
M&A REVIEW



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What to do in Times of Economic Turmoil?

As the credit crunch threatens to turn into a serious global downturn, corporate leaders have a choice: pull down their sails and ride out the storm or look for opportunities to pick up significantly undervalued assets that will help them grow and create future value for shareholders. If history is any guide, more will follow the first course—which could be a mistake. Research by McKinsey & Company indicates that although most executives know and pay lip service to the maxim “Invest in a downturn,” few act on it. Two findings stood out from this research.

First, of the potential strategic moves companies can take to grow in a downturn—divest, acquire, invest to gain share—an effective acquisition strategy (defined as growth through M&A at a rate higher than that of 75 percent of a company’s peers) created significant value for shareholders. During an upturn, on the other hand, divestments created slightly more value than acquisitions did.

Second, companies often behave in counterproductive ways. Fewer than half as many companies in the segments studied made acquisitions in downturns rather than in periods of economic growth. Significantly more divested businesses in those market segments in downturns than in upturns.

These actions are understandable. As revenues slow and margins are squeezed, management naturally switches its focus to cutting costs and maintaining earnings. The company protects its balance sheet—an approach leading to the deferral of growth and of low-priority investments, the shelving of large acquisitions, and the sale of assets. Many companies simply freeze: 60 percent of those in McKinsey’s database made no portfolio moves at all in downturns, compared with only 40 percent that made no moves in upturns. The best growth companies take a different approach. They view a downturn as a time to increase their leads and make acquisitions.

We like to think we’re in good company. The New York Times (October 17, 2008) carried the editorial of Warren Buffet, who reminds us that the time to get the best deals and create the chance to achieve the greatest rewards is when others are in despair.

“A simple rule dictates my buying: Be fearful when others are greedy, and be greedy when others are fearful. And most certainly, fear is now widespread, gripping even seasoned investors. To be sure, investors are right to be wary of highly leveraged entities or businesses in weak competitive positions. But fears regarding the long-term prosperity of the nation’s many sound companies make no sense. These businesses will indeed suffer earnings hiccups, as they always have. But most major companies will be setting new profit records 5, 10 and 20 years from now.”

Tech M&A Spending Down in Third Quarter

Tech mergers and acquisitions took a dive in the third quarter, with spending falling by a third compared with the same period last year, as Wall Street investment banks and financial institutions were rocked to the core, according to a report recently released by The 451 Group. Tech deals fell to 691 transactions with a total value of \$37 billion in the third quarter, down from 822 deals and a value of \$58 billion a year ago. That marked the second consecutive year that third-quarter M&A activity declined.

According to Brenon Daly, a financial analyst with The 451 Group: “There are a number of reasons for the muted deal flow, starting with the barren conditions in the credit market. That knocked the number of leveraged buyouts from 36 during the third quarter of last year to just 12 this year. And while the private equity firms have billions in equity capital, they have been holding onto it tightly—even as some tech companies across the board have seen their valuations cut 20-30 percent.”

Private equity firms weren't the only ones holding back. Technology titans known for their use of strategic acquisitions also curtailed their activity during the third quarter, according to the report. Google, which has seen its share price take a tumble, signed off on four deals since the start of the year, compared with 14 transactions during the same period a year ago. And IBM, meanwhile, has only acquired one company this year, compared with three companies within the same time period last year.

Buyers are also scaling back on the amount they're spending on a per deal basis. During the quarter, only six deals worth in excess of \$1 billion were announced in the September quarter, compared with 11 such deals in the previous year and 22 deals in the same period in 2006, according to the report. Advisers to prospective buyers are shaken because of investment companies like Lehman Brothers and Merrill Lynch disappearing off Wall Street to financial institutions like Washington Mutual, the nation's largest thrift, having to find a buyer themselves.

Daly noted in his report: “Besides the uncertainty concerning the advisers that help support the transactions, there's also doubt about the institutions themselves right now, which complicates deals. Consider the highly unusual step taken this week by JDA Software to shore up confidence in its ability to pull off its planned \$461 million acquisition of supply chain management vendor i2 Technologies. The company issued a press release confirming the commitment of its financial backers to finance the deal, as it added another bank to the syndicate. (The market began to bet against JDA's ability to finance the planned deal because Wachovia, an ailing bank that eventually got sold to Citigroup, was one of the two banks on the ticket to provide the debt. Wells Fargo has since been added.)”

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Tech M&A Spending Takes Big Hit in Third Quarter (cont.)

And as the fourth quarter begins, the outlook for the full year is one that is expected to post a drop in M&A spending--which would end four consecutive years of annual increases.

Meanwhile, investment banking services firm The Jordan, Edmiston Group on Wednesday issued a nine-month M&A report that reflected growth in the number of deals among some technology-related sectors but steep declines in the valuations of those deals. Within the database information services sector, the number of deals rose to 36, up 63.6 percent compared with the same period a year ago. However, the value of all deals dropped nearly 60 percent to \$8.6 billion. The marketing and interactive services sector was hit with a similar situation, where the number of deals rose to 205, up 13.3 percent, while the value dropped 64 percent to \$7.3 billion. The online media and technology sector, however, posted a decline in both the number of deals and value during the past nine months, according to the report. M&A deals in this sector fell 6 percent to 218 and the value dropped 6.9 percent to approximately \$7.7 billion.

While spending is down, a new group of buyers have focused increased attention on Federal IT service providers, namely American and Alaskan tribal companies and Alaskan Native Corporations. We at Core Capital are entertaining expressions of interest from several tribal and ANC buyers, as they consider increasing their involvements in technology-based businesses.

Software Continues to Dominate Technology M&A

For 2008 year-to-date, the number of merger and acquisition announcements targeting US information and communication companies totaled 1,199 compared to 1,112 for the same period in 2007. In September, the Software sector accounted for 36% of all announced transactions followed by Hardware & Systems (30%), IT Services (24%) and Telecom Services (10%).

In spite of attention given to cross-border transactions led by foreign firms, US buyers accounted for 82% of the announced transactions. Countries with two or more announced transactions include Canada (10), the United Kingdom (6), India (3) and South Korea (2).

Information Technology Demand Trends

Washington Technology recently reported on Gartner analyst comments at the firm's Symposium/ITxpo 2008 conference in Orlando, FL. The No. 1 item on Gartner's list of what IT execs have to prepare for was the worst of all, from a manager's standpoint: hiring freezes and possibly even layoffs. It was a somber message for the 6,000 attendees at the conference. "The next big thing in IT is not a technology — it is cost reduction, risk management and compliance," said Peter Sondergaard, Gartner's global head of research.

We at Core Capital believe that forward-leaning IT service providers will focus on the most basic of all value propositions: tailor your offerings to provide savings for your clients.

Recent Transactions

Boeing Integrated Defense Sys [MO] acquires Tapestry Solutions Inc. [CA]

Boeing Integrated Defense Systems, which manufactures commercial aircrafts, military airplanes and helicopters, missiles, space vehicles and stations, air defense systems, computing software and communications equipment, agreed to acquire Tapestry Solutions Inc., a provider of information technology services.

Cisco Systems Inc [CA] acquires Jabber Inc. [CO]

Cisco Systems Inc. (Nasdaq:CSCO), which manufactures and wholesales networking and communications products with specialization in education, government and home communications, plans to acquire Jabber Inc., a developer and retailer of web-based communications software, from Webb Interactive Services Inc.

Northrop Grumman Corp. [CA] signed a definitive merger agreement to acquire 3001, Inc. [VA]

Northrop Grumman Corp. [CA] signed a definitive merger agreement to acquire 3001, Inc. [VA] from CM Equity Partners, 3001's management and TICC Capital Corp. (NasdaqGS:TICC). 3001, Inc., a geospatial company, provides geospatial data production and analysis solutions in the United States. It offers solutions, including airborne imaging, surveying, mapping, and geographic information systems.

Infotech Enterprises America [CT] acquires Time To Market Inc. [CA]

Infotech Enterprises America Inc., which provides engineering, information technology and geospatial services in North America, planned to acquire Time To Market Inc., a provider of ASIC design and embedded software solutions services.

Red Hat Inc. [NC] acquires Qumranet Inc. [CA]

Red Hat Inc. (Nasdaq:RHT), developer of Linux and open source solutions software for Internet infrastructure, acquired Qumranet Inc., a developer of enterprise software, for an estimated USD 107.0mn in cash.

Deltek Inc. [VA] acquires Planview Inc.-MPM Solution [TX]

Deltek Inc. (Nasdaq:PROJ), which develops project management software, acquired the MPM solution and related assets of Planview Inc., a developer of enterprise software, for an estimated USD 16.0mn in cash.

Tyler Technologies Inc. [TX] acquires School Information Systems Inc [MO]

Tyler Technologies Inc. (New York:TYL), which develops information management software and government integrated software applications and services, acquired all the outstanding stock of School Information Systems Inc., a developer of educational management software.

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