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*FocalPoint Partners is a middle market investment banking firm serving the technology and telecommunications industries. Kevin Trosian, FocalPoint's Technology Operating Partner and former senior equity analyst for Banc of America/ Montgomery Securities (BAS), shares his insights into the market forces which are transforming the software industry.*

## Market Outlook

### The Number of Acquirers is Expanding: *Strategic and Creative Transactions in the Software Sector*

It has been nearly two years since we wrote about the likely consolidations in the software space. At that time, the theme was convergence: we highlighted HP and IBM making a push from the hardware side, Microsoft and Oracle pushing hard to maintain their leading software position, and the networking vendors, including Cisco and Nortel, branching into deeper software plays. In fact, Juniper and Symantec just announced a partnership that may lead to a future consolidation between the two.

Today, we have seen those trends play out and the industry mature, exposing software to another source of consolidation from unlikely players. Private equity groups, flush with cash (up to \$280 billion will be raised in 2006) and short on strong potential investments, have turned to the high margin, high cash flow realm of software. Groups such as TPG and Silver Lake Partners have been making larger purchases in the software sector, making multi-billion dollar bets, including the high profile acquisition of Freescale Semiconductor by the Blackstone Group.

Why are traditionally fast growing companies selling to PE groups, investors who usually focus on cash-flow qualities and companies that typically have slower growth or could be categorized as turnarounds? The answer is simple – as the software industry has matured from a rapid growth industry, cash flow has trended increasingly higher. These investors, armed with flexible capital markets, can now extract the full value of software companies.

And the PE groups are not the only ones seeing the cash flows and returns available from relatively unknown software companies. In fact, last week, Illinois Tool Works, a traditional bricks and mortar manufacturing business, announced a nearly \$300 million purchase of Click Commerce, a highflier during the bubble days. The deal enables ITW to capitalize on higher margins and have a clearly differentiated platform. With the software moving in-house, it now has a proprietary advantage in offering its customers a supply-chain solution.

### What does this mean for the middle market software vendor?

We believe that many of the larger mid-market software vendors have been acquired or are positioning themselves

for acquisitions in protracted auctions. This opens the field to the smaller vendors, particularly those working in the \$50-\$500 million valuation range. They have an opportunity to accelerate revenue in the SMB market and can better position themselves for a clean exit with large public companies, large customers of their products and the always hungry private equity groups.

## Industry News

### International Business Machines Purchases Internet Security Systems for \$1.3 Billion

The deal set M&A bankers rushing to put more likely acquisitions in front of IBM, in anticipation of even bigger plays in the software space. Like many of the tech giants and private equity firms, IBM is flush with cash. The acquisition builds on IBM's and other vendors' increased focus on security.

### HP Likely to Continue Consolidation of Software Firms

Aside from the boardroom battles currently plaguing HP, the company is still hungry for acquisitions. It purchased Mercury Interactive in July for \$4.5 billion and is rumored to be looking at other software vendors. We don't anticipate its hunger to dissipate for at least another 18-24 months, as it plans to grow software revenue from \$1 billion in 2006 to \$3 billion in 2008.

### PE Firms Join in \$1.3 Billion Buyout of Software Firm

Intergraph, a provider of spatial-information management software, was bought out by lead PE investors Hellman & Friedman LLC and Texas Pacific Group for roughly \$1.3 billion. JMI Equity of San Diego, a private equity firm specializing in software and business services, also joined the deal. Intergraph hit slowing revenue and a rapidly declining share price, providing a ripe target for the acquiring firms. This follows other major software deals, including Watchguard, Intuit, Sybase and Hummingbird (the PE bid ultimately lost out to Open Text).

### Mid-West Manufacturer Buys Supply Chain Management Vendor

Illinois Tool Works Inc., a diversified manufacturer, announced it will acquire Click Commerce Inc. for \$292 million. The deal will broaden its reach across industries and provide a solid growth platform for a company competing in a mature industry. Click Commerce was sold for approximately 5x trailing

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# FOCAL POINT

## Software Update - Fall 2006

revenue and 4x forward revenue, indicating the demand outlier buyers are willing to pay for growth.

### Lucent to Buy Software Company Mobilitec

On Sep. 12th, Lucent announced an agreement to purchase Mobilitec, a provider of content management software, for an undisclosed cash amount. We estimate this deal to be in the \$50-100 million range. While small in terms of Lucent's market cap, we believe it highlights the moves hardware vendors are making into the software sector.

### \$17.6 Billion Buyout of Tech Firm

While not a software transaction, the \$17.6 billion acquisition of Freescale Semiconductor by the Blackstone Group highlights the hunger among the PE shops. The transaction caught many by surprise, as Freescale was more of an acquirer than a target. But with a coffer of cash, the private equity firms are adjusting their cross-hairs and taking an out-of-the-box approach to finding new transactions and buyout targets.

Selected Software M&A Transactions

Date	Buyer	Seller	Target Description	Enterprise Value (\$ thousands)
25-Jul-06	Hewlett-Packard Co.	Mercury Interactive Corp.	Develops and markets a suite of automated software testing solutions	\$5,124.97
8-Aug-06	Universal Computer Systems, Inc.	The Reynolds & Reynolds Co.	Provides integrated information management systems and software solutions	\$2,639.52
29-Jun-06	EMC Corp.	RSA Security, Inc.	Designs and develops support security products	\$2,056.24
10-Aug-06	International Business Machines Corp.	FileNet Corp.	Develops, markets, sells and supports a software platform and application development framework	\$1,182.56
31-Aug-06	Intergraph Corp. /Private Group	Intergraph Corp.	Provides enterprise software solutions	\$1,158.40
23-Aug-06	International Business Machines Corp.	Internet Security Systems, Inc.	Provides security management solutions including technology products and services	\$1,049.71
16-Apr-06	Kohlberg Kravis Roberts & Co.	Flextronics Software Systems Ltd.	Develops communications solutions that stretch from the network infrastructure to end users	\$865.28
1-Aug-06	Silver Lake Partners	IPC Information Systems LLC	Develops a communications platform using the VoIP technology for the financial industry	\$800.00
11-Aug-06	Applied Systems, Inc. /Private Group	Applied Systems, Inc.	Develops software for the insurance industry	\$675.00
8-Aug-06	The Sage Group Plc	Emdeon Practice Services	Designs, develops, markets and supports software for managing health care organizations	\$565.00
3-Aug-06	International Business Machines Corp.	MRO Software, Inc.	Develops and distributes software; provides information technology solutions	\$549.97
27-Apr-06	Avocent Corp.	LANDesk Group Ltd.	Provides systems, security and process management software solutions	\$476.00
30-May-06	Ocwen Financial Corp.	Bankruptcy Management Solutions, Inc.	Develops case management software solutions	\$384.50
5-Jan-06	Computer Associates International Inc	Wily Technology, Inc.	Provides management solutions	\$375.00
24-Apr-06	JDA Software Group, Inc.	Manugistics Group, Inc.	Develops, markets, and supports software products for synchronized supply chain management	\$307.12
5-Sep-06	Illinois Tool Works, Inc.	Click Commerce, Inc.	Provides on-demand supply chain management solutions	\$292.00
2-Mar-06	Dassault SystFmes SA	MatrixOne, Inc.	Develops collaborative product lifecycle management software solutions	\$280.22
20-Mar-06	VeriSign, Inc.	m-Qube, Inc.	Develops mobile content messaging solutions	\$250.00
7-Feb-06	Lucent Technologies, Inc.	Riverstone Networks, Inc.	Provides ethernet infrastructure solutions for business and residential communications services	\$207.00
7-Sep-06	Thoma Cressey Equity Partners, Inc.	Embarcadero Technologies, Inc.	Provides data lifecycle management solutions	\$201.86
3-Apr-06	Global 360, Inc. / Private Acquisition Group	Global 360, Inc.	Provides business process management software services	\$200.00
12-Apr-06	Oracle Corp.	Portal Software, Inc.	Provides billing and revenue management solutions for communications and media companies	\$187.16
9-May-06	EMC Corp.	Kashya, Inc.	Provides data protection services	\$153.00
6-Apr-06	Getty Images, Inc.	Pixel Images Holdings Ltd.	Provides photo library services	\$135.00
25-Jul-06	Francisco Partners Management LLC	WatchGuard Technologies, Inc.	Provides Internet security solutions designed to protect small-to-medium-sized enterprises	\$129.56
3-Jan-06	Symantec Corp.	IMlogic, Inc.	Provides real-time solutions for archiving, querying and reporting on instant messaging	\$90.00
9-May-06	Reliant Equity Investors LLC	Tacit Networks, Inc.	Provides Wide Area File Services (WAFS) solutions services	\$78.00
22-Mar-06	CDC Corp.	Onyx Software Corp.	Provides enterprise customer management software solutions	\$71.06
29-Jun-06	Marshall & Ilsley Corp.	VICOR, Inc.	Designs support software for financial services	\$70.00

If you are interested in selling your business, raising growth capital, or want to discuss this newsletter further, please call Kevin Trosian and Nishen Radia at FocalPoint Partners.

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