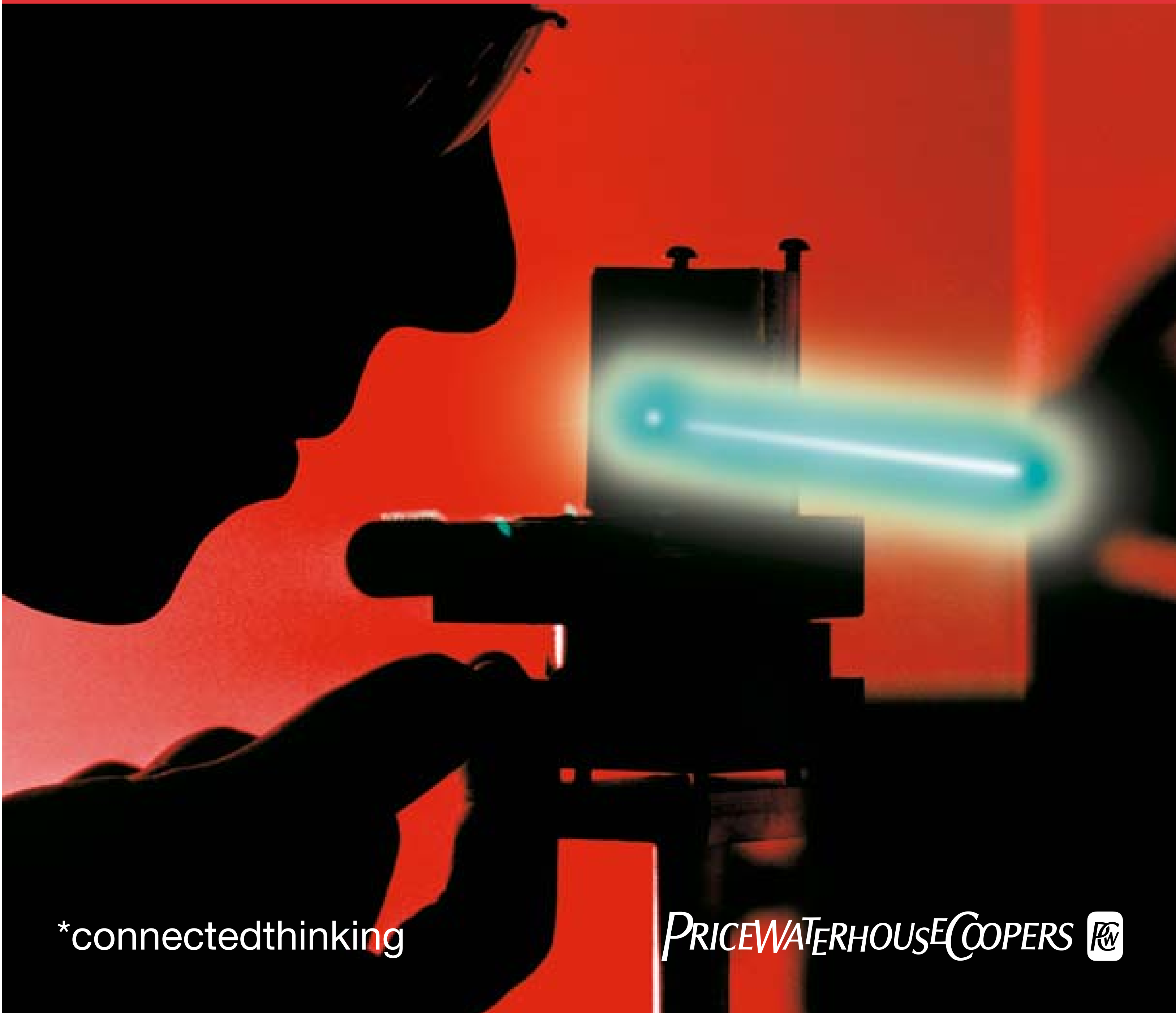
Corporate Finance

Insights

Technology Sector

2005

Analysis & opinions on global M&A activity from our network of local advisers*



*connectedthinking

PricewaterhouseCoopers

Welcome

Welcome to the second edition of Technology Insights from the Corporate Finance team at PricewaterhouseCoopers. In this year's issue we provide an overview of M&A activity in the global technology sector during 2004. We also consider the market's principal trends and driving forces, and look forward to what 2005 has in store.

Technology was back firmly on the M&A map in 2004 with deal volumes up 23% on 2003. Transaction values rose by just 6%, however, reflecting the high proportion of mid-market deals. We believe this segment - in which the Corporate Finance team at PricewaterhouseCoopers was a top adviser* in 2004 (for the third year running) - will also be at the centre of the M&A activity in 2005.

The M&A agenda shifted in 2004 from a largely domestic outlook to a more global perspective with an increasing number of cross-border deals. Increasing levels of private equity activity and the strong drivers for consolidation in the telecoms and the software and IT services segments are likely to keep deal flow on an upward path in 2005.

As our technology corporate finance business continues to grow, we are focused on the ongoing development of our relationships throughout the sector. Insights is integral to this process and we hope you find it helpful and informative.

If you would like further information or have any comments - on this report or the technology sector in general - then please do not hesitate to contact me or one of the team.

Andy Morgan

Andy Morgan
Technology sector leader
Corporate Finance

* Source: Thomson Financial M&A league table, "Volume of deals with value between $50m and $500m in 2004"

The global market

With 911 transactions totalling €155 billion recorded worldwide in 2004, M&A in the technology sector continued the upward trend begun in 2002.

The major upturn in activity was in the mid-market resulting in a 23% increase in deal volumes translating into just a 6% rise in deal values compared to 2003.

Cross-border activity has increased markedly over the last three years and in 2004 accounted for some 22% of transactions. The transatlantic route continued to be the most prolific deal channel last year, accounting for 51% of volume and 47% by value of all cross-border technology deals. International acquirers, particularly those from North America, clearly have renewed confidence in the sector and are becoming less risk-averse and more internationally focused.

North America last year continued to increase its economic influence within the technology sector, enhancing its position as the world's only net importer of technology by acquiring more overseas businesses than it sold to overseas buyers.

However, the significant increase in cross-border M&A between Asia and Europe - which looks set to continue in 2005 - highlights the further development of a truly global technology market.

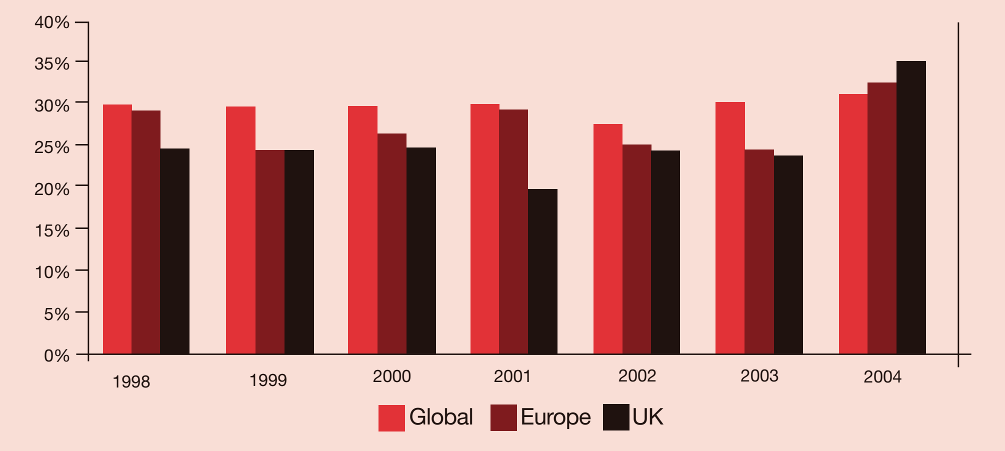
While large corporations seek further scale and breadth of offering through strategic acquisitions, medium-sized companies are consolidating to compete on the global stage. The parameters of what it takes to be a genuinely global technology player continue to be redefined.

Mid-market momentum

Transactions valued at between €10 million and €250 million represented 89% of global technology M&A activity and 97% of UK deals in 2004.

Although 58% of global technology deals were valued at between €10 million and €50 million, there has been a pronounced increase in activity in the €50 million to €250 million range, particularly in mainland Europe and the UK.

Deals between €50 million and €250 million as % of total volume of deals



Source: Dealogic M&A Global

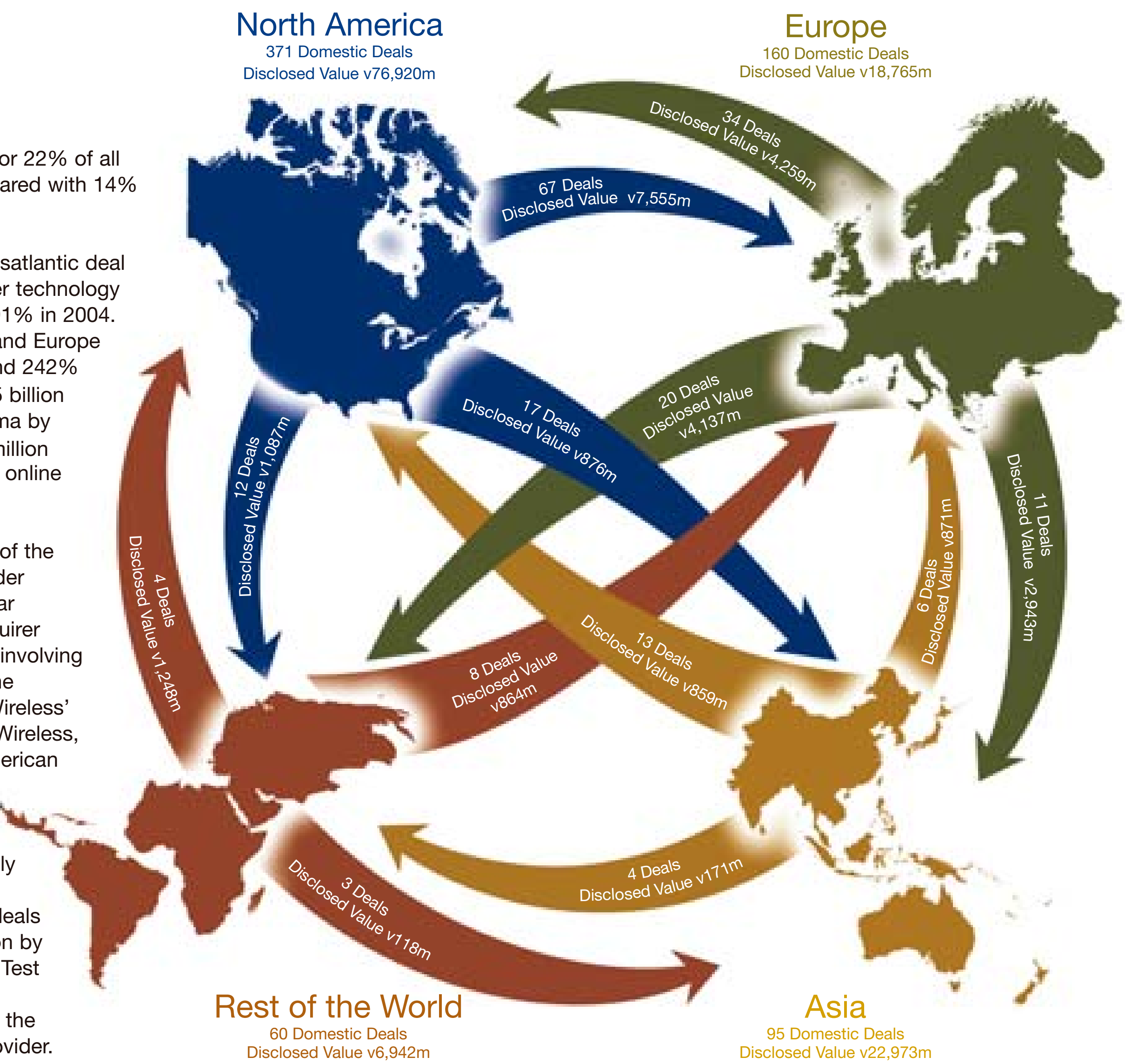
As markets mature, growth rates in much of the technology industry now correlate more closely with GDP growth. Delivering top line growth has therefore become increasingly challenging. This, alongside the need to service clients on a global basis, is fuelling expansion into overseas markets such as Sage's acquisition of ACCPAC International and Federal Liaison Services in the US.

We anticipate continued strong mid-market deal flow - particularly within Software and IT Services ("SITS") - in 2005, as smaller contenders are snapped-up by the major players. Last year saw HP expand aggressively in Europe through acquisitions including Synstar in the UK and Triaton in Germany. We expect to see more of these types of infill transactions by the major players in 2005.

Through increased profitability and improved access to capital, larger SITS companies have a growing M&A appetite and greater financial muscle. Many medium-sized businesses are also recognising that, with an established international sales platform, the larger players are also often in a stronger position to exploit intellectual property and vertical expertise.

International integration

In contrast to 2003 when technology M&A was primarily a domestic affair, last year saw more corporates doing deals beyond their national borders.



Note: The above map excludes deals involving groups of international investors. These 26 deals totalled €4,579 million in 2004.
Source: Dealogic M&A Global

Cross-border M&A accounted for 22% of all technology deals in 2004 compared with 14% in 2003.

Driven largely by increased transatlantic deal flow, the volume of cross-border technology M&A as a whole increased by 91% in 2004. Deals between North America and Europe surged by 102% (by volume) and 242% (by value) and included the €1.5 billion acquisition of SchlumbergerSema by Atos Origin and Yahoo's €475 million purchase of Kelkoo, the French online shopping portal.

Despite the ongoing weakness of the US dollar, 48% of all cross-border technology transactions last year involved a North American acquirer with 70% of these acquisitions involving a European target. Reflecting the significant impact of Cingular Wireless' $41 billion acquisition of AT&T Wireless, domestic deal flow in North American increased by 22% by volume and 132% by value in 2004.

Asian corporates are increasingly active in the accumulation of technology assets. Showcase deals last year included the acquisition by Singapore-based ST Assembly Test Services of its North American competitor ChipPac to become the leading mixed signal testing provider.

The acquisition of Expert Information Systems in Australia by Infosys Technologies is indicative of the growing trend for Asian SITS providers to acquire implementation and customer relationship capabilities in key Western markets. Many offshore providers continue to search actively for European and North American targets.

Asia continues to be an important destination for US and European buyers from the perspective of both customer acquisition and operational efficiency.

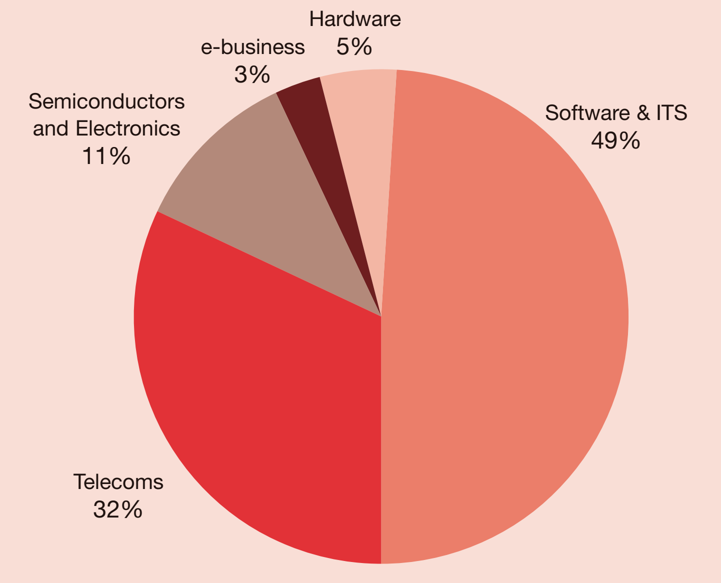
This was demonstrated by Infineon Technologies' €80 million acquisition of the Taiwanese integrated circuit manufacturer ADMtek, and HP's €252 million acquisition of Digital GlobalSoft to create an Indian-based global delivery model.

SITS and telecoms lead the way

SITS companies accounted for the greatest volume of technology deals in 2004 with 455 transactions totalling €38 billion.

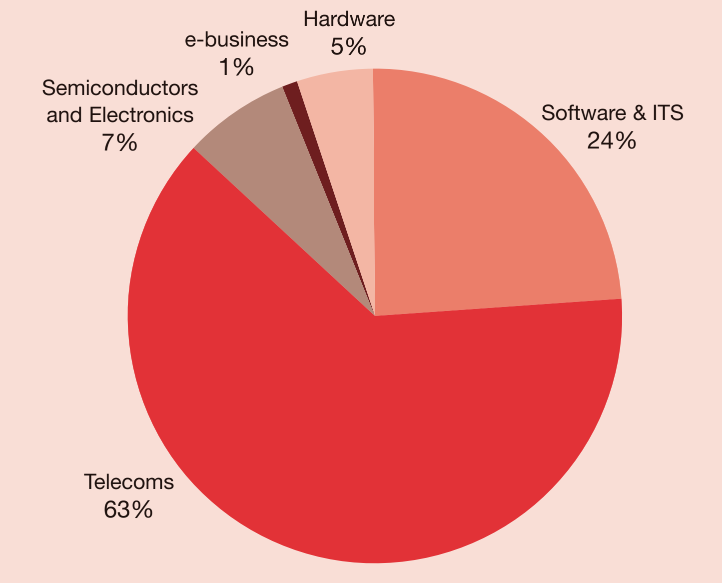
Whilst SITS deals claimed 49% of the technology M&A market by volume, the high number of mid-market deals meant the sector contributed just 24% of its aggregate value.

Number of deals per sub-sector in 2004



Source: Dealogic M&A Global

Total value of deals per sub-sector in 2004



Source: Dealogic M&A Global

In contrast, telecoms companies accounted for 32% of total technology deal volume last year but 63% of total deal value. This top-end weighting is due to continued restructuring required within the telecoms market to achieve revenue growth, economies of scale and counter the challenge of competing technologies. A clear example of such restructuring was France Telecoms' €3.1 billion acquisition of the remaining shares in Wanadoo, which strengthened its position within the broadband access market.

Semiconductors and electronics represented 11% of deal volume and 7% of total deal value in 2004, which is comparable to 2003 levels. Whilst the sector was characterised by a number of large deals, a continuing theme was for a high proportion of deals, some 62%, within the €10 million to €50 million range.

Hardware-related transactions remained relatively stable, representing 5% of total activity both in terms of volume and value in 2004. With the rise of Asia as a highly-skilled, cost effective provider of outsourced manufacturing capability; there is less strategic imperative for Western technology providers to own large scale hardware operations - hence IBM's recent disposal of its personal computing division to China's Lenovo Group.

Transformational deals stay on the agenda

The volume of technology mega-deals has lately remained relatively stable.

Transactions above €500 million represented 5% of total technology M&A in 2004 – on a par with 2003. In value terms, however, the top ten deals (see table below) represented 37% of total M&A - down from 41% in 2003.

Technology top 10 deals in 2004

Technology sector top 10 deals 2004

Rank	Date	Bid Value (€m)	Target Full Name	Nationality	Bidder Full Name	Nationality
1	26-Oct-04	31,919	AT&T Wireless Services Inc	US	Cingular Wireless LLC	US
2	30-Jun-04	6,782	Regional Chinese fixed line telecom operators	China	China Telecom Corp Ltd	China
3	28-Jun-04	3,449	Regional Chinese mobile telecom operators	China	China Mobile (Hong Kong) Ltd	Hong Kong
4	28-Apr-04	3,084	Wanadoo SA (24.65%)	France	France Telecom SA	France
5	20-Aug-04	2,770	PanAmSat Corp	US	Investor Group	US
6	29-Jul-04	2,508	Japan Telecom Co Ltd	Japan	Softbank Corp	Japan
7	16-Apr-04	2,370	NetScreen Technologies Inc	US	Juniper Networks Inc	US
8	27-May-04	1,677	UGS PLM Solutions	US	Investor Group	US
9	01-Oct-04	1,666	DDI Pocket Inc (90%)	Japan	Carlyle Group Inc (60%) and Kyocera Corp (30%)	International
10	31-Aug-04	1,650	Crown Castle UK Ltd	UK	National Grid Transco plc	UK

Source: Dealogic M&A Global

Telecoms companies continued to dominate the mega-deal league and Telefonica's recent acquisition of BellSouth's operations in Latin America suggests that this trend is far from over. However, as demonstrated by Oracle's protracted battle for Peoplesoft, powerful drivers within the maturing SITS market will also generate larger deals in 2005. Indeed, at the end of 2004, the ten largest SITS players had a war chest of some €67 billion with which to pursue acquisitions in 2005.

Private equity investors find the exit

With increased competition from trade buyers and a general preoccupation with the realisation of existing portfolio investments, private equity ("PE") investment remained relatively subdued in 2004.

Even so, PE capital is an important component of the technology M&A market as a whole. About one-third of all disclosed technology deals inthe UK above €10 million last year involved a PE investor on the buy or sell-side.

Increasing stock market buoyancy saw technology businesses returning to the IPO market in 2004. The headlines were grabbed by the high profile IPO of Google, but mid-market PE backed businesses were also quick to seize the exit opportunity – evidenced in the UK by the IPOs of the likes of Cambridge Silicon Radio, Civica and Phoenix IT.

Improved market sentiment and financial performance within the sector led to a sharp increase in technology IPOs generally, with European technology IPOs increasing from 18 in 2003 to 62 in 2004. The UK market saw 47 technology company IPOs during 2004, raising £984 million, and, in more than one third of instances, providing an exit for PE investors.

Trends to look out for in the year ahead...

ASP business models

Increasing demand for subscription-based payment models from SITS customers – boosted by the rise of broadband - is allowing application service provider ("ASP") business models to finally come of age.

ASP models encourage larger technology providers to focus on gaining - often through M&A - mid-market customers. These can be integrated with relative ease within a web-based environment.

To preserve their revenue streams, however, technology providers will need to consider how to bridge the gap between delivering the technology and receiving payment. Vendor financing may have a role to play. Together with the subscription model in general, this will create significant cash flow, revenue recognition and taxation challenges.

Infrastructure and interfaces

The historic deployment of multiple technologies and a focus on ‘best of breed’ solutions has left many organisations with complex and diverse technology infrastructures.

Many organisations urgently need to rationalise systems, align technology around real business needs and simplify the upgrades and integration process thereby reducing costs. With its €199 million acquisition of SMART in 2005, EMC’s expansion into real-time network systems management demonstrates this trend will continue to fuel consolidation within the SITS sector.

Further impetus comes from end-user demands for a smaller number of SITS providers able to offer a wider, yet integrated, suite of solutions.

Return on investment

Significant technology expenditure and poorly implemented IT projects has focused corporate minds on the best ways of maximising IT investment returns.

This is encouraging larger technology providers to acquire in areas such as business intelligence and enterprise application integration. Tibco’s acquisition of the business process management software provider, Staffware, is a case in point.

Providers are also looking to make infill acquisitions to complement their existing offerings. A broad range of fully integrated and tested solutions effectively enables providers to internalise integration costs borne previously by the end-user.

Risk management and regulatory compliance

Understanding and managing risk - a fundamental in today’s highly regulated climate - is forcing enterprises to examine their processes, reduce the complexity of systems, and ‘retool’ reporting technology. Content and knowledge management solution suites will therefore continue to be enhanced through M&A.

...and the real hot spots

Radio Frequency Identification (RFID)

The significant decrease in the cost of manufacturing RFID tags has stimulated serious consideration of their large scale use.

This will have major repercussions, particularly within the logistics and supply chain industry. The need for SITS providers to ensure that they can offer customers RFID functionality and interoperable solutions will stimulate investment and acquisitions in this area.

Voice over Internet Protocol (VoIP) & other broadband services

The increased provision of broadband has stimulated the adoption of VoIP services, providing significant cost savings to users.

Broadband services, such as VoIP, will encourage M&A by established telecoms operators seeking to secure their position within the broadband access market as well as a customer base land grab by VoIP operators. France Telecom's acquisition of the remaining stake in Wanadoo was a case in point, driven by the need to obtain full control of the broadband access platform in the context of future demand for related services such as VoIP and other online collaboration services.

Web services evolution

The provision of web services - based upon standardised protocols such as XML - allows modular applications to interact and exchange data efficiently.

Although primarily intra-enterprise in 2005, web services are expected to evolve and deliver significant benefits to inter-enterprise processes by 2006. To exploit this tectonic shift, SITS providers will be actively seeking to acquire web services skills alongside deep industry knowledge.

The market in 2005

‘Mid-market’ and ‘global’ were the technology market’s M&A buzz words in 2004. This year is set to be characterised by continued mid-market activity and increasing cross-border deal flow. Europe looks set to be a particular magnet for acquirers.

The fact that few European technology players enjoy a truly global presence leaves room for considerable domestic consolidation as companies combine to achieve scale economies. Europe will also attract global predators intent on achieving a step-change in their capabilities within this region.

Weakness in the dollar could constrain US bidders, but there is little doubt that Asian players will be making a concerted push into Europe, as well as North America, to access new markets, expand their solution offerings and capture efficiencies from exploiting regional cost differentials.

The dynamics of the SITS market, in particular, will generate mid-market and cross-border deals as end-users demand services from a smaller number of more broadly-based, international, technology providers.

Restructuring within the telecoms industry will continue to fire the mega-deals market while PE investors will ‘cherry pick’ high quality technology enterprises across the board.

Improved valuations and an increasing proliferation of exit routes – trade, public markets and recapitalisations - will also encourage the continued realisation of existing technology investments, with 2005 set to be the year of the PE exit.

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