

The Deloitte UK Technology  
M&A Survey  
Back on track



# Contents

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Foreword	1
Key findings	2
<b>M&amp;A outlook</b>	<b>3</b>
M&A activity is likely to increase driven by market consolidation and opportunistic acquisitions	3
M&A valuations are likely to remain stable or moderately improve	4
Successful M&A: the importance of the strategic fit and integration	5
<b>Capital markets</b>	<b>6</b>
The IPO market is likely to return, but it may see only a slow trickle of companies and not a flood over the next 12 months	6
The pull of the US may be overstated	7
<b>The UK's position in the global technology industry</b>	<b>8</b>
The UK technology sector could make a bigger contribution to the UK's GDP if tax incentives for companies and individuals that invest in growing technology companies were improved	8
Appendix – Historical deal data	9
Contacts	10

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## About the research

This is the first in a biannual survey of CEOs, CFOs and M&A Directors of the top 150 UK technology companies (publicly listed, or private companies headquartered in the UK with revenues in excess of £20 million). The survey took place between 15 April and 5 May 2010. 55 companies participated, over a third of the top UK technology companies.

The Deloitte UK Technology M&A Survey gauges forward-looking expectations for M&A and the capital markets.

# Foreword

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## Welcome to our first UK Technology M&A Survey.

The global economic slowdown and the economic uncertainty that followed required UK technology companies to re-evaluate fundamentally their long-term strategic aspirations. Leaders at these companies were faced with a number of important decisions: whether to drive future growth organically or inorganically; whether to retain independence as a private company or to attempt to access new capital via a public listing; or indeed whether to consider the possibility of being taken over by a larger rival.

Now that growth, albeit weak, is back, where next for UK technology M&A?

Seeking answers by drawing on the traditional measures of M&A market activity – such as the number of completed deals and their value – is akin to driving forwards while looking backwards. Such statistics reflect the market position six months after reported deals commenced, rather than its current or future state of health.

This survey looks forward – at the next 12 months – with its insights coming directly from leaders at 55 of the UK's most significant technology companies.

Collectively, this group provides an exceptional guide to the latest views on M&A and to the capital market trends that we are likely to see for the rest of this year and into next.

I would like to thank the UK technology leaders that participated in this survey. With their continued support it will be updated every six months enabling the industry to recognise and respond to those changes in direction and momentum that the survey highlights.

Kind regards



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# Key findings

- **M&A activity is likely to increase driven by market consolidation and opportunistic acquisitions.** M&A is seen as a critical driver of strategic growth plans with increased activity driven by market consolidation and acquisitions of distressed companies; 60 per cent of technology leaders are optimistic on the outlook for M&A.
- **M&A valuations are likely to remain stable or moderately improve.** Only 8 per cent of technology leaders expect valuations to decline in the next 12 months. While the bottom of the market is seen as having passed, continued macro-economic uncertainty and the susceptibility of the market to short-term jitters, has reinforced the importance of a deep focus on financial fundamentals for acquirers.
- **Successful M&A: the importance of the strategic fit and integration.** Ensuring that any acquisition is aligned to the strategy of the acquiring company is seen as the most important factor in successful M&A. The importance given to proper integration and the retaining of key personnel highlights the necessity of maintaining management attention on an acquisition after the deal is done if value is not to be eroded.
- **The IPO market is likely to return, but it may see only a slow trickle of companies and not a flood over the next 12 months.** Only a fifth of technology leaders think that the next 12 months will be a good time to float a UK technology company.
- **The pull of the US may be overstated.** Despite a perception that a US listing offers potentially greater valuation multiples, its associated regulatory regime means a UK listing is seen as the primary choice for the majority of UK technology companies.
- **The UK technology sector could make a bigger contribution to the UK's GDP if tax incentives for companies and individuals that invest in growing technology companies were improved.** 55 per cent of technology leaders chose an improvement to tax incentives among their top three factors that could help ensure that the UK's technology sector makes a bigger contribution to the UK's GDP.

# M&A outlook

## M&A activity is likely to increase driven by market consolidation and opportunistic acquisitions

The majority of respondents are optimistic about the M&A outlook for UK technology companies.

Emerging from an 18-month period of cash conservation and cost control this result may not surprise, but with the fragility of the economic recovery and the knock-on effect of the next public spending review, it will be interesting to see if there are any changes in direction and momentum when we ask this question in six months' time.

Answering an open question on the M&A outlook, respondents noted:

**"The market seems less uncertain than it has for a year or two. There is more confidence in future growth potential and an easing in the supply of investor cash."**

**"There are increased opportunities for companies/ investors with financial backing. Quality is more important than ever."**

**"Confidence is returning to the market and with it comes more deals."**

While respondents are more optimistic, the survey suggests that this is relative to the preceding period rather than an expectation of a buoyant market.

Chart 2 shows that market consolidation, distress-driven deals and undervalued targets are among the top four drivers of activity. This indicates where the market has come from.

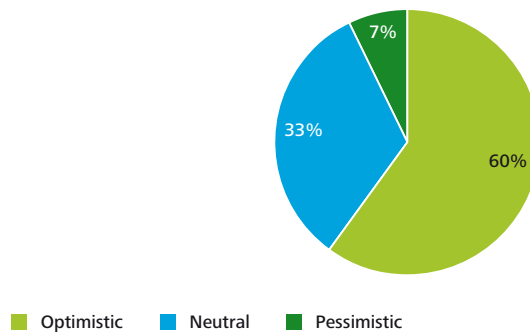
The answers to the open question also captured this dynamic:

**"Cash-rich technology companies will be in a strong position to carry out M&A activity with distressed smaller players."**

**"I think there will be consolidation and some distress sales."**

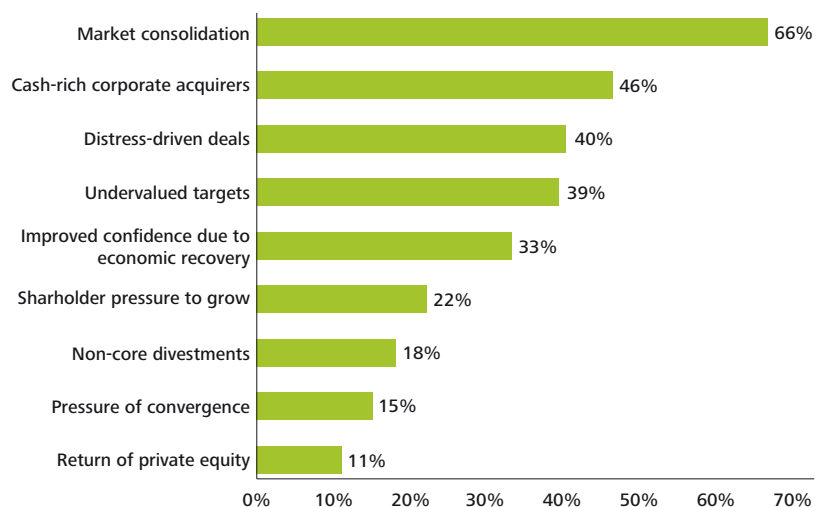
**Chart 1. M&A outlook**

How do you feel about the M&A outlook for UK technology in the next 12 months?



**Chart 2. M&A drivers**

What will be the main drivers of M&A activity?



Methodology: We asked M&A decision makers to select the three main drivers of M&A activity from the list above. The score is the percentage of respondents that included each driver in their top three.

### M&A valuations are likely to remain stable or moderately improve

While many more respondents believe that valuations will increase rather than decrease, a majority believe they will be unchanged.

When asked in an open question to describe valuation trends respondents noted:

**“Valuations are likely to remain at current levels with buyers remaining cautious and not wanting to overpay when any growth remains fragile.”**

**“Valuations will increase slowly as market confidence returns.”**

A number of respondents felt valuations were already high:

**“Should hold at already raised levels.”**

**“Valuations have generally held up well during 2009 and I see little reason for there to be much change in 2010.”**

‘Stable contractually recurring revenue’, and a ‘clear growth story and business model’, ranked highest as key valuation drivers. A clear ‘track record of development and innovation’ was the least cited, potentially indicating that either this is a given or that the real proof of development and innovation is in its realisation via sales growth. This theme of a market concerned primarily with fundamentals came through strongly in the open question on valuations:

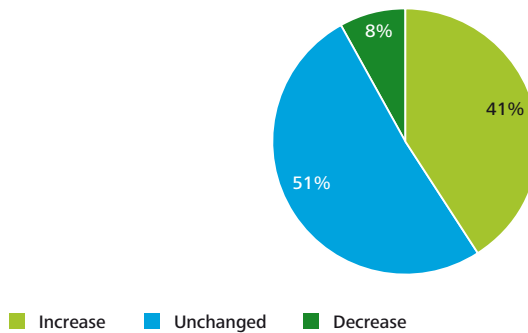
**“Valuations will be based on fundamentals – primarily cash generation.”**

**“Valuations will be more focussed on long-term contracted recurring revenue/visibility of earnings.”**

**“Recurring revenues will underpin valuations, and cost savings will augment this. Little importance will be given to non-recurring revenues as they are so unpredictable.”**

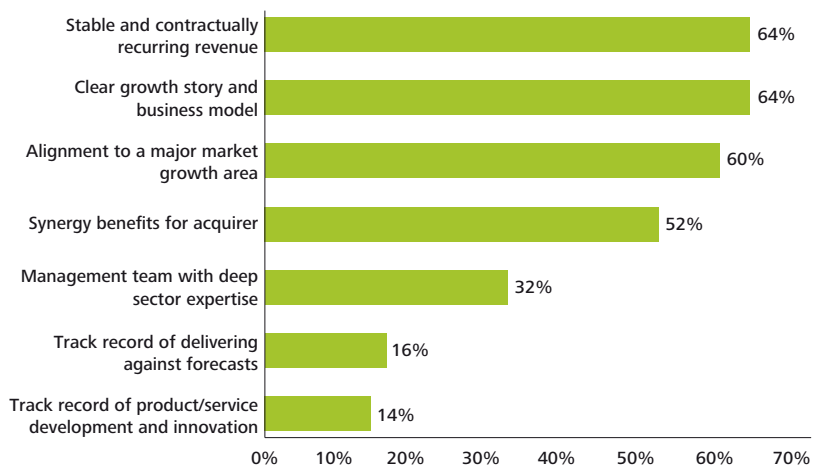
**Chart 3. M&A valuations**

Will M&A valuations increase or decrease in the next 12 months?



**Chart 4. Valuation drivers**

What will be the main drivers of value?



Methodology: We asked M&A decision makers to select the three main factors that most influence the valuation of UK technology companies from the list above. The score is the percentage of respondents that included each driver in their top three.

## Successful M&A: The importance of the strategic fit and integration

We were interested in our respondents' views on what makes a successful acquisition.

Ensuring that any acquisition is aligned to the strategy of the company was by far the most common response.

The importance given to proper integration and the retention of key personnel highlights the necessity of maintaining management attention on an acquisition after the deal is done, if value is not to be eroded.

Perhaps surprisingly, at first glance, not over-paying appears some way down the list. However, given that a strong strategic rationale is cited as the primary importance, the opportunity to accelerate growth or advance innovation via M&A would appear to allay this concern, provided the acquired company's benefits are properly captured.

In addition, a number of respondents expressed doubt that earn-outs were an effective way to manage potential over-payment.

An open question in which we asked respondents to describe the most important lessons they had learned from past transactions drew a host of valuable comments:

**"You must always understand what you are acquiring and why."**

**"The acquisition needs to be part of the strategic vision rather than just a good opportunity."**

**"Focus on having a clear strategy, and communicate relentlessly to make sure your organisations goals are met."**

**"Know what you are buying and why you are buying it. The integration post deal is the most important piece of a transaction, and the hardest to do."**

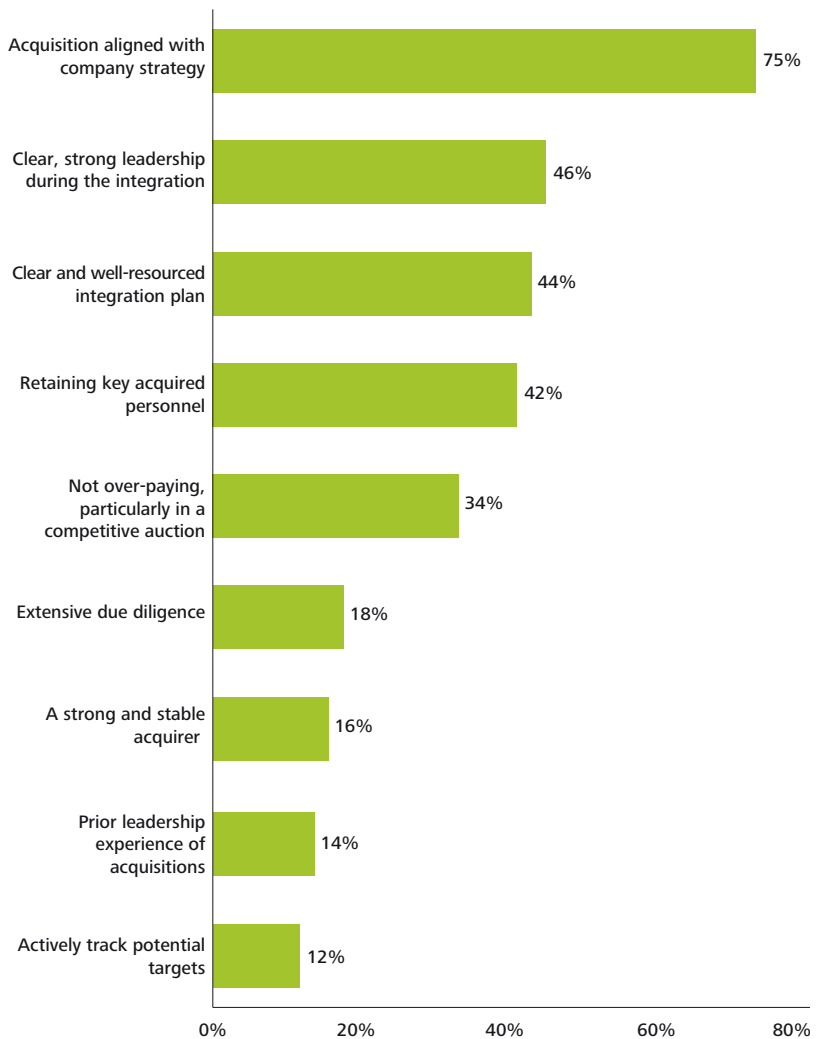
**"Integration planning starts at the due diligence phase so there is a clear direction on how things fit together on day one. Over communicate to staff and customers and make sure you monitor results of integration at business, staff, technology and customer level for at least 6 quarters – integration is not a 100 day process."**

**"Due diligence can be boring and time consuming but is critical to success in acquisition and subsequent integration."**

**"Earn-outs do not work. They drive key acquired personnel to be self-serving."**

**Chart 5. Acquisition success factors**

What makes a successful acquisition?



Methodology: We asked M&A decision makers to select the three main factors that underpin a successful M&A transaction of UK technology companies from the list above. The score is the percentage of respondents that included each factor in their top three.

# Capital markets

## The IPO market is likely to return, but it may see only a slow trickle of companies and not a flood over the next 12 months

Given significant press coverage of stock-market delistings in the last 18 months, an increase in confidence in the M&A market may not automatically transfer to an increased appetite for stock market listings.

Yet in Chart 6 our respondents indicated that they are more optimistic about investor appetite to support the flotation of UK technology companies.

While this is positive, the high proportion of respondents that see investor appetite as unchanged (47 per cent) is a clear signal that, particularly at present, capital markets remain susceptible to potential shocks. The climate for new issues is likely to remain challenging.

While investor appetite may increase over the next 12 months, only a fifth of respondents would seek to take advantage of this.

39 per cent do not believe that the next 12 months is a good time to float a UK technology company.

In our opinion, this probably reflects a wide range of unknowns, ranging from the delivery of pricing expectations, to the availability of debt finance and an ongoing low interest-rate environment.

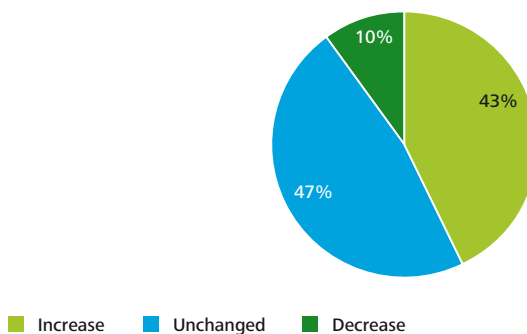
If a UK technology company does decide on a flotation, the majority of respondents would prefer to list in London (Chart 8).

In press comment, a perceived lack of liquidity is often cited as one of the potential challenges to be overcome with an AIM listing. However, from our respondents' assessment the ability to hold a public listing with a lighter regulatory touch, as well as tax incentives for investors may be behind this indication of its popularity with UK technology companies. Despite press coverage of delistings from AIM (four technology companies in 2008, five in 2009), our respondents still see AIM as a desirable destination.

While currently ranked low, the proposed use of Euronext as a stepping stone to a full listing on NYSE may raise its profile in the future. Euronext's lower regulatory requirements and US friendly access to a global investor base may make it an attractive route for some companies.

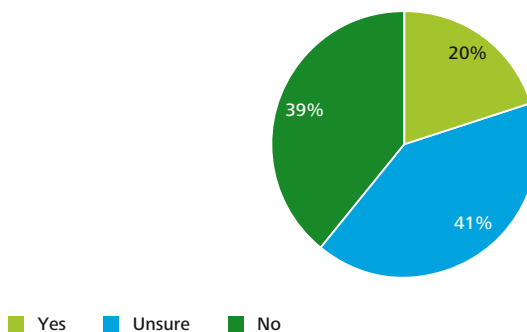
**Chart 6. Investor appetite**

Will UK investor appetite to support the flotation of UK technology companies increase or decrease in the next 12 months?



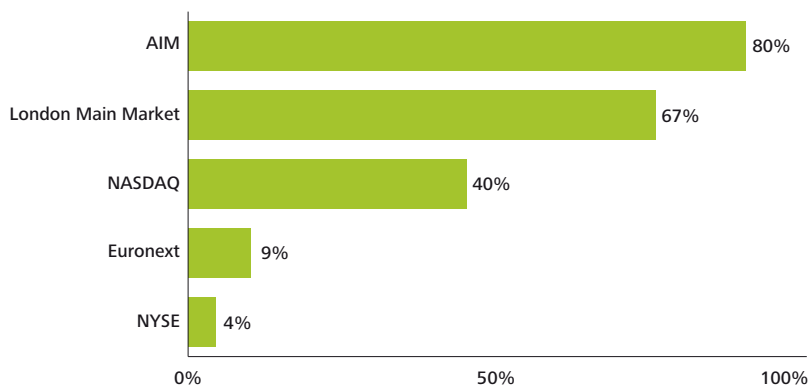
**Chart 7. A good time to float?**

Is the next 12 months a good time to float a UK technology company?



**Chart 8. Which market?**

Which is the most attractive market to float on?



**Methodology:** Respondents selected the two most attractive markets to float on from the list above. The score is the percentage of respondents that selected each market in their top two.

### The pull of the US may be overstated

Despite significant press comment on the gravitational pull of the US for UK technology companies, only 22 per cent of respondents agreed with the statement that UK technology companies will increasingly look to the US to float.

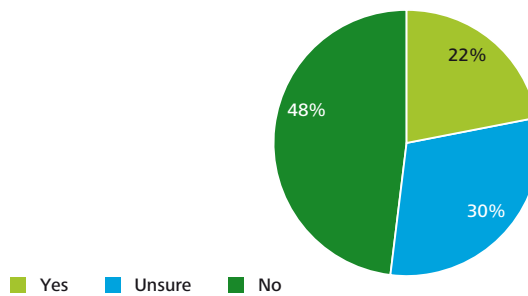
This is despite a widespread belief that UK technology companies achieve a higher valuation in the US.

Less widespread, however, is a belief that UK technology companies that float in the US benefit from better research coverage and investor understanding. Only 37 per cent of respondents agreed with this statement.

The cost of regulatory compliance may in part explain why, despite the majority of respondents believing that UK technology companies achieve a higher valuation in the US, only a minority believe that UK technology companies will increasingly look to the US to float.

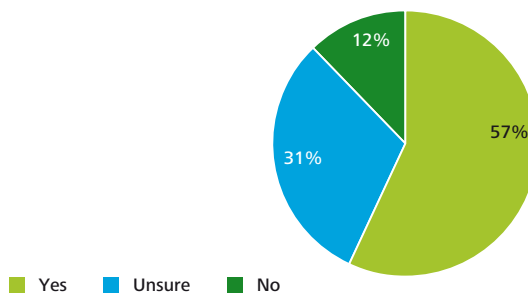
**Chart 9. The pull of the US**

Will UK technology companies increasingly look to the US to float?



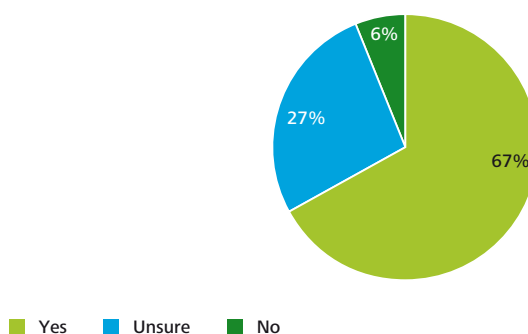
**Chart 10. Valuation and the US**

Do UK technology companies achieve a higher valuation in the US?



**Chart 11. Regulatory costs**

Is the cost of regulatory compliance in the US too great for many UK technology companies that would otherwise consider a flotation in the US?



# The UK's position in the global technology industry

## The UK technology sector could make a bigger contribution to the UK's GDP if tax incentives for companies and individuals that invest in growing technology companies were improved

The UK's new coalition government will need to consider how best to support the UK's technology sector. In Chart 12, our respondents provide a clear indication of where they believe this support would be most effective – improving tax incentives, both sector wide and to specific sectors, to stimulate investment and entrepreneurialism.

Would creating the right incentives merely increase the number of UK technology companies that are bought by overseas companies? Below are indicative responses when we asked respondents to explain their beliefs about how many of the world's largest technology companies might be based in the UK in ten years time.

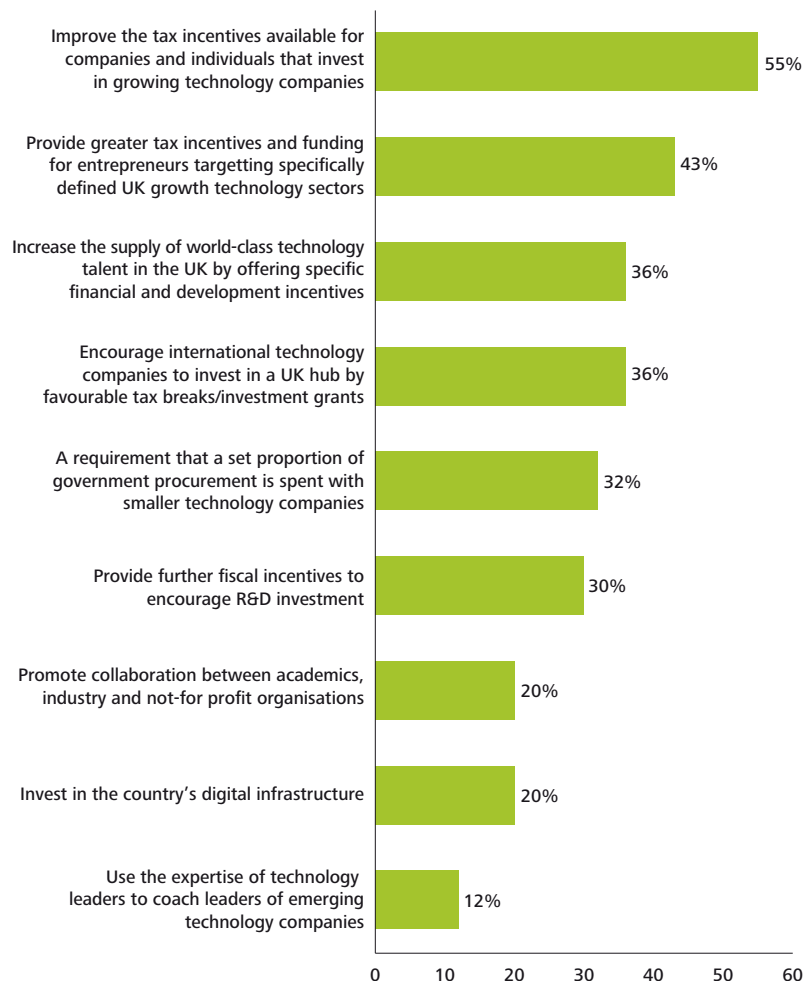
**“Without a proper government focus on creating world-leading companies, entrepreneurs and shareholders will remain incentivised to sell their business to larger, mainly US players, rather than continue to grow and acquire other businesses.”**

**“Although the UK has an inherent advantage (predominance of English used in software) success tends to result in a sale of the business, rather than the pursuit of further growth and ultimately a position amongst the world's leaders.”**

**“UK government does not have a strategic plan to grow technology companies and without government support the UK will not create world leaders. Short term focus on taxing entrepreneurs will also cause them to look for alternative locations.”**

**Chart 12. The UK's position in the global technology industry**

What are the most important factors that could help ensure that the UK technology sector makes a bigger contribution to the UK's GDP?



Methodology: We asked M&A decision makers to select the three most important factors that could help ensure that the UK technology sector makes a bigger contribution to the UK's GDP from the list above. The score is the percentage of respondents that included each factor in their top three. Responses under 10 per cent are not shown.

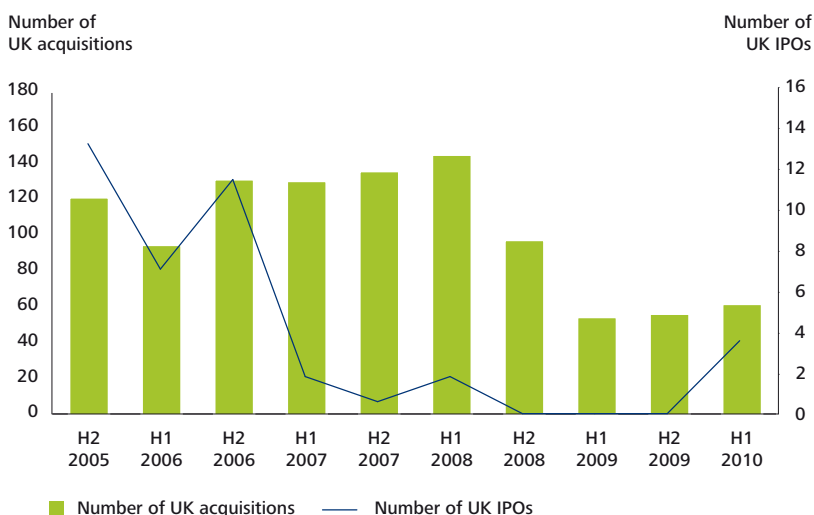
# Appendix – Historical deal data

The deal data in Chart 13 is beginning to show grounds for the optimism our respondents are reporting. The number of acquisitions involving UK technology companies has risen. Four UK technology companies have floated in the last six months (three on AIM, one on the London Main Market).

The survey indicates that M&A activity will continue to rise and while the capital markets remain nervous, IPO levels will continue to recover from what has been a very low base.

**Chart 13. M&A & IPOs**

UK technology M&A & IPO record



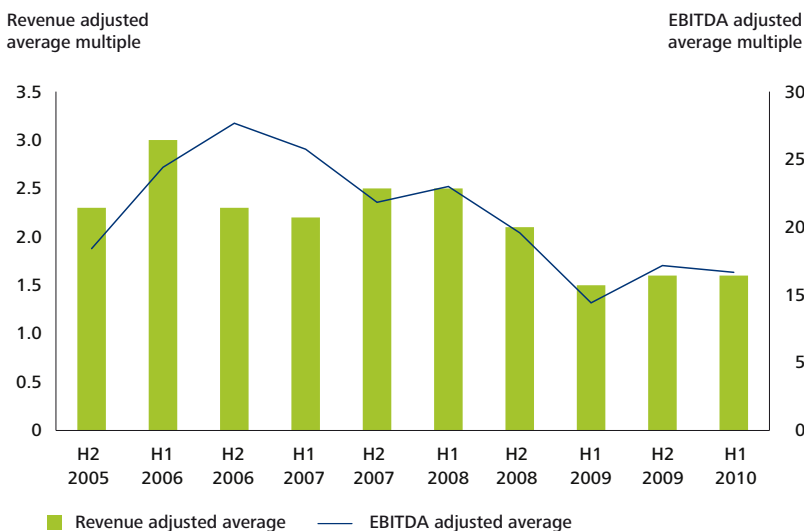
Source: Mergermarket, the London Stock Exchange and Deloitte analysis

Public data on valuations should always be treated with caution, but by considering technology deals globally and looking only at an adjusted average that removes the top and bottom 2.5 per cent of the data, a trend can be identified.

Chart 14 indicates that valuations have stabilised in the last 18 months, following a steady decline since the second half of 2007. The survey suggests that valuations will remain stable or rise only modestly over the next 12 months.

**Chart 14. Exit multiples**

Global technology exit multiples



Source: Mergermarket and Deloitte analysis

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# Notes

# Notes



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