



martinwolf IT Index

Q4 2019

martinwolf Global M&A Advisors
AZ | NY
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IT INDEX

A Proprietary Analysis of Market Value for Key Segments in Information Technology

Overview

The ***martinwolf*** IT Index is a proprietary analysis of selected global IT company securities, with separate indices for IT Services companies in India and China. Each Index is weighted according to the market value of inclusions' outstanding shares.

Individual indices are composed of companies determined by the ***martinwolf*** staff to be representatives of their space and are evaluated on a regular basis to ensure ongoing accuracy.

The ***martinwolf*** IT Index is tracked on a five-year basis and is accompanied by commentary on the latest industry news and trends.

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Economic Overview

In the latest GDP report released by the US Bureau of Economic Analysis real GDP increased 2.1 percent in the fourth quarter, matching the 2.1 percent it grew in the third quarter. Nondurable goods manufacturing, retail trade, and professional, scientific and technical services were the leading contributors to the increase in growth. A current wildcard throughout the global economy is the Coronavirus. It has led to recent market turmoil and economic anxiety, but in the fourth quarter, impacts on the market were largely contained.

Additionally, a Phase 1 trade deal was signed in mid-January. Terms of the deal included that the US would not proceed with 15 percent tariffs scheduled to go into effect on \$160 billion of Chinese goods, canceled retaliatory tariffs from China, and that China would purchase at least \$200 billion of American products and services. In Europe, Boris Johnson won the general election which enabled resolve to the uncertainty around Brexit.

According to the International Monetary Fund (IMF), global growth in 2019 recorded its weakest pace since the global financial crisis. Rising trade barriers and uncertainty weighed on business sentiment and activity globally. Several key countries and regions showed weakness in 2019. The economies in Brazil, India, Mexico, Russia, Argentina, Iran, Venezuela, Libya and Yemen all struggled – with the latter four of that list due to geopolitical tensions and social unrest.

In 2019 we also saw the emergence of negative interest rates in key economies. In Japan and much of Europe the benchmark deposit rate is below zero, punishing savers and rewarding borrowers. Additionally, this paradox has spread to the bond markets, pushing many yields to zero or lower. Negative interest rates present an economic conundrum and a huge X factor. The butterfly effect of negative interest rates on business investment, market sentiment and economic conditions is not yet known.

The IMF has become increasingly less optimistic about global growth. It recently revised its global growth rate forecasts to 2.9 percent for 2019 and 3.3 percent for 2020, with the downward revision mostly due to lower growth in India. Recovery of global growth hinges on recovery in stressed and underperforming emerging market economies. Not all is lost, though. Some of the biggest uncertainties, it notes, have dissipated with the announcement of a US-China Phase I trade deal and Brexit.

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Stock Market and Earnings

The fourth quarter of 2019 closed out a banner year for the US stock market. The Dow Jones ended the year up 22.3 percent and the S&P 500 gained 28.9 percent, its best year since 2013. Additionally, the Nasdaq had its loftiest annual performance in six years, with a rally of 35.2 percent.

While the stock market achieved booming returns, earnings growth for the S&P 500 was negative. The negative return in earnings growth led to a discrepancy in EV/EBITDA multiples between the public and private markets.

Of the 107 companies in the S&P 500 that have issued guidance, 73 have issued negative Q4 EPS guidance. Looking specifically at the 39 IT companies, 19 have issued negative EPS guidance and 20 have issued positive EPS guidance. According to Pitchbook, this will mark the highest number of companies in the IT sector issuing positive EPS guidance for a quarter since Q2 2018.

According to FactSet's latest earnings report published in early February, with 64 percent of companies reporting actual results, 71 percent of S&P 500 companies have reported a positive EPS surprise and 67 percent have reported a positive revenue surprise.

At a sector level, the Information Technology sector has the highest percentage of companies reporting earnings above estimates -- with 89 percent reporting higher than expected.

Microsoft, Apple, and Alphabet all had strong earnings beats. Microsoft's recent earnings report showed a 27 percent increase in intelligent cloud revenue, a 30 percent increase of server products and cloud services, and a 62 percent increase in its Azure cloud revenue.

In addition, Apple beat estimates on its hardware products with Apple Watches outselling the entire Swiss watch industry in 2019, according to market research firm Strategy Analytics.

Even tech laggard IBM beat on earnings. Its historic \$34 billion purchase of cloud software giant Red Hat is paying off. The stock rallied in late January in response to the news that Ginni Rometty was handing over the reins to Arvind Krishna and Jim Whitehurst.

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The IPO and M&A Markets

Mega mergers in the US worth more than \$10 billion drove corporate deal-making to its fourth strongest year on record in 2019. A surge of deal-making in the final quarter drove the value of takeovers worldwide to \$3.9 trillion in 2019 according to Refinitiv. Cross-border M&A slumped by \$1.2 trillion, making it the slowest year for cross-border deals since 2013.

Transactions announced in the fourth quarter were up 28 percent from the third quarter. On one day alone in November, dubbed “Merger Monday,” more than \$60 billion worth of deals were announced, including Charles Schwab’s \$26 billion deal to buy TD Ameritrade and LVMH’s \$16 billion purchase of Tiffany.

According to Pitchbook, the IT sector comprised 19.9 percent of total M&A value, the second highest percentage on record.

While US M&A rose 6 percent, M&A activity in Europe fell by a quarter to \$742 billion, making it the weakest year for deal-making in the region since 2016. Asia-pacific M&A deals totaled \$757 billion, down 15 percent from 2018. Deal making in Africa and the Middle East more than doubled to an all-time high of \$161 billion, boosted by Saudi Aramco’s \$69 billion purchase of a majority stake in SABIC.

After years of anticipation, public investors in 2019 were able to put their money into a myriad of famed Unicorns that finally entered the public arena such as Uber, Lyft, Pinterest, and Slack.

Several issues impacted the numerous failed IPOs of 2019 – overblown valuations, lack of profits, a government shutdown in January 2019, and lack of a direct path to profitability.

According to Dealogic, shares of technology startups and other companies that went public in the US last year are trading an average of about 23 percent above their IPO prices. That is short of the nearly 30 percent gain in the S&P 500. Even worse – Tech IPOs were trading up 8 percent compared to the Nasdaq Composite Index, which is up roughly 35 percent.

While overall tech IPOs lagged, there were a group of cloud-technology companies that outperformed the broader market. Shares of Zoom, Medallia, Ping Identity Holding, Datadog and Bill.com are all up significantly from their IPO price.

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IT Services

At the end of last quarter, the ***martinwolf*** IT Services Index recorded a growth rate of 19.08 percent.

Leading the IT service pack last quarter with stock growth of 71.52 percent was Perficient, Inc. The company hasn't missed on earnings estimates in the last four quarters. In addition, last month it acquired healthcare IT consultant MedTouch, strengthening its healthcare portfolio.

One of Perficient's main competitors, Accenture, held its own last quarter. Its stock was up 32.24 percent at the end of the fourth quarter. It continued its spending spree and acquired over 20 companies last year.

Another standout is Mastech Digital. Its stock was up 61.61 percent at the end of the fourth quarter. It reported fourth quarter revenue growth of 13 percent. The company's revenue growth was in part bolstered by record deals signed in December worth \$23 million alone.

DXC Technology, RCM, Hudson & Global and Insperit all struggled last quarter. DXC was down 43.94 percent, RCM down 28.91 percent, Hudson & Global down 17.59 percent and Insperit down 30.79 percent.

EPAM Systems was a market leader throughout 2019. According to S&P Global Market Intelligence, the stock rocketed 82.9 percent in 2019. In the fourth quarter, it was up 37.15 percent. This (in part) can be attributed to its robust financial performance – with revenues up 26 percent YoY in its most recent earnings report.

IT staffing giant Robert Half was down 6.89 percent and competitor Kelly Services was down 8.95 percent. Hudson Global, another IT staff augmentation player, was down 23.89 percent. Kforce Inc, one of the few 'leaders,' ended the quarter up 3.63 percent.

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IT Supply Chain

The *martinwolf* IT Supply Chain Index increased 24.01 percent last quarter.

There were some significant deals in the supply chain deal last quarter. Apollo Global Management announced it was acquiring Tech Data for approximately \$5.4 billion, HP launched a \$35 billion takeover for Xerox, and Intel acquired Habana Labs for \$2 billion.

Before its go-private deal was revealed, Tech Data acquired software and cloud solution aggregator DLT Solutions for approximately \$205 million in cash. It also attempted to acquire Inflow Technologies, an Indian VAR, but Inflow pulled out of the agreement.

SYNNEX, up 26.77 percent last quarter, announced it was splitting its business in two by separating its Concentrix business, a notable move for the company. SYNNEX Technology Solutions (its IT distributor arm) will have annual revenue of about \$19 billion and keep its place as a top distributor in the Americas and Japan. Stock surged after news of the split.

Insight Enterprises was up 28.45 percent last quarter. Its PCMI acquisition is already seeing returns. Insight reported net sales of \$2.30 billion for Q4, up 31 percent over the \$1.75 billion in 2018. Approximately \$560 million were sales from PCMI.

Pivot Technology saw hefty gains in its stock – up 51.35 percent. The company sold its Smart Edge software business to Intel for \$27 million in cash and entered into a three-year preferred channel partner agreement which designated Pivot as a non-exclusive preferred integrator and partner for Smart Edge Solutions.

Anixter, Wayside and CDW stock were all up over 50 percent.

ePlus, Arrow Electronics, ScanSource and Avnet saw modest gains, up less than 5 percent at the end of Q4.

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Software and SaaS

At the end of last quarter, the ***martinwolf*** Software Index performed better than SaaS, up 29.77 percent while the SaaS Index was up 14.94 percent.

Once again, Microsoft stock performed measurably better than its software competitors. At the end of Q4, it was up 72.15 percent. After its earnings report in late January, Satya Nadella said it was a “record fiscal year” for Microsoft. All of the company’s operating groups saw YoY growth. Cloud services revenue itself grew 22 percent, and Azure jumped 64 percent.

Other software standouts include Veeva Systems, up 33.16 percent, Adobe, up 46.67 percent, SAP, up 35.14 percent and Intuit, up 29.85 percent.

Adobe closed 2019 with impressive revenue growth of 21.4 percent in Q4 and also offered encouraging 2020 guidance. Its SaaS revenue model grew \$539 million compared to Q3.

German-based SAP’s cloud bookings were up 19 percent in the quarter and 25 percent in the full year, while cloud and software revenue grew 8 percent YoY. SAP also reported total revenue of €27.55 billion, up 12 percent YoY.

IBM closed its \$34 billion acquisition of Red Hat and reported better-than-expected earnings. Its stock ended the quarter modestly up 8.62 percent.

SaaS companies saw less growth on average throughout Q4. Salesforce was up 2.26 percent, Logmein was up 3.46 percent and SS&C was up 2.57 percent. Slack, with increased competition from Microsoft Teams, was down 41.79 percent at the end of Q4. Workday was down 16.20 percent and Cloudera was down 16.15 percent.

Coupa Software was one of the best performing stocks in our Index, up 52.17 percent at the end of Q4. In addition, ServiceNow was up 20.19 percent, Fair Isaac was up 55.70 percent and Paycom was up 45.1 percent.

ServiceNow released strong Q4 earnings results. It had a 35 percent YoY growth in its subscription revenues, added 76 transactions over \$1 million in net new annual contract value in Q4 alone, and added 892 new customers – an increase of 32 percent.

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China and India

The ***martinwolf*** China IT Services Index showed an increase of 10.01 percent at the end of last quarter, through continued volatile market and economic conditions.

China reported that its economy grew 6.1 percent in 2019, meeting expectations despite the trade dispute with the US. Its GDP growth last year was the slowest since 1990 according to Reuters. Chinese economic data also showed growth in industrial output and retail sales for the month of December. Fixed asset investment grew by 5.4 percent.

Despite slow growth, Beyondsoft, Wonders Info, Bringspring and Insigma ended Q4 up more than 20 percent. Chinasoft was down 10.93 percent at the end of Q4. In March, it was trading at an average of \$5. The stock dipped as low as \$3.19 in August and steadily raised its trading prices through December.

According to the Economist Intelligence Unit (EIU), factors like global trade tensions, deceleration in real GDP growth in the US, China, and India, renewed volatility in emerging markets, and political uncertainty in a number of EU countries are responsible for sluggish growth rates.

The ***martinwolf*** India IT Services Index ended 2019 with a small decrease of 3.70 percent.

The slowdown in the Indian economy was serious enough that the International Monetary Fund (IMF) indicated that global growth in 2020 will be impacted, and accounts for an expected 1 percentage point reduction in the global GDP growth rate. According to the latest IMF reports, India's GDP is expected to grow by 4.8 percent in 2019-20 and could improve to 5.5 percent in 2020-21.

In the India IT Services Index, company's hit the hardest by the global slowdown include Cognizant, Birlasoft and 3i Infotech. Other laggards include Infosys, down 3.07 percent, Wipro, down 15.05 percent, and Tech Mahindra, down 8.21 percent.

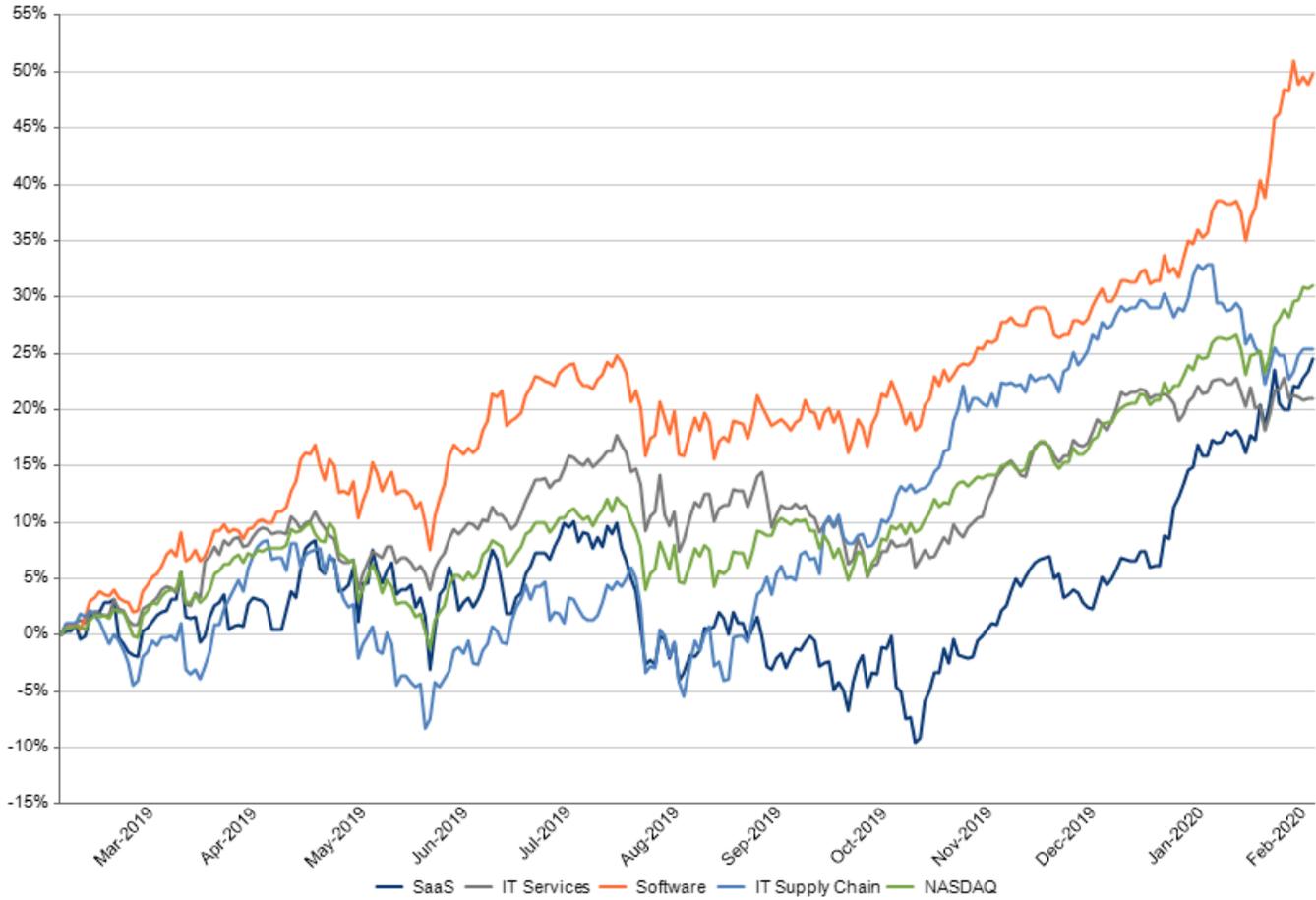
It's not all cloudy skies in the Indian tech market, however. According to research firm Tracxn, tech startups in India raised a record \$14.5 billion in 2019. There were 81 financing deals of size between \$25 million and \$100 million. In addition, 128 startups in India got acquired, four got publicly listed and nine became unicorns.

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martinwolf IT Index Last Twelve Months

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Source: FactSet

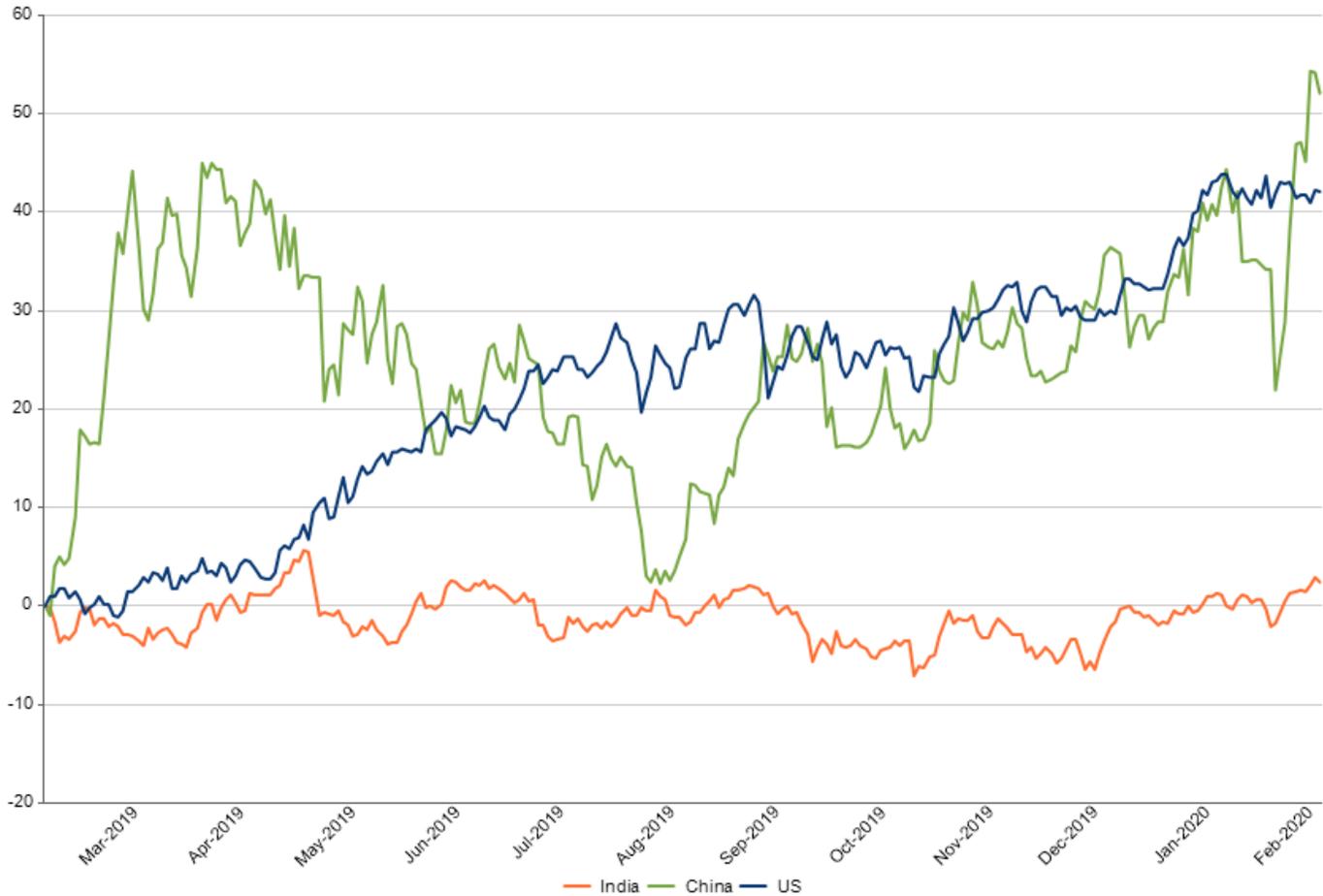


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A Proprietary Analysis of Market Value for Key Segments in Information Technology

martinwolf IT Index: China and India Edition Last Twelve Months

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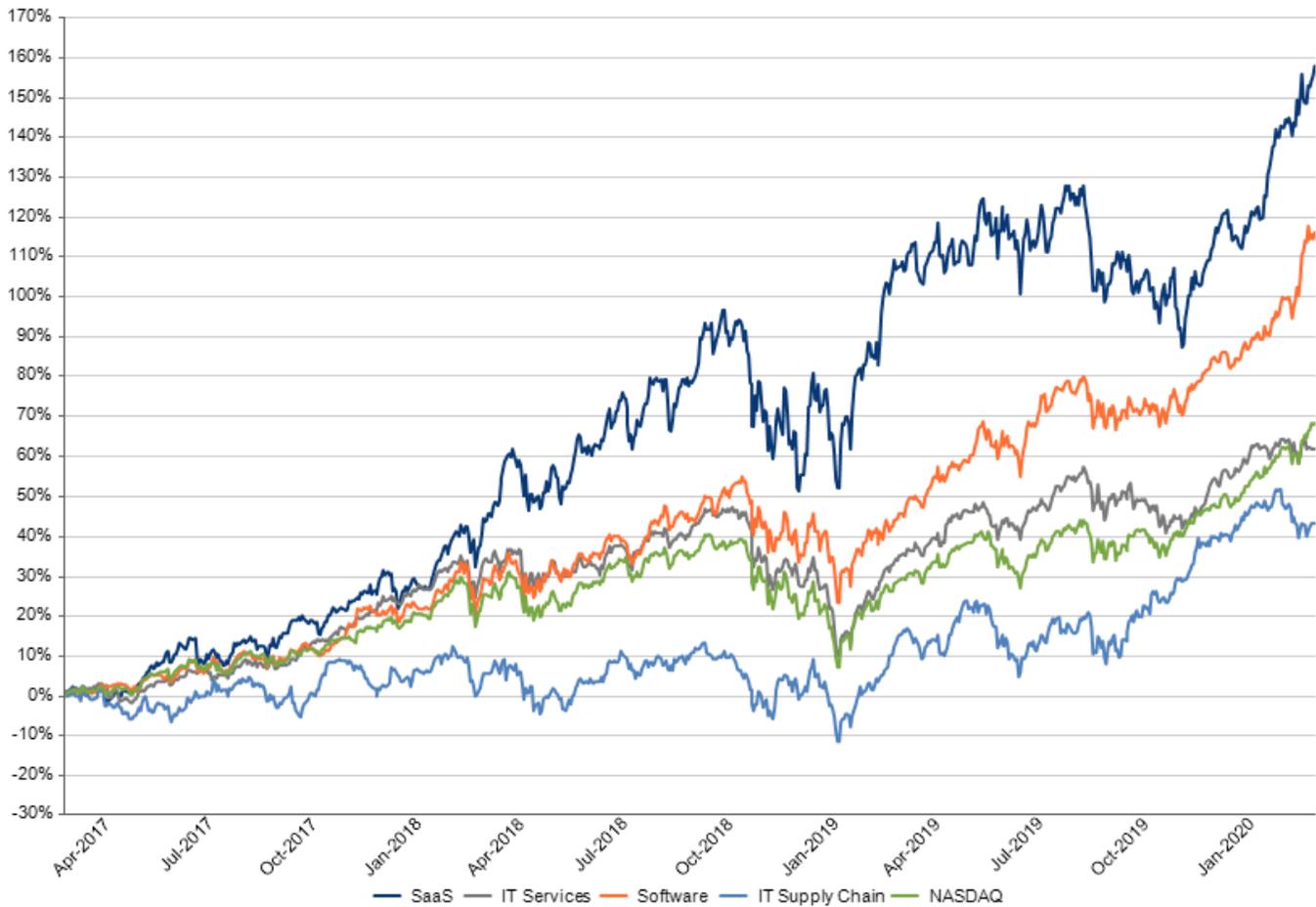
Source: FactSet

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A Proprietary Analysis of Market Value for Key Segments in Information Technology

martinwolf IT Index Last Three Years

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Source: FactSet

IT INDEX

A Proprietary Analysis of Market Value for Key Segments in Information Technology

martinwolf IT Index: China and India Edition Last Three Years

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Source: FactSet

The ***martin*wolf** IT Index includes 75+ companies that are a composite representative sampling of enterprise values in the following categories:

1. IT Services

- 26 companies

2. IT Supply Chain

- 15 companies

3. Software

- 15 companies

4. SaaS

- 24 companies

1. IT SERVICES

The IT Services category includes companies that provide a range of IT services such as application development, application management, data center operations, testing or quality assurance to organizations on an outsourced basis. Some IT Services companies provide horizontal services to organizations in any industries, while others deliver services by specialized by function or industry.

IT Services subcategories and representative companies are:

- **Managed Infrastructure Services:** Digital Realty Trust Inc.
- **Commercial IT Professional Services:** Accenture, Unisys
- **Governmental IT Professional Services:** MAXIMUS, Inc., ManTech International corporation

The Accenture logo consists of the word "accenture" in a bold, black, lowercase sans-serif font. A small purple chevron symbol is positioned above the letter "u".The ManTech logo features the word "ManTech" in a red, serif font. Below it, the tagline "Securing the Future" is written in a smaller, black, italicized sans-serif font.

2. IT SUPPLY CHAIN

The IT Supply Chain Services category includes companies providing one or more services that are directly linked to the flow of products, services, finances and information from a source to a customer.

IT Supply Chain Services subcategories and representative companies are:

- **IT Solution Providers:** Connection, Insight Enterprise, CDW
- **IT Product Distributors:** Arrow Electronics



3. SOFTWARE

The Software category includes companies involved in the development, marketing, sale and maintenance of computer software using various distribution models.

Software subcategories and representative companies are:

- **Enterprise Applications:** Microsoft, SAP
- **IT Management Software:** Symantec
- **Business Software:** Adobe



4. SAAS

The Software as a Service (SaaS) category is broken out for further analysis. SaaS includes companies delivering software of all types only through an on-demand distribution model in which software and its associated data are hosted centrally by a third party, typically in the cloud and accessed by customers using a web browser over the Internet.

Representative SaaS companies are:

- Salesforce.com
- Workday
- ServiceNow
- Twilio



martinwolf IT Index (*India Edition*)

The ***martinwolf*** IT Index (*India Edition*) includes 18 IT Services companies traded in the U.S. (NYSE and NASDAQ) and Indian (BSE) stock markets that are a composite representative sampling of enterprise values.

Representative companies are:

- Cognizant
- Infosys
- Tata Consultancy Services
- Wipro



martinwolf IT Index (*China Edition*)

The ***martinwolf*** IT Index (*China Edition*) includes IT Services traded in the U.S. (NYSE, NASDAQ, and OTC), London (LSE AIM), Chinese (SZSE, SHSE, SEHK) or Taiwanese (TSEC) stock markets that are a composite representative sampling of enterprise values.

Representative companies are:

- Chinasoft International
- Beyondsoft Corporation
- Inspur Electronic Information Industry Co.
- Neusoft



DESCRIPTION AND FORMULA

The *martinwolf* IT Index is a market-value-weighted index. The representation of each security in the index is proportional to its last sales price times the total number of shares outstanding, relative to the total market value of the respective index.

The formula used to determine the index value is as follows:

$$\text{Index Level} = \frac{\text{Current Market Value}}{\text{Market Value}} \times \text{Base Value}$$

Current Market Value

After Adjustments x Previous Base Period

$$\text{Adjusted Period Market Value} = \frac{\text{Current Market Value}}{\text{Market Value Before Adjustments}}$$

Adjustments for securities being added to or deleted from the index, or capitalization changes, are made periodically. Stock splits and stock dividends are likewise adjusted for during the process. In the case of cash dividends, no adjustment is made.

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martinwolf is a leading middle market IT M&A Advisory. Headquartered in Scottsdale, Arizona with an office in New York, ***martinwolf*** is focused on companies in the IT Services, IT Supply Chain and Software space. Since 1997, our team has completed more than 175 transactions in over 20 countries and has sold seven divisions of Fortune 500 companies. To learn more contact aaustin@martinwolf.com or visit <http://www.martinwolf.com>.