



The Catalyst Group Newsletter

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Private Equity Software Buyers Work for a Living - Ken Bresnen	page 2
European VC Funding Snapshot - Natalia Fetherston-Dilke	page 6
Top 10 European VC Investments H1 2008	page 8
The Catalyst Group Team	page 9

 Gemcom Software International Inc. (TSX: GCM) has been acquired by JMI Equity, The Carlyle Group and Pala Investment Holdings	 SSISearch Ltd has been acquired by State Street Bank Corporation (NYSE: STT)	 Ericsson has acquired Groupe Audilog	 SSA Global Technologies Inc has acquired Baan Corporation
 Exchange Systems Technology Ltd has been acquired by FFastFill Plc (AIM: FFA)	 Management and new investors have completed a MBI/MBO of Artisan Software Tools Ltd	 Tenison Technology EDA Ltd has been acquired by ARC International plc (LSE: ARK)	 The assets of Pentland Systems Ltd have been acquired by Curtiss-Wright Corporation (NYSE: CW)



Private Equity Software Buyers Work for a Living Ken Bresnen

Firms that specialize in the software industry are already used to actually working hard for a living

Private Equity firms are likely to continue to be important acquirers of software companies in the coming year despite adverse conditions in the financial markets. Why? Even more so than the numerous less-focused PE fund managers, the

small hand-full of firms that specialize in the software industry are used to working hard for a living.

As long as the world was awash with cash, generalist PE managers could readily amass equity funds from large institutional investors seeking higher returns, then leverage those funds liberally with low cost bank debt on easy terms. As long as an acquired firm had some modestly predictable cash flow or disposable assets, the PE fund could rely on financial engineering to produce results and did not really need to know overly much about the company's business, technology, markets or competition to be successful. Most could invest in numerous widely-diverse industries that they only superficially understood and things might still work out OK.

Not so with investments in software companies. Because the business success and growth in value of software firms is so

highly sensitive to dynamically changing technologies, customer relationships and competitive challenges, a relatively small number of PE Funds have specialized in the software sector. Often the managers and principals of these funds have had extensive operating and investment experience in software businesses and know the industry well. Their approach to selecting acquisitions, pricing investments and value creation is focused primarily on strategic growth of revenue and profits and only secondarily on financial leverage. Consequently, over time they have developed the talent base, the business processes and the industry relationships to successfully select, grow and realize their investments in software firms.

	US	EU	Total
All PE firms	992	381	1373
Technology investors (net)	301	83	384
Electronics	46	13	59
Telecom	91	34	125
Technology (misc)	169	42	211
IT	107	36	143
Software	74	15	89
Software specialization	30	8	38

Source: Capital Link of the Association for Corporate Growth

Over the last year or two, Private Equity buyers have accounted for about 25% of the software company M&A transactions. The sale of software companies has been fairly level at



around 400 companies per quarter. The vast majority of these acquired companies have been small to middle-market sized companies (revenues: \$5–100 million). The weighted average selling price of these firms has varied from quarter to quarter depending on the mix, but has been generally in the \$15–30 million range. About half of these companies were bought by public company buyers and half by private buyers. Private Equity funds, either

directly or through their portfolio companies, accounted for around half of the private buyers and a quarter of all buyers.

Software-centric PE Funds are careful investors and run very intense investment processes. Based on The Catalyst Group's extensive deal experience with the

major Private Equity buyers and sellers of software companies, here are some highlights of the typical approach of these investors.

Selecting and Evaluating Acquisition Candidates – PE investors seek either 'Platform' investments (companies that will function 'stand alone' and be the anchor for additional acquisitions) or 'Add-on' investments (smaller companies that bring extra value when combined with the Platform company). Some of the key characteristics they consider when initially screening candidates include:

Platform

- Large revenue potential in end market
- Information and transaction intensive customers
- Complex, specialized software ('Sticky')
- Cost to customer low relative to value
- Multiple, established, happy customers
- Dominant market position; few capable competitors
- Recurring revenue; high margins; appreciable cash flow
- Experienced management team with industry experience
- Opportunities for value creation – organic and acquisitions
- Sufficient minimum size (varies by PE firm)

Add-on (Tuck-in)

- Complementary customer-base (cross-selling opportunities)
 - Access to new markets, channels, new geographic areas
 - Complementary products (fill gaps)
 - Management and technical talent
 - Industry domain expertise/reputation
 - Technology and IP
 - Add-on revenue and profits
-

If something about the prospect intrigues the PE Firms, they will commit very substantial resources to understanding everything there is to know about the target company and its business. If managed properly by the Company and its M&A Advisor, this process can proceed without undue impact on the management team,



especially for those firms who ‘really have their act together’. However, time spent by the management team at this stage will usually have been well worth it when the PE firm is to the point of deciding how high they can reasonably bid and justify to their own boards, investors and bankers.

Pricing and Financing – Most PE deals in recent times have been done with a combination of equity and debt (subordinated; senior loans; working capital). High levels of low cost debt have enabled buyers to offer higher acquisition prices while maintaining their equity returns. As credit is tightened, PE investors are having to trade off providing increased equity against lowering offer prices. Similar considerations are impacting competing corporate buyers, as well.

	2007	1H2008	2H2008/9
EV/EBITDA range =	9-13x	9-13x	9-13x (?)
Total Debt portion =	6-8x	4-5x	0-4x
Equity portion =	3-5x	5-8x	9-9x (?)

The software PE Firms continue to have substantial funds to invest and can be expected to remain active. We believe they will be increasingly looking for ‘good’ deals, especially Add-on companies that increase the value of their existing platform investments and that can be acquired at reasonable prices. In the absence of acceptable bank financing, the debt portion of the financial structure may, in some instances, be held by the buyer PE firm itself

or another PE investor until such time as they can roll this over to more traditional lenders. This is a practice that a number of software PE firms have used in the past.

Due Diligence – By the time a transaction has been agreed to in principle, software PE buyers have very thoroughly investigated most aspects of the company. As a result,

Software-centric PE firms produce returns primarily by creating value

DD usually goes pretty quickly. The most intense effort will typically focus on verifying customer relationships and legal/accounting/IP representations.

Value Creation – As stated earlier, software-centric PE firms produce returns primarily by creating value. Their

aim is to grow revenues, margins and cash flow at exceptional rates. And they have a time frame for realizing the results of their investment, usually in the 4 to 8 year range. Consequently, the best firms are truly very active, value-added partners to management.

No PE firm wants to actually run the business; that is the job of the talented, highly-incentivized management team. Among other things, PE owners can and will provide their Platform companies with:

- A knowledgeable, active Board of Directors (including capable independent directors);



- Strategic planning support and expertise;
- Financial and operating analysis and benchmarking;
- Out-sourced services;
- Acquisition support and financing;
- Access to high-level industry people and customers;
- Talent recruiting;
- Trouble-shooting.

The support and resources they make available to their portfolio companies is usually of the highest quality

Because the software-centric PE investor has tremendous industry experience with numerous similar companies, the support and resources they make available to their portfolio

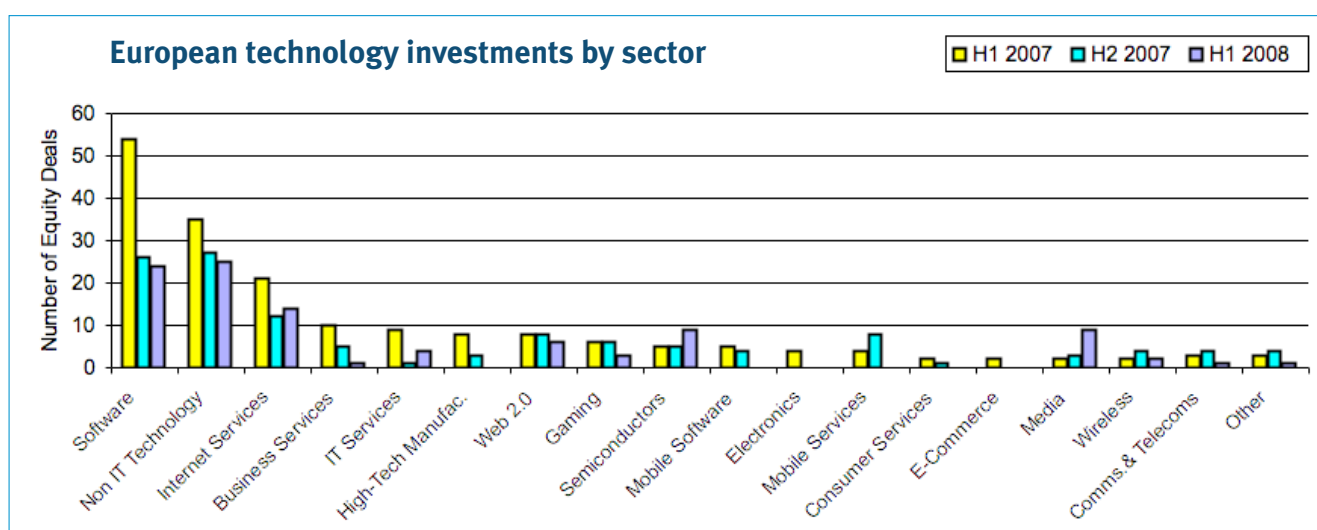
companies is usually of the highest quality.

Our conclusion – While the current financial turmoil will very likely put downward pressure on software company prices and the number of transactions completed next year, we expect the software-centric PE firms to remain active players in the market. Their business processes have been well-honed and the experienced talent needed to judiciously select, evaluate, price and grow software company acquisitions is in place. Because their focus has always been on real value creation, these software PE firms are likely to be less effected by a dearth of debt financing for acquisitions than are less specialized PE firms who have been highly-dependent on financial leverage. We expect to continue to include appropriate PE firms on our lists of potential buyers for our software clients.

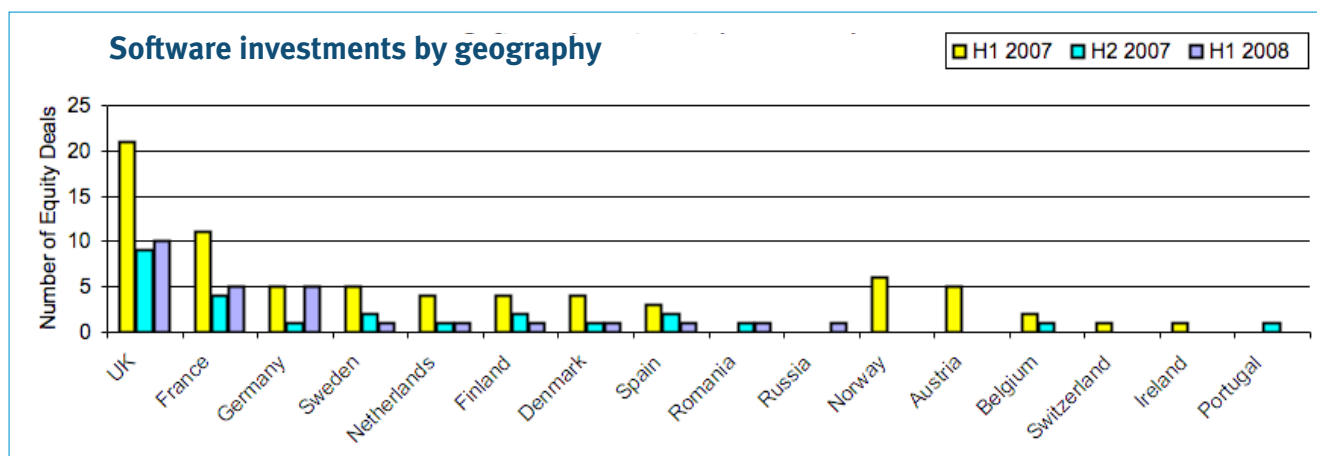


European VC funding snapshot Natalia Fetherston-Dilke

It will not come as a great surprise to see that the number technology investments made in the first half of 2008 is considerably fewer than during the previous twelve months. The total number of VC investments in European technology companies in H1 2008 is down 18% from H2 2007, which in turn was nearly 34% lower than the first half of 2007.



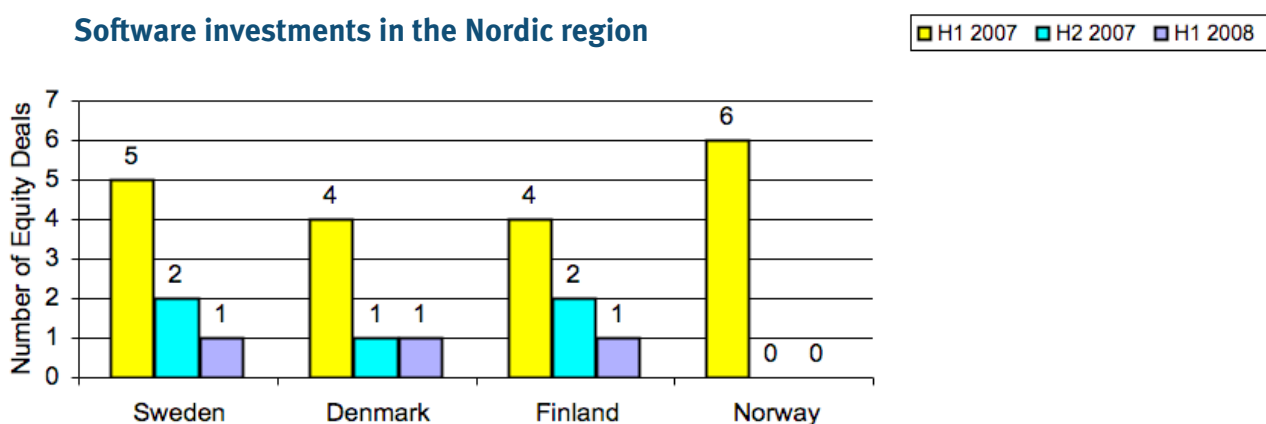
During the first half of 2008 there is a notable absence of deals in business services, high-tech manufacturing, mobile software and services, consumer services and e-commerce and electronics. However the media and semiconductor sectors have bucked the general trend and show an increase in deal numbers over the 18 months period.



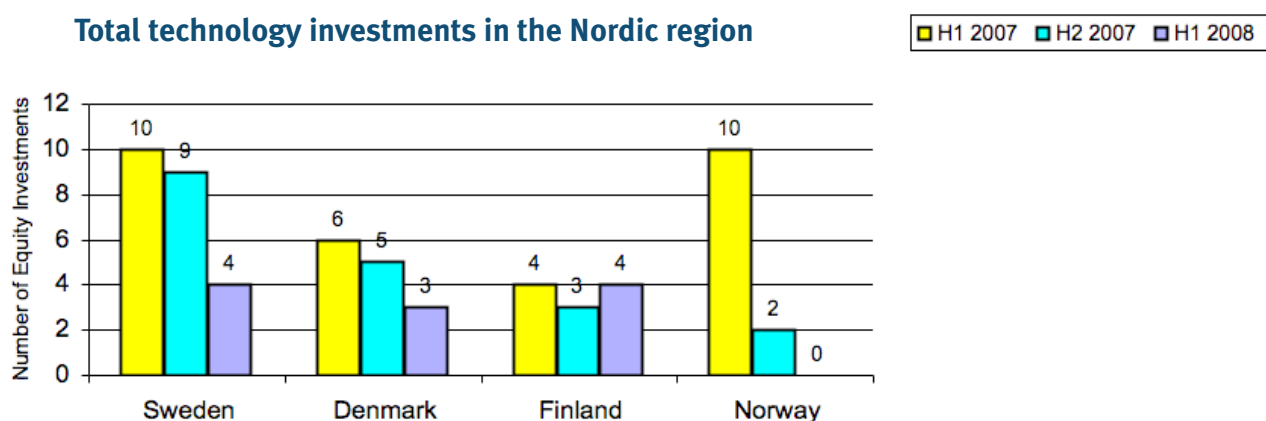


Whilst investments in software companies in the UK and France were slightly more numerous in the first half of 2008 compared to the previous 6 month period, the Nordic region shows a significant contraction in the number of investments. The total number of investments in European software companies in H2 2007 fell from 72 to 25, a 65% decrease. There was a slight improvement in H1 2008 with a total of 27 deals. However, the Nordic region saw deals fall over the 18 month period from 19 software investments in H1 2007 to 5 deals in H2 2007, to merely 2 in the first half of this year. Unfortunately, the total number of technology deals in the Nordic region shows a similar downward trend, so it appears that it is not software that is uniquely less attractive.

Software investments in the Nordic region



Total technology investments in the Nordic region



Tables drawn up from deals published in *RealDeals* magazine January 2007 to June 2008



Top 10 European VC technology investments H1 2008

Date	Target	Sector	Country	Investors	Amount
Jun-08	Weather Investments	Telecoms	Egypt	Apax Partners, Madison Dearborn Partners, TA Associates	€ 1.1bn
Jan-08	Voila Cable	Telecoms	Ukraine	Providence Equity Partners	€ 136m
May-08	Union Radio	Media	Spain	3i	€ 125m
Apr-08	SpinVox	Telecoms	UK	GLG Partners, Goldman Sachs, Blue Mountain, Toscafund Asset Management	€ 64m
Feb-08	Boomerang TV Group	Media	Spain	3i	€ 36.4m
Apr-08	Realtime Worlds	Gaming	UK	Maverick Capital, New Enterprise Associates, CIM Fund	€ 32m
Jun-08	Internet Mail	Internet Retail	Czech Republic	Intel Capital, 3TS Capital Partners	€ 28m
Feb-08	Enforta	Telecoms	Russia	Bessemer Venture Partners, Baring Vostok Capital Partners, Sumitomo Corporation, European Bank for Reconstruction & Development	€ 27m
Jan-08	Inside Contactless	Semiconductors	France	Nokia Growth Partners, Sofinnova Partners, Vertex Management, Vertex Venture Capital, Siparex, GIMV, EuroUS Venture, Granite Global Ventures, Visa Ventures	€ 25m
May-08	Ubidyne	Wireless	Germany	Doughty Hanson Technology Ventures, Accel Partners, Baytech Venture Capital, TCM Capital	€ 22m



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The Catalyst Group provides international merger, acquisition, divestiture, funding, strategic transaction and corporate development services for Information Technology, Electronics, Telecommunications, and Internet companies.

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