A most up-to-date source of UK tech sector data and analysis each quarter

Compiled for KPMG by Markit
July 2014
A snapshot report for the tech industry, giving an informative overview of market performance and expert insight on trends and outlook.

With the rate of tech sector expansion remaining close to the pre-recession peak seen in first half of 2007, it’s not surprising the data found in our latest Tech Monitor UK report suggests optimism will continue for the next 12 months.

Tudor Aw, Technology Sector Head at KPMG
UK tech sector enjoying strongest growth spell since onset of the financial crisis in 2007

OVERVIEW

Key points from the Q2 2014 data:

- **UK TECH SECTOR GROWTH OUTPACES the wider economic trend**
  - UK tech sector growth outpaces the trend seen across the wider economy in Q2

- **61% expect their business activity to rise**
  - Around ten times as many tech companies (61%) expect a rise in business activity over the year ahead as those that forecast a fall (6%)

- **Rate of tech sector expansion returning to pre-recession peak**
  - seen in first half of 2007

- **43% forecast rise in capital expenditure**
  - Capital expenditure intentions reach highest point since this series began in 2009, with 43% of tech firms forecasting a rise and only 8% a decline

- **SPECIAL FEATURE**
  - **resurgent tech sector GROWTH**
    - drives **UPTICK in new listings**
  - Special feature on tech IPOs: resurgent tech sector growth and positive economic backdrop helping drive uptick in new listings during 2014

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Commenting on the latest Tech Monitor UK results, Tudor Aw, Technology Sector Head at KPMG, said:

Our latest Tech Monitor report continues to show a UK tech sector that is firing on all cylinders with sustained growth outstripping the wider economy. Importantly, this good news story looks like it will continue in the year ahead with many tech companies planning to loosen the purse strings with strong hiring intentions as well raising capital expenditure to their highest levels since the 2007 downturn. Interestingly, our data also shows UK tech business activity closely matches the movement in NASDAQ, suggesting that the perceived six to 12 month lag of UK tech behind the US may be an urban myth. A potential blip on the horizon however, relates to the 6% fall in Backlog of Work. It is too early to tell if this is due efficiencies and increased hiring or something more worrying, but will need to be monitored in the coming months.

For the first time since 2007, we are also seeing a welcome upturn in Tech IPOs which we hope signals the beginning of a comeback of tech companies to the London bourse, something that will be important in convincing tech start-ups that the UK is the right place to be.

The tech sector is often seen as a leading indicator of UK business activity and this latest Tech Monitor report would suggest continued optimism for the next 12 months.
Tech growth: Business activity growth surpasses UK-wide trend in Q2

Tech Monitor UK uses a specially selected panel of tech sector executives within the Markit UK Purchasing Managers’ Index® (PMI®) surveys, to provide a unique and up-to-date assessment of the sector’s economic performance. Growth and jobs trends are benchmarked against Global PMI® series and other key economic indicators.

Main findings in Q2 2014*

The UK tech sector enjoyed another quarter of robust growth in Q2, according to the latest KPMG/Markit Tech Monitor UK survey, with business activity and new orders both rising sharply. Furthermore, the survey suggests that the sector is experiencing its strongest growth spell since the global financial crisis. Meanwhile, activity growth has also surged across the UK private sector economy in recent months, indicating that the economic recovery is now being felt across a broader range of sectors.

The headline Business Activity Index posted 59.7 at the end of Q2, well above the no-change mark of 50.0 and little-changed from 59.9 in Q1. Tech sector activity growth has been sustained since Q3 2012. Although the pace of increase edged down further from the record high at the end of 2013, the tech sector is still registering marked growth and continues to outperform the UK private sector economy as a whole. Tech companies also recorded a further surge in new business wins in Q2 and therefore look poised to remain key engines sustaining the UK economic recovery into the second half of the year.

Looking at the first six months of 2014, the pace of activity growth (60.0) has been much stronger than the average since data collection began in 2003 (54.3). Moreover, data for the year so far indicates the sector is on track for its best annual performance to date (exceeding 58.2 in 2004). Activity was boosted by a further rise in total new business placed at tech companies in Q2, with survey respondents mentioning that clients were more willing to spend due to increased confidence across the wider economy. This in turn led to further job creation in the tech sector, though the pace of payroll expansion moderated over the second quarter of 2014 (see Section 2 and 4 for full details of employment trends).

Tech sector demand patterns

Higher volumes of new orders were attributed by tech companies to stronger underlying client demand, the development of new products and increased business optimism within the sector, adding to hopes that new order growth will remain robust in upcoming months.

The index measuring new orders was 60.6 at the end of Q2, little-changed from 60.5 in Q1 and signalling a further steep rise in new orders at tech companies. Looking across the UK private sector economy as a whole, new business rose at an equally strong pace at the end of the second quarter.
**Tech PMI Business Activity Index**, 50 = no change

**Tech PMI New Orders Index**, 50 = no change

Source: Markit/KPMG.

*Index numbers vary between 0 and 100, with levels of 50 signalling no-change from the previous month. Readings above 50 signal an increase since the previous month, whilst postings below 50 indicate a decrease. The greater the divergence from 50, the greater the rate of change signalled by the reading. Methodology notes can be found in section 6.*
Tech growth: Cost pressures remain subdued, while profits rise solidly

Tech sector demand patterns cont…

Latest data indicated that capacity pressures at tech companies eased in Q2, with survey respondents noting that pipelines of unfinished work fell for the first time since the summer of 2013. Moreover, the fall in unfinished business contrasted with solid increases through Q1.

At 47.4, the index measuring work-in-hand (but not yet completed) was down sharply from 53.5 in the first quarter and signalled a moderate pace of backlog depletion. Some survey respondents cited strong expansions of workforce numbers through Q4 2013 and Q1 2014 as having helped reduce the volume of outstanding projects at their units. Tech companies also commented on efforts to clear unfinished work in order to generate spare capacity to meet new product initiatives.

Inflationary pressures remain subdued

The latest survey highlighted relatively modest cost pressures across the tech sector. At 54.6, the index measuring overall cost burdens remained lower than its average since the series began in 2003 (57.0). Companies that cited higher input prices generally noted rising salary payments.

Higher overall input costs and strong client demand led tech sector firms to raise their own selling prices in Q2. However, the prices charged index posted 51.2, just slightly above the neutral 50.0 mark, to signal only a modest rate of inflation.

Profits growth remains solid, while input price inflation starts to pick up slightly

Tech sector profitability continued to increase in the second quarter of 2014. Survey respondents suggested that the latest improvement in profitability was supported by greater new work intakes, higher average selling prices and relatively subdued input cost inflation.

At 54.7 in Q2, the index measuring tech sector profitability indicated a solid pace of increase, despite the trend weakening from the post-crisis high recorded in the first quarter of the year (58.2).

Meanwhile, average input costs rose at a slightly quicker rate in Q2, with the index measuring input prices posting 54.4, up from 53.9 in Q1. However, the rate of cost inflation remained slower than that seen throughout much of the past four-and-a-half years.

Source: Markit/KPMG.

*Index numbers vary between 0 and 100, with levels of 50 signalling no-change from the previous month. Readings above 50 signal an increase since the previous month, whilst postings below 50 indicate a decrease. The greater the divergence from 50, the greater the rate of change signalled by the reading.

Methodology notes can be found in section 6.
Tudor Aw, Technology Sector Head at KPMG, commented:

“The continued strong growth in tech business activity has happily been achieved within a relatively benign cost environment helping to ensure solid profitability. This growth in activity is due to a combination mixture of strong economic activity and an increase in demand for new products and services such as cloud computing.”
Employment trends: Tech sector staff hiring spree starts to moderate

In this section of Tech Monitor UK we compare tech sector employment trends against equivalent indices from Markit’s UK Purchasing Managers’ Index® (PMI®) surveys, providing a timely barometer of tech hiring patterns in the context of overall UK private sector labour market developments.

The main findings for Q2 2014* are:

KPMG/Markit Tech Monitor UK data signalled a further expansion of tech employment in the second quarter of 2014. However, the pace of job creation slowed from the steep rates seen throughout much of the past four years. Meanwhile, employment in the wider private sector economy showed signs of revival in Q2, with the equivalent index hitting its strongest since data collection began in 1998. This contrasted with stagnant or relatively modest growth in UK-wide employment since the global financial crisis, suggesting that the economic recovery has become more broad-based.

At 52.2 in Q2, the index measuring UK tech sector employment fell from 55.7 in Q1, to its lowest reading for around two-and-a-half-years. That said, the index has posted above 50.0 since the end of 2009. Anecdotal evidence linked higher staffing levels to planned company expansions and increased workloads.

Although the rate of job creation eased to a two-and-a-half year low, Tech Monitor UK data highlights that the sector has continuously expanded its workforce numbers since 2010, and at a solid clip, while UK-wide private sector employment growth has only recently bounced back following several years of stagnant or marginal growth.

According to UK PMI surveys, the construction sector remained a key driver of payroll growth in Q2, though marked rates of job creation were also noted in both the services and manufacturing sectors.

Encouragingly, tech companies expect to recruit additional staff over the next year (see Section 4 for full details on business outlook data), as firms anticipate a further boost to new business wins as demand conditions continue to strengthen.

Comparison with UK-wide trend, and company size breakdown

Tech Monitor UK data indicates that small tech sector firms (those that employ fewer than 50 people) continued to add to their workforce numbers through the second quarter of 2014.

At 50.5, the index measuring employment at small tech companies was down from 53.2 in Q1 and indicated only a marginal expansion. The moderation in payroll growth mirrored the trend seen for all tech companies in recent months.

Source: Markit/KPMG.

*Index numbers vary between 0 and 100, with levels of 50 signalling no-change from the previous month. Readings above 50 signal an increase since the previous month, whilst postings below 50 indicate a decrease. The greater the divergence from 50, the greater the rate of change signalled by the reading.

Methodology notes can be found in section 6.
Tudor Aw, Technology Sector Head at KPMG, commented:

“The pace of job creation in the tech sector has eased off but this is to be expected given the unprecedented steep increases since 2009, and importantly, continues to show an expansion in job employment.”
**ECONOMIC CONTEXT**

This section examines recent economic developments and how they relate to UK tech sector business conditions.

**Developed and emerging markets growth**
PMI Output Index (manufacturing and services), 50.0 = no change

**UK tech business activity mapped against UK GDP**
Tech PMI, 50 = no change
UK GDP, q/q % change

**UK tech business activity mapped against the NASDAQ**
Tech PMI, 50 = no change
NASDAQ yoy % change

At the end of Q2 2014, the NASDAQ was up by around **5.5%** from the start of 2014.

Sources:
Global PMI® data sourced from JPMorgan/Markit.
UK GDP data sourced from the Office for National Statistics. At the time of writing, figures were available up to Q2 2014.
Stock market data sourced from Reuters EcoWin.
The main findings for Q2 2014 are:

Preliminary data showed a 0.8% rise in UK GDP through Q2 2014, highlighting a brisk and broadly based recovery in economic conditions this year. Moreover, the International Monetary Fund has upgraded its UK GDP forecast to +3.2% in 2014, which suggests tech companies can expect to feel an uplift from improving domestic spending patterns during the second half of the year.

Equity markets rebound after spring correction

At the end of Q2 2014, the NASDAQ composite index, the benchmark for US technology stocks was up by around 5.5% from the start of 2014, and almost 30% higher on a year-on-year basis. These positive figures have been helped somewhat by a rebound in valuations since the corrections in US technology stocks this spring, during which time analysts cited a rotation out of growth stocks amid shifts in investor sentiment towards higher cash flow yield.

Global economy grows at solid clip

Signs of improvement in tech sector stock market conditions have occurred alongside a rebound in the overall performance of the global economy through the first half of 2014. Recent data from Markit’s worldwide Purchasing Managers Indices (PMIs), point to an acceleration of growth across both developing and emerging markets.

The Global Composite PMI hit 55.4 at the end of Q2, a figure well above the neutral 50.0 mark, and indicating the fastest growth momentum for just over three years. Moreover, the US and UK stand out as among the strongest outperforming areas in recent months, helping offset weakness in the eurozone and driving a positive overall outturn for developed markets.

While UK tech companies have felt an uplift in client spending from improving domestic economic fundamentals, survey data from further afield has highlighted a general downshift in economic growth rates across Asia and other key emerging markets since early 2013.

However, there are tentative signs that emerging markets finally experienced a growth rebound at the end of Q2, led by China. A continuation of this uptick into the second half of 2014 will clearly bode well for the health of the wider global economy, and should have an appreciable impact on worldwide investment spending patterns.

Tudor Aw, Technology Sector Head at KPMG, commented:

“While it is undoubtedly true that the US continues to lead the way in tech innovation, there has also been a perception that UK tech business activity typically follows the US with a six to 12 month time lag. Using NASDAQ as a proxy for US tech activity, our data would suggest that this time lag does not exist, suggesting perhaps that technology trends jump the pond more quickly than first thought.”
Tech outlook: Upbeat prospects for tech sector employment and investment

This section contains analysis of our survey data on UK tech firms’ business expectations for 2014. Figures for future business activity are drawn from monthly PMI® surveys; those on employment and capex are based on Markit’s tri-annual Global Business Outlook survey.

The main findings for Q2 2014* are:

UK tech companies hold a positive outlook with regard to business activity prospects over the coming year. Tech sentiment is stronger than the average recorded across all UK industry sectors.

Activity growth in the 12-month forecast period is anticipated by a net balance of +54.7% tech firms, above the UK average of +51.6%. The tech sector has reported a more upbeat outlook for activity for the vast majority of the period since monthly data were first available in 2003.

New product innovation, business expansion plans and entry into new markets were among the reasons cited by panellists as underpinning their positive outlook. Some respondents commented on increased investment spending, while others indicated that they had boosted their sales teams or launched new marketing initiatives, which they hoped would drive new business growth.

Employment outlook close to post-crisis high

Tech firms signal strong hiring intentions for the upcoming 12 months. The latest Markit Global Business Outlook Survey, which was conducted in June 2014, signalled that 43.1% of UK tech companies plan to expand their payroll numbers, while just 5.9% expect to shed staff. The resulting net balance is +37.3%, close to the four-and-a-half year series high of +38.6% recorded in February.

By comparison, the net balance for employment across all UK industry sectors is +34.4%.

Tech firms also signal positive intentions with regard to capital investment over the coming year, with 43.1% forecasting an increase and only 7.8% expecting a reduction. At +35.3%, the net balance of tech companies planning to raise their capital expenditure was the strongest since comparable data were first available in October 2009.

Markit Business Outlook Survey June 2014

“Do you expect employment at your business to be higher, the same or lower in 12 months’ time than the current levels?”

**Tech companies employment expectations: net balance +37.3%**

- Higher: 43.1%
- Same: 51%
- Lower: 5.9%

**All companies employment expectations: net balance +34.4%**

- Higher: 42.0%
- Same: 50.4%
- Lower: 7.6%
Tudor Aw, Technology Sector Head at KPMG, commented:

“The positive outlook on tech employment trends is driven by a good balance between economic conditions, business expansion plans and product innovation. This points to broad based drivers behind hiring plans that should lead to sustained rather than temporary growth.”

Source: Markit/KPMG.

* Methodology notes can be found in section 6.
Special feature: Tech sector growth likely to support new listings in 2014

In this section we take a look at how improving economic fundamentals and strengthening growth rates across the UK tech sector have coincided with greater numbers of companies looking to raise funds on the London Stock Exchange so far in 2014. If the backdrop remains positive in the second half of the year, the sector looks on track for its strongest outturn for new listings since the onset of the global financial crisis.

UK tech sector new issues starting to pick up after sustained post-recession hiatus

So far this year, KPMG/Markit Tech Monitor UK data has painted a buoyant picture of business conditions across the tech arena, with its overall growth performance and job hiring rates accelerating to their most positive since the onset of the global financial crisis in 2008/09. Moreover, a brighter landscape for tech companies has not gone unnoticed by investors, as evidenced by the strong equity market performance for listed tech sector companies in recent years.

Tech Monitor UK data has an historically strong correlation with tech sector equity market performance; not just during the downturn of 2007/08, but also through the twists and turns seen in the years beyond. However, while the Tech Monitor UK survey serves as a powerful indicator of underlying tech sector health, the relationship between the overall performance of UK tech companies and the number of new firms opting to raise funds in the equity markets is somewhat less straightforward.

During the period 2003-2007, a sustained phase of robust Tech Monitor UK data coincided with relatively large numbers of tech sector firms** opting to newly list on the London Stock Exchange. It was then unsurprising to see these trends reverse in 2008/09 as the global financial crisis hit investor sentiment, resulting in lower valuations and a dearth of tech companies seeing the time right to tap equity markets for the first time.

Equity markets then started to rebound in early 2009, beginning a broad cyclical upswing supported by aggressive central bank policy action and recovering global economic conditions. While companies within the UK tech sector have also enjoyed strong output gains since the recession, and indeed outperformed most other sectors, the number of newly listing firms still remained meagre from 2009 to early-2013.

Looking to new listings from the tech sector in 2014, perhaps finally the picture has started to brighten, helped by improving domestic economic fundamentals and elevated tech sector growth rates. Moreover, if the number of new tech sector listings in H2 2014 at least matches those seen in H1 2014, then this will deliver the strongest outturn since 2007.

As ever, investor sentiment and tech firms’ funding preferences remain crucial, but trends from the latest Tech Monitor UK survey at least provide encouragement that companies considering going along the IPO route will be doing so against a backdrop of sustained and strong domestic tech sector growth rates in 2014.
Tudor Aw, Technology Sector Head at KPMG, commented:

“The number of listed UK tech companies has been worryingly low in recent years due to corporate takeovers and the financial crisis. It is therefore encouraging to see the return of Tech IPOs. It is important that this trend continues to help establish the UK as a destination for tech start-ups.”

Sources: Markit/KPMG calculations from London Stock Exchange data.

* First half of 2014, annualised figure.

** List of LSE sectors covered for comparison of new listings against Tech Monitor UK data: Electronic & Electrical Equipment, Information Technology Hardware, Software & Computer Services, Technology Hardware & Equipment.
Tech Monitor UK: Methodology notes

UK Tech Sector Purchasing Managers’ Index® (PMI®) survey data

UK tech sector PMI data is derived from a representative sub-category of approximately 150 tech companies within Markit’s regular PMI® surveys of UK manufacturers and service providers. Tech is defined in this report as technology software, technology services and manufacturing of technology equipment. All figures are seasonally adjusted and smoothed using a three-month moving average, to better highlight underlying trends in the data.

UK Tech Sector Business Outlook Survey data

Business activity expectations data are drawn from the monthly PMI® surveys question on companies’ expectations for their activity/output over the next 12 months. Prior to July 2012, only service sector companies were asked this question.

Employment expectations data are based on responses from UK services and manufacturing firms participating in Markit’s tri-annual Global Business Outlook survey, which is based on the same panel of companies as the PMI® surveys.

‘Technology Sector’ industry groups:

- Software publishing (SIC 582).
- Computer programming, consultancy and related activities (SIC 620).
- Data processing, hosting and related activities; web portals (SIC 631).
- Manufacture of computer, electronic and optical products (SIC 26).
- Manufacture of electrical equipment (SIC 27).
For more methodology details, see the October 2013 Tech Monitor UK report.

Click here to download.
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