

# TECHNOLOGY INDUSTRY spotlight

## EMBEDDED SOFTWARE INDUSTRY

JULY 2001

### RAPID GROWTH AND CONSOLIDATION ▶

The embedded software space has seen significant merger and acquisition activity in recent years. While the industry is expected to grow 16% per year through 2004, the consolidation of small and mid-size embedded software firms continues to increase the margin pressure felt by many firms in the industry. Furthermore, access to the additional capital and distribution channels that a strategic buyer can bring is a way for small and mid-sized embedded software firms to capitalize on their current strengths and fortify their weaknesses.

### VALUE DRIVERS ▶

RCW Mirus believes the following points are critical in driving premium pricing for middle market embedded software firms:

- Success in the embedded software industry depends on a firm's ability to design software and development tools that are high in quality, reliability, and performance.
- Due to the significant customization needs of many products, keeping cost low and shortening the time-to-market are important in securing design wins with OEMs.
- Technical and sales support are vital to maintaining old and developing new customers.

### RECENT TRANSACTIONS ▶

The tremendous expansion of the industry is fueling consolidation at attractive prices for owners. The following is a list of recent transactions:

- Protel International Ltd. acquired TASKING – April 2001, \$38 MM
- Wind River Systems purchased the RTOS division of Eonic Systems – April 2001, \$15 MM
- Wind River Systems acquired Berkley Software Design, Inc. – April 2001, \$30.5 MM
- Lantronix, Inc. acquired US Software – December 2000, \$16.75 MM
- Virata Systems purchased Agranat – August 2000, \$27.2 MM

The overall weakness in the markets and in the technology sector in particular has lowered valuations of embedded software firms. In 1999 and the first half of 2000, acquirers paid as much as 12x sales, including Wind River's acquisition of Embedded Software Tools, a \$330 million transaction. Today, acquisitions range from 1x to 5x sales. With two acquisitions in April, Wind River has recently stepped up its acquisition activity to take advantage of the lower valuations.

Capital funding continues to flow into the embedded software industry. In April, Triscend Corp. and I-Logix Inc. received a combined \$34.6 million of venture financing.

### RCW MIRUS INC. ▲ INVESTMENT BANKING SERVICES

### INDUSTRY TRENDS ▶

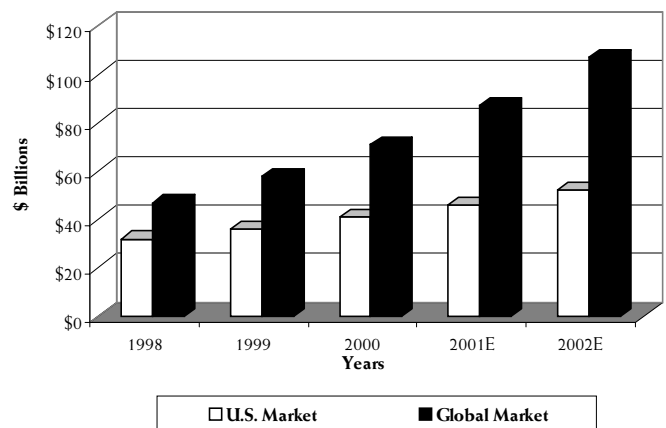
The fast growing embedded software industry is young and dynamic, driven by innovation and competition. Recent weakness in the industry is providing opportunities for strong companies to strengthen their position by acquiring smaller companies that have superior technologies.

Because embedded systems are usually designed for specific applications rather than for general purpose use, the industry is fragmented with hundreds of small companies, each trying to develop its own niche. With the advent of System-on-a-chip (SoC), these more complex systems require creative new solutions resulting in a dynamic structural change in the industry. Many embedded software firms are aggressively acquiring other firms to become a one-stop-shop for embedded software needs. In addition, embedded hardware companies and device manufacturers have started to enter the embedded software space.

Last year the global embedded systems market was approximately \$71 billion with the U.S. accounting for approximately \$41 billion of the total (see Exhibit A below). The industry is divided into four segments: memory, software, boards, and processors. The embedded software segment, which includes Real Time Operating Systems (RTOS), compilers, debuggers and development tools, is anticipated to expand from \$4 billion currently to \$5 billion in 2002. The enormous potential for smart devices in the automobile, telecommunication, Internet, and consumer electronics markets is expected to continue to fuel strong growth in the embedded software industry for the foreseeable future.

### EXHIBIT A

PROJECTED EMBEDDED SYSTEMS INDUSTRY GROWTH



If you would like to discuss consolidation and mergers and acquisitions in the embedded software industry, please contact Todd McMahon at 617-338-1333.