VALUATION INSIGHTS

The Bits and Binary Code Behind Software M&A and Technology Convergence

By Alexander Woods, AVA
December 1, 2010

Source: http://news.tigerdirect.com/

A New Era of Technology Dependence

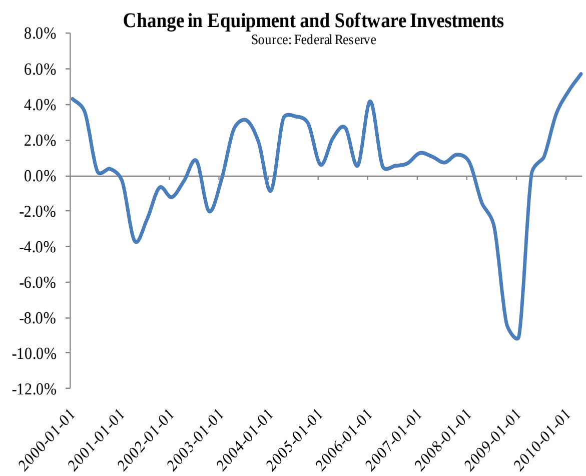
Over the last two decades, software companies have transformed the way corporations have been conducting business. From the release of Microsoft's Windows 7 to Oracle's Fusion Middleware, international economies have become increasingly dependent on various software programs to run computers, networks, storage devices, and other critical infrastructure.

This dependency is most commonly visualized by the dominance of Microsoft's Windows. This operating system has been a market leader in the software industry since its inception with 92 percent of computers utilizing various versions. However, beyond the monopolistic nature of this segment, there are a wide variety of software companies that facilitate everyday commerce, such as: Adobe, EMC, SAP, Oracle, and others.

The rapid proliferation of the internet has had a profound impact on the corporate landscape, with many companies adopting more dynamic software models such as software-as-a-service, in order to alleviate upfront costs and increase their return on investment. These increasingly popular software solutions have allowed corporations to increase efficiency by creating software and storage architectures that address the market for on-demand, turn-key solutions.

The Maturing Software Market

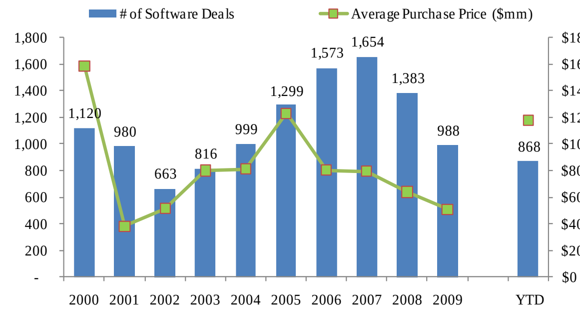
Despite these innovative trends, the software industry (the "**Industry**") is forecasted to experience mild growth, with most estimates in the single digit range.



These rates reflect the reality that new software solutions are often evolutionary, and not revolutionary, making substantial organic growth outside a precipitating event challenging. This is further exacerbated by disciplined corporate spending, increased competition and pricing pressures, and the limited ability of larger firms to quickly absorb new technologies.

The Software M&A Market

To compensate, a number of firms have become more acquisitive in an attempt to grow market share through M&A activity. Many of these deals have been getting done in the middle market with an average purchase price of $120 million and with multiples of 1.8x revenue and 8.1x EBITDA.

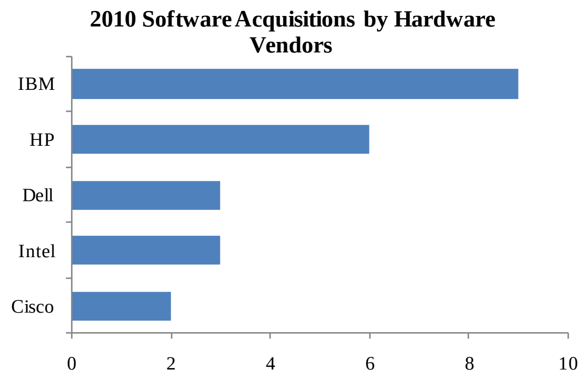


Source: Capital IQ, Internal NPC Analysis

These deals are typically best-of-breed or single point software vendors acquired to bolster existing product portfolios, enhance research and development, enter adjacent markets, or increase market share in a particular niche.

Two Peas in a Pod: Software & Hardware

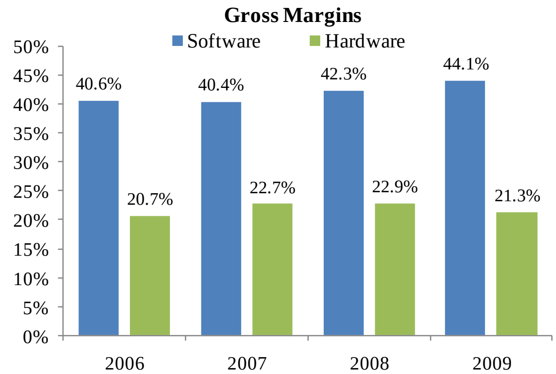
Aside from acquisitive software firms, hardware vendors such as IBM, HP, and Dell have made substantial software acquisitions in recent years to compete in high growth areas, and to increase their own products functionality and performance.



Source: Capital IQ, Internal NPC Analysis

These acquisitions allow for firms to increase their wallet share of their client's IT budget by retaining incrementally more of each dollar spent. This allows for meaningful growth in an environment where corporate spending has remained stagnant and corporate clients have trended towards vendor rationalization.

Moreover, software companies typically have more favorable gross margins than hardware vendors, making them attractive targets for vendors looking to enhance their profitability.



Source: Capital IQ, Internal NPC Analysis

Post Acquisition: Cleaning up the Balance Sheet

Once an acquisition has been closed, the purchaser is required by the Financial Accounting Standards Board ("**FASB**") to allocate the purchase price among the various assets acquired in the business combination. This analysis must be completed in accordance with FASB's Accounting Standards Codification ("**ASC**") Topic 820: Fair Value Measurements and Disclosures, and ASC Topic 805: Business Combinations.

These accounting standards require the appraiser to conduct the analysis with an emphasis on how market participants would price each of the assets acquired. This includes considering the highest and best use of each asset, removing buyer specific synergies from the analysis, and reconciling the weighted average return on assets, the internal rate of return, and the cost of capital. Once this analysis has been completed, the fair value of the acquired assets will aid the company's auditors in completing their year-end audit.

If your company has recently completed an acquisition, or if you have any questions surrounding the valuation process, please contact Alexander Woods at awoods@newburypiret.com or 617-933-2019

Founded in 1981, Newbury, Piret & Company, Inc. is one of New England's leading valuation and investment banking firms. We provide both financial accounting and IRS related valuation services to middle-market companies and family businesses throughout North America and Europe. Newbury, Piret & Company, Inc. is a member of NACVA, IBA, FINRA, and SIPC