

When a sweet deal doesn't sound sweet enough: Temenos to acquire Fidessa for £1.4bn in cash

Temenos Group (SWX:TEMN) – market cap as of 23/02/2018: CHF7.60bn

Fidessa Group (LON:FDSA) – market cap as of 23/02/2018: GBP1.47bn

Introduction

On February 21st, 2018, the boards of both Temenos and Fidessa have reached an agreement for the takeover of the former over the latter for £1.4 billion. The two European companies operate in two different segments of the broad financial services software industry: Temenos focuses on software for banks, while Fidessa mainly provides technological applications for capital markets applications. Through the deal, Temenos wants to capitalize on the outsourcing of internally-developed systems by large financial services companies by complementing its current offering.

About Temenos

Headquartered and listed in Switzerland, Temenos is a market leader in the provision of software to banks and financial institutions. With €600m in operating revenues in 2016 and a market capitalization of \$5bn, it is the fourth largest software company in Europe.

Temenos has been ahead of the curve in terms of innovation for a while now, being the first fintech house to offer a 24/7 platform and to put core processing into the public cloud. To this day, it spends a lot more in R&D - 20% of sales – than its closest competitors, who only dedicate to R&D about 10% of sales.

Thanks to strong growth fuelled by software license renewals, revenues have gone from €365m in 2011 to €601m in 2016 (CAGR: 10.5%). The fact that such renewals are reaching their peak would justify Temenos' activity in the market for corporate control: it took over Multifonds, a provider of fund administration software, in March 2015 for €235m and more recently it also bought Rubik Financial, another software provider, for €50m.

About Fidessa

Founded in 1981 as Intercom Data Systems and later renamed Royalblue Group, Fidessa was originally made up of two divisions: Royalblue Technologies and Royalblue Financial. The former was divested on 2001 so that efforts could be concentrated only on the latter, famous around the world for its trading platform, Fidessa. In 2007 the name was changed to Fidessa. It is listed on the London Stock Exchange and it is part of the FTSE250.

Today Fidessa's trading and information infrastructure provides services to both the buy-side and the sell-side, processing transactions for a combined value of around \$20tn every year. 24'500 users across 900 clients operating in more than 215 markets make up the customer base of Fidessa.

The financial meltdown halted Fidessa's rapid growth as its customer base consolidated and more stringent regulation to limit the trading activities of investment banks came into force. Indeed, revenues went from €332m in 2011 to a mere €387m in 2016 (CAGR: 2%). Lately, an increase in spending to better prepare itself for MiFID II rules has piled down on the results of the group and analysts expect that profitability could increase starting from 2019 when such spending will slow.

Industry Overview

The term “Fintech” has a very broad meaning which derives from the combination of the two words: “financial” and “technology”. As the term suggests, the “Fintech” Industry defines the diverse environment of companies involved in providing financial services through a variety of technologies and applications.

The majority of the players in the Fintech Industry are relatively young small-to-medium sized companies. Most of these enterprises are born as start-ups, each often developing specific services targeted to defined niches. Such diversity of business models and services, combined with the young age of the industry, contribute to a very wide-ranging and heterogenous competitive environment.

On its onset, the general consensus concerning the Fintech Industry was that these innovative and agile start-ups were bound to heavily disrupt the financial industry and heavily impact incumbents. Specifically, traditional Financial Intermediaries were presumed to be affected the most, as the big and clunky banks were expected to lag behind such waves of innovation, and eventually succumb to their nimbler start-up counterparts.

However, and very much to the contrary of popular belief, it soon became clear that the traditional banks would not play a marginal role in the process but would rather initiate a substantial outsourcing process aimed at exploiting all the advantages, in terms of efficiency and effectiveness, that the Fintech world could provide.

It is against this very competitive backdrop that companies the likes of Temenos and Fidessa operate, providing data analysis tools and comprehensive platforms to all types of financial services providers. This space is both B2B (Business to Business), as well as sometimes B2C (Business to Consumer).

Furthermore, due to the industry’s early stage as well as its inherent nature, the fintech industry has been recently characterized by high levels of M&A activity, both on behalf of banks, that acquire innovative start-ups, as well as from other Fintech companies themselves, that exploit acquisitions to obtain complementarities and grow faster. The overall sector’s investment volume in 2017 has been around \$31bn, of which almost \$18bn has derived from M&A deals. The overall trend is positive and expected to grow in the near future, with 82% of incumbents in the financial system anticipating to either make a partnership or buy another Fintech company in the next 3 to 5 years.

Deal Structure

On February 20th the companies announced that they were both in a state of “advanced discussions” on the deal. Temenos’ first bid was for £1.3bn, implying a takeover price per share of £35.67. Soon after, the share price of Fidessa surged substantially from £29.15 up to £36 bringing its overall market capitalization to £1.4 bn. On the 21st, the activist hedge fund Elliott Capital Advisors, which owns about a 5% stake in Fidessa, agreed with the rest of the board to accept the offer, as the value of the company had risen by 37% from its mid-February capitalization. Indeed, the price represents a premium of approximately 36.9% to the closing price of £26.05 per Fidessa share recorded on the 16th of February 2018.

The transaction will be an all cash deal: shareholders of Fidessa, the infrastructure and technology provider for financial services companies, will receive £35.67 for each share they hold. Further, they will benefit from both a special dividend and a final dividend, for an overall amount of 79.7 pence per share held. Excluding the dividend, Fidessa’s shareholders will benefit from a 36.9% premium relative to the closing price recorded on February 16th.

Finally, Temenos have entered into a bridge facility agreement which provides for term loan facilities for an aggregate principal amount of up to £1.43bn, which will be the source of the £1.4bn of cash given to Fidessa shareholders.

Deal Rationale

Fidessa would be the 12th acquisition in the last 10 years arranged by Temenos in the financial technology industry. This falls into a broader trend, which has overseen an increasing number of banks outsourcing operations/IT functions as customers move online.

The structural changes shaping the fast-evolving capital markets industry need to be backed-up by renewed software systems, that aim to encompass the entire spectrum of services: primary issuance, securities trading, M&A, facilitation of trade and advisory services etc. The next step is to shift from the current fragmented supply, characterized by legacy technology, to the highly differentiated multi-asset class B2B platform that will provide processing capabilities in a cost-efficient way.

Fidessa and Temenos, two leading fintech players, hold together the potential to reach high level of efficiencies in delivering the best value to customers, thanks to the significant cross-selling opportunities across both geographies and products. The Temenos Board foresees circa \$60 million per annum of run-rate pre-tax cost synergies, achievable within the next three years.

Analysts believe that the UK-based company will maintain its autonomy and meanwhile experience benefits from the scale, expertise and the R&D of the Swiss-based firm, strengthening Fidessa's leadership in securities trading in the City of London.

Temenos' strategy to significantly increase profitability would specifically require the implementation of Fidessa's proven sales focused model and corporate discipline. Specifically, the combination would succeed in combining Temenos' back and middle office to Fidessa's front office product offering in the capital markets segment and global cross-selling platform, ultimately creating a global stronghold in the Fintech Industry able to leverage Fidessa's long-standing client's relationships and a strong local reputation.

Market Reaction

Fidessa's shares went up by more than 7% to a record high of £38.30, £2.63 above the £35.67 takeover price. The share price has gained 42% over the next three days.



Surprisingly, the share price of Fidessa surpassed the bidder's proposed takeover price, which does seem quite puzzling. However, such unusual circumstance is probably due to the fact that Elliot Capital, an activist fund which currently detains about 5% of the target's shares, had leaked to the media that it had remained unimpressed with

the current offer price, henceforth fuelling suspicions in the market that the preliminary offer would've been rejected. As a direct consequence, the higher market price can be regarded as the market's anticipation for another, even higher offer price than the one reported as of February 20th.

On the 20th, Temenos share price fell more than 7%, being itself the worst trading day in the latest 20 months. In the latest 5 days, it went from £125 to £106.40. Such further information would also lend credibility to our previous hypothesis, as a higher bidding price might adversely affect incumbent Temenos shareholders.

Advisors

Fidessa hired Rothschild as its lead financial adviser, whereas Temenos is being advised by Credit Suisse.