ISSUE 1: JULY 2014

TECHtalk

A GLOBAL REVIEW OF CORPORATE ACTIVITY IN THE TECHNOLOGY SECTOR

BDO

INTRODUCTION

The global economy does finally appear to be on an upward trend: the US economy expanded across all districts according to the latest Federal Reserve report, the UK has enjoyed a return to growth despite concerns about the aggressive reduction of the budget deficit and even the Eurozone is showing signs it has emerged from dire straits.

We are encouraged to see that this economic positivity has translated into a flurry of M&A activity. Here at BDO, we have noticed increasing interest in the software sector for a number of months, and this appears to be reflected in the findings of this edition of TECHtalk: there were some 133 global deals within the software sector, with the high margin revenue growth potential in big data, social media, mobile computing and SaaS proving particularly attractive to dealmakers. High growth inevitably translates into high interest by VCs, and we were therefore unsurprised to learn that three-quarters of all software M&A deals were VC-backed.

The global technology IPO market got off to a strong start; the average IPO in Q1 rose 24.6% from US offer price, with some new issues seeing gains as high as 60%.

Yet as we approached the end of Q1, widespread fears of a new tech bubble prompted a widespread sell-off of tech stocks with shares taking a nosedive as investors moved their money towards safer, slow-moving stocks.

This, coupled with geopolitical tensions such as the Ukraine crisis, means the IPO market has reached near stagnancy: only four new IPOs are in the pipeline as of mid-May.

JULIAN FROST
Global Head of Technology sector at BDO

The global recovery means we continue to be encouraged about the prospects for the technology sector. A desire to stay at the forefront of product and service innovation, ever converging technology subsectors and the need to expand globally will give cash-rich corporates the stimulus they need to invest in both tactical and strategic M&A opportunities.

We are certainly not out of the woods yet, but we remain confident that the interest and opportunities available should help ensure strong growth in the tech corporate markets through to 2015.

IPO ACTIVITY

OVERVIEW OF Q1 2014 DEALS

IPO ACTIVITY

GLOBAL TECHNOLOGY IPO MARKET

Fears of a bubble and geopolitical tensions caused technology initial public offerings (IPOs) to slow towards the end of the first quarter (Q1), coming almost to a standstill by the middle of Q2, despite a strong start to the year.

At first glance, technology IPOs, and IPOs in general, had a robust first quarter. The average IPO in Q1 was up 24.6% from its offer price, and some new issues saw initial gains as high as 60% . Investor confidence was high in all things cloud, software-as-a-service (SaaS) and mobile.

Company valuations were soaring, sometimes in spite of meagre revenues and yet-to-be-proven business models. The market was hungry for new IPOs, as low interest rates and bond yields made the equities markets comparatively attractive to investors. According to a May 2014 Wall Street Journal article, the number of IPOs this year was on track to be the highest since 2000, the year the Internet bubble burst.

The equity and IPO markets have cooled since March, however, as widespread fears of a new tech bubble prompted a sell-off of technology stocks. Overvalued shares took a nosedive toward the end of Q1 and in early Q2, as investors pulled their money out and invested it in dividend payers and slower-moving blue chip stocks .

David Einhorn, founder and president of Greenlight Capital, a long-short value-oriented hedge fund with $10.3 billion in assets under management (AUM) told clients in a letter at the end of April: “There is a clear consensus that we are witnessing our second tech bubble in 15 years .”

Geopolitical factors have also played a part in the market chill. Tensions between Russia and Ukraine during the months of March and April are among the factors causing IPO traffic to come to a near standstill, with only four new IPOs in the pipeline as of mid-May, according to research firm IPOScoop .

WHILE THERE IS POPULAR SENTIMENT THAT WE ARE IN A TECH BUBBLE, THE QUESTION IS WHEN IT WILL BURST.

REGARDLESS, THE TECH MARKET IS MORE BROAD TODAY THAN IT WAS 15 YEARS AGO AND IT APPEARS THERE ARE STILL VALUE OPPORTUNITIES IN SPECIFIC SECTORS SO INVESTORS NEED TO CAREFULLY SCRUTINIZE OPPORTUNITIES AND VALUE PROPOSITIONS.

JOHN KWON
MANAGING DIRECTOR BDO, USA

THE POLITICAL SITUATION IN RUSSIA IS IMPACTING ON THE MARKET AND TRANSACTIONS ARE AT A STANDSTILL.

IRINA SMIRNOVA
BDO, RUSSIA

REGIONAL ACTIVITY

A total of 14 technology-related IPOs launched in the first quarter of 2014, according to PitchBook, a provider of data and technology services for the global private equity and venture capital community.

The largest number of technology IPOs in Q1 were in North America, with nine companies listing for the first time.

THE SENTIMENT IS POSITIVE IN THE TECHNOLOGY SECTOR IN NORTH AMERICA AND WE ARE LOOKING FORWARD TO INCREASED ACTIVITY.

SCOTT RODIE
NATIONAL HEAD OF TECHNOLOGY SECTOR BDO, CANADA

This trend is consistent with the latest findings published in BDO's IPO Outlook Survey, in which 73% of capital market executives at leading U.S. investment banks predicted an increase in offerings from the technology industry.

Three technology companies went public in the Europe, Middle East and Africa (EMEA) region, and two companies issued their first public offering in Asia .

SOFTWARE

A total of nine software companies went public in Q1: eight in North America and one in the UK .

> THERE ARE FEARS OVER A TECH VALUATIONS BUBBLE AS STOCKS ARE FINISHING THE QUARTER BELOW THEIR DEBUTS.
>
> **AFTAB JAMIL**
> **JOINT HEAD OF TECHNOLOGY BDO, USA**

As the Internet continues to become the preferred platform for software delivery, a number of the software IPOs were from makers of cloud-based software,

Most of the technology IPOs had strong debuts, only to see their share prices tumble towards the end of the quarter and into Q2. All of the software stocks that launched in Q1, including Varonis Systems and Paylocity, finished the quarter below their debuts.

Castlight Health in particular stoked fears over a new tech bubble. Castlight Health's IPO valued the cloud-based enterprise healthcare software provider at $1.4 billion, more than 100 times the company's 2013 revenues of $13 million.

Then, by the end of trading on the first day, the stock price had soared from $16 to nearly $40, valuing the company at over $3 billion. Valuations more than 100 times revenues had not been seen since the year 2000, a clear sign to many that a bubble was building. Indeed, Castlight's stock subsequently tanked, ending the quarter at just $15.02 and falling to as low as $10.90 in early Q2.

Another company that prompted bubble talk was London-based King Digital Entertainment, maker of "Candy Crush Saga," the popular mobile game. King was initially valued at $7.1 billion , the most talked about IPO since Twitter's initial offering last November.

Early performance of the stock was disappointing, however, as the share price dropped 16% from $22.50 to $18.90 on the first day of trading, dragging other gaming stocks down with it, such as Zynga and Glu Mobile.

Despite the fact the company owns more than 180 games, there are fears it will prove to be a one-hit wonder and follow in the footsteps of Zynga, maker of Farmville, which went public in December 2011 and has performed poorly on the equity markets.

MANAGED SERVICES

There were five IPOs in the managed services space during Q1: two in Asia (NSFOCUS and Netposa Technology, which are both in China); two in EMEA (French cable group Altice and UK's Manx Telecom); and one in North America (Aerohive Networks). Despite some fluctuations, these stocks on the whole performed more steadily than their software counterparts during Q1 .

AFTER A ROBUST START TO Q1 GLOBAL TECH IPOS, INVESTOR INTEREST COOLED DOWN

81 TOTAL **IPOS** GLOBALLY

14 TECHNOLOGY TOTAL **IPOS** GLOBALLY

NINE SOFTWARE IPOS

FIVE MANAGED SERVICES IPOS

POST-OFFERING PERFORMANCE IN THE SOFTWARE SECTOR HAS COOLED **ESPECIALLY** WHEN COMPARED TO **OPENING PRICES**

ALMOST ALL INTERNET AND SOFTWARE IPOS THAT WERE CONDUCTED **SINCE 2012 FELL IN APRIL**

MEDIAN DROP WAS ABOUT **11%**

OVERVIEW OF Q1 2014 DEALS

M&A ACTIVITY

GLOBAL TECHNOLOGY M&A MARKET

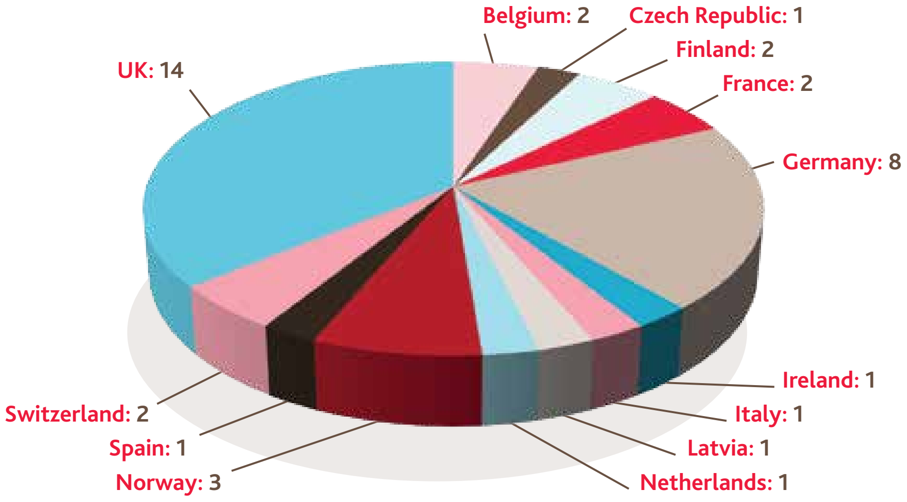
Mergers and acquisitions (M&A) in the global technology industry had a stellar first quarter, up 55.1% compared to Q1 2013 ($35 billion) and 23.1% from Q4 2013 ($44.1 billion), according to a report by M&A market intelligence firm Mergermarket. With a total value of $54.3 billion, it was the highest total value for an opening quarter since Mergermarket's records began in 2000.

The U.S. technology sector ($38.1 billion) beat all previous Q1 values and saw the highest quarterly value in over seven years (Q3 2006 was valued at $40.3 billion). A second consecutive Q1 increase saw values jump 40.6% compared to Q1 2013 ($27.1 billion), according to Mergermarket.

REGIONAL ACTIVITY

According to data sourced from PitchBook and The Deal, a total of 211 technology-related M&A transactions closed in Q1, with 158 in North America, 44 in EMEA, and nine in Asia. The United Kingdom (UK) had the most M&A activity in the EMEA region, with 14 deals taking place .

M&A DEALS BY COUNTRIES IN EMEA (PE-AND/OR VC-BACKED) Q1 2014



> COMPETITION IS FIERCE FOR QUALITY ASSETS IN THE VC AND PE MARKETS.
>
> **JAKOB SAND**
> **GLOBAL HEAD OF TECHNOLOGY, M&A**
> **BDO, DENMARK**

In North America, 97 M&A deals involved companies backed by venture capital (VC) firms (raising a total of $1.9 billion), and 24 companies were private equity (PE)-backed, according to PitchBook data.

Twenty-five of the EMEA companies were VC-backed (totalling $108.4 million), and 14 were backed by PE funds, while in Asia, PE funds backed two companies, and five companies were backed by VC firms ($3.3 million in total).

Across the regions, VC funds backed a much larger number of deals than PE funds.

This could be due to the large number of software companies involved, particularly in North America, which tend to be backed by venture capital rather than private equity, according to PitchBook.

However, the data also plays into a wider trend of leveraged buyout firms currently finding it difficult to take part in M&A deals. According to Thomson Reuters quarterly data, total PE-backed M&A fell by almost a third to $55.2 billion from a year ago.

PE deal flow has slowed as funds struggle to find quality assets in which to invest. Strong public equity markets and a recent surge of IPOs have meant that cash-rich corporate buyers have been going head-to-head with traditional PE funds.

Competition over a smaller pool of quality assets and record volumes of undeployed fund capital, or dry powder — undeployed capital hit $1 trillion at the end of 2013, according to a March report by Bain and Company — have pushed up valuations with asset prices becoming inflated.

Meanwhile, VC activity in technology is booming, with overall investment hitting its highest quarterly mark since Q2 2001, according to data and analytics firm CB Insights. With nearly $910 billion invested across 880 deals in North America in Q1 (across all sectors, not just technology), there was a year-over-year increase of 44% in funding and a five % rise in deal activity.

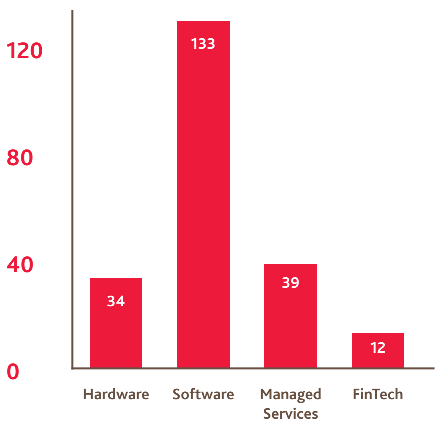
This follows a banner year for technology M&A in 2013, where North American VC-backed software companies alone raised $11 billion . VC-backed technology companies raised over $2 billion in a total of 127 M&A deals in Q1, reports PitchBook.

The largest reported amounts raised in VC-backed technology deals were for three North American software companies: Airwatch, which raised $225 million; Stretch, which raised $124.5 million; and Kovio, which raised $119.2 million, according to PitchBook.

While software company deals were heavily concentrated in the U.S., deals in EMEA and Asia had a stronger focus on managed services and hardware companies. PE-backed deals in EMEA were especially focused on managed services and included Deutsche Telekabel and T-Mobile Czech Republik, as well as hosted information technology (IT) and cloud infrastructure service providers CloudXL and e-know.net. VC-backed deals in EMEA included a broader mix of software, hardware and managed services.

Among the EMEA software company deals were a number of mobile and social technology companies such as Skobbler, Applifier, Tedemis, ePocket Solutions, and Natural Motion Games.

Q1 2014 M&A DEALS BY SUBSECTOR



AUCTIONS

The total number of technology company auctions in Q1 was 18, according to data from The Deal. Of these, 13 were in North America, one was in EMEA and two were in Asia, specifically China.

There were four M&A opportunities, namely Sensient Technologies, Juniper Networks, USA Technologies and Riverbed Technology.

Riverbed Technology rejected an acquisition bid from its second largest shareholder Elliott Management, instead increasing a share buyback scheme by $250 million to $750 million. Juniper Networks was pressured by the same activist fund to unveil a buyback and dividend plan that would return up to $3 billion to shareholders over the next three years. The company also named new independent directors to its board to avoid a confrontation with Elliott Management, its largest activist investor.

Two companies were off the block at quarter end, including education software provider Skillsoft Ltd, an Irish managed services company, which was acquired by London-based private equity fund Charterhouse in a bid worth more than $2 billion, reports The Wall Street Journal in a March 2014 article .

IN IRELAND WE HAVE SEEN TRANSACTIONS WHICH ARE PRIMARILY EITHER PRIVATE EQUITY INVESTMENT OR ACQUISITIONS BY ESTABLISHED INTERNATIONAL GROUPS WITHIN THE INDUSTRY.

TERESA MORAHAN
AUDIT, PARTNER BDO, IRELAND

GLOBAL TECH INDUSTRY SAW ROBUST M&A ACTIVITY IN Q1

211 TOTAL TECHNOLOGY M&A DEALS GLOBALLY

89 U.S. SAW THE MOST M&A ACTIVITY IN THE SOFTWARE SUBSECTOR

M&A DEALS IN MANAGED SERVICES AND HARDWARE SUBSECTORS WERE MORE COMMON IN ASIA AND EMEA THAN IN NORTH AMERICA

15 M&A DEALS IN MANAGED SERVICES WERE FROM EMEA

2 M&A DEALS IN MANAGED SERVICES WERE FROM ASIA

7 M&A DEALS IN HARDWARE WERE FROM EMEA

OVERVIEW OF Q1 2014 DEALS

M&A ACTIVITY

At the end of Q1, 12 companies were still on the block, including two Chinese firms: hardware company Montage Technology Group Ltd, and Nasdaq-listed online game developer Shanda Games . Shanda had announced in January that its controlling shareholder and an affiliate of investment firm Primavera Capital would buy it out.

Seven of the auctions were in the hardware space, six were in software and four were in managed services. (Note: Immediatek is considered both a software and managed services company).

SOFTWARE

According to Pitchbook and The Deal there were 133 M&A deals in the software sector, and of these, 99 companies were VC-backed, in keeping with venture capital's Silicon Valley bias. Twelve deals involved companies backed by PE firms.

Facebook's February acquisition of Whatsapp, valued at $19 billion, was the largest software takeover.

The large number of software-related deals can be attributed to the ongoing booms in big data, social media, mobile computing and software-as-a-service offerings. Also driving interest are growing expectations for high-margin revenue growth based on cloud technologies, which are fuelling increased investor and private equity attention in software companies, cites BDO USA's Technology & Life Sciences Winter 2013 newsletter.

> INVESTORS ARE VERY INTERESTED IN HIGH MARGIN, CLOUD TECHNOLOGIES.
>
> **ATFAB JAMIL**
> **JOINT HEAD OF TECHNOLOGY BDO, USA**

Software companies are increasingly looking to integrate with hardware devices—from smart phones to smart cars and even smart household appliances—that are increasingly connected to the cloud. Software seems to be driving deal activity and 2014 could be a big year for software M&A.

MANAGED SERVICES

The managed services space saw 39 deals in total. PE funds preferred communications and networking companies, with over half of the 14 PE-backed deals in this area. The remaining PE-backed firms included a mix of hosted infrastructure, mobile management and security services. VC investments gravitated toward companies that provide online and mobile solutions, such as cloud based and hosted IT services, cyber security for online and mobile applications and social media research and consulting services. There were 12 VC-backed deals, raising a total of $160.3 million.

> THERE IS DEFINITELY ELEVATED ACTIVITY FOR PRIVATE EQUITY FIRMS IN THE COMMUNICATIONS AND NETWORKING SECTOR.
>
> **CHRISTIAN GOETZ**
> **HEAD OF TECHNOLOGY**
> **CORPORATE FINANCE BDO, GERMANY**

HARDWARE

There were 34 M&A deals in the hardware space, 11 of which involved companies that were VC-backed, and an additional 11 that were backed by PE firms.

Three of the 11 PE-backed companies offered some kind of storage solution, including enterprise data storage company Xyratex, data storage products supplier Tandberg Data, and OCZ Technology, a provider of solid state storage for high performance computing. Demand for these types of products is especially high in a world of big data.

Further, four VC-backed semiconductor firms were acquired during Q1, according to PitchBook. These included Kovio, which was bought by Norwegian printed electronics provider Thinfilm, and cash-strapped Touchstone Semiconductors, which sold its assets to Silicon Labs for $1.5 million. Both of these acquisitions are said to place the acquiring firms in a dominant position in the so-called "Internet of Things," as device connectivity becomes more ubiquitous.

FINTECH

The financial technology (FinTech) subsector saw a total of 12 M&A deals, five of which were VC-backed (with a total value raised of $42.3 million), and four of which were PE-backed. FinTech companies targeted for M&A were mostly providers of retail, online and mobile financial services such as payments processing, mobile banking and even cashless parking.

OVERVIEW OF Q1 2014 DEALS

BANKRUPTCY MARKET

Bankruptcy volumes reached a total of 90 in Q1, according to The Deal, with 17 filings and 73 warnings. North America saw the most activity with 78 companies, while seven companies saw bankruptcy activity in Asia.

CLEANTECH

Among the bankruptcy announcements were 16 cleantech companies, including four solar technology companies. To a certain extent, some may have been the victims of their own success—renewable energy is booming thanks to falling solar technology costs. Suntech Power Holdings, for example, filed for chapter 15 bankruptcy protection from bondholders in Q1, while restructuring in the Cayman Islands . Despite strong sales, the company struggled with $2.3 billion in mostly Chinese debt as market oversupply caused solar panel prices to drop.

Clean energy accounted for 44% of newly-installed electricity generating capability in 2013, according to a 2014 report on global trends in renewable energy investment commissioned by the UN Environment Program (UNEP). However, despite a remarkable increase in renewable energy installations, an April 2014 article from Blue and Green Tomorrow reports that investment in cleantech companies was scaled back by 14% in 2013 to $214 billion worldwide. This was partly due to a significant drop in technology costs, as well as uncertainty in many countries over future environmental policy and government subsidies. VC and PE investment slumped 46% to $2 billion as funds pulled back from solar technology and next generation batteries in particular, according to the UNEP report.

SOFTWARE

In the software subsector there were 39 bankruptcies, with five filings and 34 warnings. Healthcare technology company Legend Parent, wireless e-commerce firm Simplexity, healthcare systems provider Vertical Health Solutions and enterprise mobility firm Webalo filed for bankruptcy protection. MtGox, a Tokyo-based bitcoin exchange operator, filed for bankruptcy after 850,000 bitcoins valued at $475 million disappeared after a massive digital theft. Lawyers for creditors to MtGox have since reached an agreement to support a group of U.S. investors' bid to revive the bankrupt company.

HARDWARE

The hardware space saw a total of 31 bankruptcies, with seven filings and 24 warnings. Five of the 31 were for companies making healthcare technology, including: ScanSys, Biolase, Micro Imaging Technology, Safebrain Systems and CDEX. The hardware companies filing for bankruptcy were seismic data recording company Autoseis, energy grid sensor startup Optisense, electronics firm United Electronics, agriculture manufacturing firm Alterrus Systems, printed electronics provider Plextronics, networking hardware and software firm EP Liquidation and audio visual systems provider Electro Sonic.

MANAGED SERVICES

Some 18 companies saw bankruptcy activity in the managed services subsector, with three filings and 15 warnings. The filings included Autoseis (note: Autoseis is considered a hardware and managed services company), Electro Sonic and marketing solutions provider Edgenet.

FINTECH

Six FinTech companies saw bankruptcy proceedings, with two filings and four warnings. Invest n Retire went under after a private investor called in a loan using the firm's patents and technology as collateral, forcing the firm to sell its patented 401(k) technology to the highest bidder. The other filing was MtGox, which is considered a software and FinTech company, as previously mentioned.

OVERVIEW OF Q1 2014 DEALS

CONCLUSION

It is worth noting that a number of the companies mentioned in The Deal and PitchBook data were listed under more than one category. As more of the technology we consume moves online and into the cloud, we will see an increased blurring of the lines between hardware, software and managed services companies. Companies will try to acquire other companies that offer services and products they cannot build themselves.

While IPOs were hit by the correction in the technology markets, M&A activity flourished. This was bad news for IPOs, but the market correction could spur M&A activity as cash-rich corporate buyers look for ways to grow earnings.

It remains to be seen whether the technology market correction will continue into a bear market over the coming months as interest rates continue to rise. Many analysts also expect stocks to drop between 10-20% in the second half of the year, which would likely affect deal activity in the technology sector.

Although technology companies must quickly adapt and innovate to stay ahead of competition and consumer demand, it is crucial that they take the time to carefully assess any opportunities for growth before taking action.

Whether companies are considering acquisitions, international expansion or entry into the public markets, working with trusted advisors to conduct thorough due diligence and study of financials, liabilities, operations and controls is key for any successful transaction in Q2 and beyond.

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