positive and if anything had improved over the last year given economic recovery and increasing momentum behind the Cloud.

Roll on one year, and the sector has had a mixed share price performance, with an average one-year increase of 36% outperforming the FTSE, NASDAQ and Megabuyte Taylor Wessing All-Share by 36%, 17% and 25% respectively. However, the most noticeable trend has been the marked decline in the share prices of the two managed hosting players – Rackspace and Iomart – versus a much better relative performance for the more data centre-focussed players.

**FIGURE 1:** Data Centre & Hosting Services share price performance



| | | Share price | Mkt Cap (m) |
|---|---|---|---|
| DLR | $ | 68.3 | 9,257 |
| Equinix | $ | 222.6 | 12,226 |
| DFT | $ | 30.8 | 2,019 |
| CyrusOne | $ | 27.4 | 1,034 |
| Telecity | £ | 8.1 | 1,640 |
| Interxion | $ | 27.4 | 1,896 |
| Coresite | $ | 37.4 | 796 |
| Rackspace | $ | 44.3 | 6,361 |
| Iomart | £ | 2.2 | 236 |
| DADA | $ | 2.49,257 | 44 |



**Source:** Megabuyte, Capital IQ

# SHARE PRICES LACKING DIRECTION

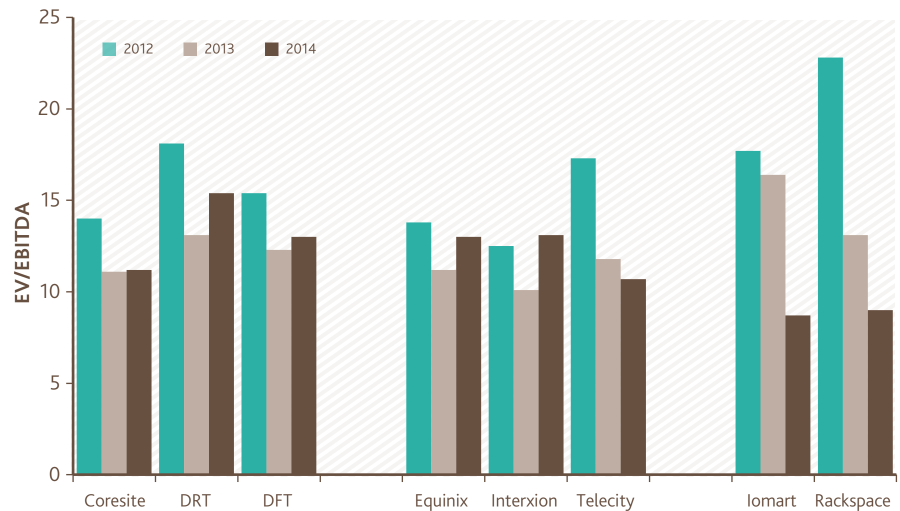
This has also been reflected in valuations (a clue that underlying trading hasn't changed much), with the wholesale data centre players (DRT, DFT and Coresite) and retail data centre players (Telecity, Equinix and Interxion) experiencing a mid-teens decline in current year EBITDA multiple over the last two years versus a near two-thirds decline for managed hosting (Iomart and Rackspace). The latter two, particularly Rackspace, have gone from being the highest to the lowest-valued companies of the peer group over that time.

It does not help that both companies have been involved in failed M&A transactions in recent months:

- Rackspace launched a strategic review in May 2014 in response to various 'inbound strategic proposals' but, despite being linked with companies such as IBM, HP and CenturyTel, the company abandoned the process four months later in September.
- Iomart announced an informal approach from Cinven-backed Host Europe in late July at 285p per share, valuing Iomart at 11x current year EBITDA. Host Europe subsequently raised its indicative offer to 300p, or 11.6x EBITDA, with the support of senior Iomart management but walked away in mid-September, coincidentally about the same time that Rackspace called off its M&A search.

However, the fact that Rackspace's share price had already declined before it launched its strategic review shows that its decline is not just about M&A failure. Iomart's share price weakness has also coincided with a share price underperformance at Telecity, the only other UK-listed data centre and hosting company of size, reflecting the latter's management and market issues. Despite being very different businesses, Iomart and Telecity valuations more often than not track each other.

**FIGURE 2:** Data Centre & Hosting Services valuations




**Source:** Megabuyte, Capital IQ

# PRIVATE INVESTORS AND STRATEGIC BUYERS TAKE A DIFFERENT VIEW

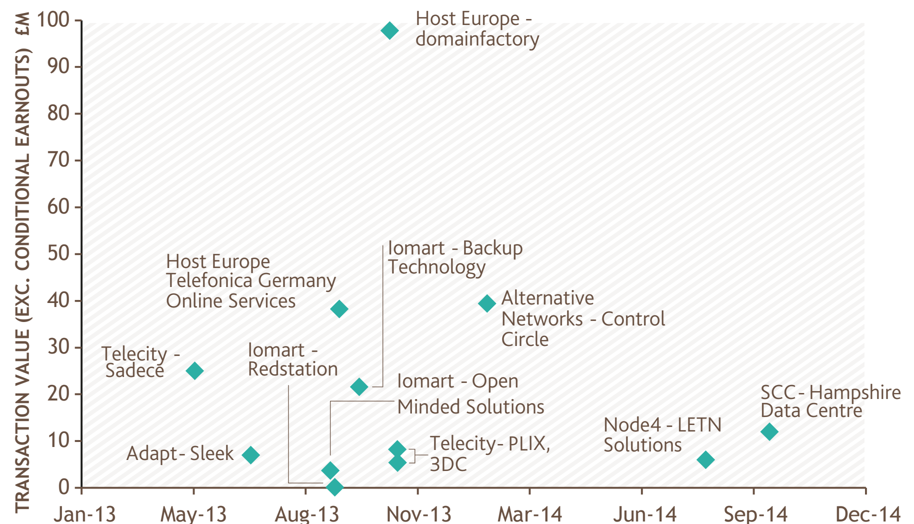
In contrast to the malaise in Rackspace and Iomart share prices, there remains plenty of activity in hosting M&A and private equity activity, often at higher multiples than current public market trading. Indeed, Host Europe's indicative offer for Iomart at 300p represented 11.6x EBITDA for the year to March 2015, and we suspect that the talks broke down more to the refusal of the Iomart Board to accept a bid at that level than to Host Europe deciding not to bid over concerns on trading or other matters.

Host Europe itself had changed private equity owners in August 2013 for about 11.5-12x current year EBITDA, with Cinven buying out Montagu. Host Europe has subsequently made several acquisitions, including DomainFactory and Telefonica Online Services in Germany which substantially boosted its German presence, and Iomart would have had a similar impact on its UK business. We consider multi-country hosting providers such as Host Europe later in this report.

Other significant private equity deals in the space include Oakhill's acquisition of Pulsant in June 2014 and LDC's acquisition of Node4 in May 2013, both believed to be in low double-digit EBITDA multiples. Both companies have a mix of activities including managed hosting and data centre colocation, enabling solid double-digit organic growth and EBITDA margins of 36% and 23% respectively. Just after buying Pulsant, Oakhill exited a similar US-based business – ViaWest - for 13x EBITDA.

Strategic buyers from other sectors are also prepared to pay full prices for hosting assets, a good example being business comms provider Alternative Networks paying £39.4m, or 18x run rate EBITDA for high-end managed hoster Control Circle.

**FIGURE 3:** Data Centre & Hosting M&A

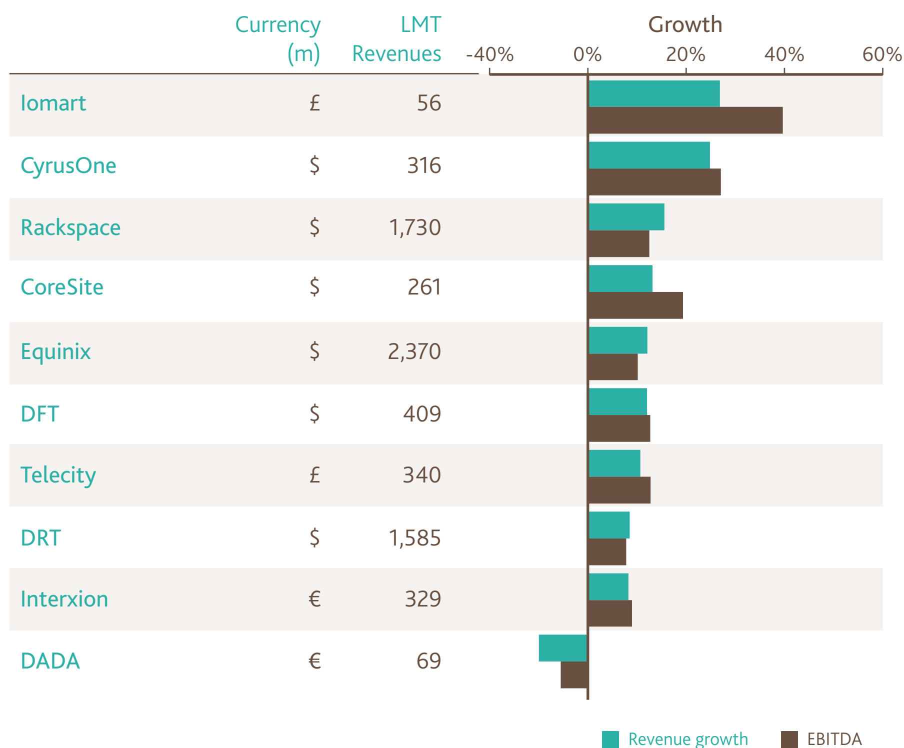



**Source:** Megabuyte, Company accounts

# FINANCIAL DYNAMICS

This section reviews individual company performance, splitting the companies into public-listed and private companies. The public-listed group includes three European companies – Telecity, Iomart and Dada Group – with the remainder being US listed. Of the public companies, the proportion of revenues derived from the UK and Ireland ranges from 100% for Iomart to 49% for Telecity, 25% for Rackspace and 15% for Interxion, and nothing for CyrusOne, CoreSite and DFT. Most of the private companies generate all, or most of their revenues in the UK; the exceptions are Claranet (UK, Germany, France, Spain, Netherlands and Portugal), Host Europe (UK and Germany); Telehouse (UK, Germany and France), UK2 (US and UK), and we also include two companies with no UK revenues (Basefarm and OCOM).

**FIGURE 4:** Public company growth rates

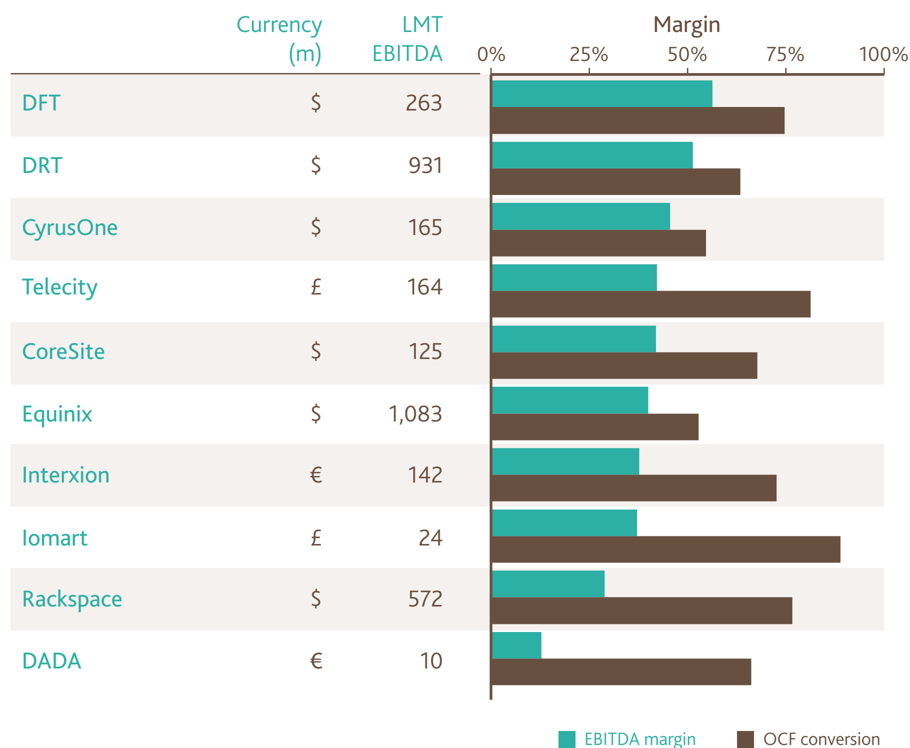



**Source:** Megabuyte, Company accounts

## PUBLIC COMPANIES

Most of the public companies are achieving double-digit growth (as measured for the last 12 reported months), with EBITDA generally growing faster than revenues due to operational leverage; the one exception is Italian-listed hosting group Dada, where revenues are falling at 11% due primarily to its Performance Advertising business, though the core hosting business also fell 2%. Iomart is enjoying the strongest headline growth, of 29% over the last 12 months, though half of this comes from acquisitions, and its organic growth is more of the order of a still impressive 15%. Wholesale data centre provider DTT and European carrier neutral colocation providers Interxion and Telecity are growing at about 9% organically, with the latter's peer Equinix at 13%. Despite its share price travails, Rackspace still enjoys the highest organic growth rate of the group, at 17% over the last 12 months.

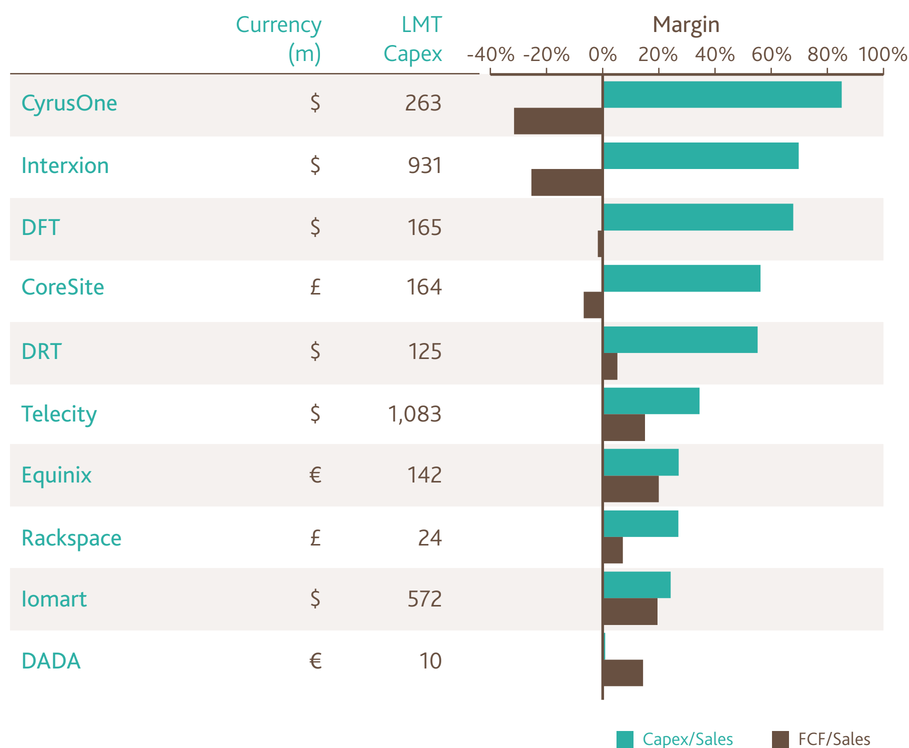
**FIGURE 5:** Public company margins and cash conversion




**NB:** Net OCF conversion used for US-based peers
**Source:** Megabuyte, Company accounts

# FINANCIAL DYNAMICS

**FIGURE 6:** Capex and FCF (EBITDA-Capex) Margins




**Source:** Megabuyte, Company accounts

### EBITDA

There is a clear differentiation in margins by type of business. The mainly or wholly wholesale-focussed data centre operators such as DFT, DRT and CyrusOne are generating 50-65% EBITDA margins, followed by the retail colocation-focussed operators such as Telecity, Interxion and Equinix, on 43-58%, whilst the managed hosting providers are on somewhat of a wide range: from Dada's 15% to Iomart's 42%, with Rackspace on 33%. Rackspace's margins have declined slightly from the 36% of 2012 due to investments in Public Cloud services.

### CAPEX

Whilst margins and operating cash flow are strong, high capex levels are a feature as companies invest in capacity and growth. The US wholesale data centre providers (Coresite, CyrusOne, DFT, DRT) are investing 55-85% of annual revenues in buying and equipping new properties.

Meanwhile, there have been contrasting trends among the carrier-rich retail data centre providers; Telecity and Equinix capex has been falling as a percentage of sales to about 34% and 26% respectively, whilst Interxion has been increasing its capex guidance to nearly 70% of sales, with recent increases in data centre capacity in Amsterdam and Frankfurt reflecting strong demand in those particular

markets. As a Dutch company, Interxion probably generates a higher proportion of its business in Amsterdam than Telecity and Equinix, though this would not explain all the difference in capex levels.

The less capital-intensive hosting-focussed providers are investing as low as 1% of revenues (Dada) and up to 26% for Rackspace, though the success-based nature of hosting capex (servers etc.) means that a faster-growing company (such as Rackspace) would be expected to be investing more than one in decline (Dada). Overall, the FCF profile of public-quoted players has changed significantly over the last year due to declining capex at Telecity and Equinix, resulting in relatively strong FCF (EBITDA-capex), with Interxion a clear exception.

## PRIVATE COMPANIES

There is, not surprisingly, a greater variation in financial performance for private companies than for the public companies, reflecting their different stages of development, generally smaller size and the greater flexibility afforded by being a private company to sacrifice profitability for growth. Perhaps the most noticeable difference is that many of the companies have single-digit growth, in contrast to the high-single/low-double digits of the public companies.

The two companies with the fastest growth are data centre companies, with Infinity's 363% growth reflecting the provision of data centre space to two large customers off a low base, whilst Gyron's doubling of revenues is due primarily to its majority shareholder NTT Coms shifting its colo demand to Gyron from Telecity. Another pure-play data centre company with strong growth is Next Generation Data (+33%), again off a relatively small base.

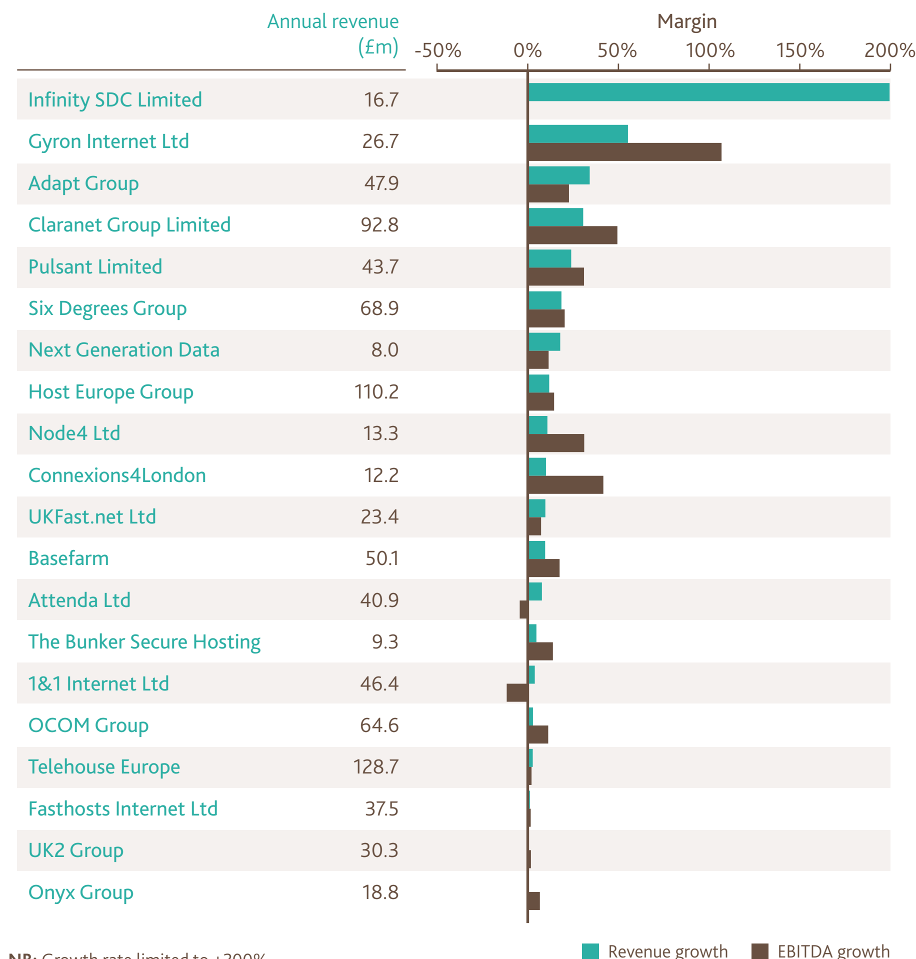
The growth rates of the next few companies largely reflect M&A; with Adapt Group (+62%) buying Sleek and eLINIA; Claranet (+56%) benefitting from the acquisitions of Star and Typhon; Pulsant (+44%) from a full year of ScoLocate; Six Degrees (+34%) from almost a full year of BIS; and Host Europe (+22%) from two German acquisitions in the Autumn of 2013. With these and subsequent acquisitions, Claranet and Host Europe particularly are now much bigger than these 2013 financial results, at about €165m and £150m respectively. Without M&A, Pulsant and Host Europe are growing in the teens due to their significant exposure to managed hosting, whilst the larger connectivity revenue element of Six Degrees, Adapt and Claranet suggests single-digit organic growth.

The teens growth rates for Node4, Connections4London, UKFast, BaseFarm and Attenda are all mainly organic, with most benefitting from managed hosting demand alongside colocation. The laggards, with no or single-digit growth, include companies exposed to more mature mass hosting markets (1&1 Internet, Fasthosts and UK2 Group), a perennially underperforming colocation player The Bunker, and a peer of Telecity, Interxion and Equinix - Telehouse – with a surprisingly low 5% growth. Onyx is the only company to see a decline in revenues, which it attributes to pulling back from some low-margin legacy contracts; its EBITDA performance was much better, at +12%.

With a few exceptions, EBITDA growth has outpaced revenue growth, highlighting economies of scale inherent in data centre and hosting businesses. The most notable exceptions are Attenda and 1&1, where EBITDA declined due to investments in new data centre colocation activities and to new product marketing respectively.

# FINANCIAL DYNAMICS

**FIGURE 7:** Private company growth rates




**NB:** Growth rate limited to +200%
**Source:** Megabuyte, Company accounts

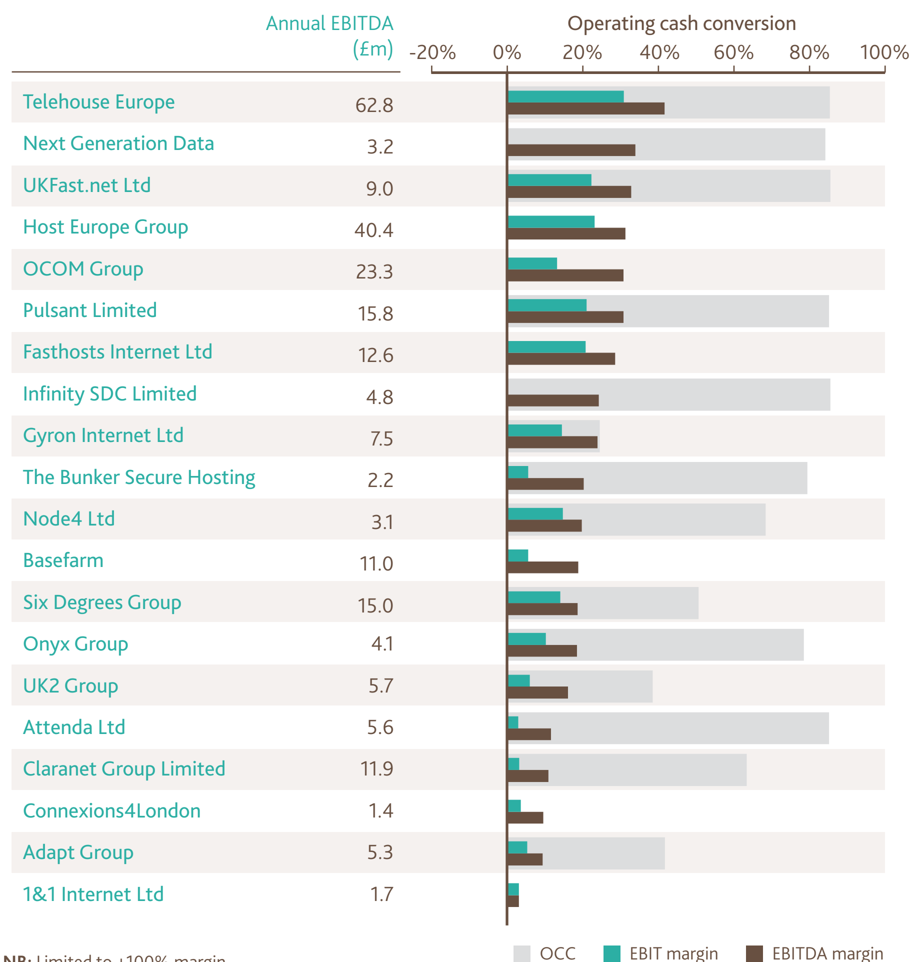
## EBITDA

Private company EBITDA margins are generally lower than for public companies, due to their smaller size. The benefit of scale is demonstrated by the better margins of the two largest companies – Telehouse Europe (49%) and Host Europe (35%). Telehouse's margin also reflects its retail data centre model, and is in line with Telecity, Interxion and Equinix. Likewise, Host Europe's high margin also reflects its shared hosting model, with peer Fasthosts having the fourth best EBITDA margin, at 33%. Shared hosting peer 1&1 Internet's lowly EBITDA margin reflects heavy TV advertising. Next Generation Data's 40% margin is reflective of its data centre model.

Several other companies generate 30-40% margins, reflecting a mix of higher-margin colocation and lower-margin hosting, for example UKFast, OCOM and Pulsant. In some cases, EBITDA margins reflect a company's approach to data centres and particularly whether they prefer to own or lease space; for example, Adapt's EBITDA margin is depressed by the cost of leasing data centre space, though its capex will also be lower.

Most of the remaining private companies have EBITDA margins of 20% to 30% – it is worth noting though that margins tend to be less stable for smaller private companies, compared with their larger public peers, both on account of their smaller size and due to one-off investments in growth. Irrespective of margins, most DCH companies achieve high conversion of EBITDA to operating cash flow, reflecting the working capital-friendly nature of data centre and hosting services, with high recurring revenues and services often paid for in advance.

**FIGURE 8:** Private company margins and cash conversion




**NB:** Limited to +100% margin.
**Source:** Megabuyte, Company accounts

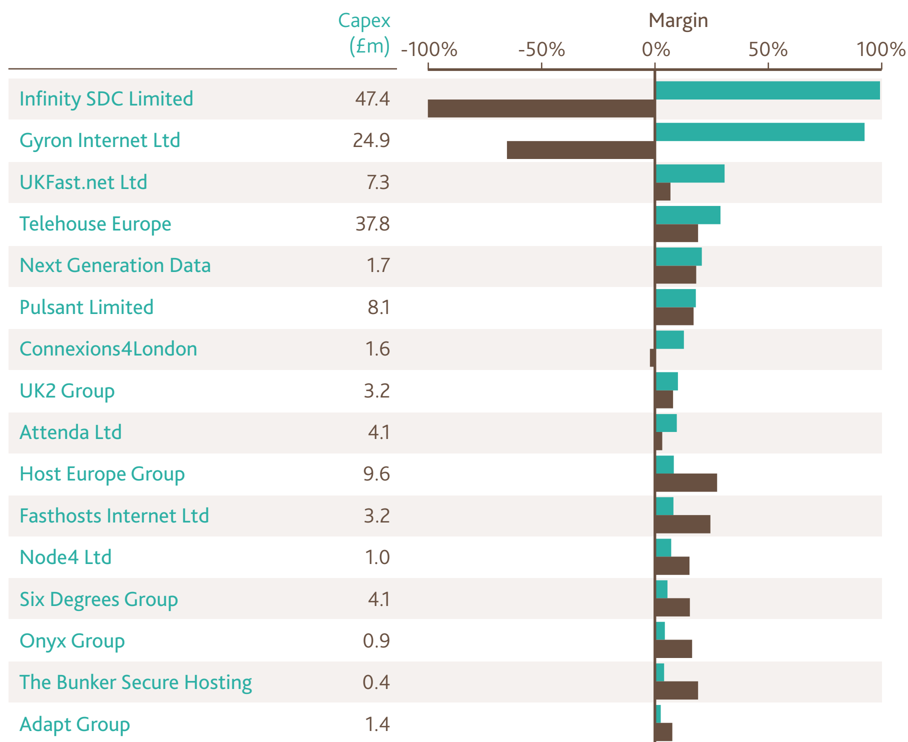
# FINANCIAL DYNAMICS

## CAPEX

Not surprisingly, data centre-focussed companies are investing the highest proportions of revenues, in particular the early-stage wholesale data centre companies such as Infinity and Next Generation Data (and Ark and Virtus if full accounts were available for them). Gyron is also investing heavily, with backing from 85% shareholder NTT Comms. Similar Japanese telco-backed Telehouse (KDDI) has also been investing heavily, although its 29% capex-to-sales ratio in 2013 is considerably lower than in previous years. UKFast's high capex reflects investment in a new HQ and data centre.

The companies with the lowest capex are those with a hosting focus (Fasthosts, UK2 and Host Europe), or companies such as Adapt that lease rather than build data centre facilities.

**FIGURE 9:** UK private company capex and FCF % of revenues




**NB:** Limited to +/-100% margin
**Source:** Megabuyte, Company accounts

In contrast to the public companies, most of the private companies are financing capex out of EBITDA, partly reflecting a mixture of less access to capital and generally more conservative owner-managers. However, this also applies to the private equity-backed businesses on the list. The net result is that many of the private companies are generating solid FCF margins – of 20% plus in the case of the established shared hosters Fasthosts and Host Europe – whilst still achieving solid revenue growth rates. The main exceptions, with negative FCF, are Infinity and Gyron, which are both undertaking major data centre builds with backing from institutional investors and NTT Coms respectively.

# CORPORATE DEALS REVIEW

The fourth quarter marked a standout period for private equity activity, with the seven deals registered under our coverage collectively valued at £3.2bn. Significantly, public-to-private transactions featured in the period, with deals for Allocate Software (agreed with HgCapital), Daisy (the Riley/ Penta/Toscafund consortium) and Advanced Computer Software (Vista Equity Partners). While the current bubble-esque debt markets helped fund the PE frenzy, the capital markets were in a quieter mood leading up to the New Year, albeit that Gamma got its IPO away at a market capitalisation of £165m and Ideagen raised £17.5m to part fund its £18m acquisition of Gael.

The volume of M&A activity improved modestly to 39 deals, helped by a busy December. Having failed to land Iomart, Host Europe bought German hosting firm Intergenia from Oakley for €210m, Kelway sold a 35% stake to CDW Corp while, in software activity, Incadea received a knock-out £122m bid from Dealertrack. As we enter the New Year, there could be significant M&A to come, with BT entering into a period of exclusivity for the purchase of EE, at a £12.5bn, 7.9x run rate EBITDA pre-synergy valuation, which may trigger other UK consumer telecoms-focussed M&A.

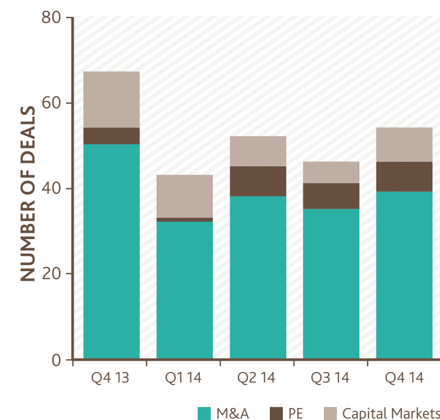
## INSTITUTIONAL INVESTORS LACK APPETITE

What a difference a year makes. At the turn of 2013, the capital markets were awash with cash, with 13 deals under our coverage raising close to £400m, including the IPOs of Kalibrate Technologies and Servelec. Fast forward twelve months and, while Gamma's IPO marked a success for the AIM market, overall capital markets fundraising activity in the tech sector was muted. While the eight institutional placings in the quarter marked a slight improvement in volume, the amount raised, at just under £41m collectively, remains low. With global stock markets still being hit by recent oil price shocks, it could take time before more significant investor appetite returns.

## DECEMBER'S M&A SPREE

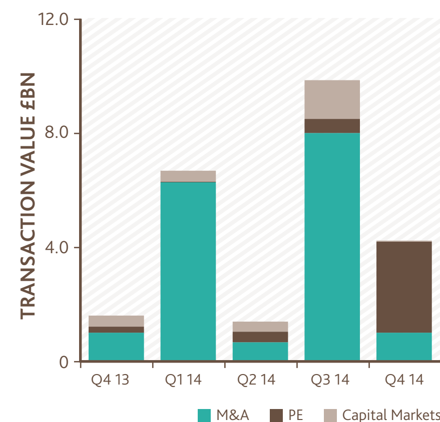
Following a steady year for M&A activity, December saw the usual rush of deals being pushed over the line, with the 18 M&A transactions completed representing the highest monthly volume of deals in a year, and accounting for just under half of the deals in the quarter, following a lull of activity in November. The 39 deals in the quarter also represented the most for a year – though was still well below the 50 recorded in the final three months of 2013.

**FIG 10:** Corporate Activity Deal Tracker




**Source:** Megabuyte, Company announcements

**FIG 11:** Corporate Activity Value Tracker




**Source:** Megabuyte, Company announcements

# BUOYANT DEBT MARKETS LEAD TO SURGE IN PE ACTIVITY

Private equity activity broke recent records in the fourth quarter, with the seven deals completed by companies under our coverage valued at an aggregate £3.2bn; the highest level since at least the end of 2009, reflecting both the buoyant debt markets but also on-going stock market frailties. Through the 2012 and 2013 stock market rally, public-to-private (P2P) transactions came to an abrupt halt. However, with the EV/EBITDA multiple attached to the MBTW All-Share – an index of around 100 UK-headquartered software and ICT Services companies – reaching lows of 9.7x in October, take-private activity reawakened in the fourth quarter.

In total there were three P2P transactions, with Allocate Software, Daisy and Advanced Computer Software agreeing offers from HgCapital, the Riley/Penta/Toscafund consortium and Vista Equity Partners respectively. These deals were valued at a total of £1.5bn, with Vista's ACS buyout, which was struck at an enterprise value of £761m (15x current year EV/EBITDA), the largest take-private under our coverage since Vista took Misys off the public markets in June 2012 for £1.3bn.

Fresh from its acquisition of insurance software vendor Sequel Business Solutions in July, HgCapital's bid for workforce management solutions provider Allocate valued the equity at £110m, equivalent to a current year EV/EBITDA multiple of 13x. As with the ACS deal, the transaction underscores the recent trend of private equity software transactions being valued at low-mid teens EV/EBITDA multiples for high-quality assets.

The ACS deal also means that yet another leading European enterprise software vendor will move into private hands, with the rationale of facilitating the SaaS transition. Indeed, of the top players, only Sage and SAP remain in public hands, following a spate of deals as Unit4 was taken private by Advent International, while Exact was acquired by Apax, and Cinven joined the shareholder list at Visma.

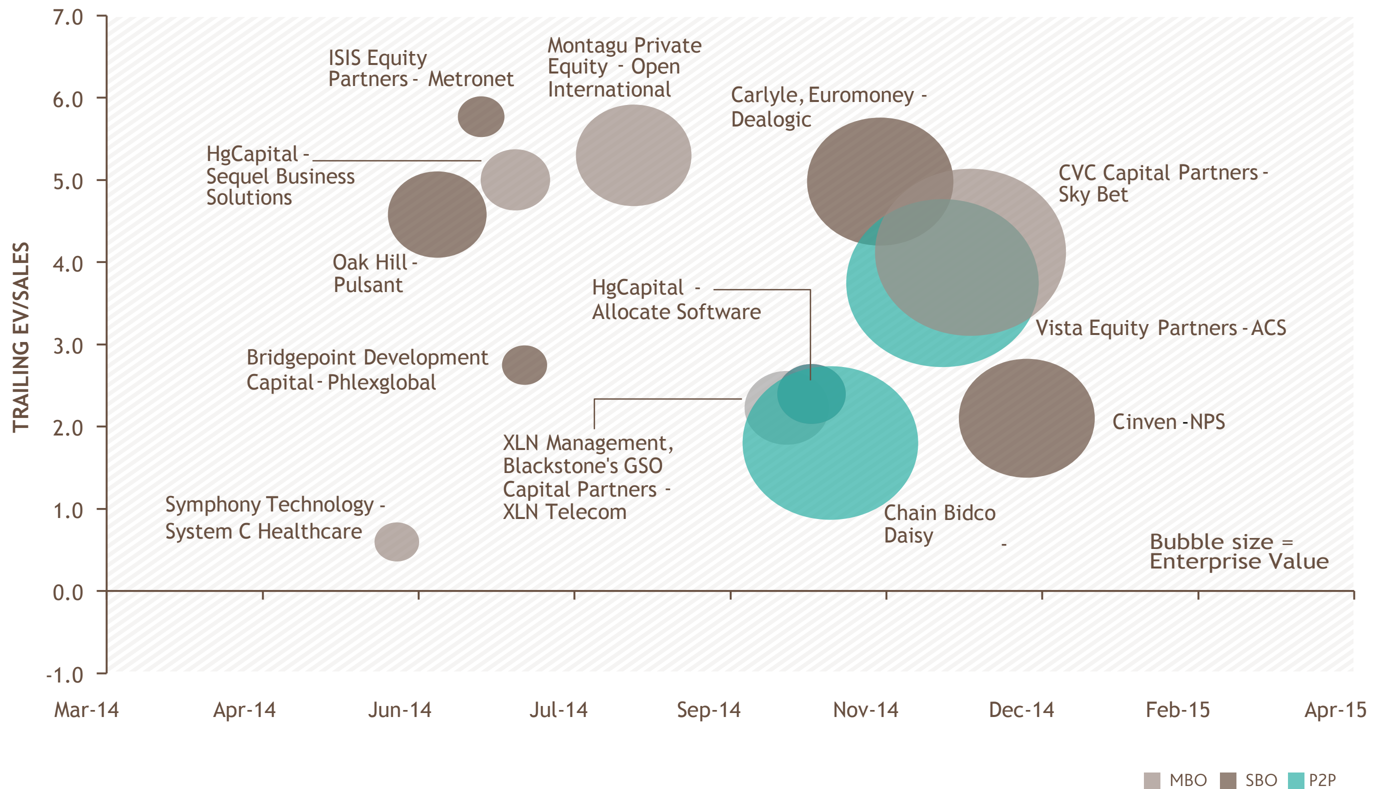
Cinven was also busy in the UK enterprise software market, buying Northgate's Public Services unit from KKR. While no deal value was announced, we estimate a deal value of around £380m, or 9x trailing EV/EBITDA, given NPS's £42m trailing EBITDA. This deal would seem to represent something of a coup for Cinven, given that, as mentioned, similar enterprise software businesses are changing hands for 13-15x EBITDA.

Carlyle, Euromoney and private investors funded the estimated $700m buyout of Dealogic, little more than three years after it was taken off AIM for just under $250m. Dealogic, which provides software and data solutions to the investment banking market, de-listed from AIM in 2011 as it believed its trading performance had not been reflected in the share price. Although the lack of free float (around 10%) was certainly a major factor in the poor valuation, this does seem like another case of a quality business that has been undervalued by the stock market, only to be properly valued by the private equity community.

Meanwhile, B2B comms provider Daisy recommended the 11x trailing EV/EBITDA, £635m deal from CEO Matt Riley and private equity investors Toscafund and Penta. The stated rationale for the take-private is for Daisy to undertake larger acquisitions than in the past, involving more risk and time for proper integration etc. Phoenix IT, in which Toscafund owns a 29% stake, is one possible target. Such a deal would provide Daisy with a much stronger presence in mid-market IT and comms services, albeit with a major integration challenge.

# BUOYANT DEBT MARKETS LEAD TO SURGE IN PE ACTIVITY

**FIGURE 12:** Private equity transactions




**Source:** Megabuyte, Company Announcements, Company Accounts

There are a host of other potential candidates for Daisy. Larger deals could include Redcentric, Azzurri or Six Degrees, though the latter deal seems much less likely. There will also be a number of private equity exits to come from IT/hosting businesses over the next couple of years, including Adapt Group, Onyx and Intrinsic, though these would be smaller deals in EBITDA terms.

Keeping in the telecoms space, there was a change in owners for provider of telecoms services to small businesses XLN, where Blackstone's GSO Capital Partners backed a secondary buyout from ECI for a reported £140-150m, or about 8x trailing EBITDA. The deal is likely to predicate more M&A, and with Vitruvian in its third year of ownership of Universal Utilities, XLN could be getting ready to pounce on UU; such a deal would double XLN's size and increase EBITDA by around 1.5x.

Most, if not all, of Blackstone GSO's funding is in the form of debt, meaning that XLN will be reasonably fully leveraged. Indeed, in the current low interest rate environment, debt financing has become easier to source, as we have seen in a number of the buyouts this quarter. Whilst there are general concerns about the long-term sustainability of significantly leveraged balance sheets should the trading environment take a turn for the worse, XLN's high recurring revenues, profitability and FCF is more conducive to debt finance than some businesses with low recurring revenues.

In the case of ACS, Vista put in place a £320m term facility and total leverage of £434m, equivalent to rather eye-watering 6.3x and 8.5x current year EBITDA multiples respectively. While Vista will look to bring down the debt multiple by substantially increasing ACS's margins as it puts its software playbook into action, the leveraged buyout model has been subject to more scrutiny in the IT reseller community. This follows well-documented issues at Dunedin-backed Trustmarque, Trinity (both of which were acquired by Liberata) and of course 2e2, with excess leverage being a common underlying factor in their respective downfalls.

As such, the sale of Core Capital's long-held minority stake in infrastructure services provider Kelway attracted scrutiny. In this case, strategic buyers prevailed over private equity, with US infrastructure services giant CDW Corp taking a 35% stake, with the deal valuation approaching £250m. Post the deal, Kelway will be left with a leveraged balance sheet. However, given the presence of a company of CDW's stature as a key shareholder, the leverage was less of an issue than it would be in a traditional PE buyout, particularly given that CDW has an option to purchase the remaining 65% of the company between mid-2015 and mid-2017 – which it intends to take up as long as Kelway performs as expected.

Finally, in another sizable PE deal this quarter, CVC Capital Partners purchased an 80% stake in Sky Bet from Sky (formerly BSkyB), for £600m in cash upon completion with a further deferred and contingent consideration up to £120m. The funds help Sky finance its recent European splurge – in which it acquired Sky Italia and a majority stake in Sky Deutschland for up to £7bn – and potential UK convergence investments.

# A FLURRY OF STRATEGIC M&A

The final quarter of 2014 was the busiest of the year, with the 39 deals in the period modestly above the average 35 deals in the prior three quarters. This was helped by a flurry of deals in December, 18 in total, which also represented the highest monthly volume for a year. However, with a total of 144 deals under our coverage in 2014, the year's M&A activity was down on the prior year's 168.

There was a broad spread of deals across the ICT Services and Software sectors in the fourth quarter, with the majority of deals completed for sub £20m in deal value. The largest deal, excluding CDW Corp's investment in Kelway, was completed by Host Europe, through its acquisition of Intergenia from Oakley for €210m (£165m), at a valuation of just over 10x run rate EBITDA. Having failed to land Iomart in the summer, the Intergenia deal takes Host to almost £200m revenues, nearly double the size when Cinven acquired the business in Summer 2014.

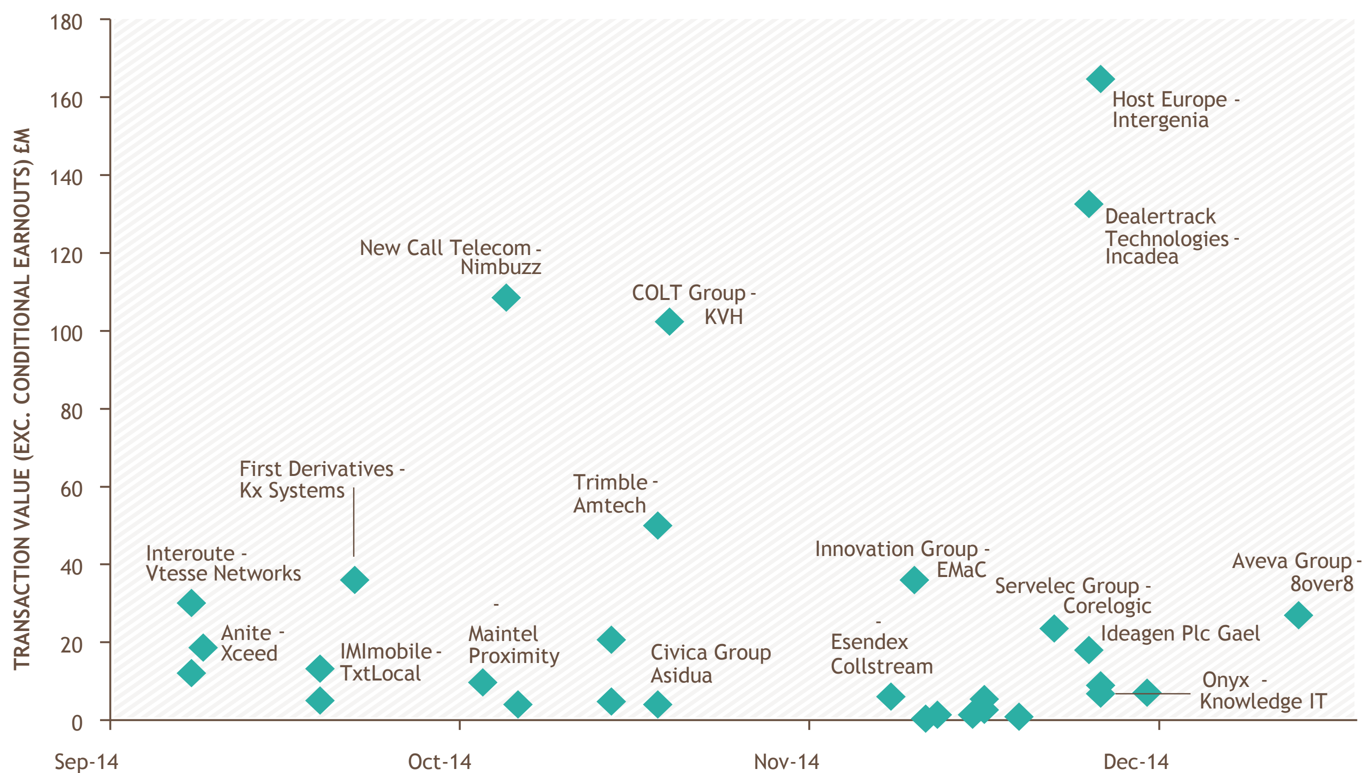
In a busy period for data centre and hosting M&A, there were also deals for Iomart, Onyx and SCC. Having disappointed investors with first half results, Iomart revealed the bolt-on acquisition of London-based Cloud hosting provider ServerSpace for up to £4.25m. Living Bridge-backed Onyx completed the acquisition of fellow North East business Knowledge IT for £6.7m, increasing Onyx's revenues by around 50% while, at the start of the quarter, SCC substantially boosted its UK data centre estate with the £12m acquisition of SSE Enterprise Telecoms' Fareham data centre.

From a pan-European perspective, UK-headquartered supplier of software to the public sector and other verticals **Idox** completed its first acquisition for 18 months in the form of German compliance software player Digital Spirit. Datatec's ICT Services subsidiary **Logicalis** completed the significant strategic acquisition of Inforsacom, to build a critical mass in the German region, whilst, in the opposite direction, privately owned pan-European network operator **Interoute** acquired Vtesse, substantially boosting its UK network and data centre presence, and adding about 5% to revenues.

The Asia Pacific market also attracted corporate interest in the period, with **COLT** spending €130m on sister company KVH, or 5.7x 'underlying' EBITDA, adding an APAC presence and about 9% to 2014 revenues. In addition, low-cost broadband provider **New Call Telecom** spent a rumoured $175m for a 70% stake in emerging markets-focused messaging provider Nimbuzz, following up this deal up with the purchase of UK-based wholesale voice carrier Wavecrest for a deal value we would estimate to be in the high-single-digit $ millions (someway off the $240m rumoured in the press!).

Rounding off activity in the ICT services sector, business comms provider **Maintel** continued with its usual Autumn shopping spree, through the £9.6m/7.4x EV/EBITDA acquisition of systems integrator Proximity Communications. In mobile messaging, **IMImobile** completed its first acquisition since its June IPO, buying SME-focused messaging provider TxtLocal for £11m or 11x net earnings. And, finally, public sector IT buy and build Castleton acquired social housing software supplier Documotive for £4m, as £3m in cash and £1m in convertible notes, funded by a £5.5m share placing, in which MXC Capital subscribed £1.2m.

**FIGURE 13:** M&A Transactions

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The most significant deal in the Software sector saw US-listed Dealertrack Technologies make a formal offer for Incadea, an AIM-quoted provider of software solutions and services to the global automotive retail and wholesale market. The offer, at 190p per share, values the equity at £122m, equivalent to a very healthy 20x current year EV/EBITDA and marking a near 2.5x return for investors in the 2012 IPO.

The UK design/engineering software sector continues to attract significant interest from international buyers. During the quarter, NASDAQ-listed Trimble acquired UK-based Amtech for an estimated valuation upwards of £50m, providing Primary Capital with an exit. This follows last year's purchase of AIM-listed Delcam by Autodesk for around £173m and the more recent acquisition by Hexagon of Vero for an estimated valuation of at least €350m.

More recently, in January 2015, design and engineering software vendor AVEVA acquired 8over8, a provider of contract risk management software to the oil & gas, mining and other infrastructure industries, for £26.9m. The acquired business will likely be integrated into AVEVA's Enterprise Solutions division and Aveva has paid what looks to be a reasonable price for a fast-growing complementary business, which should partly ease recent investor concerns at the firm.

The largest deal among the UK-headquartered security & infrastructure software peers saw investment banking software provider First Derivatives acquire a further 46% stake in US-based Kx Systems, a provider of data processing tools, for £36m. In the security space, Sophos completed the small acquisition of California-based start-up Mojave Networks to enable hybrid deployment options for its network security portfolio, while identity management company GB Group acquired provider of customer data analysis technology services Transactis for up to £6m.

Elsewhere, information management software provider Ideagen raised £17.5m to finance the £18m acquisition of one its closest peers, Gael. The deal, completed at 7.8x EV/EBITDA, represents one of the group's most significant acquisitions and approximately doubles Ideagen's revenue base to £20m.

There were also a couple of significant deals within the healthcare software vertical. Provider of technology and services to the healthcare and utilities markets Servelec acquired Corelogic for £23.5m, in order to expand into the complementary social care market. The acquired product set complements Servelec's existing RiO offering and market position in mental health and community care trusts.

Meanwhile, EMIS purchased diabetic eye screening and ophthalmology imaging services provider Medical Imaging for up to £9.5m. The deal further enhances its position in this particular market niche, following the acquisition of Digital Healthcare in August 2013, and it adds a high-value recurring service element to what is largely a software-based product portfolio.

Other software deals included Microgen's acquisition of Unity Software, a Jersey provider of wealth management software, while telecoms and testing software vendor Anite acquired US-based Xceed Technologies, a provider of wireless network data analytics software, for $30m or 19x trailing EBITDA. Public sector-focused Civica acquired Belfast-headquartered Asidua, a provider of consulting and integration services, while Lyceum-backed Access Technology acquired Cloud hosting specialist StratoGen in order to extend its control over the delivery environment. In the BPO and insurance software space, The Innovation Group acquired EMaC, a provider of outsourced motor plan services.

# GLOBAL DEAL FLOW

European telecoms corporate activity shows no signs of abating, with Altice entering into exclusive talks for the acquisition of Portugal Telecom from Brazilian operator Oi. There had been a flurry of bids for PT, with Bain/Apax also looking to do a deal; however, subject to shareholder approval, Altice looks to have come out on top, having increased its initial bid to €7.4bn with a €0.5bn earnout.

Highly acquisitive Spanish telecoms operator MasMovil Ibercom continued on its acquisition hunt, buying Spanish fixed wireless operator Neo on a debt-free basis for €31m (7x 2014 proforma EBITDA) and Aragonese operator Embou for a minimum €4.3m (4.8x EBITDA). In private equity activity, Apax sold Orange Switzerland for CHF2.8bn (€2.3bn), 6.8x run rate EBITDA, to NJJ Capital, the investment arm for Xavier Niel, founder of disruptive French telco Iliad. In addition, euNetworks, the Singapore-listed but Europe-focussed provider of long-distance and metropolitan fibre networks, announced an agreed take-private offer led by major shareholder Columbia Capital, valuing the company at an estimated 11-12.6x EBITDA.

The North American market remains a key battleground for European and Indian IT services providers attempting to grow their international footprint. In the period, Atos took a major strategic step with the purchase of Xerox's IT Outsourcing business for €840m. The division, which generates revenues of $1.5bn and employs nearly 10,000 people, will make North American Atos's largest market. Likewise, Tech Mahindra also made a significant move in the US, through the $240m acquisition of network integration player Lightbridge Communications, and it soon followed this up with the purchase of Swiss banking consultancy provider Sofgen.

# GLOBAL DEAL FLOW

There were also bolt-on deals for Accenture (of Structure) and Infosys (Cadient) in the fourth quarter, while listed Nordic IT services specialist Evry was subject to an offer from Apax following its strategic review, with the bid equivalent to an EV of NOK7.27bn, or 6x trailing EV/EBITDA.

Meanwhile, the security sector continues to be a hot spot for corporate activity. AVG Technologies, which was rumoured to be in discussions with PE buyers as well as at least one other technology company over a possible take-private, made two small tuck-in deals, of European-based competitor Norman Safeground and of Winco, a Brazilian security software distributor. Elsewhere, Proofpoint acquired social media security and compliance solution provider Nexgate for $35m in cash, while BAE Systems purchased US-based managed security services provider SilverSky for $232.5m.

In capital markets activity, two big-name Big Data players made strong debuts on the public markets in December with hadoop platform provider Hortonworks raising $93m at a market cap of $666m, while software analytics player New Relic raised $107m at a market cap of just over $1bn. Back in Blighty, Apax-backed security software vendor Sophos looks to be heading for a London IPO according to press rumours, at a valuation of around £1bn (13.5x trailing EV/EBITDA) – that said, a tertiary buy-out or a trade sale are also possibilities.

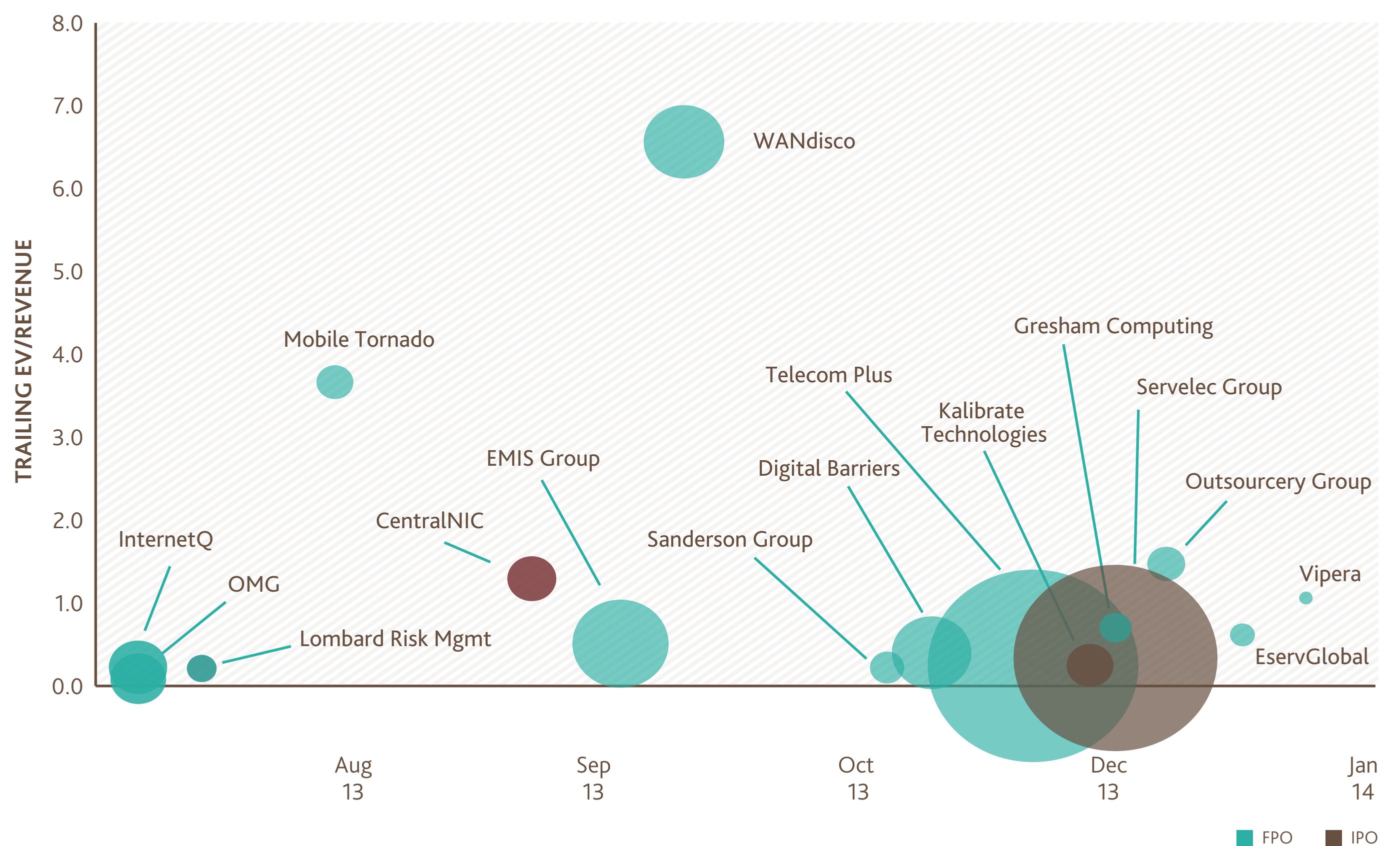
In the SME-mid market accounting software space, Intuit acquired Jersey-headquartered provider of global, cross-border and Cloud-based payroll services provider Acrede for an undisclosed sum, while HgCapital-backed e-conomic purchased a majority stake (around 70%), in Sweden-based SaaS accounting software firm SpeedLedger. Fast-growing New Zealand-based Xero acquired online payroll provider Monchilla to accelerate the rollout of its payroll business in the US.

KKR, HgCapital and Cinven-backed Nordic business management software provider Visma completed three deals; Finale Systemer AS and Mokastet Data AS are both based in Norway and provide solutions to the accounting industry, specifically for year-end accounts production, while Creno is one of Norway's leading debt collection agencies.

Apax-backed ERP software provider Epicor also completed two deals in the form of ShopVisible, a provider of SaaS-based solutions that help businesses monitor and refine online sales strategies; and QuantiSense, a provider of analytics solutions for the retail industry. And, finally, provider of SaaS talent management solutions Cornerstone OnDemand acquired Evolv, which provides Cloud-based predictive hiring analytics solutions built on Big Data technologies, for $42.5m.

# LIMITED CAPITAL MARKET ACTIVITY

**FIGURE 14:** Capital Market fundraising



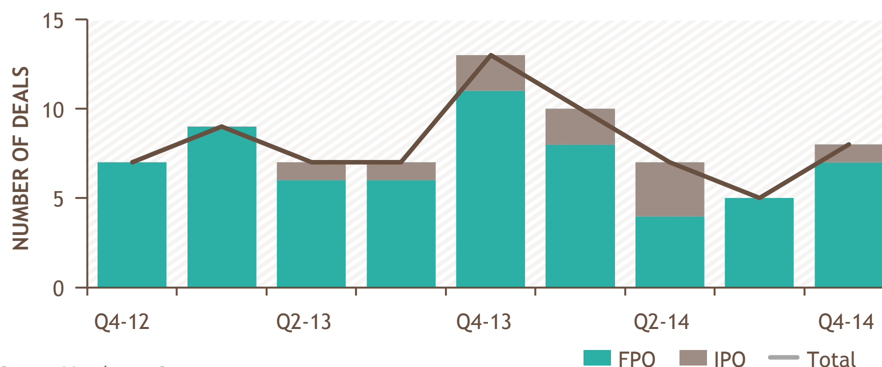

**NB:** Sky not to scale, actual amount raised was £1,358m.Gamma Communications did not receive any proceeds from the IPO.
**Source:** Megabuyte, Company Announcements

# LIMITED CAPITAL MARKET ACTIVITY

There were eight institutional placings in the fourth quarter, representing a slight improvement in volume compared to the prior six months. However, the total amount raised from institutions in the period, at just under £41m, pales in comparison to the near £350-400m raised in consecutive quarters between Q4-13 and Q2-14. Despite this, Gamma got its IPO away, placing 50% of its shares to institutions, at a market capitalisation of £162m. Gamma did not raise any money given an already healthy balance sheet and good cash generation; the main aim of the IPO was to raise its profile. Ideagen's £17.5m fundraise, which was used to finance its acquisition of Gael, was the other notable institutional round this quarter.

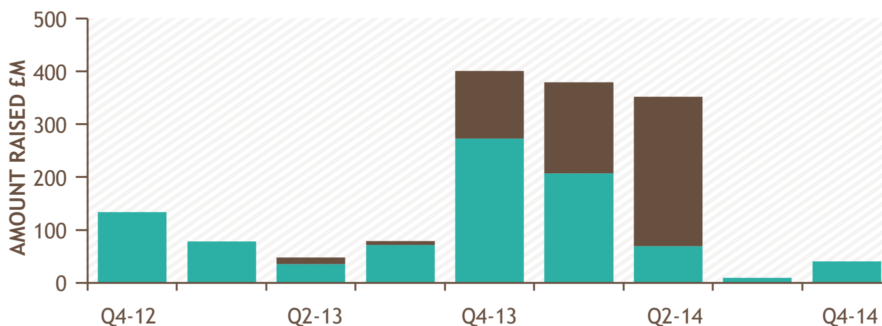
Mobile money provider Monitise received strategic non-institutional investment as part of a significant deepening of its existing relationships with Santander, Telefonica and Mastercard; the three firms collectively invested £49.2m at a price of 30.5p. This was a welcome boost of confidence for Monitise, following key shareholder Visa Inc's decision to sell its stake in the business and move mobile development increasingly in-house. Meanwhile, Cloud-based unified comms provider Outsourcery announced a £1m equity fund raise from Encore Capital at 20p per share, with the funding completed at the same price as Outsourcery's August £1.5m emergency funding round.

**FIGURE 15:** Number of deals by type



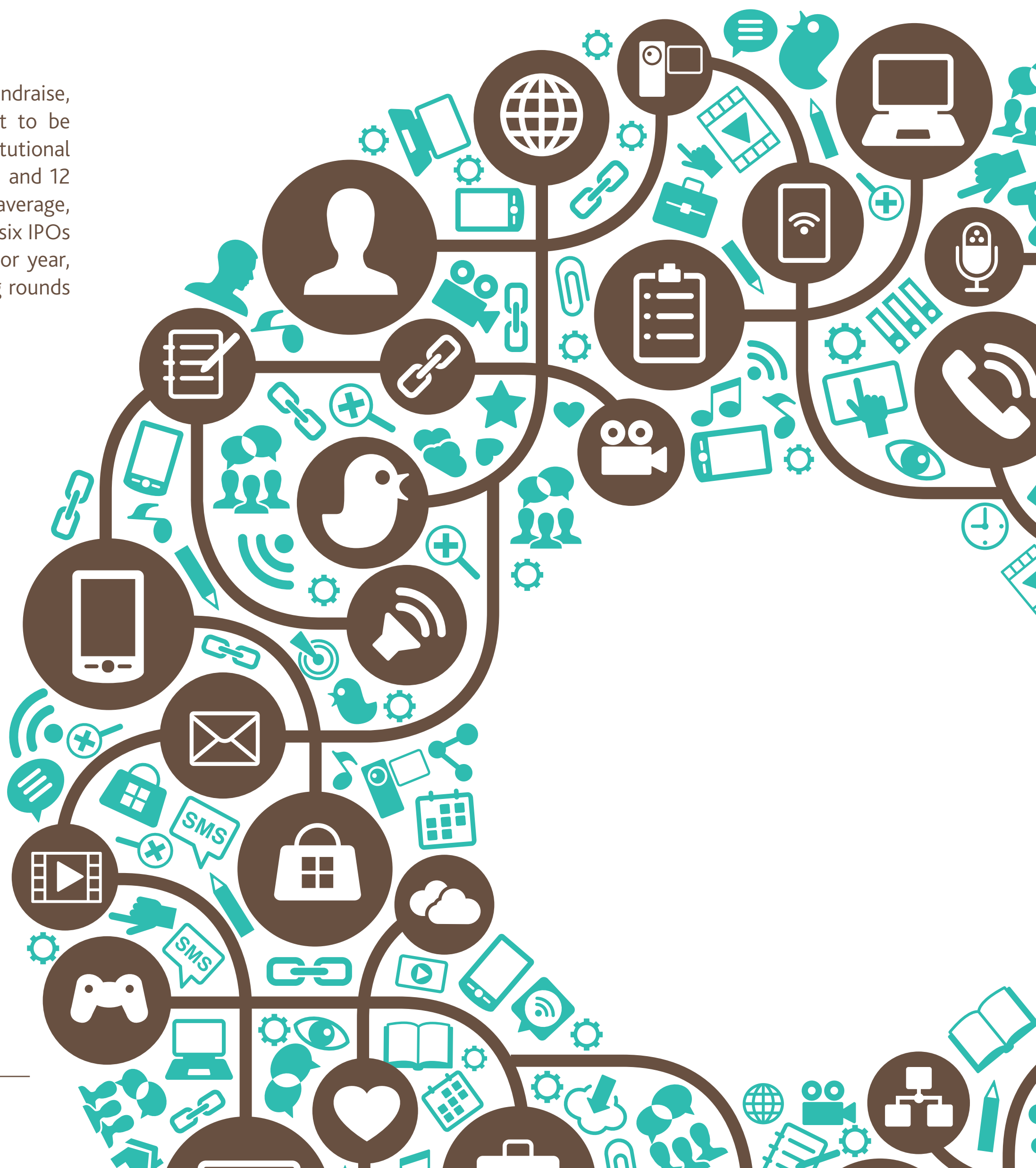

**Source:** Megabuyte, Company announcements

**FIGURE 16:** Amount raised by type




**Source:** Megabuyte, Company announcements

Notwithstanding Sky's £1.4bn fundraise, the second half of 2014 turned out to be something of a damp squib for institutional funding, with only one IPO (Gamma) and 12 follow-on rounds which raised, on average, just under £4m. There were however, six IPOs in 2014, compared to four in the prior year, although the total number of funding rounds dropped by 17% in 2014, to 29.



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