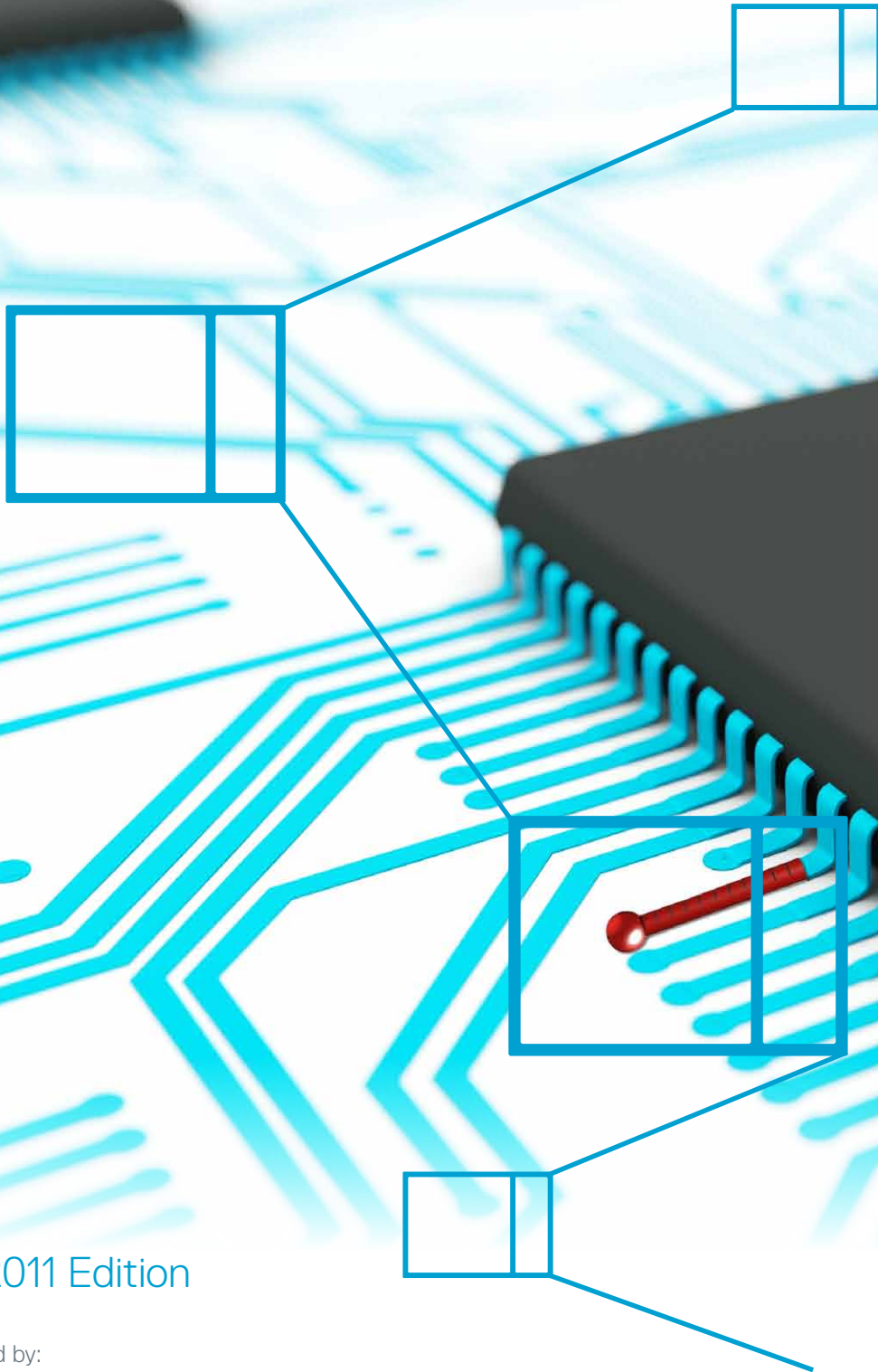


The Taylor Wessing Technology Barometer

Tracking the temperature of the
UK technology sector



Q4 2011 Edition

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About this publication

The Taylor Wessing Technology Barometer is a new quarterly publication providing an overview of the trading environment, board room confidence, valuations and M&A activity within the UK technology sector. It is produced by Taylor Wessing and Megabuyte and will form part of the on-going series of Megabuyte Forum events.

About Taylor Wessing

Taylor Wessing LLP is a leading international law firm. The firm provides a full suite of legal services but is particularly recognised for expertise in technology and other IP-rich industries. The Taylor Wessing technology team comprises lawyers who can advise on M&A, funding arrangements, intellectual property, commercial contracts, and employment and disputes, as well as a number of other areas associated with a full-service firm.

Clients of the firm include public and private companies, financial institutions, high net worth individuals and their corporate vehicles, and public-sector bodies. The firm has worked with the world's largest technology companies as well as exciting new start-ups.

Within Taylor Wessing there is a highly regarded equity capital markets team, a leading team for advisory work with UK listed technology companies. The team's work includes acting on initial public offers and secondary issues for technology companies, as well as public company M&A work. The team was mentioned in the *FT Innovative Lawyers Awards* for the initiative it created to assist public-to-private and de-listing with tender offer structures.

About Megabuyte

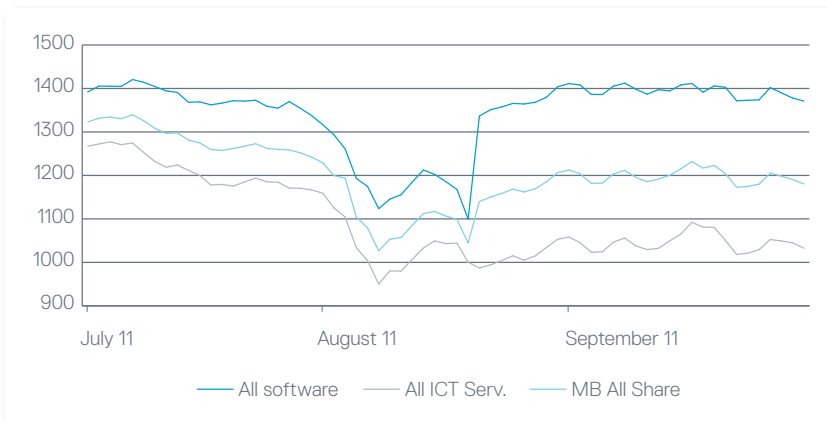
Megabuyte is a company intelligence service that monitors the corporate and financial performance of UK-based privately owned and publicly quoted technology companies. The Megabuyte service is considered by many of the sector's leading CEOs, board level executives, investors and advisers as an indispensable way to stay informed about company results, M&A and fundraising activity and sector trends.

Delivered by e-mail before 9am each morning, the Megabuyte daily Newswire provides independent, well-informed and pithy analysis of the latest sector news, empowering recipients for the working day ahead. Subscribers can also validate strategic decisions, monitor competitors and identify possible acquisition targets by drilling down into our unique on-line company database which contains company profiles, peer group analysis, valuation statistics and sophisticated tools enabling users efficiently to mine this extensive resource.

Megabuyte is provided by I S Research which was founded by Ian Spence in 2007. Ian has been involved in researching and advising companies in the UK technology sector for over 15 years and was voted TechMARK analyst of the year in 2004 and again in 2008 making him the only analyst to win twice and the only independent analyst to be recognised in this way. In 2009, he was joined by Philip Carse, who brings 20 years telecoms experience as a consultant and equity research analyst, expanding Megabuyte coverage to include all aspects of communications services and technologies.

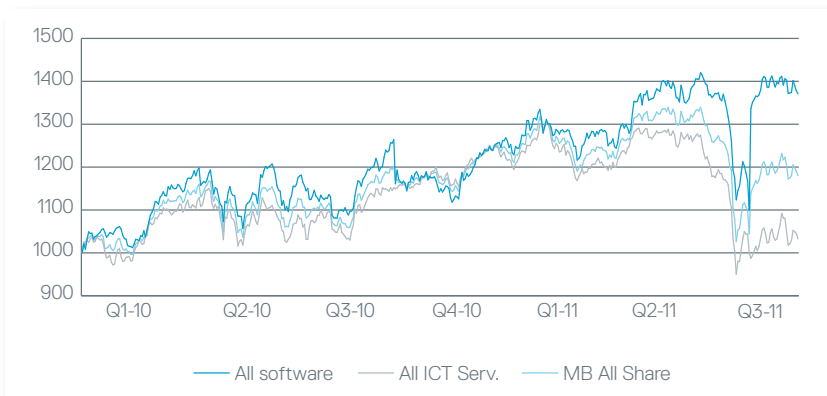
Rollercoaster quarter

Chart 1: The Megabyte Taylor Wessing Index Series – Q3



Source: Megabyte, Statpro Revolution

Chart 2: The Megabyte Taylor Wessing Index Series – since inception



Source: Megabyte, Statpro Revolution

Readers will not need us to tell them that the last few months have been a rollercoaster ride for stockmarkets globally and the UK technology sector has taken its fair share of pain. The newly created Megabyte Taylor Wessing Index Series shown in charts 1 and 2 demonstrates the severity of the fluctuations in the sector over the last few months.

The Megabyte Taylor Wessing All Share Index, which is a weighted index of 100 UK listed software, IT and telecoms stocks, traded as low as 1,026.60 in the period, suggesting that prices sailed close to their January 2010 level. However, prices recovered quite significantly towards the end of the period although our main index did still end Q3 down 10.3% 1,190.70.

The Autonomy effect

Drilling down a little further into the detail of the indices, we can see that the Software Index has significantly outperformed the ICT Services Index. Moreover, the divergence in performance of the two has increased markedly in recent months. The main reason for this has been the inversely proportional performance of two heavily weighted stocks: Autonomy and Logica.

The bid for Autonomy at a near 80% premium to the trading price had a very significant impact on the performance of the sector and especially the Software Index which was only 1.2% lower in the quarter. By comparison, the ICT Services Index was down 18.0% in Q3; a figure which was significantly influenced by a 39.2% fall in Logica shares following a profit warning.

The Megabyte Taylor Wessing All Share Index

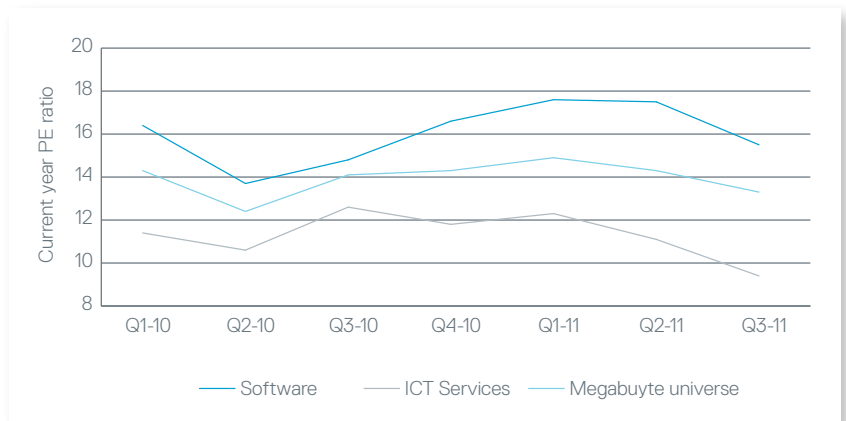
We track the valuations for the All Share and a series of peer groups which make up the All Share Index. As an overall observation on Q3, tech sector valuations continued on the downwards trend established in Q2 and, significantly, valuations for the universe as a whole are at their lowest point since the second quarter of 2010. Software valuations remain higher than ICT services valuations with the average software PE currently tracking at 15.5x current year earnings against 9.4x for the ICT services group.

Looking at the individual peer groups, it is interesting to note that, despite the turmoil in global financial markets, Banking and Insurance Software valuations have remained robust in this part of the sector. Conversely, Business Management Software PEs have come back quite sharply over the last quarter, as have those of Public Sector Software companies.

Turning to the ICT Services sector, the Mobile segment has been the best performer over the last quarter with a 2.1% increase in average PEs, whilst the Consulting & Systems Integration group has been hard hit and is once again the lowest valued group in the sector. Within ICT services, Hosting & Fixed Line companies remain the most highly valued at 13.1x current year earnings, although this figure contracted sharply in Q3.

“ Notwithstanding the volatility of global stock markets, the technology sector outperformed in Q3. ”

Chart 3: Valuation statistics



Source: Megabyte

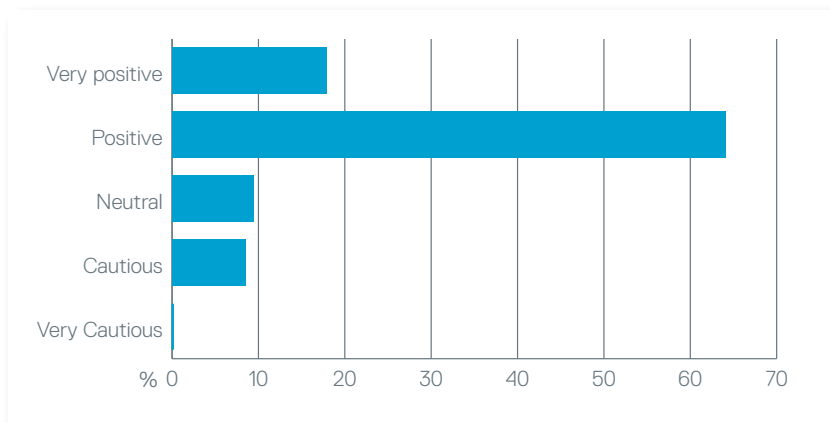
Table 1: Peer Group valuations

Peer Group	Average current year PE		
	Sep-11	Jun-11	3m chg
Banking & Insurance software	15.6	16.2	-3.7%
Business Management software	16.4	19.0	-13.7%
Media & Telecoms software	13.3	14.6	-8.9%
Public Sector software	17.3	20.1	-13.9%
Software total	15.5	17.5	-11.3%
Infrastructure Services	9.4	9.7	-3.1%
Consulting & Systems Integration	8.9	10.5	-15.2%
Hosting & Fixed Line Services	13.1	14.8	-11.5%
Mobile, Wireless & Satellite	9.7	9.5	+2.1%
ICT Services total	9.4	10.3	-8.7%
All Share	13.3	14.3	-7.0%

Source: Megabyte, company announcements

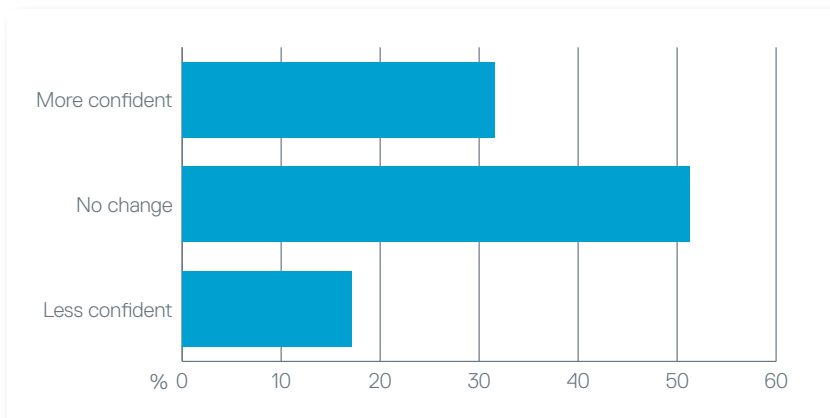
The Taylor Wessing Confidence Index

Chart 4: CXO level of confidence over next 12 months



Source: Megabyte

Chart 5: CXO change in confidence in Q3



Source: Megabyte

Although share prices have partially recovered from their recent lows, in general terms, we believe that a significant amount of damage has been done to overall business confidence and, further, that this is likely to have an impact on IT spending over the coming months.

Tech boardrooms keep their chin up

Each quarter, we survey 500 CEOs, CFOs and other board level executives from UK-based software, IT and telecoms companies about their level of confidence in the business outlook. Of the 117 responses to the survey this quarter, 71 were CEOs and all but nine were from companies with revenues in excess of £5m.

The results of the survey are highlighted in Charts 4 and 5 and reveal that, notwithstanding the resurgent worries over a potential double-dip recession, over 80% of respondents feel either positive or very positive about the outlook for their businesses over the next 12 months. Conversely, only 9% said that they were cautious.

Looking at the change in mood over the last quarter we can see that, perhaps counter-intuitively, nearly a third of respondents were more confident than three months ago against 18% who said they were less confident. If we take as read that the macro picture is worsening, this unexpectedly robust attitude could perhaps demonstrate an inherent resilience in the tech sector or, conversely, over-optimism on the part of respondents.

“Despite the very difficult trading environment, over 80% of CXOs feel either positive or very positive about the outlook for their businesses over the next 12 months.”

Technology sub-sector trends

Business Management Software

This segment of the software market is arguably one where the trend to SaaS delivery is at its most disruptive. Consequently, to us, short-term demand patterns are less relevant than the product and strategic positioning of vendors in this peer group. In general terms, we see the larger incumbent vendors being nibbled at by newer SaaS vendors and, unless the likes of Sage start making more concrete plans for a credible SaaS offering, we believe that the nibble will in due course turn into a rather nasty bite.

Banking & Insurance Software

As in 2008, it is the banking and insurance software segment which has the potential to be the first to feel renewed downward pressure on demand resulting from the re-emerging banking crisis. To varying degrees, we have already seen weak trading statements from Misys, Patsystems and Ffastfill which are likely to be the thin end of the wedge for those supplying both the retail and investment banking segments if the new banking crisis develops further.

Media & Telecoms Software

Performance has been mixed among this rather disparate group. We highlight broadly positive dynamics in contact centre solutions (Netcall and Eckoh), mobile handset testing (Anite) and new IPTV and OTT content hardware and services (Amino and ANT), following more troubled times for all the companies concerned. Conversely, trading has been tougher for those companies supplying software to the traditional media sector with recent weak results from Atex and Miles 33.

Public Sector Software

Increasing evidence of the slowdown in public sector spending on software & ICT services continued in Q3. Most notable amongst the news flow was RM's profit warning and restructuring announcement which made pretty grim reading and underlined our view that the education sector will be the hardest hit of public sector segments. That said, we are also seeing increasing evidence of a slowdown in healthcare IT spending in the UK whilst local government remains reasonably steady.

“Recent trading weakness from some companies supplying software to the banking sector may be the thin end of the wedge if the banking crisis develops further.”



“ Hosting demand remains a bright spot with Cloud services as the main driver; companies in this segment report strong demand and double digit growth.”

Hosting & Fixed Line services

The bright spot of this peer group remains the data centre and hosting companies, where vendors such as Telecity and Iomart are benefiting from double-digit demand growth and operational leverage, with Cloud deployments now increasingly becoming a demand driver. The Fixed Line element of the peer group is seeing less buoyant conditions, but splits into two halves: resellers such as Alternative Networks who can eke out organic growth in otherwise relatively flat markets due to share gains, whilst generating good cash flow; and the network operators such as BT, COLT and CWW who face relentless price pressures and on-going capex requirements.

Mobile Services

The dynamism of the mobile sector has created a clear distinction between those companies exposed to newer market opportunities and/or with well adapted business models that are enjoying very strong growth, and those more mature companies where decline in legacy business continues to outshine their newer activities. The former includes companies in areas such as mobile money (Monitise), marketing (InternetQ), gambling (Probability) and messaging (Synchronica, Globo), whilst the latter include content and billing companies such as 2ergo, Bango and Zamano.

Infrastructure Services

Short-term demand trends are quite opaque currently with differing messages coming from the leading infrastructure services players. Some vendors are clearly seeing a slowdown from the post-recession rebound experienced last year whilst others, most notably Specialist Computer Holdings, have been making more bullish noises about current trading. Looking longer term, the dominant trend within the infrastructure services segment continues to be the move from desktop to datacentre which we see as simultaneously an opportunity and a threat to vendors in this segment. We expect vendors that are well placed for the Cloud to take market share from those that are not.

Consulting & Systems Integration

As ably demonstrated by Logica's recent profit warning and share price collapse, we continue to see this segment of the sector as arguably the most challenged. A ten-year trend of margin erosion driven by a flight to offshore provision and, more recently, the move to Cloud-based solutions is rendering many vanilla people-based services as a commodity. Moreover, it seems clear that investors share our view as this is also the lowest valued peer group in the sector.



M&A and fundraising

“M&A activity continues at a steady pace despite market volatility.”

M&A trends

M&A activity has continued at what we think can best be described as a steady pace in Q3 but it remains focussed on a small group of hot spots. But before we get on to those, we must of course start with the mother of UK tech M&A deals; HP's acquisition of Autonomy for £7.1bn. There were many things that were remarkable about this deal over and above its size, not least the 70% premium paid, the fact that very few observers can see any strategic rationale for the deal, that it sparked a very public spat between Autonomy and Oracle CEOs Mike Lynch and Larry Ellison and that the HP CEO who was in post when the deal was announced had left the company by the time it completed.

But for us, one of the most significant consequences of the deal, which has been less of a focus for comment, is how the departure of Autonomy from the London market is yet another blow to an already

seriously depleted quoted UK tech sector. As we mentioned earlier, Autonomy represented around 15% of the Megabyte quoted universe and its removal will leave a big hole in potential trading commissions and corporate fees for the London investment banking sector. And the trend just rolls on with another significant company in the sector, Group NBT, being taken private with backing from Hg Capital in a deal valued at £153m.

Coming back to some of the peer group trends in M&A, the hosting and managed services hot spot has been particularly evident in recent months driven in part by increasing M&A activity from leading provider Telecity. Also completing a significant deal in the sector in recent weeks was Bridgepoint-backed acquisition vehicle Lumison, which acquired Dedipower for what Megabyte estimates was around £20m.

M&A has also continued in the Fintech sector during the summer with Patsystems' acquisition of Mixit and Ffastfill's purchase of Spread Intelligence. There has also been takeover activity coming the other way with Misys engaged in takeover talks with Fidelity although these talks ultimately came to nothing. At the smaller end, Lombard Risk Management and FRS Global are still talking.

Infrastructure software also continues to be an area of heightened deal activity. Following on from the recent investment by Goldman Sachs in AppSense, US-based Riverbed Technology paid top dollar for Cambridge-based Zeus Technology providing a happy outcome for long-suffering shareholders in the once-feted dotcom darling.

Table 2: Selected Q3 M&A deals

Acquirer	Target	Date announced	Value
Lumison	Dedipower	4 Oct	£20.0m*
Aveva	Z+F	3 Oct	£6.3m
Telecity	UK Grid	23 Sep	£11.7m
Interoute	Quantix	13 Sep	£16.0m*
HP	Autonomy	19 Sep	£7,091m
Allocate	Zircadian	12 Aug	£4.5m
Telecity	Data Electronics Group	8 Aug	£87.6m
Riverbed Technology	Zeus	19 Jul	\$110.0m
Patsystems	Mixit	21 Jul	£12.6m

* Megabyte estimates

Source: Megabyte, company announcements

The fundraising environment

At the start of the year, we predicted that private equity would remain the primary funding source for UK tech companies whilst stock market activity would remain subdued, but not even we expected such divergent levels of activity.

As the year has progressed we have seen a very active private equity segment, especially in the £20m-£100m deal size range. Conversely, after what looked like being some green shoots in Q1, as typified by the admission to AIM of Ubisense, the IPO market has seized up again. Even secondary fundraisings, demand for which had remained resilient through much of the downturn, have largely ground to a halt over the summer.

Looking more specifically at private equity deal flow in Q3, we can see from table 3 that the hosting and managed services theme is clearly evident here as it is with M&A activity. Of the seven deals highlighted in the table, five could reasonably be put in the hosting and managed services category.

Interestingly, the other area of activity for the private equity community in Q3 was Fintech software with Carlyle Group's acquisition of ITRS Group and talks underway for a P2P of internet banking software provider Parseq backed by Nova Capital. For us, the reason this is interesting is that, whilst the Fintech sector has been very active for M&A, until now, there has been only limited private equity activity.

Fundraising outlook

The underlying dynamics currently causing the disconnect between capital markets and private equity activity look set to continue for the foreseeable future. The private equity segment continues to have significant funds to put to work in the technology sector and deal valuations are generally higher than a company would achieve with a stock market flotation.

At the same time, whilst cash flow into equity capital market funds is solid enough, and might even improve with the advent of QE2, lack of confidence amongst fund managers remains a core issue. Moreover, this lack of confidence, which is depressing both trading and IPO valuations, is driven primarily by weakening macro-economic factors which currently seem to be rather intractable.

“Private equity activity continues to substantially out-strip capital market activity in the UK technology sector.”

Table 3: Recent Private Equity deals

Company	Value	Investor	Deal type
Adapt	£30.0m	Lyceum Capital	MBO
ITRS Group	£60.0m*	Carlyle Group	MBO
Group NBT	£153.0m	Hg Capital	P2P
Parseq	£34.1m	Nova Capital	Possible P2P - no formal bid yet
Attenda	£50.0m	Darwin Capital	Secondary buyout
Six Degrees Group	£60.0m	Penta Capital	Growth capital for buy and build
Intrinsic Technologies	£30.0m	RJD Partners	MBO

* Megabyte estimates

Source: Megabyte, company announcements

About Taylor Wessing

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Taylor Wessing has one of the largest dedicated capital markets practices in Europe, with genuine cross-border capability and a strong presence in Asia and the Middle East.

The ECM team advises on transactions involving public companies engaged in European and global securities offerings. As well as having experience advising many technology companies, large and small, we act for listed companies, their sponsors, nominated advisers, brokers and investment banks across all types of European securities offerings.

Our particular expertise in capital markets law and regulation allows us to deal effectively with the increasing disclosure and other ongoing obligations of listed and quoted companies. Our specialist transaction lawyers are highly skilled not only in drafting and negotiating legal documentation, but also in project-managing the transaction process through all stages. This advice includes planning the deal structure and a strategy to

complete the transaction, consideration of the tax consequences of the transaction, and how best to mitigate tax.

The ECM team is part of Taylor Wessing's Technology Industry Group. The firm has a long history for acting for technology companies. A large portion of our work is providing advice to technology suppliers and users. This means we have a greater familiarity with emerging technologies and business practices than would otherwise be the case.

Our in-depth understanding of the legal issues that can arise in connection with the use of technology is based on specialists who have the requisite experience, both legal and practical, needed to analyse that issue, undertake an informed assessment of the risks and deliver a solution.

We undertake the full range of legal services for our clients in the technology sector including M&A, funding arrangements, intellectual property, commercial contracts, employment and disputes.

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