Capital Times

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Tech M&A report 2019

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GLOBALSCOPE
INTERNATIONAL M&A ADVISORS

Foreword

Our M&A team in IT sector

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Welcome to the first edition of Annual Tech M&A Report

We are delighted to present you the results of our overview of M&A trends and activities in IT sector. Almost 3,000 deals were completed last year. Despite overall decrease in the number of IT deals globally, we have noted stable interest from wide range of investors to the CEE region.

This year we decided to pay special attention to IT service companies, especially on most active investors in the industry, valuations of target companies, and deal rationale for both sides of the transaction with detailed analysis of several interesting cases. A clear opportunity – further industry consolidation by larger players – is a good chance for smaller IT service companies to benefit from rising opportunities.

We hope you will enjoy this report and our insights will help you better understand the market and its trends. Should you have any further questions or feel the need to discuss our findings, do not hesitate contacting us.

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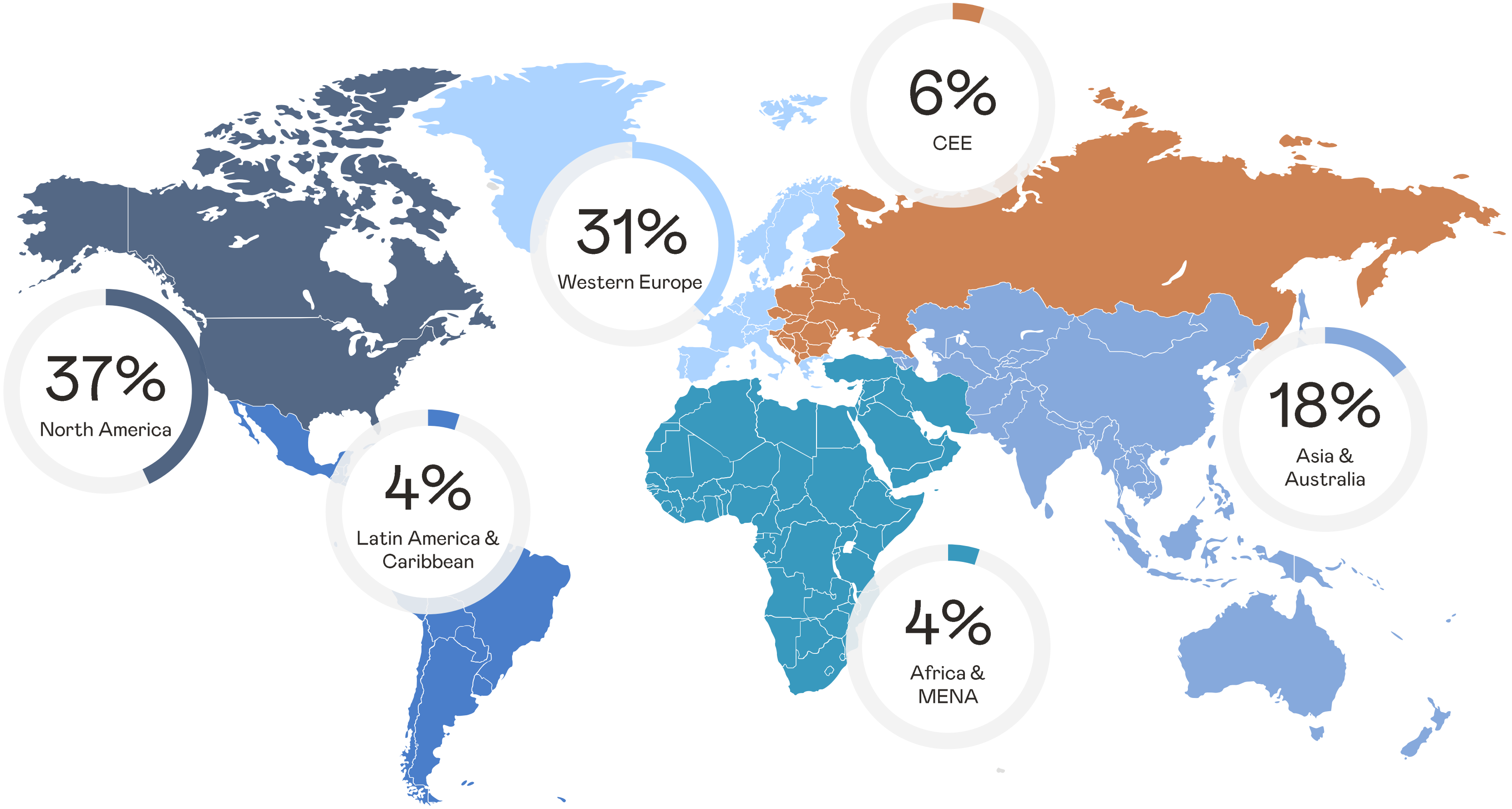
Report's content

North America and Western Europe continue to be the main markets for M&A transactions in 2019



2,959

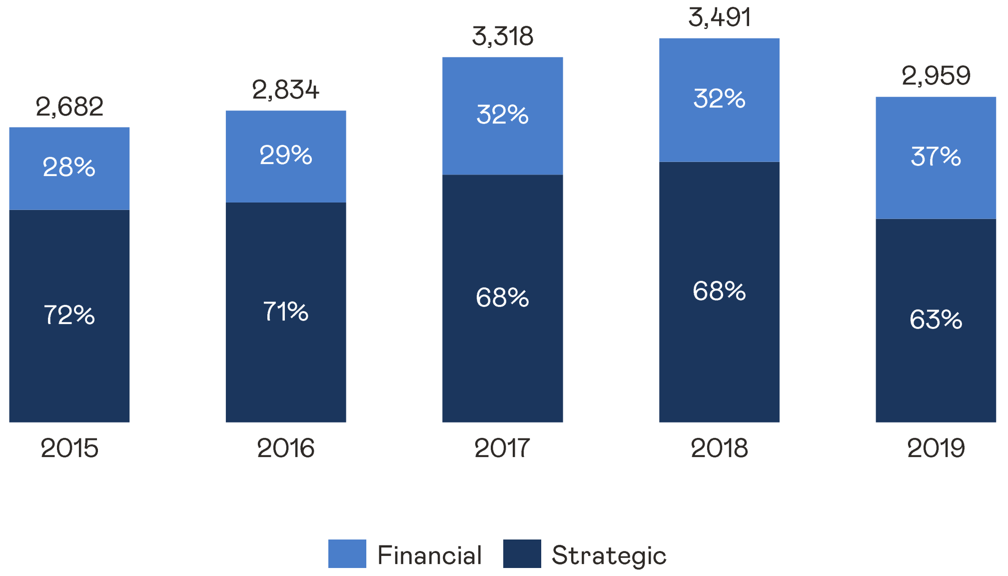
deals in 2019

North America and Western Europe continue to be the most active regions for M&A in IT industry. At the same time, the CEE region remains negligible on a global scale – only 182 transactions were closed with the targets from that region – performing slightly better than Africa & MENA, Latin America & Caribbean

Source: MergerMarket, EMIS

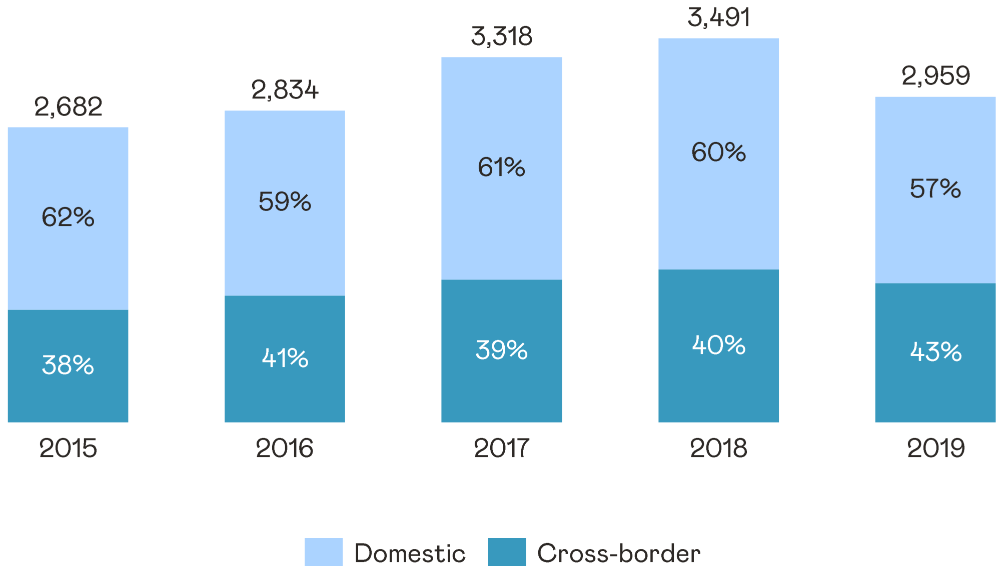
2019 is the worst year in terms of M&A activity for IT industry over the past 3 years

Number of completed transactions: financial vs strategic investor, 2015-2019



Three years of continuous growth in the number of transaction were halted by a 15% drop in 2019. Although better than 2015 and 2016, many analysts linked this drop with ongoing worldwide economic uncertainty and the risk of global recession.

Number of completed transactions: domestic vs cross-border, 2015-2019

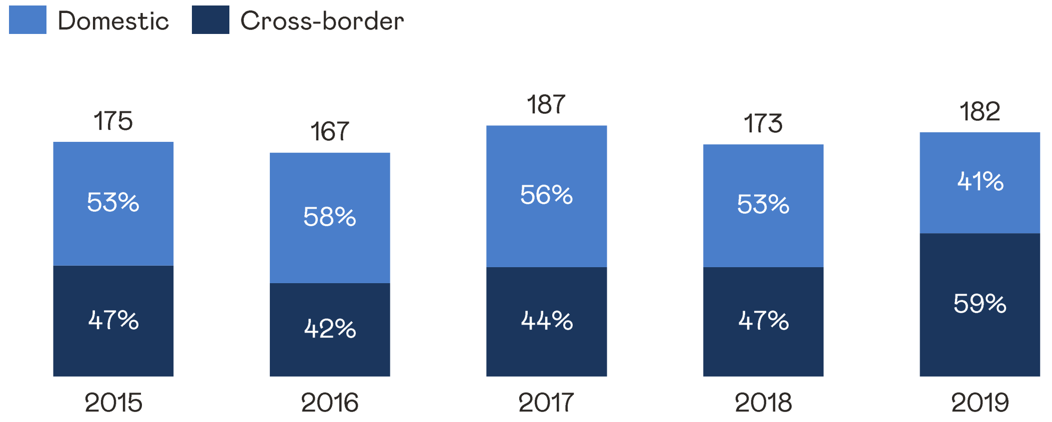


Overall decrease in the number of deals did not have an affect on the trend of growing share of cross-border transactions. The trend is defined by strategic investors that want to maintain their growth and seek acquisition opportunities out of their domestic markets. Meanwhile, financial investors prefer to invest in the local dominion.

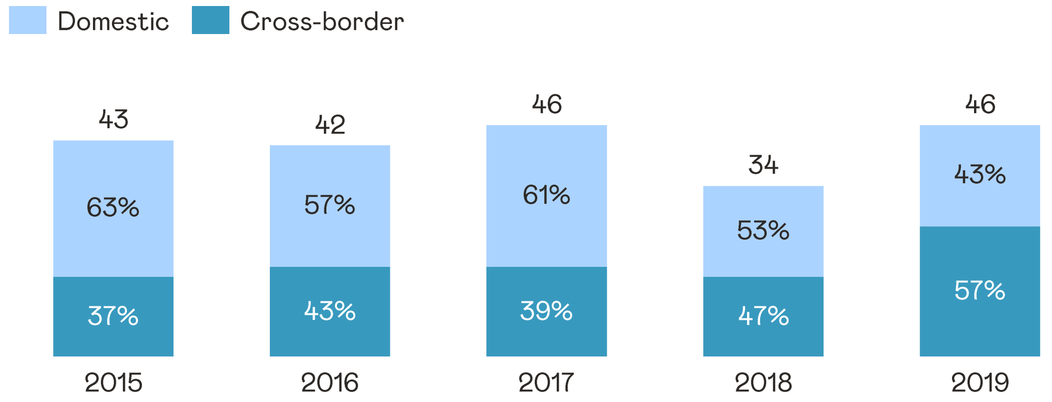
Source: MergerMarket, EMIS

M&A activity in the CEE region is somewhat different from the global trend: it is stable

M&A deals with IT companies in the CEE region, 2015-2019



M&A deals with IT service companies in the CEE region, 2015-2019



Source: MergerMarket, EMIS

Key trends

01

Apart from peak 2017, the overall trend is positive, and CEE attracts stable interest both from local players and foreign investors. In 2019, the number of cross-border transactions in IT for the first time exceeded domestic.

02

The most active cross-border investors in the CEE IT sector over the past 5 years were companies from the United States (108 transactions), UK (33 transactions), Russia (32 transactions), Germany (27 transactions) and Czech Republic (21 transactions).

03

IT service companies are also popular targets for M&A. Past year repeated the record 2017 – 46 deals.

TOP 10 most active strategic investors in IT service industry by number of deals in 2018-2019 years

Strategic investors in IT service companies

#	Company	Country	Deals, 2018	Deals, 2019	Cross-border, 2018-2019	Region for M&A focus
1	Accenture	Ireland	5	9	6	Global
2	Visolit	Norway	4	4	4	Nordic
3	IT Relation	Denmark	4	3	-	Denmark
4	Converge Tech. Solutions	Canada	2	5	6	North America
5	DXC Technology	USA	4	3	6	Global
6	Bechtle	Germany	2	3	2	DACH
7	Devoteam	France	4	1	5	Europe
8	Iron Mountain	USA	4	1	4	Global
9	Lutech	Italy	3	1	-	Italy
10	Dustin Group	Sweden	2	2	4	Nordic

The most important aspect for strategic investors is maintaining annual growth. Despite the difference in their headcount, technical specialization, deal size or region of activities, all of them chose inorganic growth as one of the drivers for the company's development. In many cases their acquisitions are supported by internal or external M&A advisors.

Cross-border deals are a natural for these investors. Despite low level of M&A activity, the CEE region is on the radar for the companies from all over the world. They consider our region as an important place for expansion with major focus on companies from Ukraine, Belarus, Poland and Romania. These countries are marked by fair quality/price ratio and a large pool of highly-skilled engineers.

Based on our experience, low preparedness for M&A and the gap in price expectations are the biggest issues for successful completion of transactions in the CEE region.

Source: MergerMarket, EMIS

Financial investors pursue different goals and are in general less active, especially in cross-border M&A, than strategic investors

Financial investors in IT service companies

#	Company	Country	Deals, 2018	Deals, 2019	Cross-border, 2018-2019
1	Thoma Bravo	USA	3	2	-
2	Warburg Pincus	USA	3	1	1
3	IK Investment Partners Ltd	UK	3	-	1
4	New Mountain Capital	USA	1	2	-
5	Ardian	France	2	1	1
6	SoftBank Group Corp.	Japan	1	2	-
7	FSN Capital Partners	Norway	3	-	-
8	Arlington Capital Partners	USA	2	1	-
9	GI Partners	USA	2	1	-
10	HgCapital	UK	2	1	2

Financials investors, unlike the strategic players, mostly focus on companies located in their home countries. This is mainly stipulated by the terms of their mandates that place geographic restrictions on possible countries for investment.

Private equity (PE) funds in CEE have the same features. In their majority, funds that are active in Poland or Romania, will not consider direct investments into Ukraine or Belarus.

Lower total amount of deals compared to strategic investors is explained by the strategy of some PE funds. They focus on acquisition of a stake in a promising target company with cash generation or exit potential and support its further growth.

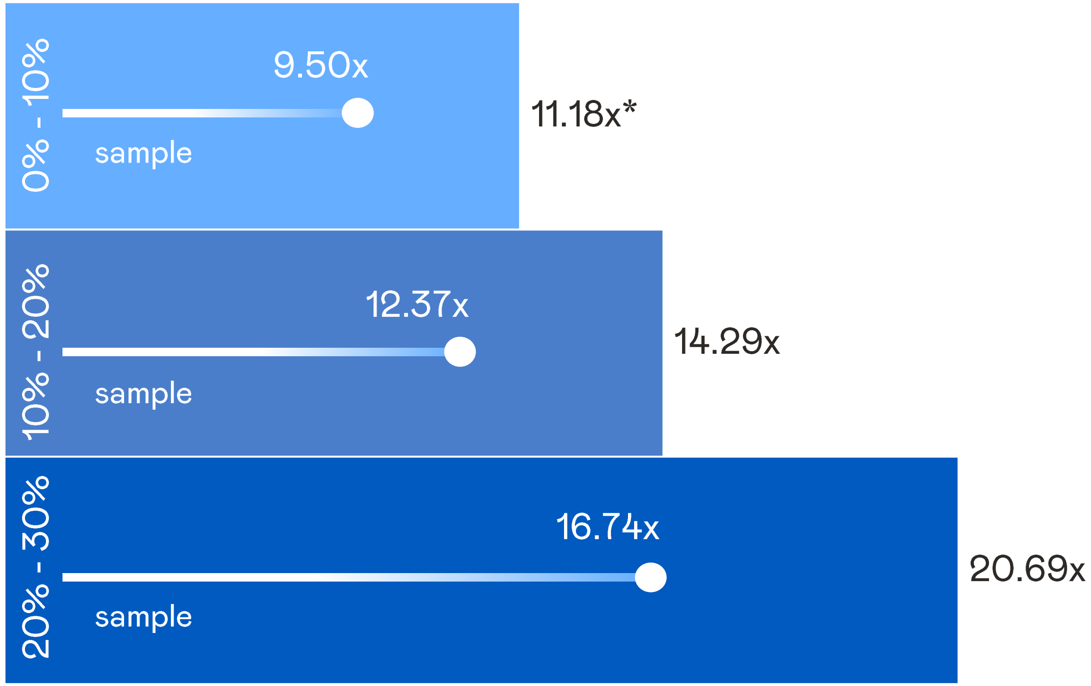
Companies with desire to attract a financial investor should mainly focus on local or regional PE funds.

Source: MergerMarket, EMIS

EBITDA multiple is the most indicative measure for the valuation of public IT service companies

Compared to private deals, average multiples of public companies are typically higher due to the number of reasons associated with their size, such as liquidity, transparency, access to cheap financing etc.

Average EV/EBITDA vs 3Y Revenue CAGR



*Including outliers

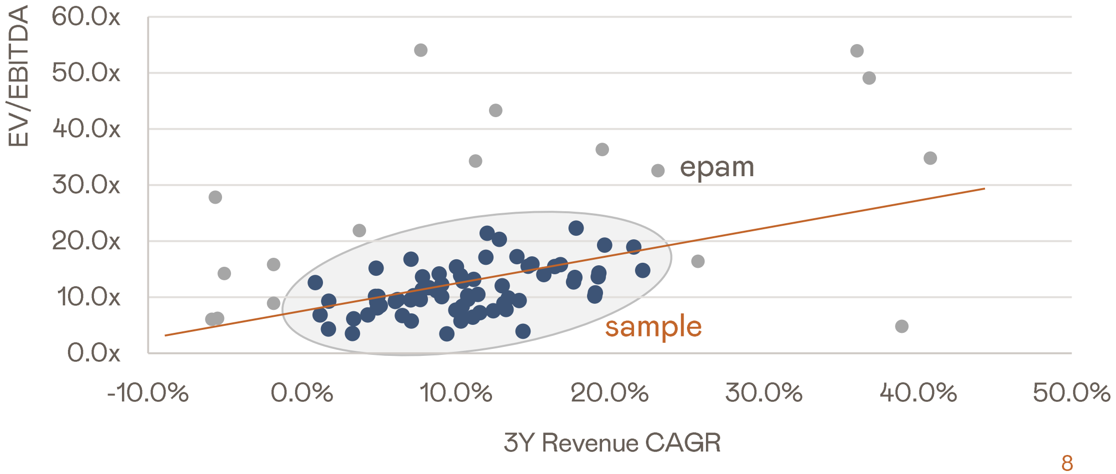
EBITDA multiple is the most indicative measure for the valuation of public IT service companies. Among the major factors that impact their valuation is compound annual growth rate ("CAGR") of revenue. Public companies with long-term 20%+ revenue CAGR are favored on the market.

EPAM is a good example of such company – current valuation of 32.54x EBITDA that is heavily driven by 23% revenue CAGR over the past 3 years.

At the same time, EBITDA margin has very limited effect on EBITDA multiple of such public companies.

epam

EV/S: 5.10x
EV/EBITDA: 32.54x
3Y CAGR: 23.13%
EBITDA %: 15.67%



Source: CapitalIQ

CEE private deals report much lower valuation compared to their peers in advanced economies

1.50x
North America

1.49x
Europe (excl. CEE)

1.45x
Asia

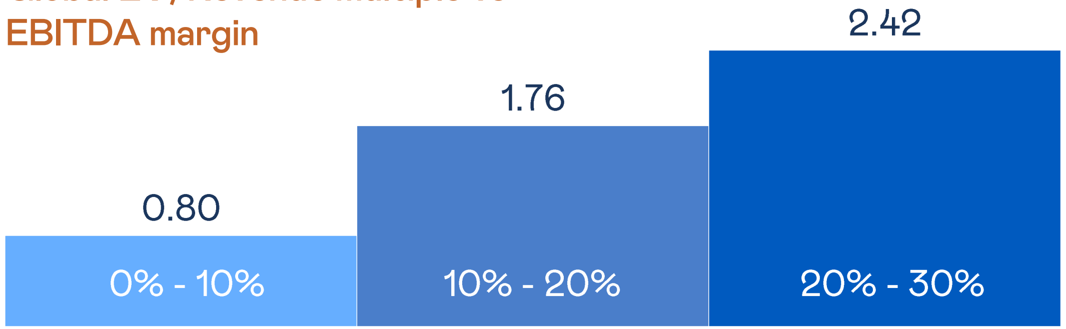
1.07x
CEE

EV/Revenue multiple averaged by region

In private transactions with IT service companies buyers focus on revenue growth rate, quality of customer portfolio, headcount and proficiency of engineers. A company with robust metrics noted above is valued at a slightly higher EBITDA multiple compared to the industry average.

EV/Revenue multiple in CEE is significantly lower than in other regions – 1.07x is the average valuation for private deals. Taking into account average EBITDA margin of mature and efficient IT service companies (15-20%), the average EBITDA multiple in the CEE region is in the range of 5x-7x.

Global EV/Revenue multiple vs EBITDA margin



Source: MergerMarket, EMIS

Strategic investors pay increased attention to the expertise, client portfolio, personnel, and transparency of the target company

Opportunity for IT service companies

Some investors, whose strategy assumes rapid inorganic growth, are particularly active in the CEE market. In most cases, they have own delivery offices in the region, but opposite cases also exist when the company makes a decision to expand the delivery geography. Sometimes their acquisitions are supported by a financial investor.

After becoming large enough, owners of such companies may decide to sell it to a larger strategic player or hold an IPO. In both cases, the shareholders will earn extra income due to the difference between the valuation of the acquired businesses and the exit price.

Such situation gives at least two possibilities for further development through M&A to the owners of the IT service companies: 1) Become a new market leader actively developing both organically and through M&A, 2) Sell a majority stake with subsequent additional earnings after selling the remaining stake at the exit.

Important aspects for strategic investors

01 **Company's expertise:**

- Verticals
- Technologies

02 **Client portfolio:**

- Geography (e.g. German companies prefers targets with sales in DACH region)
- Availability of enterprises or promising start-ups

03 **Personnel:**

- Location of delivery centers
- Attrition rate
- Management and its ability to develop the company

04 **Company's transparency:**

- Financial
- Legal

Source: Capital Times

Selected M&A transactions completed in 2019 with/by IT service companies in the CEE region

Target	Target's country	Target's headcount	Deal value, $M	Stake, %	Bidder	Bidder's country	Bidder's headcount	
CIKLUM	Ukraine	3,500	no info	minority	Dragon Capital	Ukraine	n/a	Deals in Ukraine
COREVALUE	Ukraine	480	no info	majority	it KONTRAKT	Poland	1,500	
Acceptic	Ukraine	150	2.25	100%	Yael Group	Israel	900	
Rademade	Ukraine	60	no info	53%	InSoft partners	Ukraine	n/a	
rozdoum	Ukraine	50	no info	70%	InSoft partners	Ukraine	n/a	
test IO	Germany	n/a	17.3	100%	epam	Belarus	30,100	Deals in Belarus
COMPETENTUM	Russia	n/a	no info	100%	epam	Belarus	30,100	
nayatech	Israel	n/a	no info	100%	epam	Belarus	30,100	
SmartexLab	Belarus	n/a	no info	100%	solbegsoft	Belarus	250	

Source: MergerMarket, EMIS

Selected M&A transactions completed in 2019 with/by IT service companies in the CEE region

Target	Target's country	Target's headcount	Deal value, $M	Stake, %	Bidder	Bidder's country	Bidder's headcount	
asseco	Poland	24,000	287.5	21.9%	Cyfrowy Polsat	Poland	n/a	Deals in Poland
BlueSoft Efficient Solutions	Poland	650	53	100%	Orange	Poland	1,800	
Tecsisa	Spain	50	5.5	51%	asseco	Poland	24,000	
sevenval	Germany	200	no info	100%	it Kontrakt	Poland	1,500	
OEX Archidoc Outsourcing Experts	Poland	150	16.8	100%	Oasis Information Secured	Ireland	650	
Vauban Fortify your business	Romania	450	no info	99.9%	gfi New Challenges, New Ideas	Poland	19,000	Deals in Romania
Pitech+Plus	Romania	270	no info	100%	Webhelp	France	50,000	
Brinel Bring Innovation. Enjoy Life!	Romania	110	no info	100%	Groupe Snef	France	9,000	

Source: MergerMarket, EMIS

Several notional M&A transactions stirred the market in 2019

Leading companies from different industries are focused on market consolidation through acquiring direct competitors or supplementary targets. The IT services market has not bypassed this trend.

As the major IT companies try to increase their capabilities in new technologies, tier-2 service providers and smaller digital services companies — which are nimbler than their larger peers — become attractive acquisition targets for these larger organizations.

Companies will continue to invest heavily in strategic and targeted acquisitions, and the industry is expected to witness further service provider consolidation going forward.

We have selected three interesting transactions that stirred the market in 2019.

Case #1	Case #2	Case #3
altran & Capgemini	tieto & EVRY	DXC.technology & luxoft
Deal value $4,100M	Deal value $1,500M	Deal value $2,000M

Case #1: Capgemini + Altran: transaction highlights

FY 2018 figures	Capgemini	Altran	COMBINED
Revenues, $M Constant YoY growth	$15,110 +8.1%	$3,339 +8.0%	$18,449 +8.1%
EBITDA, $M % of revenues	$1,930 12.8%	$421 12.6%	$2,351 12.7%
Headcount	211,000	47,000	258,000
Transaction value	1.71x EV/S	13.55x EV/EBITDA	$4,100M

Revenue synergy

$230-400M

- Cross-selling
- New clients
- Development of innovative sectoral offer

Cost synergy

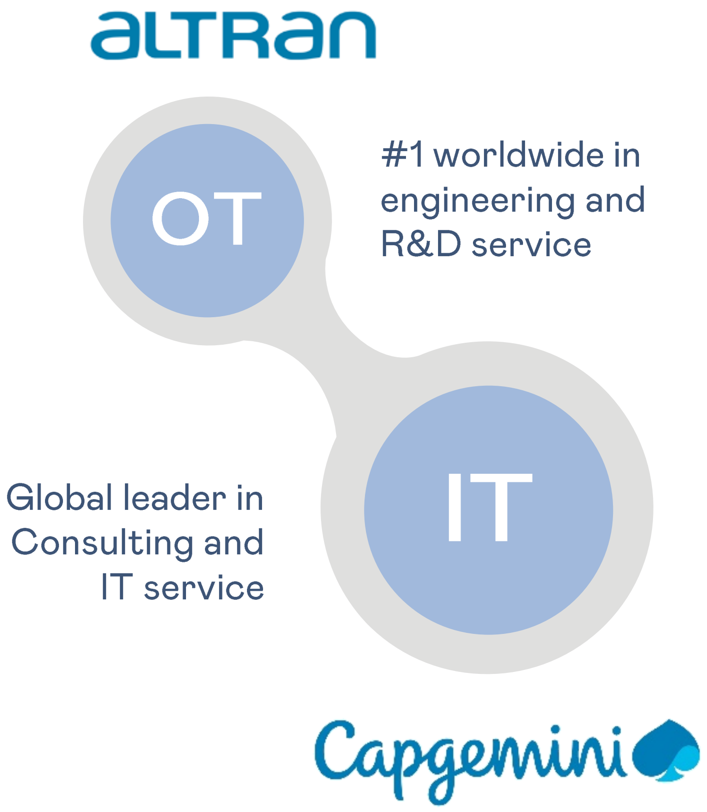
$80-115M

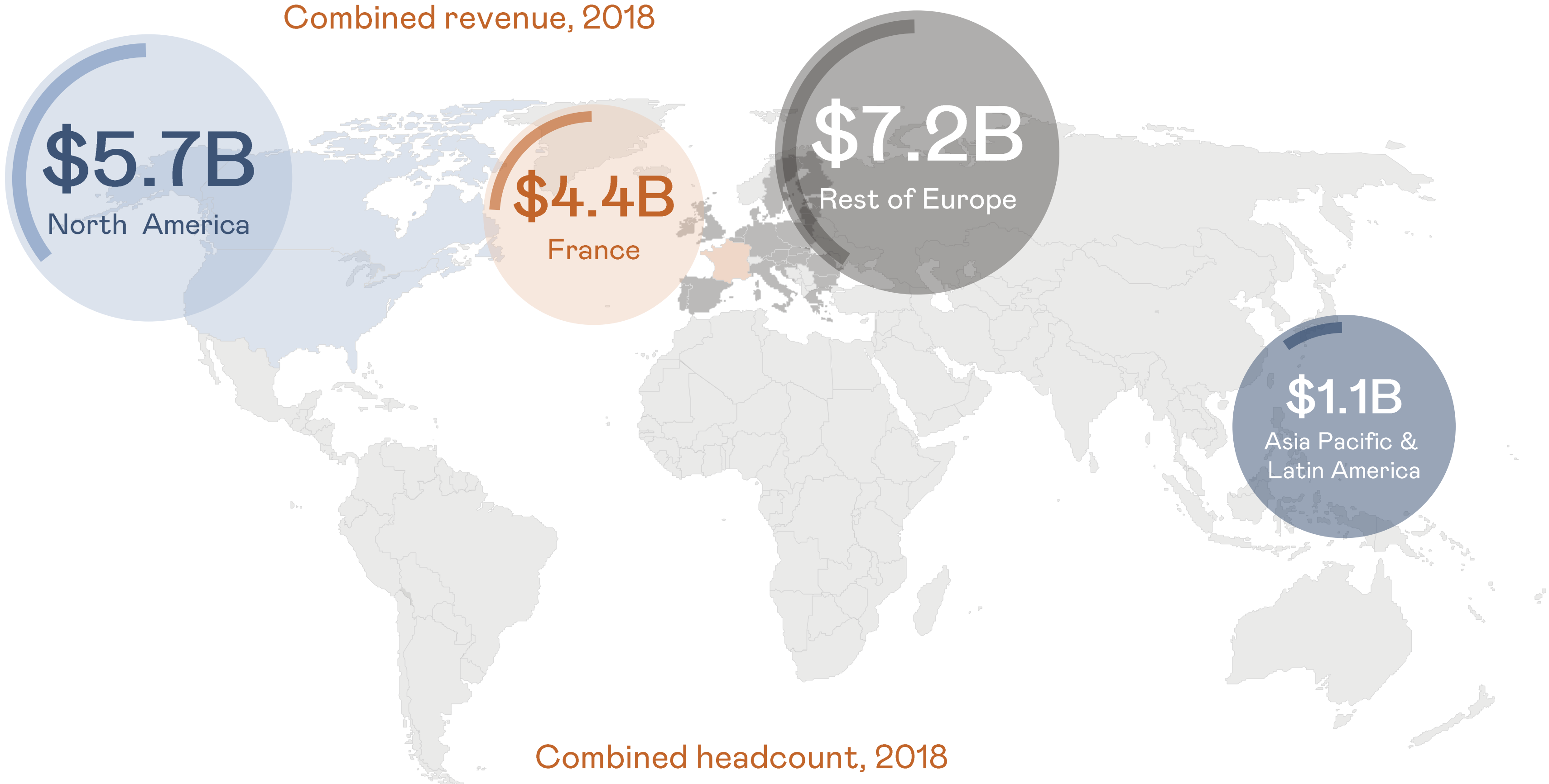
- SG&A
- Facility optimization

Synergies achieved in 3 years

Source: Capital IQ, Altran Technologies S.A.

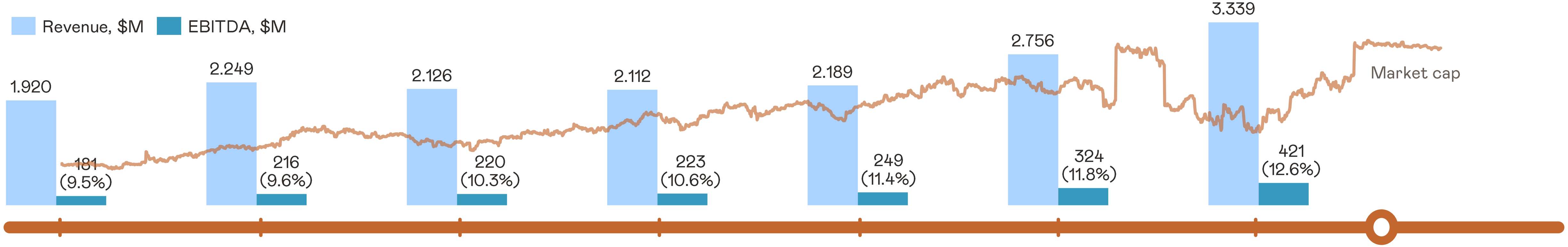
Case #1: Capgemini merges with Altran to become a leading software engineering company





Source: Capital IQ, Altran Technologies S.A.

Case #1: 'Altran 2020. Ignition' strategic plan to strengthen its position as a global leader has well been paid out turning into $4.1B deal



2012	2013	2014	2015	2016	2017	2018	Deal date	
0	3	5	3	4	4	1	0	# of acquisitions
18.1K	20.4K	22.7K	25.9K	28.9K	33.7K	46.7K	48.5K	Headcount
0.70x	0.80x	0.86x	1.22x	1.26x	1.21x	1.18x	1.71x	EV/S
7.42x	8.33x	8.37x	11.52x	11.10x	10.32x	9.39x	13.55x	EV/EBITDA

Altran's 2012-2015 strategic plan

Disposals of non-strategic businesses, recovery and optimisation of "non-core" countries, acquisitions in strong growth-potential markets, development in China. Revenue target > €2 Bn

'Altran 2020. Ignition'

Strategic plan set a new horizon for the Engineering and R&D services (ER&D) market. 'Altran 2020. Ignition' targeted > €3 Bn Revenue and best-in-class profitability

Source: Capital IQ, MergerMarket, Altran Technologies S.A.

Case #2: Creation of a Leading Nordic Digital Services Company with 24,000 professionals globally and $3.3Bn in sales

Finland IT software and service company providing IT and product engineering services, with approximately 14,000 employees, active in around 20 countries

tieto

Evry

Norwegian IT company that supplies services relating to computing, including operation, outsourcing and online banking has 10,000 employees in 16 countries

62.5%

37.5%

tieto Evry

$82M

Cost synergy

60% achieved by 2021 and ~90% by 2022

10.2% EBIT margin

$1.8Bn

tieto

$3.3Bn

Combined revenue

12.2% EBIT margin

$1.5Bn

Evry

Case #3: DXC + Luxoft: transaction highlights

FY 2018 figures	DXC.technology	Luxoft	COMBINED
Revenues, $M Annual	$20,753 -4.5%	$904 +3.0%	$21.961
EBITDA, $M % of revenues	$4,228 20.3%	$95 10.5%	$2.025 20%
Headcount	130,000	12,900	142,900
Transaction value	2.1x EV/S	19.7x EV/EBITDA	$2,072M

Revenue synergy

$300M-400M

- Expanding into new markets and offerings
- Scaling digital talent

Margin expansion

~2%

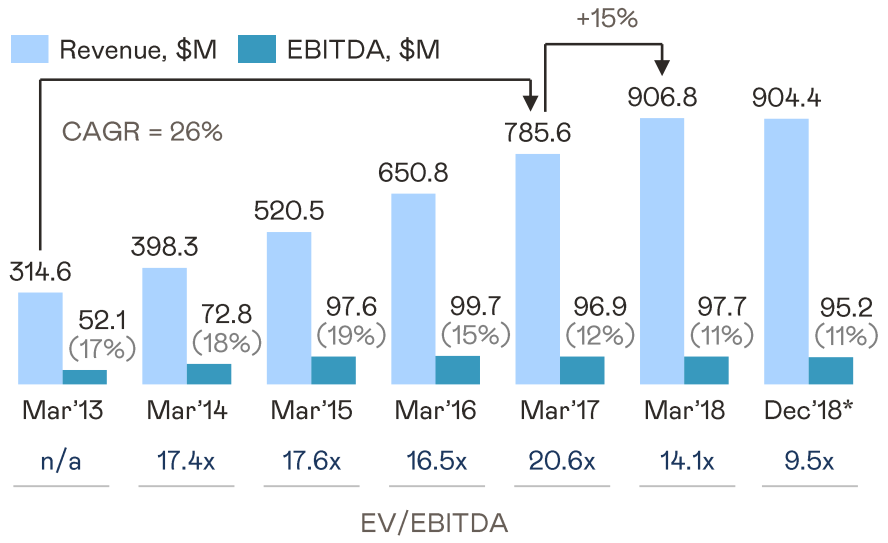
- SG&A
- Facility optimization

Synergies achieved in 3 years

Source: Capital IQ, DXC Technology

Case #3: DXC Technology acquires Luxoft for $2Bn

luxoft



$2Bn
Deal value

$22Bn
Combines sales

19.7X
Deal EBITDA multiple

*for the last 12 month ended in Dec'18

DXC background

Since the beginning of 2018, revenues have been posting steady declines and the company was unable to cut costs at the same pace, leading to weaker investor interest.

Furthermore, DXC had more than $14Bn annual contract value that had to be extended in the next 2 years, and most of that was traditional ADM and infrastructure work. These deals would likely be smaller even if they did renew, which was no guarantee in competitive environment.

All of the above turned into very low EV/EBITDA and P/E ratios compared to the peer average.

According to the latest news DXC is apt to divest three low-performing divisions representing around 25% of its revenues. It shall yield around $5bn, $4.25 of which the company intends to use for shares buy-back and dividends repayment.

Deal rationale

1. Leveraging Luxoft's offerings in financial and engineering services (combined company will serve half of the top financial institutions in the Americas and Europe)
2. Access to Luxoft's automotive vertical that expanded sales for 42.9% in 2018
3. Access to digital talent complementing DXC global reach:
   - Pool of 450,000 potential CEE digital resources
   - 80% of Luxoft's engineers have masters/PhDs, and 70% with >5years' experience
4. Revenue synergies by cross selling the best DXC and Luxoft offering to their respective clients and expanding into new industry verticals and service offerings

Source: Capital IQ, DXC Technology, Forbes

CTIS index has hit new height this year reaching +32.5% growth rate compared to 2018

CTIS Index, 2015 – 2019

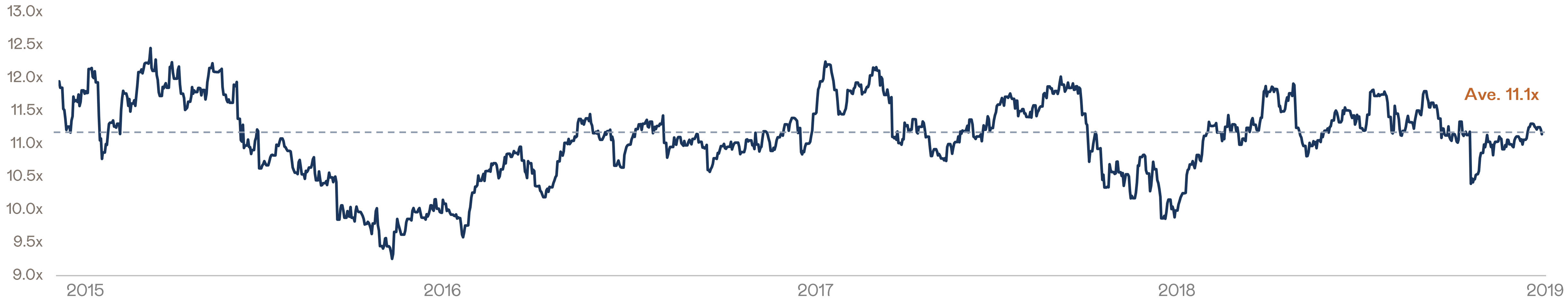
Capital Times IT Service (CTIS) measures the stock performance of 40 large IT companies, specialized in software development and IT service. CTIS is weighted by market capitalization. It should be seen as a gauge of prosperity for so called "IT services" industry.

- 40 software development and IT service companies
- Weights are revised quarterly
- Weighted by market capitalization
- Geography and stock exchange agnostic

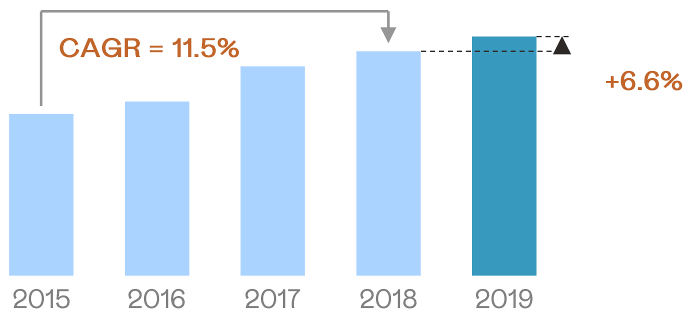
Source: Capital IQ

At the year-end EBITDA multiple aggregated for our top 40 IT service companies ended up at its average of 11.1x

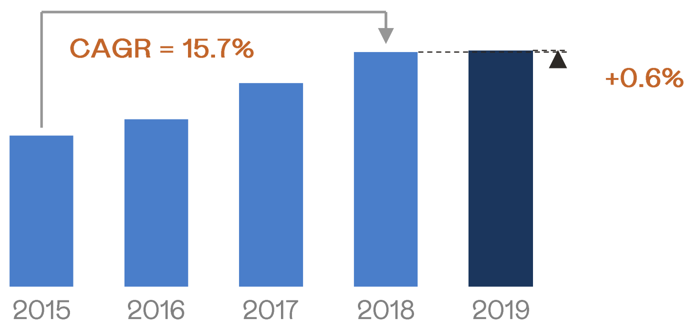
Index EBITDA multiple, 2015 – 2019



Revenue growth



EBITDA growth



Revenue and EBITDA composites are a simple sum of 40 independent items for the period of 2015–2019

CY 2019 financials look pretty weak underperforming historical growth. EV/EBITDA is on its average and CTIS is at its MAX (+32% y-o-y growth)

The lag between market capitalization growth and EBITDA indicates positive outlook of market participants on the development of IT service industry. EV/EBITDA does not trigger overvaluation at this point

Source: Capital IQ

Investment advisory firm with 2 own offices in Kyiv and Minsk and global footprint in 45 countries through Globalscope, international network of M&A specialists

We are investment advisors with a major goal to create and increase wealth for our clients. Our M&A and Wealth Management departments use the best practices to create maximum added value and meet highest expectations of our clients.

26 Closed deals

150+ Consulting projects

2 Offices: Kyiv & Minsk

5 Ongoing projects in IT

35+ Investment professionals

45 Countries covered by Globalscope

250+ Deals closed in TMT sector by Globalscope

Sale of a minority share of IT company — Private equity fund

intellias — Horizon Capital

Capital Times is an Exclusive Financial Advisor, Ukraine, 2018

Sale of majority shares of IT company — Strategic investor

solbegsoft — Helmes

Capital Times is an Exclusive Financial Advisor, Belarus, 2018

Sale of integration department — Strategic investor

Terrasoft — SoftClub

Capital Times is an Exclusive Financial Advisor, Ukraine, 2016-2017

Merger Advisor to IT company

Ukrainian Intelligent Systems

Capital Times is an Exclusive Financial Advisor, Ukraine, 2016-2017

Source: Capital Times

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