Valuation and perspective - Schneider Electric offers to buyout UK tech business Aveva but faces shareholder opposition

Introduction

On September 21st, Schneider Electric, which owns 60% of Aveva, submitted an offer to buy the remaining shares for £31/share. It will take the company private, in a deal valued at £9.5bn, one of the largest deals in the UK in 2022. However, with falling tech valuations and a troubled market, minority shareholders regard the purchase as an opportunistic takeover that does not reflect Aveva's true long-term potential.

About Aveva

Aveva is one of the last large technology businesses to be listed on the London Stock Exchange and one of the most successful technology companies to emerge from the "Silicon Fen" cluster around Cambridge. The company is a global leader in industrial software, providing services such as innovative AI solutions that assist oil & gas and manufacturing companies in reducing greenhouse gas emissions and meeting decarbonization targets.

However, Aveva has in recent years struggled to shift its focus from a business model based on software licensing to a subscription-based one. Given the complexity of the adjustments, the company revealed in July 2021 that planned revenue growth would fall short of the 15% forecast, falling to 11%. In less than a year, the stock price fell from £55 to £24, losing half of its value and underperforming the FTSE 350 Software Index by almost 40%.

Deal Rationale

Schneider Electric, a French industrial conglomerate, submitted a formal proposal to acquire the remaining 40% of the shares for two reasons. At first glance, it appears counterintuitive for a conglomerate like Schneider to acquire its technology unit in which it already has a controlling stake. To better understand the proposal, Schneider, which already owns a couple of energy efficiency companies and has its own Internet of Things (IoT) ecosystem, aims to fully integrate Aveva into its business. It aims to gain greater control over its operations and build a One Data Hub, a platform that offers everything from asset strategy to supply chain management and data analytics.

Further, as of 2022, prices in the technology industry have collapsed, with Aveva following a similar pattern. With net debt less than half of next year's EBITDA, the energy management and industrial automation group can easily afford a £3.5bn buyout. Schneider Electric intends to capitalize on the opportunity by purchasing Aveva for £31 instead of £55 as it was at its peak in 2021. Furthermore, Aveva is valued at an EV/Revenue multiple of 8.2X, which is significantly lower than the average multiple of 34X for Software as a Service (SaaS) companies in 2021.

Deal structure

As mentioned, Schneider has offered £9.5bn to buy Aveva, intending to pay £31 per share for the 40% of Aveva it did not already own. This represents a 41% premium over the company's closing share price in August before the prospective deal surfaced. The French company has owned 60% of Aveva since a £3bn reverse buyout in 2017 in which Schneider folded its software assets into the UK company, keeping a place at the London Stock Exchange (LSE).

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Despite an apparently relatively high premium, shareholders are unsatisfied with the current bid. This is due to the fact that Aveva's share price has been affected by different internal and macroeconomic factors throughout the year.

Aveva issued a profit warning in April, stating that increased cloud computing spending and competition for engineering talent would reduce its margins. The company is also adjusting to rely more on subscription revenue, which analysts predict will be difficult and require time. Additionally, the current macroeconomic factors contributed significantly to pushing down its valuation, with rising interest rates implying a higher cost of capital used to discount future cash flows. Further, the current macroeconomic outlook has severely depressed the markets. This has decreased growth opportunities and therefore valuations, especially for tech companies, such as Aveva, which usually are highly dependent on future growth assumptions.

Opposition from minority shareholders

Schneider needs 75% of the minority votes to pass the deal, which is expected to be completed by Q1 2023. The company's management has sided with Schneider, with the Aveva board of directors recommending the offer after receiving advice from Lazard, JPMorgan, and Numis, and stating that the transaction will provide much-needed liquidity to the company. Analysts at Jefferies believe the deal will go through as well, claiming that Schneider is the only possible buyer given its existing majority stake.

However, a significant number of minority investors, including M&G Investments, which owns 0.45% of Aveva, have stated that they will reject the deal for two reasons. The stock price is trading at low levels due to a combination of depressed technology valuations, macroeconomic uncertainties, and a complex business model evolution from license to subscription-based revenues; thus, the offered price does not reflect the company's true potential and growth opportunities. Other investors, such as Mawer Investment, stated that they would expect an offer in the upper thirties, or they would reject it.

Deal aftermath

The initial agreement between Aveva and Schneider in 2017 barred the French business from increasing its interest for two years after the acquisition was completed and set a holding limit of 75% for an additional 18 months. Since then, Aveva has expanded through acquisitions, purchasing Softbank Group-backed software firm *Osisoft* in 2020 for $5bn in total valuation, including debt. Aveva has also increased its software services capabilities. Jean-Pascal Tricoire, the CEO of Schneider, has been disposing of Schneider's non-core businesses and devoting more money to initiatives that support core businesses as they transition to a digital economy.

Arguably, the merger will enable Schneider Electric's software expansion strategy to be implemented faster, with the One Data Huub singled out as a priority area of development. The takeover would focus on assisting Aveva in switching to a subscription-based business model and collaborating in fields like research and development.

Given the current macroeconomic climate, the acquisition might help the UK company to get through the current rough period and turn around its business model faster than it could on its own. Even though the acquisition is one of the largest in the UK this year, it will leave the London Stock Exchange with very few large tech companies. Canada's OpenText acquired UK software maker Micro Focus International for £5.1bn late last month. Recently, another UK tech company was taken from the market when Eutelsat Communications SA, which is listed on the Paris Stock Exchange, decided in July to merge with OneWeb Ltd.

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Schneider's takeover effort is the most recent instance of an undervalued UK tech company being purchased by a foreign investor or delisted by private equity. This phenomenon can be explained by lower valuations which are making tech companies an attractive takeover target. However, it is also reinforced by the fact that UK stocks have lagged other major equity benchmarks in Europe over the past six years. Cheap valuations have unleashed a flood of share buybacks by UK companies and encouraged foreign buyers and private equity firms to swoop in and pick up bargains, helping the FTSE 100 outperform other developed markets this year.

Future outlook

With the current economic outlook, especially and foremost for tech companies, Aveva could benefit from new cash to invest in its business model shift and from synergies with Schneider. This is due to the fact that the current macroeconomic scenario is unfavourable - in particular to Aveva, which is in a process of a challenging transition that may take years and has previously acknowledged that it was having some issues with profit margins.

As mentioned earlier, several investment banks, such as JP Morgan and Lazard, suggested the offer is fair and that it would be acceptable. This has led the board to accept the offer, urging shareholders to follow. However, Berenberg analysts wrote in a note that the bid was lower than the £32-£37 per share they had expected, saying that the valuation does not fully reflect Aveva's true potential. Its share price has gone down in the last few months mostly due to current macroeconomic factors, and not due to convergence to Aveva's fundamental value, making the company currently undervalued.

They added, however, that shareholders would be tempted to support the deal given the share price's decline in recent months and the difficulties Aveva faced. Jefferies also expected the deal would go through, saying Schneider was the only possible buyer, given it is already the majority shareholder. The approval from the Board of Aveva will likely push shareholders to accept the offer, however, it is hard to establish whether the takeover will be completed or not, as many large shareholders remain convinced the offer substantially undervalues Aveva.

TAGS: Schneider, Aveva, UK, LSE

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