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Viewpoint: **Changing Times**

By Marty Wolf

Founder | President

It's earnings season, and the slew of reports over the past couple of weeks have served to remind us just how much the IT landscape continues to change. Talk of the cloud has dominated earnings announcements, especially from the traditional tech giants as they seek to offset declines in revenue from falling PC sales. At the same time, we're also seeing IPO activity [more than double](#) compared with last year, with first quarter IPO proceeds topping \$11 billion, many of them in the technology industry.

I'd like to open this VDI by talking about some of these changes, both in the United States and abroad. It's an exciting time to be part of the always dynamic IT industry, and I think you'll find the analysis in the following articles particularly useful in helping you parse these new developments.

Microsoft's [third quarter results](#) came out on April 19, and the words "mobile-first, cloud first" were all over them. New CEO Satya Nadella is showing signs that Redmond is willing and able to make necessary changes to its longstanding business model, presiding over a growth in cloud momentum, the long-overdue release of Microsoft Office for the iPad, and the waiver of licensing fees for Windows on devices with screens smaller than nine inches. With the Nokia acquisition finally concluded, and revenue from recent initiatives Azure and Surface quickly growing, there is ample opportunity for future transformation.

When HP was a great company, they cannibalized their own business all the time. So far, Microsoft has been mostly unwilling to do the same—but with the appointment of Nadella they may now have someone who could make an indelible mark by being willing to do just that.

Another tech giant that has doubled down on the cloud is IBM. The company, once synonymous with mainframe computing, has been [committing billions](#) of dollars toward cloud initiatives such as hosting and licensing its software portfolio, building new cloud systems and investing heavily in data centers and its [Watson initiative](#) while shedding its lower margin products and services.

With the cloud as the newest stage in its transformation, IBM is taking more risks than before and finding itself going up against market leaders like Amazon Web Services. But as any seasoned investor or

When I was in India, I came out of my meetings with IT leaders struck by an overwhelming sense of bullishness.

executive will tell you, transforming a business—especially one with an enterprise value larger than the GDP of Portugal—takes time and risk. And IBM needs to do something—the company reported on April 17th its eighth straight quarter without revenue growth, amplifying pressure from observers and investors. You can find more analysis in an article published on Yahoo detailed on page 11.

Looking abroad, it's also a time of change for India and China. In India, voting has been underway for three weeks as the world's largest democracy debates displacing the long-ruling INC party and instead elevating the challenging BJP party. I expect the BJP to come out on top—Indians are tired of the corruption of the old guard and are optimistic about a new party more focused on commerce rather than on social issues. This will be a positive step for the economy, and the Indian IT executives I've spoken with expect a better business climate going forward.

When I was in India in March, I met with leaders of several firms, ranging from the public Tier 1 companies to public Tier 2 players, as well as private and private-equity backed IT companies. I came out of the meetings struck by an overwhelming sense of bullishness—business leaders have a constant eye to the future and are positioning themselves to serve areas of growing customer demand by boosting their higher-end offerings, such as domain-specific services, business intelligence and data analytics. For a more detailed look at the state of the Indian IT industry, see Gaurav Sharma's article on page 8.

In China, annual GDP growth is forecasted at 7.3%, the [weakest showing](#) in 24 years. This follows recent reports that first-quarter growth was below annual targets in almost all Chinese provinces. But China remains a formidable presence in the IT space. China's public and private sectors are forecast to spend \$124.5 billion in 2014, an increase of 10.5% over last year and enough to retain its position as the world's third-largest tech market and ¼ of all APAC IT spending. And China is famous for taking the long-term view—legend has it that in the early 1970's premier Zhou Enlai claimed it was too early to measure the effects of the French revolution.

China shows every indication of continuing to figure prominently in the news cycle. On April 30, it was announced that according to a new calculation by the World Bank based on purchasing power parity, the Chinese economy could surpass that of the U.S. later this year. And Alibaba's pending IPO in New York is expected by all accounts to be the biggest IPO of the year (possibly even the biggest of all time).

Through the rest of the year, we expect to see a few major trends defining Chinese IT spending: a rise in demand for cloud computing and Software as a Service, increased investment in data center

construction and other big technology, larger investments in the consulting and solution-based space, and finally a new focus on mobile offerings. For more detailed analysis of these trends, see the overview of Hao He's piece on page 8.

Also in this issue of VDI you will find our my thoughts on Dell's channel sales transformation plan (page 9), the latest edition of our MW IT Index (page 10) and our annual report on the state of the SaaS industry (page 10).

And our Executive Perspective this quarter features Sam Katz, managing partner at TZP Group—a leading private equity professional and a friend of the firm with whom we've done a transaction. I think you'll find his comments interesting and useful, especially if you are pursuing or have completed a private equity transaction of your own.

As always, we thank you for your continued support and encourage you to reply with any feedback that you have.

Happy Selling,



Executive Perspective

Sam Katz

Managing Partner, TZP Group

Editor's Note: In this issue, **martinwolf** interviews Sam Katz, Managing Partner at TZP Group. Sam began his career in 1986 as a Financial Analyst at Drexel Burnham Lambert. From 1988 to 1992, he was an Associate and Vice President at The Blackstone Group, where he worked on numerous private equity transactions, including the initial LBOs of several hotel franchise brands, which created the predecessor to Cendant Corporation. From 1992 to 1995, Sam invested in private and public equity as Co-Chairman of Saber Capital, Inc. and Vice President of Dickstein Partners Inc. He joined Cendant in 1996 and through 2005 led the execution of numerous transactions as Cendant's most senior corporate and strategic development executive. He also served on Cendant's Investment Committee and held various operating and management roles. After Cendant, he joined MacAndrews & Forbes Acquisition Holdings, Inc. (2006-2007) as CEO. Sam serves as a member of the Boards of Directors of DLT Solutions, The Dwyer Group, Inc. LLC, Water Cooler Group, Total Military Management, LLC, BQ Resorts, LLC, Cloud5, LLC, Lift Brands, Inc., and Global Employment Solutions (GES). Sam also serves as a member of TZP's investment committee.

There's definitely a correlation between a strong stock market and a strong financing market.

MW: US markets were really strong in 2013, but currently they're slightly down or flat YTD. What do you see going on for the market for the rest of the year?

SK: Generally, I believe the markets are going to trend higher because the economy is really picking up, tapering is working well and global markets seem to be shrugging off geopolitical risks. I don't expect major gains, but we are going to see the markets shifting higher.

How much does that affect TZP? Is the market a broad heuristic for the private equity environment?

I think it really depends on which part of the market we're talking about. At the higher end of the spectrum, the largest deals are very impacted by the market. There's definitely a correlation between a strong stock market and a strong financing market, so the impact on multiples is greatest at the higher end—but this relationship cascades down even into the lower middle market, where we participate, composed of companies between \$5 and \$35 million of EBITDA. The market going up affects all multiples and ultimately the financing is stronger as well, but the effect is lesser as you go into smaller and smaller companies.

Do you think M&A deal volume will be greater, less than or about the same as 2013?

I think it'll be about the same. The dynamics are similar—corporations have significant liquidity, PE firms have more capital to spend and a favorable financing environment along with a positive outlook of the economy. 2013 was a good year and I think 2014 will be similar.

Let's talk about TZP. What do you look for in an acquisition?

We look for companies that have strong underlying value propositions so that in 5 or so years when we're going to go sell that business again—because we have to on behalf of our investors—that the companies, customers and business partners are going to want to keep buying the services or products that the companies are providing.

So value propositions are really at the core, but the second aspect is that we're looking for is a good outlook for the future. We tend to pay fair values for the companies that we invest in—we don't consider ourselves deep value buyers, we try to pay fair value—so we need to find companies and industries with good growth prospects for us to get our target return on investments.

The last thing, which is the most important, is alignment with management. In each of our deals, the sellers in the company have

(IT companies) offer strong scalability as you increase volumes because they have...the ability to scale without much capital required.

reinvested a significant portion in the company going forward and are running the business that they built. We're really looking for a strong alignment so that everyone benefits as the company succeeds.

What level of board control or influence do you desire?

The strategy that we refer to in our firm is being a "partner of choice." What that means is that sellers choose us because if they are going to retain a significant stake in the company, they care who their investor is and they believe TZP is the best investor—their partner of choice—while they run the business.

Our deal structure is predominantly to do control deals. In some cases we own 50%, in some cases we own 80%—but regardless of whether we hold legal control we run all the companies we have as real partnerships and we're proud of the references we have from our portfolio companies about the way that we've allowed them to continue to run the companies.

Where we focus our energies is working with management to identify areas where they don't have the necessary capabilities or qualities today. We try to spend our time on enhancing or expanding the strategic bandwidth so they don't feel like they are just getting money out of the relationship. We don't change CEOs—we're pleased to say all of our CEOs are with us today. We have had instances where we have supplemented management, but our approach means aligning with a great management team.

Do you partner with other firms?

As partner of choice, it's difficult to be partner of choice in a three-handed game. Theoretically we're being picked, so the nature of our relationship is to partner with management so that we're the sole PE investor. We have had our LPs and lenders co-invest, but they had no governance involvement in the companies.

What have you found, if anything, differentiates investments in IT companies?

We love the IT sector—we have three investments coming at it from different perspectives. It's a huge part of the economy, and it's characterized by a lot of growth and change with new business models. What we like about a lot of the IT companies we look at is that they offer really strong scalability as you increase volumes because they have really high gross margins associated with the products and services and the ability to scale without much capital required. The difference that exists, and the greater risk, is that you have to be mindful of external risks from technological change, which especially can pose challenges when you exit (going back to the earlier point about the successful value proposition). So you have to

We believe that with the economic recovery what it is, and with issues like the ACA, we believe people will continue to be reluctant to take on full-time hires—particularly in the IT space.

spend time investing or innovating and understanding what's going to come down the path or you'll find yourself in a situation that affects your value proposition.

What are your three investments in IT companies? Can you walk through them?

Our first deal was DLT Solutions, thanks to Marty Wolf and co. This was a real Partner of Choice situation with Rick Marcotte and Craig Adler. We felt the company had a great value proposition as a product and IT solutions provider with a great set of vendor relationships and a really unique lead generation and conversion process that added great value to its customers and built on a unique platform. We also liked the government space, which was relatively stable in '09, and the company has continued to outperform the growth and profitability that we expected.

The next one was Thing 5, completed in 2013, which predominantly offers a PBX in the Cloud system to Hotel Operators, offering large cost savings and capital avoidance as well as allowing for owners to have more visibility into their customers and potential incremental revenue flows. This is another example of the CEO looking for an investor that would be value-added—and we've been active with them on building their sales and marketing infrastructure and other business development work. This really dovetails with what we find attractive as the recurring revenue model—leads to meaningful profit growth and stickiness as we add customers.

Most recently we have invested in Global Employment Solutions, an IT Staffing company. Management continues to run the company and made a significant reinvestment. We've been looking at the staffing space for years, looking at quite a few assets, and IT appealed to us the most. Furthermore, we believe that with the economic recovery what it is, and with issues like the Affordable Care Act, we believe that people will continue to be reluctant to take on full-time hires—particularly in the IT space, which by virtue of its project nature and specialized skills, creates strong sustained demand.

Relative to the other staffing companies we looked at, we liked GES because it was middle-market focused, has a diverse number of clients, and ultimately again it's a business where we have offices that can grow their profits efficiently without having to increase overhead.

Do you have other broad segments that you're looking at?

We have a couple core segments but we also like to develop things that are adjacent. One of them is Lift Brands, which has five gym concepts and combines our knowledge in franchising and our enthusiasm for the wellness category, which we think is an attractive

category. We think the staffing investment is a good example of us spending a few years researching an area before building a thesis and making an investment. We have a nice complement of industries and business models that we're comfortable with, but at the same time we're always learning about new industries and building relationships in those verticals.

What makes your firm so attractive to your investors?

Investors care about our results, and we've had exceptional results. The partner of choice value proposition has been attractive to our investors in the context of actually being able to validate through their due diligence that we have done things to create additional value in the portfolio. Our positioning is a strong positioning—we compete with a lot of good firms, and the success we've had testifies to our firm's strengths. Additionally, we're a small firm but we have strong industry expertise, so we bring a lot to our portfolio companies.

What can PE offer a company that a strategic can't?

It really depends on who the strategic or private equity is and what their business model is. There are some acquirers who opt for a hands-off approach, and there are some that look for more integration and more ways in which to leverage the strengths of the acquirer to bring value to the acquisition target. Both strategic acquirers and private equity firms can bring some discipline around financial planning or investment prioritization. Additionally, the line is blurred—many strategic acquirers are themselves backed by private equity investors. Really, any target company in IT services should understand the philosophy of the buyer and decide what they ultimately want. In terms of upside, with strategic acquirers the leaders are typically bought out and often leave the company—while with private equity deals, management in companies that get acquired usually have the opportunity to roll over equity into the new company and participate in the further upside from the growth in their business.



Adaptability Remains Key to Indian IT Services Firms' Success

**By Gaurav Sharma,
Senior Vice President
Published in VCCircle, March 10, 2014**

Since last November, when our firm [last reported](#) on the status of the Indian IT Services industry, valuations increased for both Tier 1 and Tier 2 companies. But, as before, challenges continue to face both groups: a significant valuation differences remains between Tier 1 companies and their Tier 2 counterparts. And changing customer demand from India's Western IT clients means keeping with the status quo is no longer an option.

In an article published VCCircle on March 11, *martinwolf* Senior Vice President Gaurav Sharma found that along with growing confidence in and demand for IT Services companies, Indian firms have benefitted from a depreciated rupee-creating higher future earnings growth potential and a greater competitiveness in the global marketplace.

The effect is more pronounced on smaller firms, which have a greater susceptibility to market forces. Since November 2013, Tier 2 firms have been growing slightly faster on both a revenue multiple and EBITDA multiple basis. On a revenue multiple basis, Tier 1 valuations have gone up from a 3.7x to 4x (6.7% increase) while Tier 2 valuations have grown from 0.9x to 1.1x (23% increase). For EBITDA, the numbers are similar: 15.1x to 15.9x for Tier 1 vs. 6.5x to 8.4x (increases of 5.5% and 29.5% increase, respectively).

To read the complete VCCircle piece, [click here](#).



China's IT Services Industry: Past and Present

**By Hao He
Senior Vice President
Published in Caixin Magazine, March 18, 2014**

With the conclusion of both the Western New Year and the Lunar New Year, *martinwolf* Senior Vice President Hao He looked back at

the major developments and deals of 2013 as well as the expected trends for 2014 in the Chinese IT Services industry.

On a macroeconomic level, the past year saw many of China's major indicators either down or flat, with GDP growth slowing to 7.7% and indicating future downward movement.

But there remains significant activity and opportunity in the Chinese IT space, particularly in the fields of cloud computing, data center investment, higher-end consulting and mobile expansion.

To read the Caixin piece in English, [click here](#).

To read the Caixin piece in Chinese, [click here](#).



Michael Dell: Dell Channel Sales Transformation is Ahead of Plan

Featuring Marty Wolf
Published April 7, 2014

Michael Dell, in an interview with CRN, announced that Dell's Channel Sales Transformation is ahead of plan. CRN reporters Tom Spring and Steve Burke interviewed Dell partners to get their perspective on Dell's transformation, and learn more about how it has affected the company's partners across the channel.

Marty Wolf was interviewed to provide his perspective—and to him, Dell's choice to turn to more experienced distributors to build their accounts is a no-brainer. "PC Connection, Insight and SHI are better equipped to go into those accounts than Dell itself," said Wolf. "They are lower cost operators and they aggregate customers, they are good at developing customers. The [product] unit itself doesn't matter that much. What matters is the cost that they can provide a solution and make it work. These guys are experts at adding other product procurement to lower margin sales."

To read the complete article, [click here](#).

SPOTLIGHT

Q1 2014 Index Shows Industry Optimistic for Coming Year

Released on April 9, 2014

The maturity of the IT Services market continues to preclude any major collective shifts in the Index, though we are seeing a general optimism as enterprise spending returns. We expect continued performance as the recovery continues, with IT spending expected to increase 4.6% from 2013.

The most volatile performers in our Index continue to be the SaaS and Supply Chain sectors, which remain, respectively, the highest and lowest valued sectors that we track. The SaaS industry in particular is seeing higher valuation multiples than ever before, while many of the Supply Chain companies faced further difficulties this quarter as holiday revenues came in significantly below expectations.

On a global scale, we anticipate continued convergence in the Indian IT services field, especially among Tier 2 players looking to better compete with the higher-valued Tier 1 companies. Additionally, the Chinese IT industry, which already this quarter has seen milestones in M&A activity with Lenovo's acquisitions of Motorola Mobility and IBM's x86 server division and Chinasoft's investment in SaaS provider Deem, Inc., will continue to accelerate in both size and market presence in the year to come.

For more information, and to read the full Index report, [click here](#).

 SaaS in the Enterprise
where IT executives get answers about applications in the cloud

The SaaS Boom Is No Bubble

Featuring Sunil Grover
Executive Vice President

Published in SaaS in the Enterprise, April 11, 2014

Martin Wolf M&A Advisors released its annual report on leading SaaS companies by valuation multiples, comparing the Top Ten (The "SaaSiest") with the Next Ten (The "SaaSy"). Bill Terdoslavich at SaaS in the Enterprise interviewed Sunil Grover and discussed four major trends that define the current SaaS industry.

First, valuations are at record highs. The SaaSiest companies have a median multiple of 21.2x, 160% higher than last year. The SaaSy list boasts a median multiple of 10.4x, 250% higher than it was last year. As with 2013, this is fueled by massive revenue growth rates.

Second, Seven of our Top 20 SaaS companies had an IPO during the last year. Only ExactTarget was acquired from last year's Top 20.

Third, market penetration remains low. According to [Sunil Grover](#), SaaS companies amount to \$13.4 billion in revenue-compared to \$334 billion for traditional software companies -- a market penetration of less than five percent.

Finally, the most successful and highest valued SaaS companies remain those that offer broad appeal across multiple industries due to their greater growth potential.

For more detailed analysis, [click here](#) to read the article in SaaS in the Enterprise, or [click here](#) to read the complete report.



For IBM, Growth Remains Elusive

By Marty Wolf
President & Founder
Published on Yahoo!, April 15, 2013

On April 16, IBM issued its quarterly report. Earnings were in line with analyst estimates, but revenue was below expectations due mostly to a decline of almost 25% in both hardware and systems storage revenue.

The report marked the fifth consecutive time IBM had missed its revenue expectations, and serves as a reminder that the company is still progressing through its long transition to become a cloud-oriented software and services provider.

Before the earnings report was released, Marty Wolf looked back on IBM's performance over the last ten years to get a better sense of how successful this transition has been thus far and where it's going next. He found that though net income has doubled in the past ten years, revenue has risen just 3.6% - and the market demands growth from its elite stocks.

The company's latest headlines have been centered on its massive investments in the cloud services space, which is in hot demand and has the potential to help IBM attain the growth that it needs going forward. Expect more such commitments as their transition continues-and as investors demand revenue progress instead of just earnings growth.

To read the Yahoo! piece and its accompaniment, [click here](#).

Key Transactions

Transactions shaping the IT mergers and acquisitions space, March – May 2014.

IT Services

March 11, 2014

Blackstone Group (NYSE:BX), a leading private equity group, announced that it had entered into an agreement to acquire IT Security firm Accuvant from current investor Sverica International. For more information, read our [complete analysis](#).

March 18, 2014

Acuative, a provider of IT and network support services, acquired the U.S. division of Thrupoint, Inc., a provider of IT/network consulting and professional services. For more information, read our [transaction announcement](#).

March 27, 2014

Pactera Technology International Ltd. (NASDAQ:PACT), a leading Chinese IT services provider, announced that it had completed a merger with Blackstone to be taken private. For more information, read our [complete analysis](#).

April 3, 2014

A holding company that is 99.1% controlled by Alibaba Group Holding Ltd. Chairman Jack Ma will pay \$531 million to acquire a 20.6% stake in financial IT solutions provider Hundsun Technologies (SHSE:600570). For more information, read our [complete analysis](#).

April 10, 2014

Symphony Teleca, a US-based technology services company, is acquiring software product and services company Aditi Technologies. For more information, read our [complete analysis](#).

April 21, 2014

Birch Communications, Inc., a business communications firm, announced that it had entered into a definitive agreement to acquire Cbeyond, Inc. (NASDAQ:CBEY), a cloud services provider. For more information, read our [complete analysis](#).

April 22, 2014

The CEO of iSoftStone (NYSE:ISS), a leading Chinese IT services and solutions provider, announced a definitive agreement with current investors to take the company private. For more information, read our [complete analysis](#).

April 23, 2014

Dimension Data, a South African ICT solutions and services provider, announced today that they were acquiring California-based IT solutions provider Nexus IS. For more information, read our [complete analysis](#).

SaaS

March 31, 2014

Bottomline Technologies (de), Inc. (NASDAQ:EPAY) announced that it had entered into a definitive agreement to acquire SaaS-based BFSI-focused customer acquisition specialist Andera. For more information, read our [complete analysis](#).

About *martinwolf*

With offices in San Francisco and Bangalore, ***martinwolf*** is the world's leading middle market IT M&A advisory. Since 1997, the firm has completed more than 120 transactions in ten 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 completed transactions with six *Fortune 500* companies.

For more information, visit <http://www.martinwolf.com>.

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