



IT & Technology
M&A update
Quarter Two 2023

Lexington's key highlights

Overall decline in volumes in H1 2023

- Deal volumes in the sector reduced in Q2 compared to Q1 which was in line with reduced activity across the wider M&A marketplace^[1].
- Sector deal volumes were down 15% to 144 when compared with Q1, but still remained above that of pre-pandemic levels. The numbers are starker when H1 2023 is compared to H1 2022, which highlighted that deal volumes are down by 20%. This is slightly better than the overall UK market, which saw a 23% decline in volumes in H1 when compared with 2022.
- Average deal values have dropped slightly as the impact of macro-economic factors have dragged on bigger-ticket transactions, particularly where the debt markets are involved. It also points towards a potential softening of multiples.
- The wider Private Equity market also cooled during H1 when compared to the previous year but the number of deals remained flat in the IT & Tech sector. Anecdotally, we expect PE activity to increase throughout the remainder of 2023 and early 2024 as Funds look to deploy their "dry powder".
- Across the subsectors, digital transformation and cloud migration remained two key areas driving activity. Cyber security remains a hot investment target and we see this as being a key focus, particularly for Private Equity, throughout the remainder of 2023 and beyond.
- In conclusion, we still feel that the immediate outlook for IT & Tech dealmaking remains positive. The attractive subsectors will continue to be favoured while talent shortages will increase the need for consolidation.

Reduction in deal volumes on Q2 2022 and H1 2022

Median deal value continues to drop, suggesting a cooling of valuations in the sector

Software development and application software products are the most active subsectors in Q2 2023

Base rates and macro economic pressures continue to impact larger transactions

Lexington's
IT &
Technology
M&A team



Nigel Griffiths
Commercial Director



Thomas Edwards
Director



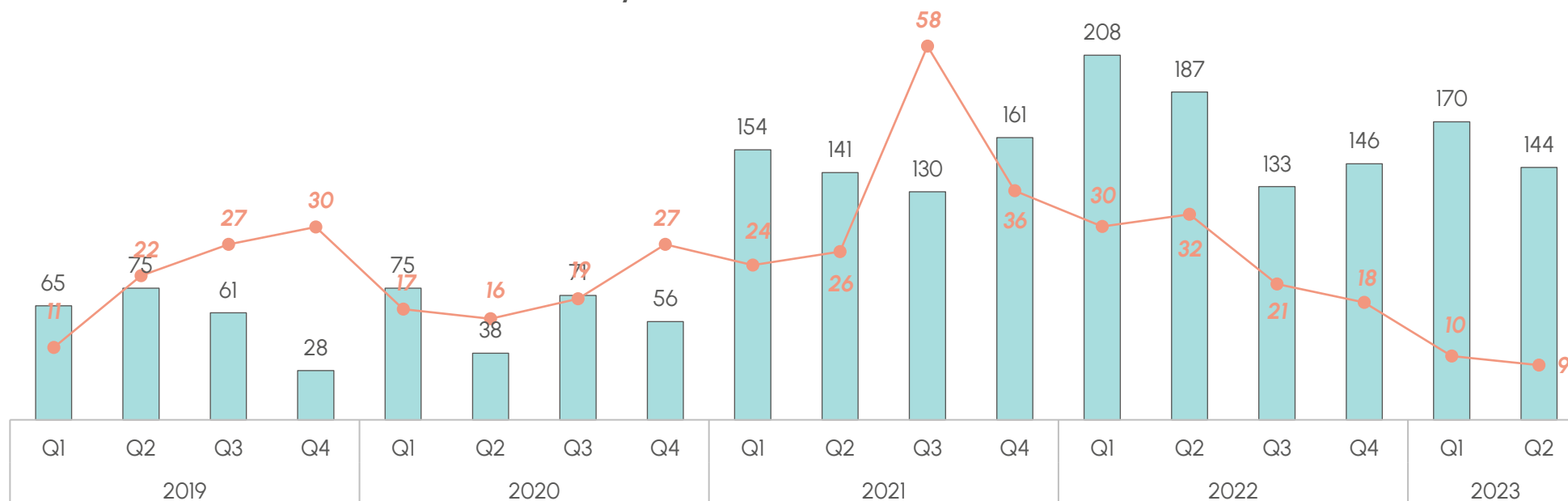
Charles Lesbirel
Senior Associate



Jade Burgess
Senior Associate

Quarterly activity snapshot

Q2 deals volumes remain buoyant



Key themes:

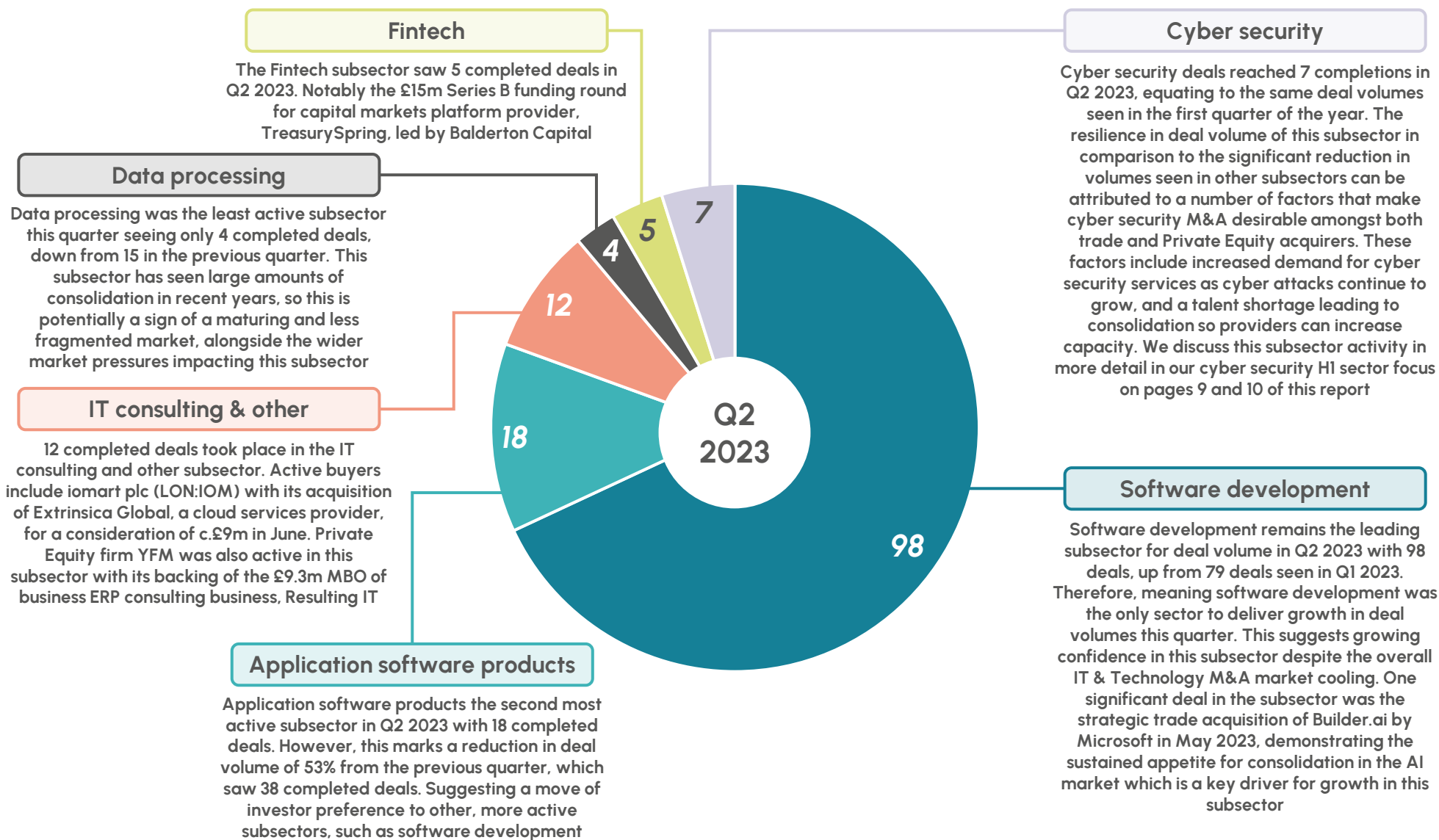
■ Deal volume

—● Median deal value (£m)

- In Q2 2023, M&A deal volumes dropped to 144 from 170 in Q1. This continues the trend of lower Q2 activity since 2020. Median deal value shows that UK's lower middle market continues to take up a high proportion of tech M&A activity.
- Activity remains significantly higher than pre-pandemic levels and increased proportion of deals are Private Equity backed in Q2. International and US buyers continue to develop and bolster their portfolios, prioritising cash generative tech companies to help mitigate the instability of the UK economy, with sub-sectors Cyber Security and AI attracting notable investments.
- We continue to see interest from some of the major PE acquirers such as BGF, Phoenix, Bridgepoint and LDC, along with continued activity from Trade. Due to increasing interest rates, PE have turned to optimising their portfolio with focuses on cash generating companies such as digital/ cloud transformation and data analytics. While taking this into account, we expect to see a steady deal volume continue in the coming quarters; we also expect continuation of a modest median deal value.

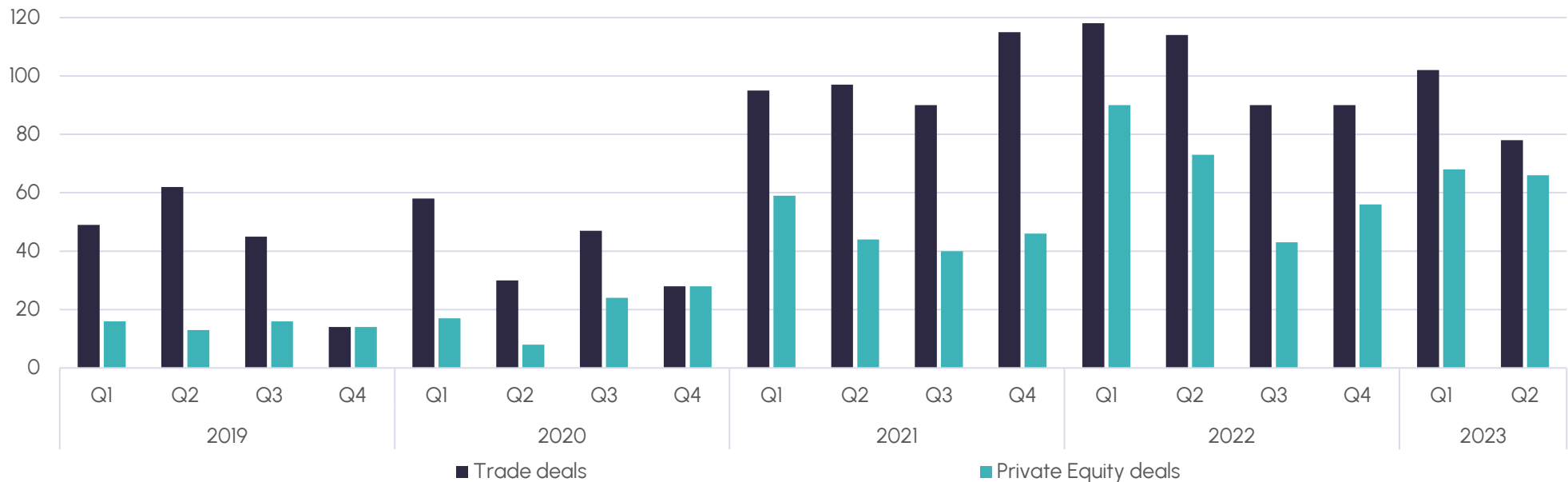
IT & Technology M&A subsector analysis

Software development deals continue to dominate M&A activity in Q2 2023



Trade v PE

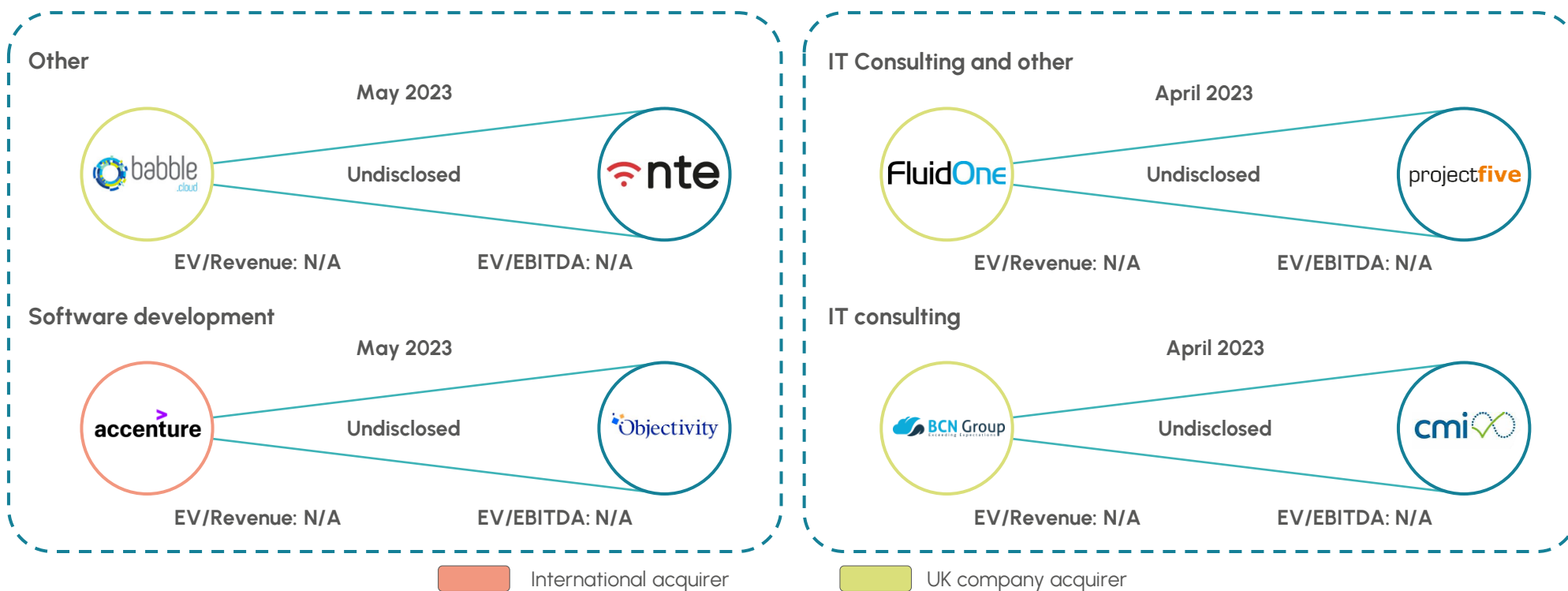
Comparison of buyer types by deal volume in the UK IT & Technology sector



- Deal volumes for both trade deals and Private Equity transactions have remained significantly above pre pandemic levels. In Q2 2023, out of the 144 UK IT & Technology deals announced, 78 were strategic trade deals and 66 were Private Equity deals, illustrating that opportunities in the sector remain of significant interest to Private Equity investors. This was in contrast to the wider M&A market as a whole which saw a larger contraction in the number of PE backed transactions.
- This quarter we have continued to see Private Equity investors make stand-alone investments in the sector whilst supporting existing portfolio companies in their buy-and-build strategies. One example is FluidOne (backed by Private Equity investor, Livingbridge) which has made its fifth acquisition in the space with the acquisition of IT support company, Project Five.
- Of the subsectors, software development and cyber security targets are highly sought after by Private Equity firms, and will continue to be in the coming years as the market continues to adapt to these technologies.

Notable transactions - 1

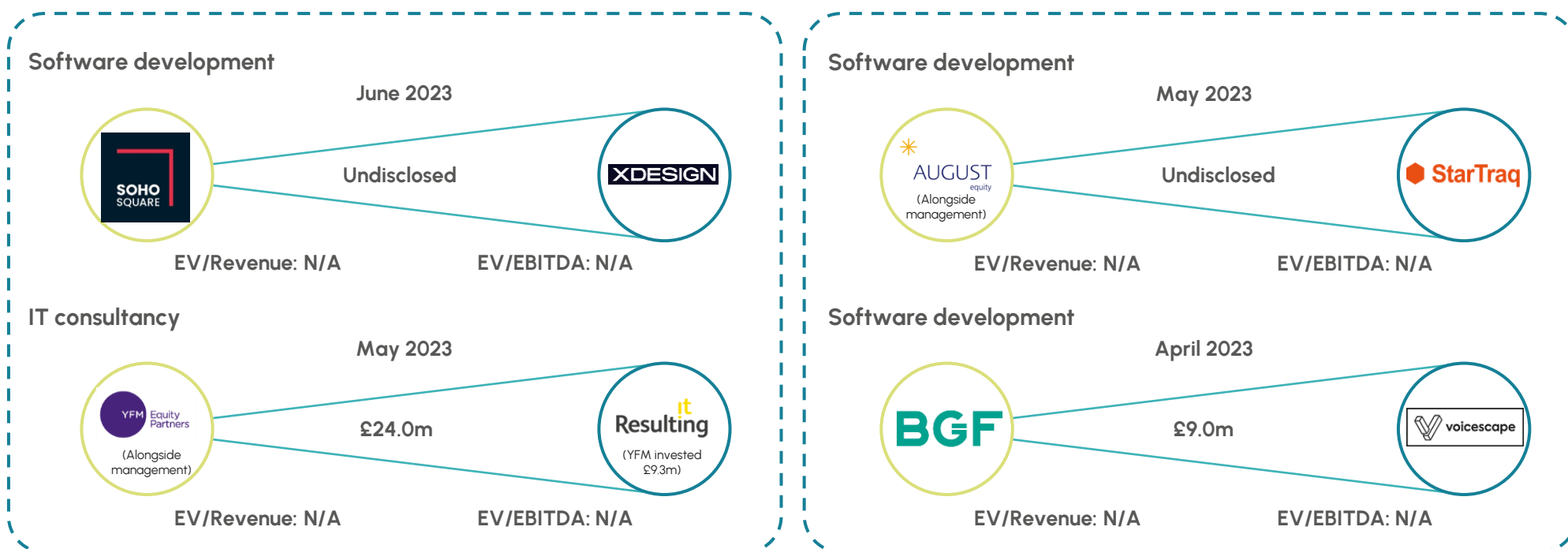
Recent strategic trade acquisitions in the UK IT & Technology sector



- Despite total deal volumes in the UK IT & Technology sector decreasing by 15% since the last quarter, activity levels have remained strong in Q2 of 2023 with 144 deals announced during the period. Of these deals, 78 were strategic trade purchases.
- During the period, deal volumes in the lower mid market have risen since the last quarter with serial acquirers like Babble, Accenture, FluidOne and BCN making acquisitions in the period. Of the 78 deals with disclosed transaction values, 57 were lower mid market transactions, illustrating that IT and technology continues to be a focus in this market.
- Some other notable acquisitions in the sector in the second quarter of 2023 include the acquisition of NetworthNet by Kerv Group for an undisclosed consideration and the acquisition of CloudStratex which was US serial acquirer Brillio's (backed by Bain Capital in Jan-19) first UK acquisition.

Notable transactions- 2

Recent Private Equity deals in the UK IT & Technology sector

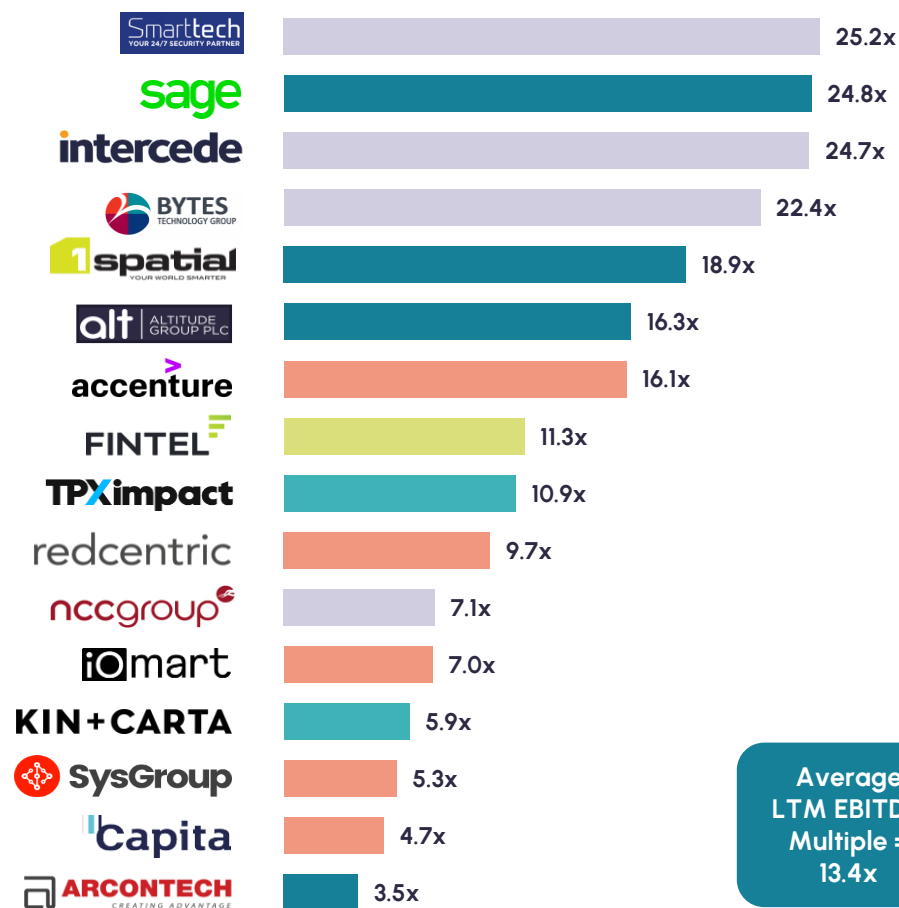


- Out of the 144 transactions in the UK IT & Technology sector in Q2 2023, 66 were Private Equity or Venture Capital investments.
- In June 2023, Soho Square acquired a minority stake in xSolutions365, a digital product development company for an undisclosed amount. In May 2023, August Equity and YFM acquired undisclosed stakes in StarTraq and Resulting respectively alongside the respective management teams. BGF acquired an undisclosed stake in Voicescape, a communications software developer for £9m.
- During the period, BGF invested in four companies in the sector; MRM Global, Hedgehog Lab, Caristo Diagnostics (series A funding) and as mentioned, Voicescape. Other Private Equity that have made transactions in the sector during Q2 2023 include; LDC, Foresight and Apiary Capital.

Quoted company benchmark multiples

The listed companies in the UK that are active in the IT & Technology sector

LTM EBITDA Multiple



Overview

Lexington's own research has identified 16 quoted companies in the UK and Ireland that are active in the IT & Technology sector. It is clear from the data sample that companies in the cyber security and software development space continue to exceed the industry average with Smarttech, Sage, Intercede and Bytes all trading with an LTM EBITDA multiple of over 22x as at 30th June 23.

Predictions

The LTM EBITDA multiple average for the 16 companies is 13.4x, (Q1 2023: 12.0x) an increase of 12% on the previous quarter. This quarter we have seen average sector multiples remain at a more normalised level, albeit, multiples in this sector are still significantly outperforming the general market. Large market players have continued buy and build strategies to consolidate the market and expand service offering.

Trends

The graph below illustrates the average EBITDA multiple since 2020 for the quoted companies shown opposite (with the exception of any anomalies). Multiples in the sector peaked towards the end of 2021 into 2022, where demand was at an all-time high. In the first half of 2023, we have seen multiples in the sector remain at a more normalised level, which is expected to continue for the remaining six months of the year.



● Cyber security ● Software development ● Application software products ● IT consulting and other ● Fintech

Sector in focus – Cyber Security (1)

Cyber security is a key driver for the IT & Technology deal activity in H1 2023

Notable strategic trade buyers in H1 2023

UK	International
 	 
  	     

Overview

- Activity in the cyber security space has been strong in the first half of 2023 with interest from both strategic buyers and Private Equity investors.
- Some of the most notable strategic trade buyers who have been active in the UK cyber security market in H1 of 2023 include Wavenet, FSP, Daisy Holdings who are all highly acquisitive with Private Equity backing.
- Strategic trade buyers with Private Equity backing continue to consolidate the market with the acquisition of smaller, innovative companies being the fastest way to expand and achieve substantial growth. This has been a key trend for PE firms across all sectors in 2023.

Key market drivers and trends

- Increased cloud cyber attacks – As digitalisation and cloud adoption continues to grow amongst all industries in the UK, the volume of cloud-based cyber attacks has grown significantly alongside. This has increased pressures for companies to adopt stricter cyber security measures which has driven the rise in cyber security transactions and multiples.
- Changes in investor preference – Many investors favour innovative opportunities in high growth areas which is why IT and technology, specifically cyber security, are particularly attractive for investors.
- Talent shortage⁽¹⁾ – According to the UK Government, there is an estimated shortfall of 11,200 people to meet the demand of the cyber workforce. This results in high levels of consolidation in the market so key players can increase capacity and continue to expand.
- Technology progress – As technology continues to evolve and progress it threatens those who do not adapt to fall behind the innovation curve and become quickly obsolete, which is a key M&A driver in the sector.

Notable Private Equity buyers in H1 2023

UK	International
 	      

Sector in focus – Cyber Security (2)

Deals demonstrating strong appetite for cyber security M&A in the UK

Notable cyber security Private Equity investments

Date	Target	Acquiror	Deal value (£m)	Deal description
Jun-23	 LOGIQ CONSULTING	Phoenix	N/A	Phoenix Equity Partners, the UK-based Private Equity firm, has invested in Logiq Consulting, a cyber security consultant
Mar-23	 CADO	EURAZEO	16.8	Eurazeo, the Private Equity firm led a funding round to acquire an undisclosed stake in Cado Security, the UK-based provider of a cloud-native cyber forensics and response platform
Jan-23	 HACKTHEBOX	 THE CARLYLE GROUP GLOBAL ALTERNATIVE ASSET MANAGEMENT	45.3	Hack The Box, the UK-based provider of ethical hacking community and cyber security training platform has raised £45m in its funding round led by Carlyle Group

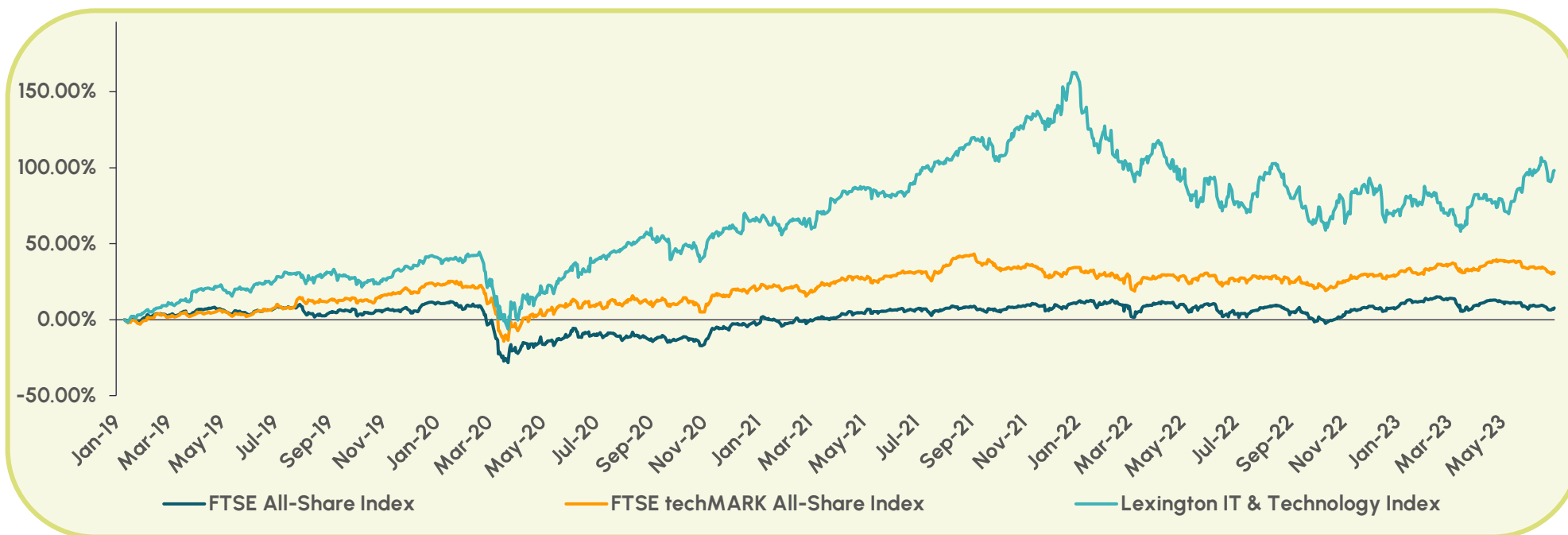
Notable cyber security strategic trade acquisitions

Date	Target	Acquiror	Deal value (£m)	Deal description
Jun-23	 ECSC	 daisy	6.7	Daisy, the UK-based provider of telecomms solutions and internet services acquired ECSC Group plc, a provider of information and cyber security solutions
May-23	 cyberlab	 chess	N/A	Chess acquired CyberLab, a specialist cyber security consultancy that provides a range of compliance and managed security services
May-23	 Bitweave	 CACI	N/A	CACI acquired Bitweave, a UK-based provider of software engineering, data science, and analysis for the cyber security industry
Feb-23	 Fidus	 wavenet	N/A	Wavenet acquired Fidus, a Cambridge based advanced Penetration Testing consultancy

- The adjacent tables display a selection of Private Equity backed and strategic trade deals that took place in the UK cyber security space in the first half of 2023
- Phoenix Equity Partners marked its first deal in the space with the acquisition of Logiq Consulting in June 2023. This is the third investment from Phoenix's 2022 Fund, following investments in risk analytics provider, 4Most and data solutions business, Dufrain.
- Alongside growing domestic interest, there has also been continued Private Equity appetite from overseas for UK cyber security companies in the first half of 2023. This can be seen with the acquisition of Cado Security by Eurazeo for £16.8m.
- Alongside interest from Private Equity investors, there has been extensive interest from strategic trade acquires in the UK market. Serial acquirer Chess, acquired cyber security specialist Cyberlab. This was not Chess' first acquisition in the space having acquired Armadillo in Aug-21 and Foursys in Apr-17. Market consolidator Wavenet also made it's second acquisition in the space with the acquisition of penetration consultant, Fidus.
- With the shift to remote working during the COVID-19 pandemic and the increasing use of IT into all areas of business, Cyber security continues to play a pivotal role in 2023.

Tech v FTSE index

The UK IT & Technology industry is a consistent market out-performer



- The above graph illustrates how the IT & Technology market has performed against the market as a whole. We have compared the performance of the FTSE techMARK All-Share Index and our own tech index (which includes the 16 quoted companies on page 8) against the FTSE All-Share Index. The techMARK All-Share Index tracks the performance of all quoted large cap to lower mid-market IT and technology companies included in the Financial Times Stock Exchange Group (FTSE).
- The IT & Technology market has continued to outperform the general UK market in Q2 2023 despite further economic pressures including rises in interest rates. Index values for the 16 UK quoted companies mentioned have risen since the last quarter to 98.2% and the FTSE All-Share Index has risen to 31.0%, compared with 7.7% for the overall market across the same period.

Who we are

Corporate Finance advisory boutique with focus on the IT & Tech mid-market



An entrepreneurial, corporate finance advisory boutique, providing hands-on, trusted advice to businesses, owners and investors with growth, succession and buyout ambitions.

www.lexingtoncf.co.uk



Feedback from the clients we work with

We are really proud of the testimonials we receive from all our clients



Lexington advised the shareholders of Evo-Soft, a Microsoft Dynamics 365 specialist, on its sale to BCN Group

"The BCN acquisition provides a true opportunity for Evo-Soft to continue its growth as a leading Microsoft Dynamics 365 Business Central solutions provider, and represents a huge milestone in Evo-Soft's successful history. Lexington's services have been invaluable to us throughout every step of the sale process, and I'd have no hesitation in recommending them or using their services again."

Ashley McIntyre,
Managing Director



Lexington advised the shareholders of Redcortex, a digital transformation consultancy, on the sale to TPX Impact PLC

"Lexington really helped us through this process, providing invaluable advice at every step and helping make sure we achieved a good valuation for RedCortex. The Lexington team made sure the transaction ran smoothly and kept us informed at every stage."

Martin Britton,
Executive Director and Founder



Lexington advised the shareholders of DevOpsGroup, a cloud services consultancy, on the sale to Amdocs

"Lexington were an excellent corporate finance partner. They took time to understand what support and guidance we needed, and provided invaluable advice throughout the process. The team were professional and easy to work with, always available when needed and the clear and frequent communication throughout, delivered an extremely successful outcome for DevOpsGroup."

James Smith,
Chief Executive



Lexington advised the shareholders of CashCalc, a cashflow planning provider, on the sale to FE fundinfo (backed by HG Capital)

"We're delighted to join the FE fundinfo family and we'd like to thank Lexington for all the work they put into making this happen. Thomas and Pablo were both efficient and effective and we would highly recommend them. Everyone at CashCalc is incredibly excited, so a big thank you from all of us."

Ray Adams,
Director and Founder

lexington



Nigel Griffiths – Commercial Director

ngriffiths@lexingtoncf.co.uk

07771 756 032



Thomas Edwards - Director

tdmedwards@lexingtoncf.co.uk

07432 053 868



Charles Lesbirel – Senior Associate

clesbirel@lexingtoncf.co.uk

07539 986 698



Jade Burgess – Senior Associate

jburgess@lexingtoncf.co.uk

07377 500 976

If you would like to learn more about our services and how we can assist you in your growth journey or exit, please don't hesitate to get in touch with any member of our technology team