TECH SECTOR OUTLOOK
21 NOTABLE BUYOUTS SINCE COVID-19 PANDEMIC

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Executive summary

Potential for upgrades as the year progresses

With the January trading updates out of the way, we examine the outlook for the UK tech sector. As we entered January, the mood among investors was downbeat, given the tepid economic outlook, the changes announced in the UK Autumn budget, combined with the ongoing geopolitical uncertainties. However, the January trading announcements, across the sector, were better than expected, with two earnings outlook upgrades to every downgrade, on our estimates. While uncertainties prevail, including over the US regime transition and trade wars, attractive business drivers remain in place, and we see an increased opportunity for upgrades as the year progresses.

Surprisingly positive January trading updates

We entered January with an air of pessimism, given the political and economic backdrop. However, generally, trading news has been healthy across the tech sector. Most companies, across the sector, have significant international exposure and are not reliant on the UK economy, and some benefit from the strengthening US dollar. One company that is UK-focused is Fintel, which estimates that it will have an additional £0.65m of costs as a consequence of the increase in employers' national insurance (NI) contributions that was announced in the budget. This equates to ca.3% of adjusted EBITDA, and Fintel says it is making the necessary steps to absorb these costs.

Trading updates not as bad as expected

We examined trading updates and earnings announcements during January on 104 UK tech-related stocks of all sizes, the vast majority being small caps. Based on commentary (including profit beats/misses, as well as new business wins and outlook statements), we estimate that these announcements resulted in 36 elevations to forward earnings expectations, compared with 13 likely decreases.

Notable positive surprises came from Quartix, Filtronic, Concurrent, SRT Marine, Alphawave Semi, Luceco, IQE, Microlise, Eleco, Dialight and Alfa Financial Software. In addition, some companies rallied after trading was not as bad as some investors had feared. For instance, Computacenter shares made solid gains after it announced that it expects FY'24 adjusted profit before tax to be at the low end of analysts' forecasts, and the news also led to small cuts to forecasts for FY'25 and FY'26.

Strengthened balance sheets

The small cap and micro cap space, in particular, found itself under much pressure when inflation hit in and interest rates tightened in the 2021/22 period. Consequently, the market was largely closed to equity finance for high-risk small caps for ca.18 months, and the weakest companies disappeared from the markets. However, there was a gradual reprieve as inflation abated and, over the past two to three years, most remaining companies have been able to strengthen their balance sheets sufficiently through fundraisings and disposals. The overall picture now is one of generally healthy balance sheets.

Growth drivers remain in place

Digital transformation and AI are growth drivers

Digital transformation and artificial intelligence remain strong business drivers. The AI revolution remains at its early stages and all industries and businesses will need to adapt to the new environment, as they did with software, the internet, cloud computing and ecommerce. This will mean implementing AI projects, adapting workforces and partnering with solutions providers. The UK government's changes, announced in the budget, could accelerate digitalisation and automation as companies seek to absorb the increase in employers' NI contributions.

Shrinking equity supply

We estimate that ca.£34bn has been removed from the tech-related space via takeovers since the COVID-19 pandemic began, while ca.£10bn has been added via new listings. Even after adjusting for fundraisings and buybacks, there has been a significant shrinkage in the sector, and this huge disparity should sway the odds for the bulls.

Investment conclusion

The small cap space remains modestly valued as investors have focused on liquid large caps in the recent market rally. Nearly a third of the software and service companies in the selection trade at less than 7x EBITDA in the second year (see table on page 7).

Nearly a third of companies in our selection trade at less than 7x FY2 EBITDA

The lowest EV/EBITDA rating in our table goes to Oxford Metrics, which had net cash of £50.7m, as at 30 September 2024, and generated £41.5m of annual revenue in that year, while its equity market capitalisation has fallen to £63m. Since the period-end, the group has made a small acquisition and conducted a share repurchase programme. However, it retains a strong balance sheet, and based on our formula, has an enterprise value of just £21m. Hence, the market is pricing in very low expectations for Oxford Metrics.

While the market indices have been trading at near-record highs, the technology services area is surprisingly depressed, with Softcat, Bytes, Kainos and Computacenter all trading well below their heights, despite being likely beneficiaries of the AI revolution. At the micro cap end, SysGroup has nearly halved since its June 2024 fundraising, which was partly used to refocus the group on AI-driven technologies. Other services businesses to keep an eye on in the small cap and micro cap space include Made Tech (which released a bullish outlook with its strong interim results), Inspired (an in-line update and deleveraged balance sheet), and TPX Impact (cut guidance, but long-term digital transformation and AI business drivers remain in place).

Tech sector listing changes

21 notable buyouts since pandemic

Substantial decline in UK technology sector listings

We have identified 21 takeovers of UK technology and technology-related businesses since the COVID-19 pandemic began in 2020, which have a deal value of at least £100m. On our estimates, these 21 deals aggregated ca.£34bn. This compares with the total market capitalisation of the technology sector on the LSE of £46.4bn, as at 31 December 2024, according to LSE data (we have excluded Ricoh Co for this purpose). This acquisition wave began at the peak of the technology boom during the pandemic, with deal sizes larger at the early phase, and has continued relentlessly.

Other departures

Micro caps departing to save costs

A hidden investment risk was made apparent when, in May 2023, AIM-listed iEngergizer shocked investors by announcing plans to delist, in spite of having an apparently healthy financial position. The announcement sent its shares crashing, and highlights the risk to investors if a major shareholder or shareholders can achieve 75% of votes cast by shareholders at a general meeting. Merit Group is facing a similar issue, currently, as its 42% shareholder has requisitioned a GM to seek a delisting, and this proposal has gained the support of management. We have also seen a number of struggling micro caps delist in recent years to save money. Many of these companies were able to survive during the period of easy money but, once interest rates were tightened, found that the funding window had closed.

Flotations

New tech listings replace less than a third of the value of the departures

The bulk of listings since the start of the pandemic were during the late 2020/21 bull market. We count 28 companies in the LSE technology sector that were admitted to the LSE markets since the pandemic and remain listed, as at 31 December 2024. These 28 companies had an aggregate market capitalisation of £9.8bn at 31 December, according to the LSE data. The list includes several companies that are better described as technology-related businesses, such as Trustpilot, Deliveroo and Baltic Classifieds. It also includes the recent highly successful listing of Raspberry Pi, which has a market capitalisation of £1.4bn.

Selection of notable technology-related, UK-quoted companies acquired since the pandemic

Target	Estimated value	Announced	Completed	Acquiror
Avast	$6bn	August 2021	September 2022	NortonLifeLock
Blue Prism	$1.6bn/£1.25bn	December 2021	March 2022	SS&C
Ideagen	$1.3bn/£1.1bn	May 2022	July 2022	Hg Pooled Management
Emis	£1.2bn	June 2022	October 2023	UnitedHealth
Microfocus	$5.8bn	August 2022	January 2023	OpenText
Aveva	$10.8bn/£9.5bn	September 2022	January 2023	Schneider Electric
Kape	$1.6bn	February 2023	May 2023	Unikmind
Instem	£203m	August 2023	November 2023	Archimed SAS
Blancco Technology	£175m	August 2023	December 2023	Francisco Partners
Onthemarket	£100m	October 2023	December 2023	CoStar Group
Kin & Carta	£239m	December 2023	April 2024	Valtech
Sopheon	£115m	February 2024	December 2023	Wellspring Worldwide
Spirent	$1.5bn	March 2024	TBD	Keysight
Gresham Technologies	£147m	April 2024	July 2024	STG Partners
Darktrace	$5.3bn	April 2024	October 2024	Thoma Bravo
IQGeo	£333m	May 2024	September 2024	KKR
Alpha FMC	£626m	June 2024	August 2024	Bridgepoint
Keywords Studios	£2.2bn	July 2024	October 2024	EQT, CPP Invs, Temasek
Eckoh	£162m	October 2024	January 2025	Bridgepoint
Learning Technologies	£836m	December 2024	TBD	General Atlantic
Windward	£216m	December 2024	TBD	FTV VIII LP

Source: Company announcements, Hardman & Co Research

Tech sector performance

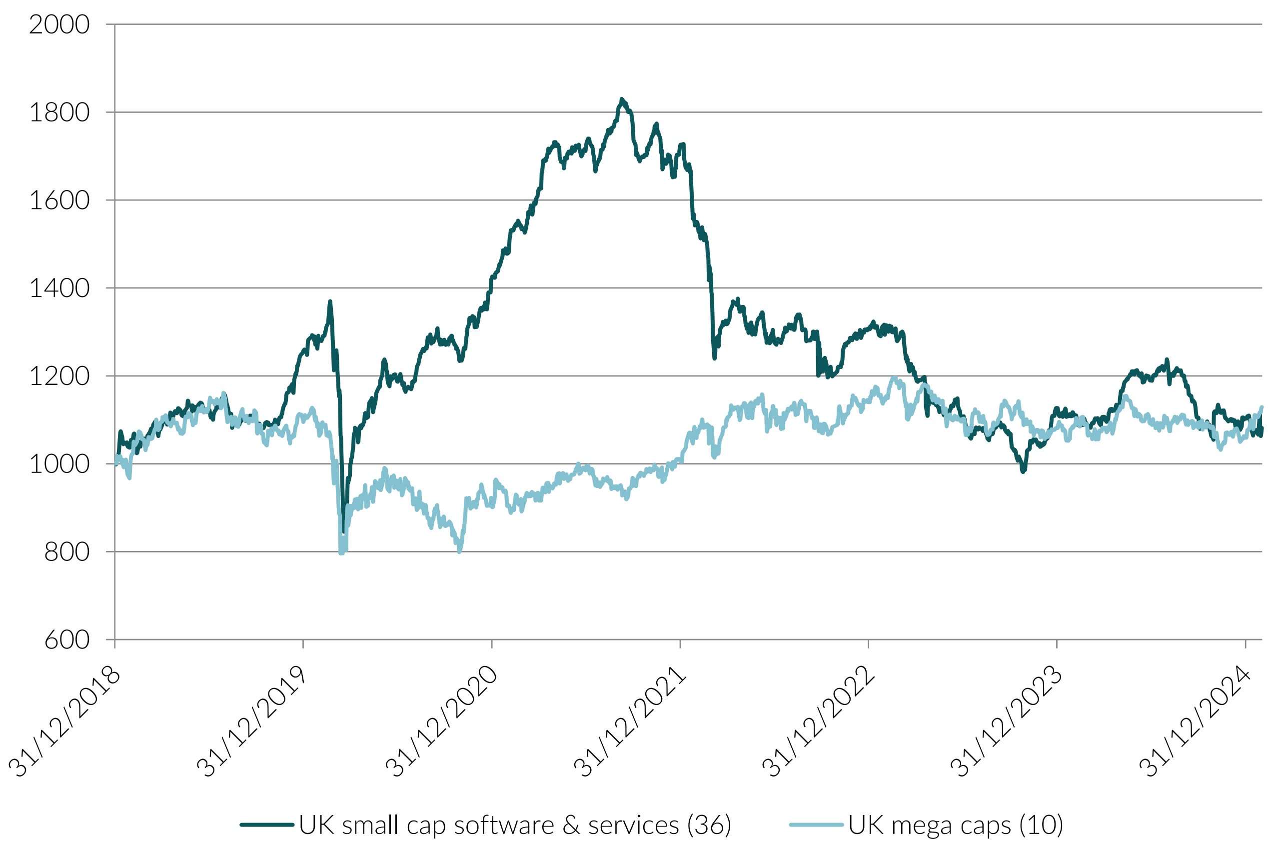
Finding support in wake of pandemic-induced volatility

We follow an equal-weighted index of 36 small cap software and services companies and compare it with an equal-weighted section of 10 UK mega caps. The latter acts as a useful proxy for the broader weighted index.

After slumping with the broader markets when the pandemic hit in early 2020, the small cap software and services sector was swept up as the economy was flooded with liquidity, substantially outperforming the broader markets. Our index peaked in September 2021 but, subsequently, fell back when inflation hit and rates were tightened. It nearly halved from the peak, bottoming just over two years later in 2023. In the past two years, the sector has been showing signs of stabilising and is modestly ahead of where it began at the start of 2019.

Our small cap software and services index now sits virtually on par with the mega caps in terms of capital performance over the past six years.

Small cap software and services performance against mega caps since before the pandemic



Source: Hardman & Co Research, LSEG data

Valuations

Modest valuation multiples with growth

We have constructed a simple valuation table of 36 small cap software and services companies. Although we monitor the broader technology sector, this analysis focuses on software and services companies to ensure there is comparability, while excluding hardware and other companies that are disparate. For simplicity, we have used the consensus forecast balance sheet position as at the end of the first financial year (31 December 2024, in most cases).

Software and services valuation table

Name	Price (p)	Est. EV (£m)	EV/sales FY1	EV/sales FY2	EV/sales FY3	EV/EBITDA FY1	EV/EBITDA FY2	EV/EBITDA FY3
Alfa Financial Software	223.5	639	5.81	5.12	4.86	17.2	16.6	15.7
Cerillion	1,620.0	443	8.93	8.08	7.33	20.1	18.0	16.3
NCC Group	142.8	435	1.37	1.31	1.22	9.5	8.7	7.7
Nexxen	388.0	398	1.43	1.27	n/a	4.7	4.1	n/a
Boku	178.0	393	4.95	4.33	3.83	15.4	13.2	11.5
FD Technologies	1,864.0	392	2.72	4.16	3.65	25.2	29.1	18.0
Team Internet	108.0	338	0.50	0.49	0.48	4.3	4.3	4.2
Elixirr	735.0	332	3.03	2.39	2.19	10.9	9.0	8.2
Fintel	280.0	320	4.10	3.81	3.62	14.4	12.6	11.3
IDOX	63.4	297	3.20	3.02	2.86	11.0	10.3	9.5
Pinewood	343.5	286	8.86	7.28	6.13	20.9	15.4	12.2
Redcentric	130.0	243	1.39	1.32	1.26	6.4	5.9	5.5
FDM	234.5	236	0.92	1.09	1.03	6.3	7.6	6.9
Seeing Machines	4.0	221	4.03	3.18	2.61	-205.4	15.1	9.7
Dotdigital	86.7	217	2.51	2.33	2.15	8.1	7.5	6.9
Fonix	217.5	188	2.31	2.10	n/a	12.7	11.6	n/a
Beeks Financial Cloud	284.0	183	4.68	4.05	n/a	12.8	11.2	n/a
Iomart	70.4	175	1.23	1.09	1.05	4.8	4.5	4.4
Accesso	495.0	175	1.44	1.41	1.31	10.5	9.7	7.9
Inspired	68.5	170	1.76	1.42	1.29	7.4	5.6	4.9
Aptitude	335.0	165	2.34	2.20	2.05	14.3	13.0	11.5
Netcall	108.5	152	3.21	2.84	n/a	15.7	13.2	n/a
Microlise	130.0	151	1.84	1.65	1.57	13.4	11.8	10.9
Intercede	191.5	129	7.65	7.18	n/a	38.0	34.9	n/a
Eleco	145.0	112	3.45	2.85	2.39	15.7	12.6	10.5
Tribal	47.0	100	1.11	1.11	1.09	6.2	6.9	6.6
Eagle Eye	363.0	95	1.99	1.83	1.55	8.4	7.3	5.8
Quartix	177.5	86	2.66	2.41	2.28	13.9	12.7	12.0
Tracsis	350.0	79	0.94	0.89	0.84	4.9	4.4	4.0
Bango	102.5	78	1.81	1.60	1.46	6.3	5.6	5.1
ActiveOps	104.0	69	2.33	2.17	2.00	29.4	22.6	17.7
Celebrus	227.0	67	1.94	1.80	1.68	11.5	10.2	9.0
Pebble Group	45.5	63	0.50	0.48	0.47	3.8	3.6	3.4
Pulsar	49.0	63	n/a	n/a	n/a	n/a	n/a	n/a
Zoo Digital	28.5	26	0.59	0.53	n/a	11.7	4.3	n/a
Oxford Metrics	49.45	21	0.44	0.41	0.37	3.2	2.7	2.3
Averages of stocks with at least 2 yrs' data			**1.56**	**1.47**	**n/a**	**9.0**	**7.8**	**n/a**
Averages of stocks with 3 years of data			**1.53**	**1.45**	**1.35**	**8.7**	**7.8**	**6.9**

Source: Hardman & Co Research, LSEG data. Priced at the close on 31 January 2025.

The averages look attractive, with EV/revenue at 1.53x in FY1, falling to 1.45x in FY2 and 1.35x in FY3, while EV/EBITDA falls from 9x to 7x over the same period. This equates to ca.8.3% compound revenue growth over the two-year period and a ca.240bp increase in average EBITDA margins.

About the author

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Richard Jeans is an equity analyst at Hardman & Co, covering the technology sector.

Richard has worked in the investment research industry and financial media for over 35 years. He has covered small cap technology stocks from across the globe for more than 15 years. He has built up a strong knowledge of the global capital markets, having worked on the capital markets desk at the Financial Times. Prior to that, he worked at an independent equity research company in the early 1990s. Brought up in New Zealand, his first job involved compiling the stock market data for New Zealand's largest newspaper.

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