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Valuation & Deal Insights®

Industry Coverage: IT Services, SaaS, BPO, and IT Supply Chain Services

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15 YEARS

San Francisco | Bangalore

Transaction Highlights

Transactions shaping the IT mergers and acquisitions space

IT Services

March 26, 2012
Avnet Inc. (NYSE:AVT) acquired Ascendant Technology (terms undisclosed). Ascendant provides IBM systems integration services and has annual revenue of $90 million.

February 8, 2012
Perficient Inc. (NasdaqGS: PRFT) acquired substantially all of the assets of Pointbridge Solutions, LLC for $22 million in cash and stock. Pointbridge is an IT consulting company focusing on Microsoft and has annual revenue of $17 million. EV/Revenue: 1.3x

SaaS

February 9, 2012
Oracle (NASDAQ:ORCL) acquired Taleo Corporation (NASDAQ:TLEO) for $1.9 billion or $46/share. Taleo provides on-demand talent management software solutions. EV/Revenue: 5.7x

March 8, 2012
Cornerstone OnDemand, Inc. (NasdaqGS:CSOD) acquired Sonar Ltd. for $14 million in cash and stock. Sonar provides cloud-based talent management solutions to small businesses.

IT Supply Chain Services

January 31, 2012
Avnet Inc. acquired Canvas Systems from Platinum Equity (terms undisclosed). Canvas is an IT solutions provider with $120 million in revenue.

March 1, 2012
Presidio Networked Solutions, Inc. acquired BlueWater Communications Group (terms undisclosed). BlueWater provides IT infrastructure and unified communications solutions.

Viewpoint:

Who's the Best?

By Marty Wolf
Founder | President

I recently read a short but very interesting article in McKinsey Quarterly entitled, "Are You Still Best Owner of your Assets?" It was written in November 2009, but it is still spot on. It summarized in more detail and by category a theme we debate in our offices frequently: "Worth more to me or worth more to you?"

First, you can only determine the best buyer by weighing competing alternatives. Better buyers might include private equity (PE), public equity, domestic or foreign strategics, smaller and larger private companies and so on. Each one can provide unique links and qualities, or core differentiators, which in our spaces are distribution and sales.

For example, we are currently engaged to sell a leading, deep vertical Knowledge Process Outsourcing (KPO) group in India that has global clients -- but no real sales and marketing engine. Similarly, we are going to market today with a Managed Services Provider (MSP) with global clients, real proprietary software IP, recurring revenue (the holy grail of business models today) – but NO direct sales team, lower than warranted margins and client control. Clearly, both assets in the hands of a sales and marketing acquirer is a better fit than the status quo, so consequently these buyers can pay more than it's worth to the seller on a standalone basis.

We once sold a wonderful, high-end consulting company with no English speakers, but great clients and processes. We sold it to a large public company with no presence in the vertical, but lots of sales people without solutions to sell.

A second key link is whether the buyer holds distinctive skills and is a driver of success in the industry. For example, the McKinsey article cites an example of a manufacturing company not necessarily being a better owner of a consumer packaged goods firm because manufacturing is too small a component. IBM and Oracle, on the other hand, leveraged R&D and IP integrated into hardware, distribution and sales, and have proven over and over why they are in many cases the best buyer for point solution software businesses.

"If you are the best buyer for multiple businesses, you should be prudent and diligent on how you systematically identify, assess and integrate these opportunities."

A third key link that is often overlooked is corporate governance, which is where certain PE firms excel. The best performing PE firms gain more efficiency by improving operations than through good timing or financial leverage. McKinsey found that two-thirds of the top quartile proved this. Our experience has proven that all PE groups indeed are not the same and all initial money is not the same.

For example, some PE groups have a strong performance culture, not just focused on customers or vendors, and they pull the trigger quickly on underperformers. Additionally, they abandon sacred cows, introduce real planning, and look over three to five years -- not annually. They also spend 3x as much time on their director role focused on strategy and performance, not compliance and risk avoidance.

These factors are some of the difference between a seven times investment return many successful PEs achieve and the microscopic growth in shareholder value over the past years as measured by the MW IT Index®, U.S. Edition.

A fourth key link is better insight or foresight into how markets evolve. You see this a lot in software and it is especially evident in the SaaS space today. Many operators are running so hard and fast with customers demanding support and competitors cropping up all over the globe, along the way, where the company actually fits in and goes from here gets sidetracked. Intuit, with Quicken, is a cited case and almost all local and mobile transactions fit this today.

A final key link is access to capital, talent, and relationships. This is very prominent in emerging markets and explains why some conglomerates have grown so large, across so many markets. Good examples are Hyundai and Tata. They have the ability to be the best buyer of many businesses due to their access to talent, large balance sheets, and distinctive relationships with multi-billion dollar corporations and leading governments.

The best owner concept, which applies to all businesses, isn't static, however, and instead changes over the life of the business. Typically, the founders are its first best owner. But over time, capital, distribution, technology or growth may cause a need for more capital and resources. Passion and commitment can only go so far. Also, in the case of larger enterprises, the same rule applies to divisions or entire units. Some executives view the sale of an asset as a failure of strategy or an acknowledgement that they are too small to effectively compete. However, the inability to adjust and change with market demands is a flaw. This is why it's more common for a new leader to come in and review the business and sell what's no longer determined to be strategic.

McKinsey research shows that stock markets react positively to spinoffs and also shows those spun off businesses increase their own profit margins by a third within three years of being sold. We have sold six non-core divisions of *Fortune 500* companies and experienced shareholder acceptance in each case.

"If you are not the best buyer for your business, you should find the best one. "

Bottom line, if you are not the best buyer for your business, you should find the best one. If you are the best buyer for multiple businesses, you should be prudent and diligent on how you systematically identify, assess and integrate these opportunities, and proceed full speed ahead. We currently have three global buy side engagements with very specific criteria in mind, and segments where they are clearly the best buyer. If we find the right targets, it's off to the races.

Happy selling.

India Update: Significant Deal Volume

By Gaurav Sharma
Senior Vice President

We are seeing an increased interest from Indian players in the M&A market. Since 2005, we have been actively connecting with India based IT companies and have executed several mandates. We are currently engaged in a sell-side mandate for a KPO company and two buy-side mandates of meaningful size in the IT Services space.

martin*wolf* expects an uptick in M&A activity in India during 2012 spurred by (1) reduced inflation and lowered interest rates in India coupled with (2) growth in the US economy enhancing the outlook for Indian based outsourcers serving US companies. Additionally, we believe an improving US economy will push cash rich American companies to acquire India companies. This insight is based on our discussions with various C-level executives across the country.

On the private equity (PE) front, various reports from mergermarket, Thomson Reuters, McKinsey and others, all point to growth in India-based investing from US PE firms. According to mergermarket, US private equity-backed buyouts in India surged from USD $1.16 billion in 2010 to USD $2.01 billion in 2011. Looking at the total deal value in 2011, US PE firms slowed their pace of acquiring Asia-Pacific businesses except those in India.

"The cloud solutions industry in India is around USD $400 million, and by 2015 is poised to grow 10x to $4 to 4.5 billion."

Furthermore, the National Association of Software and Services Companies (Nasscom) believes that India software exports are projected to grow 15-17% to generate about USD $70 billion in 2011-12 against USD $59 billion in 2010-11.

Additionally, the India market is witnessing a rapid adoption of the latest IT trends. The cloud solutions industry in India is around USD $400 million currently and, by 2015, is poised to grow by 10x to USD $4 to 4.5 billion. Furthermore, Internet retailing and e-commerce are completely new areas that are growing rapidly with a significant increase in the number of online shoppers. As a result, the Internet retailing companies are attracted to India markets, which are poised to grow substantially in the years to come.

martin*wolf* anticipates significant deal volume in India in the next few years. The world's largest internet retailer, Amazon.com, has recently launched an Indian version of its website,Junglee.com. Seattle-based Amazon is looking to harness the burgeoning online shopping market in India that is expected to triple in size by 2015. India's largest and most-funded e-commerce company Flipkart Online Services Pvt. Ltd has acquired Letsbuy.com, the country's second-largest online electronics retailer, for an undisclosed amount. The move reflects Flipkart's strategy of becoming a major player through acquisitions and eventually grabbing substantial market share of the ever-increasing Indian online retailing space.

Based on our historical success in the Indian market and these strong market trends, we have decided to open our first office in Bangalore, India. We see a compelling opportunity to leverage our deep domain expertise in the IT sector with an experienced banking team in India to capture significant market share in the middle market area in which we are focused. According to Marty Wolf, President & Founder of ***martin****wolf*, "The decision to expand our presence in India is driven by increased M&A activity among buyers and sellers in India, as well as between companies in India, the U.S. and other parts of the world. Specifically in the IT services space, which is our focus, India has an established core competency that is increasingly appealing to companies outside India seeking growth through acquisition."

India is becoming an increasingly larger portion of our business during the next few years as our presence and the M&A market in India both continue to expand.

A tale of two tasks

Branding for Sales vs. Branding for "The Sale"

By Tim Mueller
Principal

It's said that luck sits at the intersection of preparation and opportunity. And for those selling their businesses at incredible valuations, preparation is typically the common denominator.

But in today's ultracompetitive space of global IT, how do companies stand out first as better and desirable to customers. And second, how do they stand out as better and desirable to potential acquirers of the business?

For the sake of argument, we will assume that a company seeking to be acquired has created its market with customers. Without a doubt, well-managed companies providing value to customers with unparalleled subject matter expertise will always be invited into M&A conversations.

But branding a company to customers and the general market is not enough for a company seeking to be acquired. In fact, once a company decides it wants to delve into the marketplace of M&A, the branding begins again. So how does a company make its brand resonate to prospective buyers during a transaction?

To be clear, branding the company to customers and the marketplace versus branding the company to the M&A marketplace are two different jobs that require full-time attention.

Step One: First Impressions

As companies are marketed to a collection of qualified buyers, something unique is required to attract the attention of someone combing through their inbox stuffed with introductory emails. In many cases, the professionals assigned to cull this list to a manageable number are charged with finding companies with a fresh perspective and a new twist toward dominating a particular vertical or geographic footprint.

In these cases, the successful communication of a company's brand can be the difference between "let's pass" and "let's make a deal."

"Branding is the DNA that defines a business, and often extends into the company's culture and the longevity of customer relationships."

Branding is the DNA defining a business, and often extends into the company's culture and the longevity of customer relationships. Equally important, it tells the story of an organization that can't be told by simply measuring revenue and EBITDA growth.

Step Two: Branding Due Diligence

For marketing heavyweights such as HP, Cisco and Intel, brand contribution can be as much as 40-50 percent of Enterprise value. For others, a brand's value is difficult to measure and ends up getting less attention than tangible assets.

For buyers, clearly that is a mistake.

We recommend buyers complete ***martin****wolf's* 10-point **Brand Value Assessment**™ (BVA) to better understand and measure the value of the seller's brand. This diligence provides the data needed to develop a brand transition plan that begins during the deal-closing announcement, and extends through post-deal integration. Unfortunately, most buyers don't invest enough time conducting a BVA before closing the transaction, which results in a constant game of catch up during integration.

The following is a list of 10 elements making up a BVA pre-sale audit:

1. **Brand awareness**: How do customers, competitors and industry analysts perceive the company's image?
2. **Industry Influence**: Are members of the seller's management considered leaders in their industry's media, events, trade shows and regulatory commissions?

"…branding a company to customers and the general market is not enough for the company seeking acquisition. In fact, once a company decides it wants to delve in the marketplace of M&A, the branding begins again."

3. **Internal Brand Awareness**: Employees are a direct extension of a company's brand. Does the company educate employees so they "talk the talk" and "walk the walk?"
4. **Recruiting**: If it's really about the people, how well does the seller leverage its brand to attract and retain top-notch professionals?
5. **Website**: Is it an electronic version of the company's brochure, or is it a living, breathing tool demonstrating market leadership and vision?
6. **Social Media**: It's an integral element today of dominant, industry leaders. How is the seller using it to connect in conversations with customers, suppliers, media and more?
7. **Conventional Media**: Does the seller engage with writers and publishers who influence customers and stakeholders?
8. **Company and Product Literature**: Is it forgotten, or does it receive the attention it deserves to make positive first impressions at face-to-face meetings?
9. **Consistent Corporate ID**: Are standards in place to ensure the logo, colors, product names, customer proposals, business cards, etc…are consistent?
10. **Brand Extensions**: Is the seller leveraging the strength of its primary brand as a vehicle to launch other products or services? If it is inconsistent with the brand's identity, the mother ship's reputation will be damaged.

For the seller, it's critical that a similar BVA is completed well before introductory teasers are distributed, and certainly before CIMs are released. A proactive approach to this exercise will help a seller get in position to be in position.

Step Three: Following the Sale

A critical decision following a merger, acquisition or divestiture is blending two brands together, or the decision to keep them separate. When SBC purchased AT&T, it was a no-brainer to decide which brand to keep. AT&T had the brand equity. The three letters actually meant something and was positively embraced by SBC customers and shareholders. But most situations aren't as clear cut, which means the thoughtful and flawless integration of a brand may be one of the most challenging of all issues post close.

In our next issue of ***Valuation and Deal Insights***, we'll walk through the key elements of successful brand integration following an acquisition.

M&A Remains Consistent Path to Liquidity Events

By Geoff Rhizor
Senior Associate

During the past 12 months, a series of technology companies have "successfully" completed IPOs. I use quotes because success is in the eye of the (stock)holder. First of all, many of these companies are high-flying social based Internet companies with daily news coverage. Pandora (NYSE:P) went public at $16 dollars per share, went up to $26 and now languishes below $10. Groupon (NASDAQ:GRPN) went public at $20, rose to $31 and now is just above $10. LinkedIn (NYSE:LNKD) went public at $45, shot up to $122 and now after falling in December to around $60 is back up to nearly $110.

For Groupon and Pandora, the main beneficiaries are the founders and other pre-IPO investors as they were able to exit at favorable valuations post-IPO. LinkedIn went public at a more reasonable valuation and successfully completed a follow-on offering after strong stock performance. It has since continued benefiting all investors and the company, with the price up over 100% from the IPO. Although LinkedIn managed to buck the trend, on the whole, these companies with high profiles and millions of users have struggled to win the hearts of investors, mainly due to a lack of profitability.

"Although an IPO appears to be the holy grail for any company, M&A will continue to be the most frequently used way to achieve a liquidity event."

EPAM Systems (NYSE:EPAM), an offshore outsourcing firm with significant operations in Eastern Europe, is the most relevant company to go public in the space where we focus and it was only able to do so after reaching over $300 million in sales and $60 million in EBITDA. The company completed the IPO well below the initial range of $16-18, going out at $12/share. EPAM has since performed strongly and is currently trading at over $20/share.

Why do I bring this up? We often hear entrepreneurs talk about their exit options including a potential IPO. Although this can be a possibility for almost any company, it is the least likely exit outcome, as less than 1% of companies ever become publicly traded. EPAM is a strong example of a company with scale successfully accessing the public markets in IT services albeit doing so at a much lower valuation than initially anticipated.

Some large IT companies such as FusionStorm and GlassHouse Technologies have gotten close recently but have been unable to get over the hump. FusionStorm, an IT solution provider based in San Francisco, has over $400mm in revenue (potentially over $700 million if it were to close planned acquisitions), but faced difficult market conditions and a complicated series of planned acquisitions that ultimately limited investor interest. With over $100 million in sales, GlassHouse, based outside Boston, is a leading IT Services firm focused on data centers and cloud computing. After changing CEOs in November 2011, the firm was unable to complete an IPO due to market conditions and economic uncertainty. This was its second failed attempt to access the public markets.

We now know that Facebook will likely go public on May 18, 2012, but it, like EPAM, is the exception not the rule. Although an IPO appears to be the holy grail for any company, M&A will continue to be the most frequently used way to achieve a liquidity event.

Understanding "Rollover Equity"

By Chris Covington
Principal

We are strong believers in private equity (PE) and in selling owners "rolling over" their equity into a new entity going forward. Some of the absolutely best financial results for our clients have involved the sale of a controlling interest in their companies at a current market valuation to a PE firm followed (often within 36 months) by the sale of the balance of their interest at some multiple of the original valuation. While the seller(s) have probably worked for several more years, the total sales price is significantly larger than what they could have reasonably expected on the initial sale.

There are occasions, however, where selling owners of privately held companies understand neither the mechanisms nor the tax implications of "rollover equity"; this article will touch on some of the essential considerations.

While the "rollover" concept is not difficult to understand – the seller will have a minority interest in a new entity in essentially the same business going forward – the actual form of the transaction and resulting entity can seem unnecessarily complicated, and generally turns on tax considerations.

While the "rollover concept is not difficult to understand…the actual form of the transaction and resulting entity can seem unnecessarily complicated."

Keep in mind that the seller desires to pay tax only at the capital gains rate on the portion of the company sold; ideally the seller also wants a structure that will allow for a tax free rollover of its retained equity. The PE buyer, by contrast, is theoretically unconcerned with the purchase price tax consequences to the seller; its interest is in a transaction that will result in a "stepped up" basis in the company assets, so that it will be able to maximize depreciation (and therefore maximize profits) going forward.

So what are the different possible forms of transactions?

- A sale of assets will provide for the step up in basis that the buyer is looking for, but it will mean that the seller (the company) will pay tax on 100% of the purchase price, and the selling individuals will be investing in Newco on an after-tax basis. As a result, a sale of assets is almost always disfavored.

- A sale of a majority of the stock is generally attractive to the selling shareholders – as they are only paying tax on that portion of the company that is in fact changing hands, and generally at a capital gains rate – but the buyer will miss out on a step up in basis.

- If the selling company is an S Corporation, the selling shareholders may be able to sell a portion of their stock and make a 338(h)(10) election. This is attractive in that it is an election made with the IRS that results in treatment as if it were an asset sale: the buyer gets a step up in basis, and the selling shareholders are, of course, required to pay tax on their pro-rata share (that it, it is NOT a tax free rollover). There are a number of limitations to a 338(h)(10) election: among them are that the company must have S status and at least 80% of the company must be sold.

- In a tax-free merger, sellers can get the tax results they want if they are able to effect a tax-free merger, meaning that in a "forward" merger their rollover must be at least 40% of the total deal value and in a "reverse" merger it must be at least 80%. Unfortunately, the PE buyer will not get a step up in its basis, and, combined with the ownership limitations, means that such mergers are generally not favored by PE buyers.

- Most PE buyers will acquire the sellers stock through a holding company, with the expectation that there will be (or perhaps there have already been) add-on acquisitions. The sellers transfer a portion of their stock for a portion of the stock in holding Newco – which transaction should be tax-free – and then the balance of their stock for agreed to consideration. Unfortunately, under this scenario, there is no step up in basis and the seller must be careful to insure the structure permits it to get the benefits of increased value resulting from additional add-ons.

- Some PE buyers have embraced the use of LLCs for their operating companies, as LLCs (like S Corporations) avoid the double taxation of C Corporations. Accordingly, the selling company's assets are transferred to an LLC on a tax-deferred basis (that is, there is no tax to the sellers), and a portion of the LLC is sold to the buyer. However, to avoid double taxation, the original seller company must have been an S Corporation.

So what does this mean for our sellers?

- First, recognize that rolling over a portion of your equity can be a tremendous opportunity for you. It allows the parties to "bridge" any substantial differences in valuation, and results in buyer and seller having substantially aligned interests going forward. It is as much the formation of a "new partnership" as it is the sale of a controlling interest in a company.

- Second, you should retain a tax adviser early in the process. As noted above, the differing deal structures have significantly different tax implications, and there are a number of sometimes competing considerations: the form of the selling entity (C or S Corporation, LLC and so on); the tax basis in selling entity's assets, stock; the amount of depreciable assets involved, and the most anticipated exit scenario. The competing considerations can, in almost every instance, be accommodated by thoughtful deal structures.

- Third, you should consider appropriate governance provisions that will help you protect your minority interest going forward: Board of Directors participation rights and tag-along rights are just two considerations.

"The changing move to the cloud model will spur additional investments and acquisitions by IT reseller and service companies as they position themselves for the future in the IT industry."

Best Owners of Assets in Human Capital Management (HCM)

By Sunil Grover
Executive Vice President

The familiar idea of "best owner" within M&A can be used to review several recent M&A transactions within the HCM marketplace.

SAP (NYSE:SAP) and Oracle both paid significant premiums to acquire Success Factors (NYSE:SFSF) (12/3/2011) and Taleo (2/9/2012) respectively because they were better owners of these assets and could create more value than either company could independently. In the 12 months prior to being acquired, both Success Factors and Taleo spent over 50% of their revenues in sales and marketing costs. Most of their revenues and sales and marketing efforts were focused in North America.

After these changes of ownership, the global sales and marketing organizations of SAP and Oracle can sell their respective SaaS offerings to a broader base more effectively. While it took significant market premiums to acquire these assets, it is almost certain that expected benefits outweigh these premiums by an order of magnitude.

While the above mentioned talent management deals captured the headlines, the time and attendance space within HCM also saw several M&A transactions based on the same thesis. SaaS-based time and attendance management provider WebApps' shareholders decided that the undisputed leader in time and attendance, Kronos, was the better owner of their asset (3/29/2012). Similarly, Dayforce (2/7/2012) and ICON Systems (1/9/2012) decided that payroll service leaders Ceridian and PayChex (NASDAQ:PAYX) were better owners of their assets, respectively.

While established companies, also known as strategic buyers, are the best owners to leverage operating infrastructure and capture synergies, a private equity or venture capital firm can be the best owner of an asset if it has significant growth potential as a stand-alone entity. These financial buyers can bring in better managers; refine strategy and performance management; and create a stronger performance culture. oDesk (3/21/2012), PlanSource (2/1/2012), and iCimms (1/3/2012) raised private equity or venture financing in Q1 and we expect others to follow. With additional capital and better

***"…as a business owner or executive, you should periodically assess whether changing market trends enable you to create the most value* for your company."**

governance in place, these companies and others can create more value with their respective sponsors.

The best owner of an asset goes through a lifecycle often calling for a changing of the guard. Private equity firm Frontier Capital was the best owner for HealthX and acquired it from another private equity firm Liberty Partners (1/5/2012) while payroll service provider ADP(NASDAQ:ADP) was the best owner for recruitment process outsourcing firm The Right Thing (10/10/2011) and HR solutions firm SHPS Holding (3/8/2012) and acquired these assets from private equity firms Kayne Andersen and Welsh, Carson, Anderson & Stowe, respectively.

In summary, as a business owner or executive, you should periodically assess whether changing market trends and circumstances enable you to create the most value for your company or if the marketplace dictates that another entity will create the most value over the long term. Value destruction occurs when owners miss this strategic inflection point.

Valuations? It Depends…

By Anthony Lembo
Principal

One of the questions we often get from owners of private companies is: "What is my business worth?" Unlike the public marketplace, where a shareholder can see the value of his investment on a daily basis, determining the value of a private company is a more complex exercise. In fact, a private business has a range of values at any one point in time, depending on a number of variables both external, such as budget cuts and GDP growth – as well as internal company factors including sales growth, profitability, and industry focus.

The valuation for the same company can be quite different based on the purpose of the valuation. A valuation for an insurance company would use the fair market value of the net assets, while an estate planning valuation would follow guidelines developed by the IRS. A market valuation when looking to sell the company would be based on comparables and cash flow. All of these valuations would be "accurate," but most likely very different.

"…it is important to understand the motivations of the seller so the proper buyer type can be determined."

Prospective sellers are most concerned with their market valuation, the price at which a buyer and seller agree on a majority control transfer. We express market valuation as a range of values rather than a single point. The range of a fair market valuation represents the range of values a universe of buyers would be willing to pay for the company. This valuation range is calculated through an analysis of several valuation methodologies including public company comparables, transaction comparables, and a discounted cash flow analysis.

In determining the appropriate range, it is important to understand the motivations of the seller so the proper buyer type (strategic, financial, asset) can be determined. The buyer type significantly influences the valuation range. For example, a strategic buyer with large cost saving synergies can be expected to place a higher valuation versus a financial private equity buyer who would not experience the same cost synergies. However, the seller may be unwilling to allow cost cutting measures and the elimination of jobs for his employees, thereby ruling out highly synergistic buyers and the maximum potential value.

In contrast to the fair market value that provides the range of values a willing buyer and seller would exchange, in an M&A sell-side engagement, the goal for an investment banker looking to maximize value is to find the highest price a buyer will pay. It's called the "unwilling buyer and seller rule," which is the price ceiling just before which a buyer will walk away from the transaction. This highest valuation requires a strong sell-side process, multiple bidders, skilled advisors, and focused, dedicated sellers. This value cannot be determined by methodology and number crunching, but only through canvasing of the market and talking with prospects via a complete sell side process.

In summary, the only reasonable answer to the seller's question regarding value is: It depends.

The China Report: M&A in 2012

By Hao He
Vice President

Given the economic turmoil in the US, followed more recently in the Euro Zone, and coupled with China's increasing role in the global economy, there is no doubt that the buzz around Chinese M&A activity is at an all-time high. Recently, we have started a new round of strategic initiatives in the Chinese IT M&A market. Based on conversations with top executives from IT companies, private equity firms, and investment bankers in China, in addition to our own in-house research, we have come up with a few observations.

China outbound M&A activity flourishes but obstacles remain

According to an article from PriceWaterhouse Coopers dated January 13, 2012, overall M&A activity in China during 2011 increased 5% from 2010 with a total of 5,364 transactions. Within this group, outbound investing by Chinese firms continued its inexorable rise to a new record of 207 deals worth USD $42.9 billion. This represents a 10% increase in transaction volume and a 12% increase in transaction value over 2010. Of these outbound deals, 16 were valued at greater than USD $1.0 billion. Besides the obvious natural resource focus of the Chinese market, the search for strong IT assets is on the rise. Additionally, US and Europe based assets are the main geographic locations for these outbound investing activities.

But despite being cash rich, Chinese entities face the same political and legal obstacles when making outbound investment as foreign buyers face investing in China. Several high profiles transactions have not closed. China National Offshore Oil Corp. (NYSE:CEO) ran into a political storm when it bid for US energy firm Unocal in 2005, while Huawei (SHE:002502) has seen US regulators express concern over several acquisitions. Similarly, China Development Bank failed to buy Royal Bank of Scotland's (NYSE:RBS) aviation-leasing unit, despite making the highest bid. Other obstacles, such as cultural differences, currency development, and lack of transparency will further influence M&A growth.

Private equity rush to enter Chinese technology market

In 2011, private equity invested a record high USD $31.2 billion in China. Cash has been flooding into the country at a record pace as investors look to one of the few growing geographic markets today. For example, Intel Capital invested USD $90 million into 13 Chinese companies in 2011 or more than 15 percent of its total global invested capital, making China its No. 2 market after North America.

With an estimated 8,000 private equity firms in China alone, top foreign private equity groups are competing with local PEs that have government ties for the top opportunities. Additionally, strategic buyers are generally treated as the preferred bidder given top dollar is no longer the sole consideration. Both domain expertise and global reach are critical factors Chinese companies consider when choosing investor partners.

"…strategic buyers are generally treated as the preferred bidder given top dollar is no longer the sole consideration."

With leading public technology companies seeing rich valuation multiples an IPO remains the preferred route for a private equity exit; however, M&A is by far the most likely exit route for any private company. Whether looking at an IPO or M&A transaction, foreign PE and strategic investors are facing significant political and regulatory obstacles in China and need to pay close attention to the approval processes and consider the challenges that accompany investing in this hot market.

Overall, ***martin****wolf* strongly believes that the Chinese market will continue to see growth in outbound M&A activities as its buyers become more mature and foreign investors continue to seek out leading technology companies. Additionally, the wave of recent M&A activity provides exit opportunities for Chinese businesses to capitalize on value creation amid these uncertain economic times. Keep your eye on China's IT industry, there is much more to come.

Selected Transactions

In an effort to keep you apprised of various transactions that we believe are significant to the marketplace, shareholders, and the M&A industry, we offer the following analysis.

1. Oracle acquires Taleo Corporation

Target: Taleo Corporation provides on-demand talent management software solutions. The company was founded in 1999 and headquartered in Dublin, California. With more than 1,400 employees, the company has offices in the US, Canada, UK, Australia and France.

Buyer: Oracle

Implied Enterprise Value: $1.8 billion, EV/Revenue: 5.7x

Synopsis: Oracle completed the acquisition of Taleo from shareholders for $1.9 billion or $46/share on April 5, 2012.

Transaction Highlights: This transaction highlights the heated consolidation wave in the cloud space. Oracle will benefit from Taleo's broad customer base of 5,000 businesses which includes 47 of the Fortune 100. Oracle should be able to leverage its strong sales organization to cross-sell Taleo's offerings. Taleo, on the other hand, benefits from high SaaS valuations despite relatively flat EBITDA for the past three years.

Its second acquisition in four months, Oracle's purchase of Taleo demonstrates its commitment to being a strong player in the SaaS space. The quest for the leadership position among enterprise players has been like a game of chess between titans. Oracle is famous for getting into a space fast with huge acquisitions as it did with its acquisition of Rightnow Technologies in October 2011. Its rivals made similar moves, such as IBM's acquisition of Demandtec and SAP's acquisition of SuccessFactors. Oracle hopes that its acquisition of Taleo may prove to be checkmate; along with the acquisition of Rightnow, Oracle has spent $3.7 billion to acquire $530 million in annual revenue.

More acquisitions among providers of enterprise software/applications will be forthcoming with large purchase tickets and rich valuations. It is not yet clear if, as a company, Salesforce is ready to place a billion dollar bet as they don't see why CRM and HCM need to be from the same vendor. Our prediction is that Salesforce will not make a major acquisition (>$1 billion) in HCM over the next 12 months. Instead they will continue to make group/IP hires and small tuck-ins at an accelerated pace with rich multiples.

2. Perficient Acquires PointBridge

Target: PointBridge provides IT consulting services with a focus on Microsoft technologies. The company was founded in 2004 and is headquartered in Chicago. With over 130 employees, the company serves healthcare, retail and manufacturing clients.

Buyer: Perficient Inc.

Implied Enterprise Value: $17.0 million, EV/Revenue: 1.3x

Synopsis: Perficient completed the acquisition of all of the assets of Pointbridge for $22 million in cash and stock on February 8, 2012. The consideration includes $14.4 million in cash and $7.6 million in stock. The transaction is expected to be accretive to earnings per share immediately.

Transaction Highlights: This acquisition will raise Perficient's revenue to over $300 million and expand the company's presence in the Chicago, Milwaukee, and Boston markets. It also will increase the company's staff, adding 130 consulting, technology, sales and support professionals. As an additional benefit, Perficient will inherit PointBridge's talented executive team led by Co-Founder and CEO Mike Gersten, a leading Microsoft Services executive and a recognized thought leader.

Historically, Perficient has been very acquisitive. They acquired JCB Partners, a technology consulting firm that leveraged the IBM Cognos software suite, in July 2011. In April 2011, they purchased Exervio Management Consulting, Inc., a business and management consulting firm. Prior to that, they acquired speakTECH, Inc. in December 2010 and Kerdock Consulting, LLC in March 2010.
This deal marks the second transaction within the last two months in the highly fragmented Microsoft services space. In December 2011, Tribridge acquired ePartners, a Microsoft consultancy.

***martin**wolf* expects strong deal flow as slow organic growth encourages IT services firms to acquire as theyseek to expand both their locations and service offerings.

Select MW Transactions

Below are selected transactions in which *martinwolf* served in an advisory capacity.

softchoice acquired UNIS LUMIN Experience Excellence December 2011	SPS Strategic Products and Services has been acquired by Court Square September 2011	Infinisource has been acquired by ACCEL KKR September 2011
ValCom has been acquired by PC Connection March 2011	Benefits XML enabling e-benefits has been acquired by SS&C March 2011	Innovative Process Administration, LLC has been acquired by MERCER MMC Marsh Mercer Kroll Guy Carpenter Oliver Wyman August 2010

About ***martin**wolf*

With offices in San Francisco and Bangalore, ***martin**wolf* is the world's leading middle market IT M&A advisory. Since 1997, the firm has completed more than 115 transactions in six countries. Its knowledge and experience with IT outsourcing and managed services combined with its disciplined approach, which includes a proprietary, proven, step-by-step work plan customized for each client, has produced one of the highest transaction completion rates in the industry. The firm has active engagements in six countries and has complete transactions with six *Fortune 500* companies.

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