Equiteq

Equiteq Market Intelligence

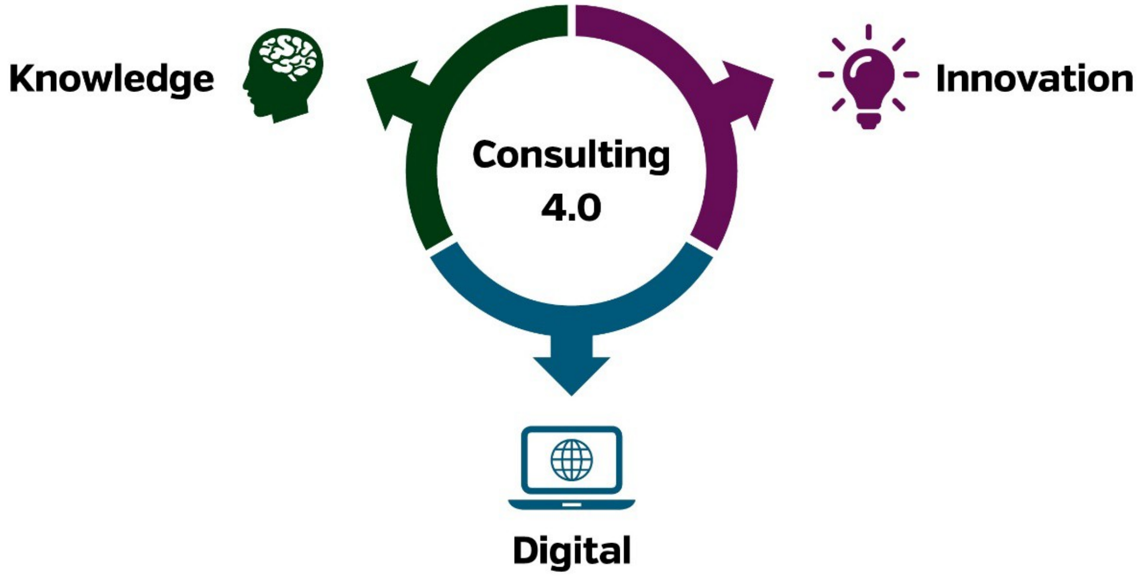
Knowledge Economy Industry and M&A Outlook 2019

Will your consulting business experience growth and investor demand through the Fourth Industrial Revolution?

Growing equity, realizing value

Knowledge Economy
Industry and M&A Outlook 2019

Ensure your consulting business is positioned for value creation at the disruption zone of the knowledge economy.



Equiteq's five key predictions for business owners in 2019:

1. Economic and political uncertainties will create opportunities for agile consulting companies to develop solutions that can help mitigate the current business risks facing their clients.

2. Businesses across industries will accelerate innovation, creating and utilizing new digital technologies, which will further disrupt consulting firms and their clients.

3. The abundance of capital available for acquisitions, as well as the limited availability of consulting talent, will fuel robust M&A of sale ready businesses at strong valuations.

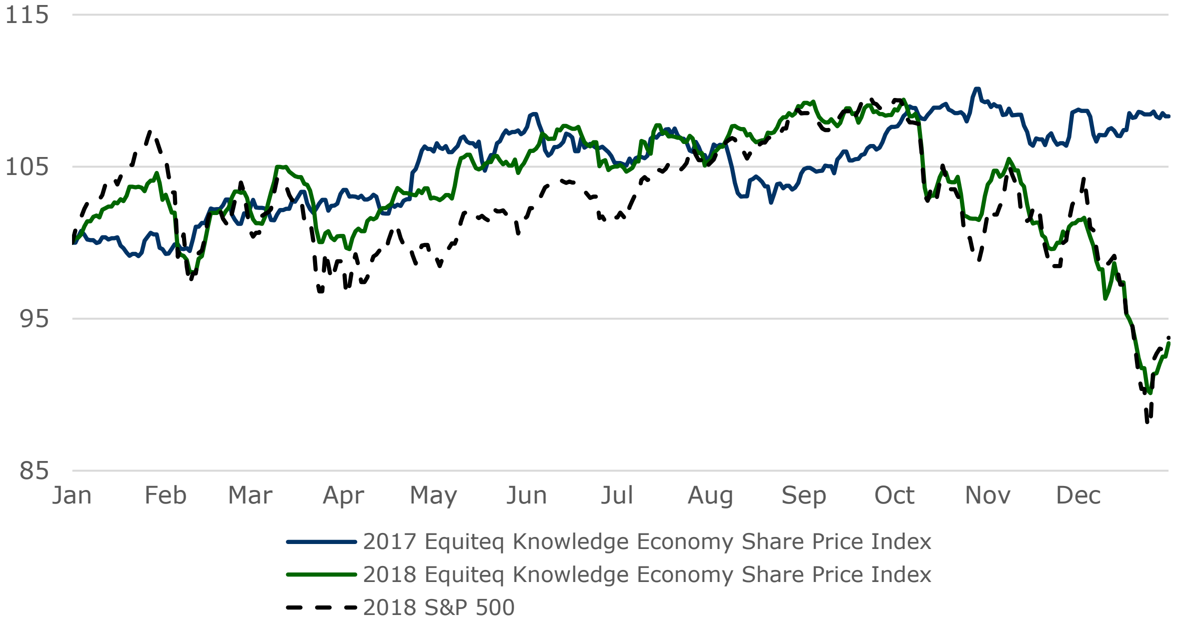
4. The long-term demand for disruptive and innovative consulting firms will not follow traditional cyclical patterns.

5. Knowledge-led businesses with a strong culture of innovation and advanced digital capabilities will build value in 2019 and beyond.

Economic and political uncertainties will create opportunities for agile consulting companies to develop solutions that can help mitigate the current business risks facing their clients.

In 2018, the Equiteq Knowledge Economy Share Price Index fell 6.6% - its biggest decline since 2008. This mirrored weak performance across broader market indices. After a highly volatile end to the year, we commence 2019 with increased equity market uncertainty. The signs of a global mid-cycle slowdown or even a downturn is fueled by concerns about the impact of interest rate rises, trade tensions and political risks. Looking ahead, some investors are positive about growth in asset prices during the second half of the year, on the basis that monetary policy could be loosened to underpin economic growth.

Figure 1. Equiteq Knowledge Economy Share Price and S&P 500 Index 2018 vs. Equiteq Knowledge Economy Share Price Index 2017 [1]



Source: S&P Capital IQ (January 2019)

There are widespread political concerns among many business owners, which is creating demand for specific knowledge-led services and consulting capabilities. These political risks include more political stalemates in the US, the impact of "tit-for-tat tariffs" between the US and China, and continued uncertainty around the UK's Brexit deal in Europe. Against this backdrop, consulting business owners will need to be aware of the opportunities to position their organizations appropriately in 2019.

During the preparation for the UK's Brexit negotiations, we observed new business demand for strategy, regulatory and organizational redesign consulting services. Since its creation, the Department for Exiting the EU has worked with various consultancies, including the Big Four, McKinsey, BCG and Accenture. Many of these firms had quickly mobilized new teams as early as 2016, which offered bespoke solutions relating to Brexit concerns of their clients. Furthermore, some management consulting firms tell us of growth in operational and restructuring work in some spaces of the market that are beginning to observe signs of a slowdown. As such, business owners are building these capabilities in anticipation of further expansion in demand.

Businesses across industries will accelerate innovation, creating and utilizing new digital technologies, which will further disrupt consulting firms and their clients.

The Fourth Industrial Revolution is being shaped by companies innovating with new digital technologies faster than ever before. This creates new opportunities for consulting firms and their clients across rapidly changing industries. The high-performing technology sector was a space facing notable disruptions over 2018, illustrating that no industry is protected from transformation in the digital age.

Volatility in the share prices of some of the leading players was led by new regulatory concerns, signs that some end markets are maturing, and high levels of debt at record valuations. The biggest regulatory pressures came from Facebook and Google's high-profile data scandals. Amazon also faced notable pressure from vocal online criticism by the US President. There were signs from Apple's recent earnings results that the smartphone market is maturing. Businesses that created some of the most recent disruptive innovations are now in need of new strategies for growth and transformation themselves, creating new demands on innovative consulting firms.

Accenture is an example of a consulting business with an innovation-led approach that we believe is well positioned for continued growth from assisting businesses with navigating new industry disruptions. The company offers advanced solutions for its clients' business transformation initiatives and posted growth in revenue and EPS, as well as expanding operating margins, for the first quarter of FY2019. The business remains a prolific buyer with a track record of acquiring niche capabilities that build depth in core sector vertical and digital capabilities, as well as breadth across management consulting, technology and media services. An example of this strategy was Accenture's purchase of Equiteq's client Orbium at the start of the year. Orbium is the largest services provider for the Avaloq Banking Suite, a leader in digital and core banking software for the banking and wealth management industry. The services form part of the digital transformation initiatives of a traditional sector undergoing disruption and the need for rapid innovation.

"As the leader in Avaloq implementation, Orbium has a unique combination of management consultancy, technology and program-management resources and capabilities that will enable us to accelerate and scale our services to the wealth management industry globally — bringing efficiency and enhanced customer experience to the next generation of wealth managers and their clients."

Michael Spellacy

Senior Managing Director and Head of Accenture's Global Capital Markets Practice.

DXC's acquisition of Luxoft for $2bn was another deal that represented a transformational acquisition of niche digital capabilities and sector vertical solutions. Luxoft is a software development firm that enabled DXC to build capabilities in strategically important areas like analytics and user experience. The deal also expanded the buyer's capabilities in the automotive and financial services sector verticals. Our conversations across prolific technology services buyers highlighted that the asset would have also been a strong strategic fit for many of them.

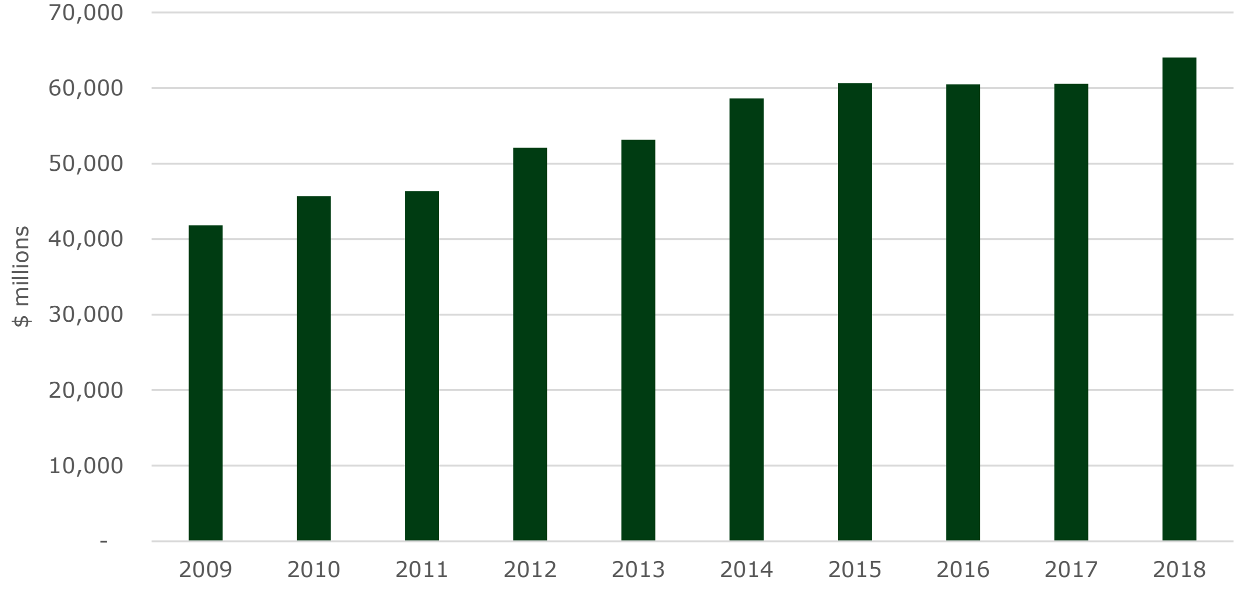
> *"Luxoft and DXC are highly complementary, and our shared vision of digital transformation makes this strategic combination a great fit for both organizations -- as well as enormously beneficial for our clients… Luxoft has a proven track record and expertise in producing measurable business outcomes at-scale for global clients across key industries, including automotive and financial services. The addition of Luxoft accelerates DXC's growth strategy as we equip the company to meet the digital requirements of our clients today and in the future."*
>
> **Mike Lawrie**
> **Chairman, President and CEO, DXC Technology.**

The abundance of capital available for acquisitions, as well as the limited availability of consulting talent, will fuel robust M&A of sale ready businesses at strong valuations.

In 2018, global M&A volumes across the knowledge economy rose by 2%, highlighting a robust market for acquisitions. Nevertheless, knowledge-rich businesses with an innovation-led approach are questioning whether continued equity market volatility and rising interest rates could result in a dip in buyer demand and valuations over 2019. For acquirers, rising interest rates increase borrowing costs, which can deter some investments in growth, including M&A. This is particularly important for private equity buyers that typically rely on gearing to boost equity returns.

Nevertheless, there is currently an abundance of capital among strategic buyers that we expect to maintain strong deal flow. We are also observing strong levels of dry powder and robust fund raising among private equity investors. Furthermore, although interest rates are gradually rising, they are still historically low. This is maintaining pressure on strategic and financial buyers to put their cash to work on new investments including M&A at premium valuations. It should also be noted that steeper rises in interest rates over the long-term are expected to have a greater impact on asset-intensive industries, as compared with knowledge-intensive services businesses that rely less on debt for investment and acquisitions.

Figure 2. Cash and cash equivalents among constituents of the Equiteq Knowledge Economy Share Price Index, 2009 to 2019



Source: S&P Capital IQ (January 2019)

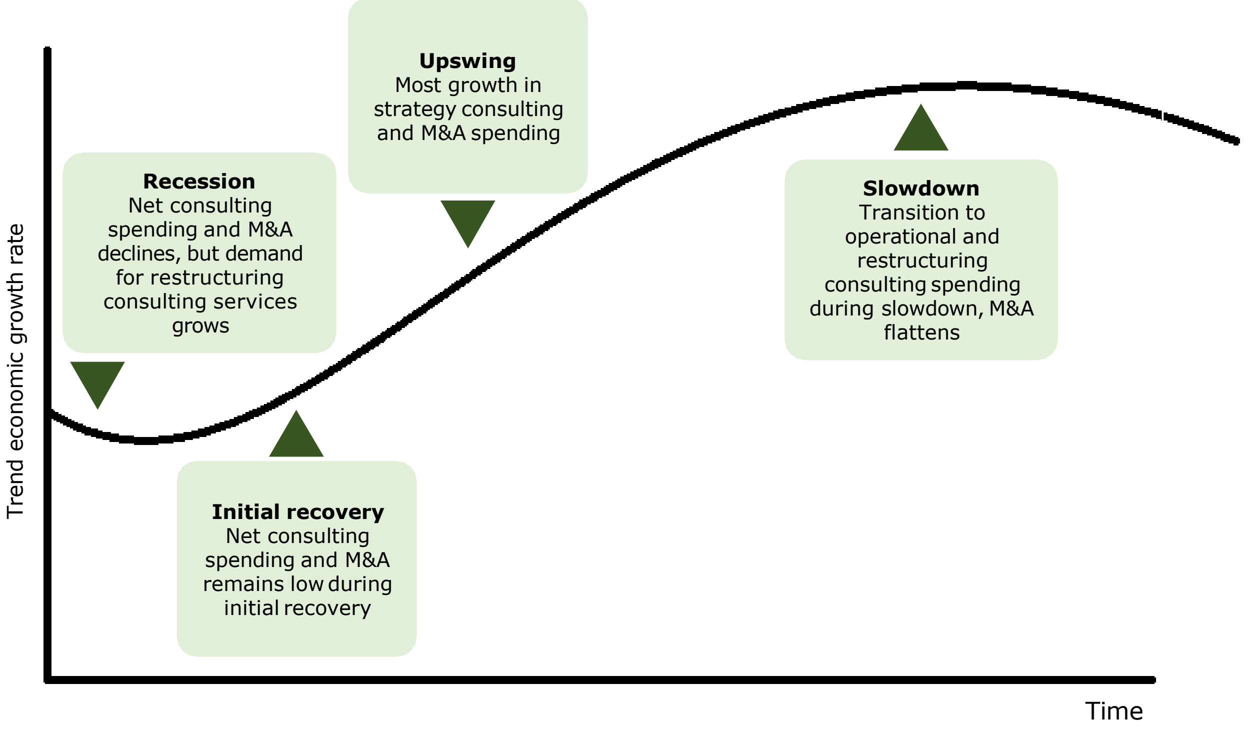
In the knowledge-intensive services space, we have already observed major deals announced in the last three months. This includes DXC's acquisition of Luxoft, Paychex's acquisition of Oasis Outsourcing and NEC's acquisition of KMD. Recent milestone acquisitions in other quadrants of the knowledge economy include Bristol-Myers Squibb's acquisition of Celgene and Eli Lilly's acquisition of Loxo Oncology.

In addition to the strong business dynamics of the target companies in these transactions, such transformative deals will have been supported by the substantial capital available for M&A. Furthermore, buyers continue to tell us of material shortages of consulting talent, particularly in hot spaces of the market like advanced data analytics and machine learning. As such, we expect more major transactions at premium valuations to occur throughout the year. Acquisitions of listed companies may also be encouraged if publicly quoted valuations continue to decline.

The long-term demand for disruptive and innovative consulting firms will not follow traditional cyclical patterns.

The consulting industry is a mature sector whereby spending has typically lagged the economic cycle as companies shift from strategy to operational-focused consulting during a downturn. Although the net impact on client spend is typically negative, the shift in consulting spending provides some cushion to consulting providers during the slowdown. As an economy moves further into a recession, companies will cut consulting spending more aggressively and M&A activity also falls. The uptake in spend is not necessarily immediate when the economic outlook improves, which is a trend that many consulting providers noted after the 2008 financial crisis.

Figure 3. Traditional consulting spending and M&A activity during previous economic cycles



Source: Equiteq Market Intelligence

In 2019, it is unclear whether the global economy will experience continued strong growth or if we are commencing a downturn. Nevertheless, there are a variety of factors that are likely to disturb previous cyclical trends for the industry, the most important of which is the need for businesses across sectors to receive fresh perspectives and to constantly innovate with the latest digital technologies through the Fourth Industrial Revolution. Knowledge-intensive firms positioned at the disruptive intersection of knowledge, innovation and digital will therefore be able to drive growth and attract robust buyer demand at optimal valuations through the next cycle.

Knowledge-led businesses with a strong culture of innovation and advanced digital capabilities will build value in 2019 and beyond.

The traditional consulting firm and the companies it advises are facing unprecedented transformation in a rapidly changing interconnected digital world where knowledge can be generated, stored and transferred ever more effectively. This shift to the knowledge economy is centering knowledge-intensive companies at the core of economic growth and redefining businesses across industries. Consulting firms and consumers of consulting services that are shaping the Fourth Industrial Revolution need to be rich in knowledge that remains cutting-edge from a culture of constant innovation, which includes a deep understanding of the latest digital technologies that are fusing to enable many of the latest industry transformations.

Those consulting and other knowledge-intensive services firms positioned at the disruption zone of the knowledge economy will therefore continue to attract demand for strategy-through-execution advisory services. Cash-rich strategic buyers will drive deal flow at robust valuations, as they use M&A as a tool to build in-demand and scarce capabilities at this intersection.

For business owners it will be important to ensure that your business is appropriately positioned for growth and value creation during this period of unprecedented disruption for the industry. If you would like to have a chat about your current strategic objectives as a business owner or acquisition strategy as an acquirer, please get in touch.

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About Equiteq

Equiteq is a global leader in providing strategic advisory and merger & acquisition services to owners of IP-rich technology and services businesses

There are unique challenges to value growth and equity realization for shareholders and investors in the knowledge economy. Equiteq helps owners transform equity value and then realize maximum value through global sale processes.

Selected recent Equiteq transactions:

Cervello Data Analytics Consulting Sold to ATKearney Advised on the sale	orbium Business & Technology Consulting Sold to accenture Advised on the sale	LightStream Data Analytics Consulting Sold to ABeam Consulting Advised on the sale	OEE Operations Transformation Consulting Merged with gobeyond Advised on the merger
Essential Innovation & Product Design Consulting Sold to PA Advised on the sale	COPPERMAN SAP BPC Specialist Sold a majority stake to DECISION INC. Advised on the transaction	solidiance Corporate Strategy Consulting Merged with YCP Holdings Advised on the merger	System Partners Salesforce Consulting Sold to DXC.technology Advised on the sale
mexia Microsoft Integration Consulting Joined Deloitte. Advised on the joining	DBM CONSULTANTS EXCELLENCE-INNOVATION-INSIGHTS Market Research Consulting Merged with THE ILLUMINERA GROUP Advised on the merger	TheNAVPeople Microsoft Dynamics NAV Partner MBO backed by FPE Capital FPE CAPITAL Advised on the MBO	DARTMOUTH Recruitment Consulting Received investment from Literacy Capital plc Advised on the investment

Equiteq market intelligence & further resources

This report has been compiled by Equiteq's dedicated market intelligence team with unique insights from Ramone Param, the firm's thought leadership director. The report utilizes multiple data sources including proprietary newsfeeds, press releases, various third-party information sources and data services. Additionally, our daily activities in the M&A marketplace with buyers and sellers provide insights into emerging trends and informs our research report's point of view.

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Note 1: The returns of the S&P 500 index has been provided in this presentation as appropriate benchmarks for comparison to the Equiteq Knowledge Economy Share Price Index. The S&P 500 represents the Standard & Poor's 500 Index. We believe it is relevant to compare the Equiteq Knowledge Economy Share Price Index with broad U.S. and international public equities. These indices each focus on large capitalization public equities and can be viewed as proxies for the market overall. Notwithstanding the foregoing, there will not necessarily be a correlation between the performance of the Equiteq Knowledge Economy Share Price Index, on the one hand, and either of these indices, on the other hand. Investments cannot be made directly in indices and such indices may re-invest dividends and income.

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