

M&A Activity Dips In 3Q: Deals In Cloud Computing And Cyber Lead Transactions

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Mergers and acquisitions activity in the defense and government services sector continued to move along in the latest third quarter, and is expected to remain robust for the remainder of the year as larger contractors continue to seek out smaller firms operating in hot sectors like cloud computing and cybersecurity to help offset expected federal budget cuts.

Among the contractors we track, there were 40 deals announced during the latest third quarter, off slightly from 43 deals announced in the second quarter, and 47 deals in last year's third quarter.

M&A activity in the third quarter was driven by five transactions which had valuations of over \$1 billion, including Dell's acquisition of IT management software maker Quest Software for \$2.4 billion, and Chicago Bridge & Iron Co.'s purchase of AEC firm Shaw Group Inc. for roughly \$3 billion.

Other significant purchases in the third quarter included VMware's buyout of software-defined networking firm Nicira for \$1.26 billion, and IBM's purchase of HR management software provider Kenexa Inc. for \$1.3 billion. Also in the latest quarter, private equity firm Thoma Bravo acquired enterprise software firm Deltek Inc. for \$1.1 billion.

FIA Perspective:

Smaller deals in federal growth markets drive M&A activity. During the latest third quarter, there were several M&A transactions announced in the cloud computing and cybersecurity markets, and we expect these trends to continue going forward. M&A activity in the cloud sector was very strong in the latest third quarter, continuing its momentum from earlier in the year.

In one of the larger deals announced in the cloud market (besides IBM/Kenexa above), VMware agreed to acquire DynamicOps, a Burlington, Mass.-based cloud computing startup that was spun out of banking giant Credit Suisse's IT department, for between \$100 and \$150 million. DynamicOps is a leader in the emerging market for cloud automation solutions.

Cisco also continued its foray into the cloud in the latest third quarter, acquiring Virtuata to help secure virtual machine data in multi-tenant data centers. Virtuata helps to isolate each virtual machine from others in the same virtualized data center or cloud environment, and will allow Cisco to address security concerns among enterprises and service providers.

Other notable deals in the cloud sector included Rackspace's purchase of e-mail application integrator Mailgun, and Citrix's acquisition of Beetil, which provides cloud-based service desk technology. In addition, Lenovo agreed to buyout Stoneware, which makes cloud products used in the education and government sectors, for an undisclosed amount.

Overall, top-tier IT companies enhancing their presence in the cloud computing space should come as no surprise; the cloud market is slated to be one of the most attractive growth markets for IT firms over the next several years. According to Deltek's [Federal Cloud Computing Services Outlook, 2012-2017 report](#), the demand for vendor-furnished cloud computing services by the U.S. government will increase from \$734 million in FY2012 to \$3.2 billion in FY2017, representing at a CAGR of 34%.

For the remainder of the year, we expect top-tier IT firms to continue their expansion into the cloud market, targeting smaller firms providing unique or distinctive solutions to enhance their overall market share, while allowing them to compete for future opportunities.

On the cybersecurity front, there were five deals announced in the latest third quarter which involved firms providing cyber solutions or products, up significantly from the number of cyber-related deals announced in the second quarter.

Notable deals included Apple's acquisition of AuthenTec for \$356 million, and General Dynamics' purchase of Fidelis Security Systems for an undisclosed sum. AuthenTec designs security products for mobile devices such as fingerprint sensors, while Fidelis provides cyber tools that provide real-time network visibility, analysis and control.

Earlier this month, KEYW Holdings Corp. also made two significant cyber purchases, acquiring Poole & Associates for \$126 million and Sensage for \$34.5 million. Poole will expand KEYW's software engineering presence in the Intelligence Community (IC), while Sensage will allow KEYW to expand its addressable market into securing critical infrastructure. Both of these acquisitions should significantly enhance KEYW's top-line growth moving forward.

We believe that M&A activity in the cyber arena will continue to be robust for the remainder of the year, as larger IT firms look to extend their addressable markets while recognizing the vast number of smaller firms with unique cyber-related capabilities.

Elsewhere, there were several notable acquisitions in other markets which were previously hot sectors (health IT, geospatial and wireless). In July, SAIC acquired health IT consulting firm maxIT Healthcare for \$493 million, while DigitalGlobe acquired rival satellite imagery firm GeoEye for \$900 million. AT&T also made a significant purchase in the latest third quarter, snapping up mobile service provider Nextwave Wireless for \$600 million.

Our Take:

Looking ahead, we expect M&A activity in the defense and government services sector to continue to be strong for the remainder of the year, as federal contractors look to acquisitions in new and adjacent markets to make up for lost revenues resulting from expected future budget cuts.