

Market View: SITS companies – Perspectives in challenging times (II)

In this second article of the series Sean Whelan, a partner at a Private Equity house (see left side panel), comments on the role and need of such companies in the SITS (“Software and IT services”) sector. He particularly focuses on their relevance to those currently on AIM where many have found the public arena has not delivered all they hoped. What follows is an independent perspective and does not necessarily coincide with Westchester’s own view.

Is private equity investment still possible for SITS companies? As the credit crisis continues to bite, many commentators are sounding the death knell of private equity, as though this form of ownership was simply fly-by-night. Their theory is that if private equity can’t raise debt, it can’t buy businesses. Meanwhile, they argue, the good old institutional investors in the public markets are always there for the long term.

The facts tell a very different story. Take the AIM market. The vast majority of companies listed on AIM have done so for access to growth capital – it is a growth market, after all. Yet while they are often able to raise finance when times are good, in times of uncertainty and falling asset prices, shares often become undervalued and illiquid. Not good conditions for raising capital. Yet private equity investors, who expect to be invested in companies for at least three years and often up to five years or more, take a much longer term view. They also understand that uncertain times are often the best ones in which to be acquiring businesses.

Why is the relevant of the SITS sector?

There are 194 SITS (including telecoms) companies on AIM and a further 114 in the techMARK. Given the tough times for public companies one might expect a rush for the door. However there were only 10 public to private deals (P2P), across all sectors, in the first half of 2008. Given that there are c.1,600 companies on AIM and c.1,100 on the main market, this isn’t exactly a rush.

In the SITS sector Civica and Northgate turned to private equity following a disappointing share price performance. Their new private equity backers are supporting both businesses in their acquisition strategies. Great news for the boards of these companies but again hardly a rush of stampede P2Ps.

Could it really be that the doomsayers are right and private equity has run out of steam? In short, “no”. There were 138 UK private equity deals in the first half of 2008 (per Centre for Management Buy-out and Private Equity Research). Debt funding is available to fund quality businesses, despite the credit crunch, so debt is not the constraint. The fact is that P2Ps can be costly and complex and it’s simply a question of private equity firms choosing to invest selectively in companies that have the potential to perform well over the long term. They are doing this with the interests of their investors and the ultimate shareholders, such as pensioners, uppermost in their mind. This patient and selective approach appears to work. According to a PriceWaterhouseCoopers report, the private equity industry has recorded ten year returns of 20.1%, compared with a 7.1% average return from total pension fund assets. The success of private equity is driven by more than just clever stock picking. The goal

congruence of private equity professionals, their investors, and management (who have a substantial equity stake in any private equity backed business), means that both are committed to long term value creation rather than short term announcements to please a fickle group of analysts.

So as a publicly list IT business considering its ownership options, or a privately owned SITS business that had been hoping to list, who should you talk to?

Well, it is essential to find the right partner, seeking advice from your trusted advisors. When it comes to choosing a private equity backer make sure they understand your business: where you are today and more importantly, where you want to take the business over the next 3-5 years. Make sure they have a reputation for delivering: there are many firms with money to invest but only a few who regularly complete deals in the SITS sector and have closed P2Ps. Most importantly make sure you get on well together: like a marriage an MBO is not about the deal but a longer term relationship.

A P2P is not a panacea for listed IT companies, but is certainly worth serious consideration as a way of unlocking a businesses full growth potential. Likewise if you had been thinking of listing you may want to consider private equity.

Sean Whelan – September, 2008

Sean is responsible for the coordination of ECI's IT services investment activities and has been with ECI since 1998. He is currently a director of Clinisys and WCI Group and was on the boards of Bounty, Communicandum, MM Group and ClarityBlue until their successful exits. ECI is one of the longest established private equity groups in the UK, specialising in buyouts, buy-ins and development capital deals valued between £10 and £150 million. It has an enviable track record of investing in the SITS sector and has recently closed one of the 10 P2Ps completed in 2008.



Sean Whelan
Partner, ECI Partners LLP

www.ecipartners.com

© ECI Partners LLP