

# *US technology deals insights* Q1 2014 update

*May 2014*

*A publication from  
PwC's Deals practice*

## ***At a glance***

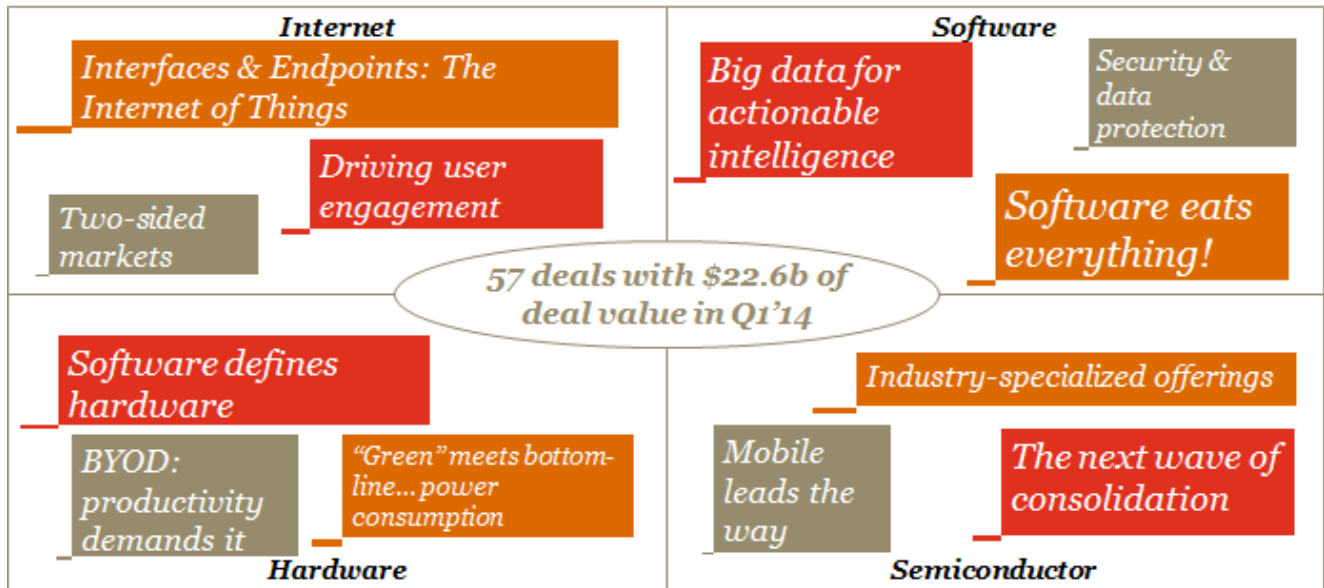
*First-quarter deal volumes and value returned to historical norms and announcements show a modest increase*

*Software and Internet M&A increased in both volume and value, offset by declines in other sectors*

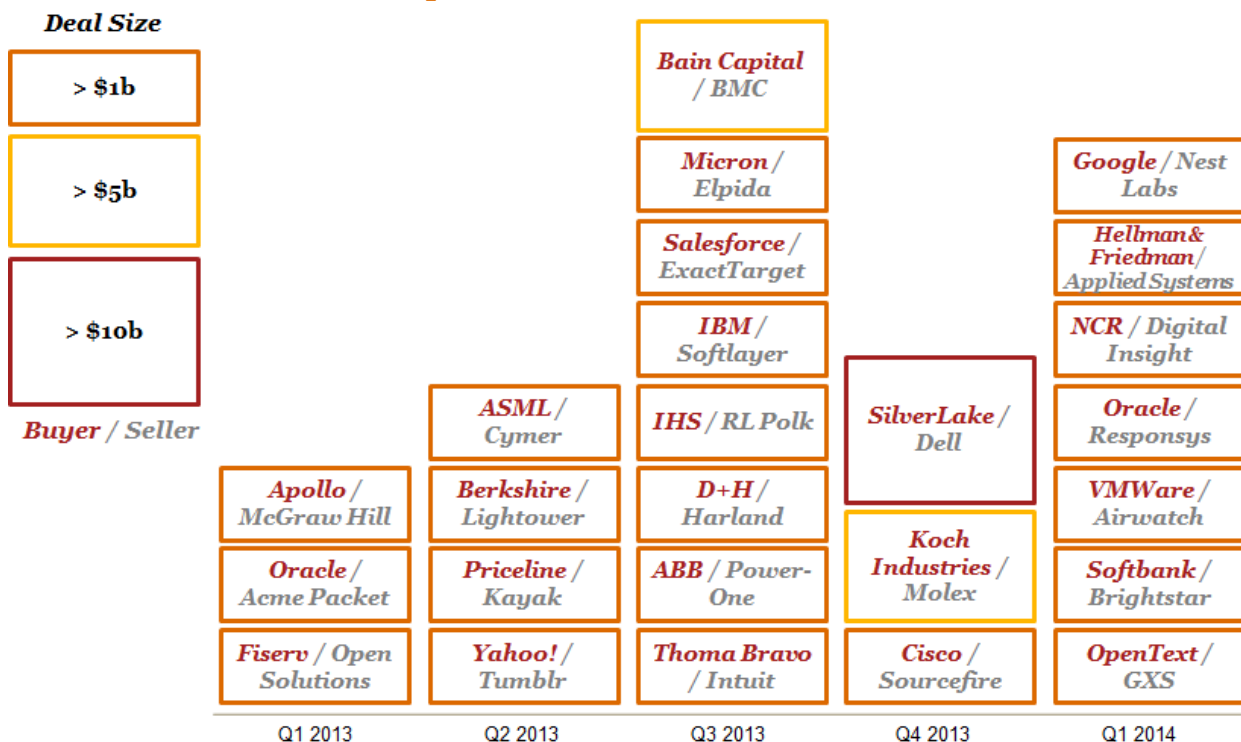
*Improving economic stability and increasingly positive outlooks point toward similar levels of deal activity for technology over the coming quarter*

# Volume of billion-dollar deals picks up amidst a host of changes across the industry

## First Quarter 2014 Highlights



## Deals over \$1 billion, last five quarters



# *Technology deal volume remains active amid improving global economic conditions*

Welcome to the first-quarter 2014 issue of PwC's *US technology deal insights*. Technology M&A activity in 2013 came in with a whimper but out with a bang. The first quarter of 2014 kept pace as the technology sector deal market continued to thrive. Equity markets remained at near record highs, IPO activity remained robust, and overall economic outlooks remained modestly positive. With the US Federal Reserve providing well-received monetary guidance, and quantitative easing continuing through 2014, interest rates remained near record lows. Coupled with the warm economic sentiment, the US housing market continues to rise and unemployment continues to fall. Cash balances of large corporates are ever-increasing, and private equity funds continue to hold mounds of dry powder.

While economic sentiment continues to rise, both in the US and abroad, 2014 growth can be characterized as modestly optimistic, still challenged by uncertainty abroad. As companies minimize long-term commitments in order to stay agile, long-term capital spending and the level of full-time hiring continue to remain in question. While unemployment held below 7% in the US, concerns still remain about the participation rate and exclusion of part-time workers. However, PwC's recent 2014 CEO survey revealed hiring plans are at their highest in five years, suggesting a turn toward planned growth. Further, mixed results amongst recent earnings for leading technology companies put pressure on business model efficiency and competitive positioning. Consolidation may become an increasingly important driver for 2014 deals.

Abroad, China fared better than most expected with a reported GDP growth of 7.4% for the first quarter, but the country's manufacturing sector has recently been reported to be shrinking. The economy in the Eurozone continues to improve, to varying degrees between countries. After several years of slow recovery, the Eurozone now stands as a major source of potential growth for technology companies in years ahead. Headwinds do remain, however, with declining Eurozone inflation rates potentially mitigating the ability of countries like Greece to reduce debt, and concerns of rising energy costs as a result of the Ukraine crisis. BRIC countries continue to attract attention, but many feel the economic growth may stagnate as interest rates and wages rise, and currencies fall. While we may see increases in cross-border deal activity as the year progresses, the first quarter of 2014 remains in line with 2013 activity levels.

US Equities posted a strong start to 2014 as they continued to set and remain near record highs. The NASDAQ and S&P 500 rose 2.2% and 2.0%, respectively, while the Dow Jones declined 0.7%. Continued strength in equities helped to maintain the pace of technology initial public offerings (IPOs), adding 13 new pricings with proceeds exceeding \$1.9 billion. Technology IPO average one-day returns neared 34% and current year-to-date returns averaged 12%, both surpassing the overall growth of 2014 market indices. New registrations followed suit, with publicly announced IPO registrations totalling 24 for the quarter and additional registrations filed confidentially under the rules of the US JOBS Act. IPO activity for the sector and overall stability of the equity market indices during the quarter are reflected in the top 25 global technology businesses' average enterprise-value-to-EBITDA multiples, which remained relatively constant at 10.0x.

Aside from several broader global economic trends that undoubtedly remain at the forefront of companies' strategic priorities, the technology deals market remains active. Several large deals announced in the hardware space still await regulatory approval, and the software and internet sectors continue to demonstrate volume growth as cloud, mobile, and data are driving much of the industry focus today. Semiconductor deal activity was the contrarian, reaching a low not seen in at least the past three years, perhaps a temporary decline as the industry digests recent consolidation moves.

The whimper of 2013's start is now a distant memory as technology deals maintained recent momentum, posting consistent quarter to quarter closed transaction volumes despite a slight dip in the number of divestitures. The volume of announced deals increased, with some newly public registrants utilizing their newfound capital for deal financing, perhaps a harbinger of more stock-financed deals to come. Looking ahead, we expect continued strong deal activity for 2014, tempered only by valuation pressures from IPO alternatives and overall competition for quality assets.

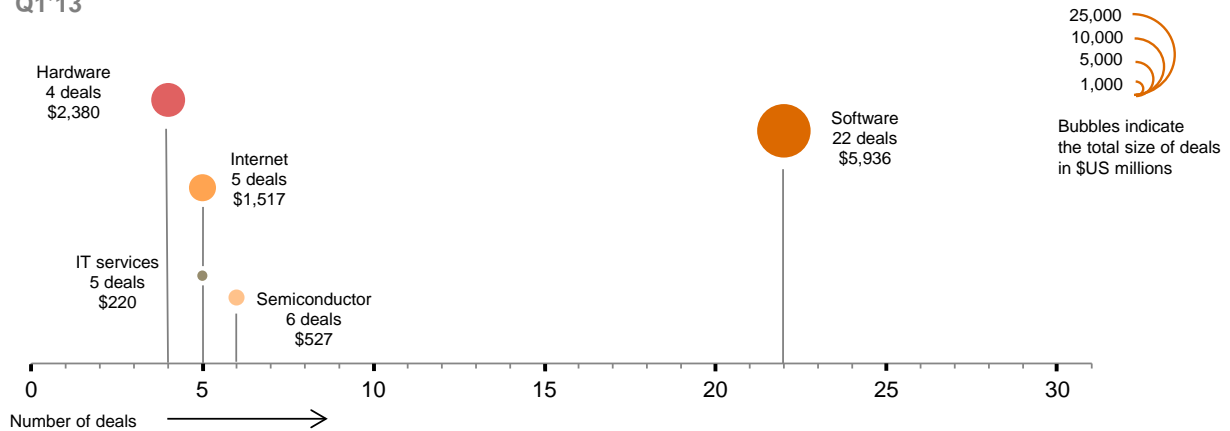
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*Deal volume momentum continues and increased announcements point toward an active 2014*

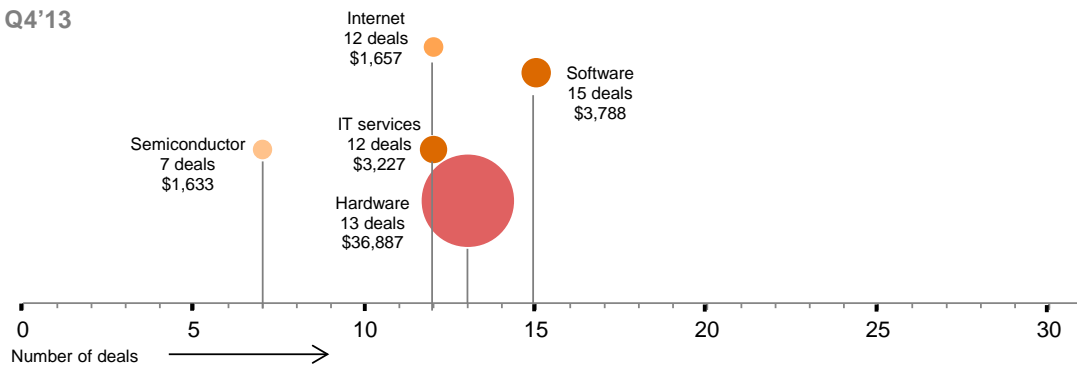
# Volume remains stable in the first quarter of 2014 after a rise in the second half of 2013

Number of closed technology deals and deal value by sector, \$US millions

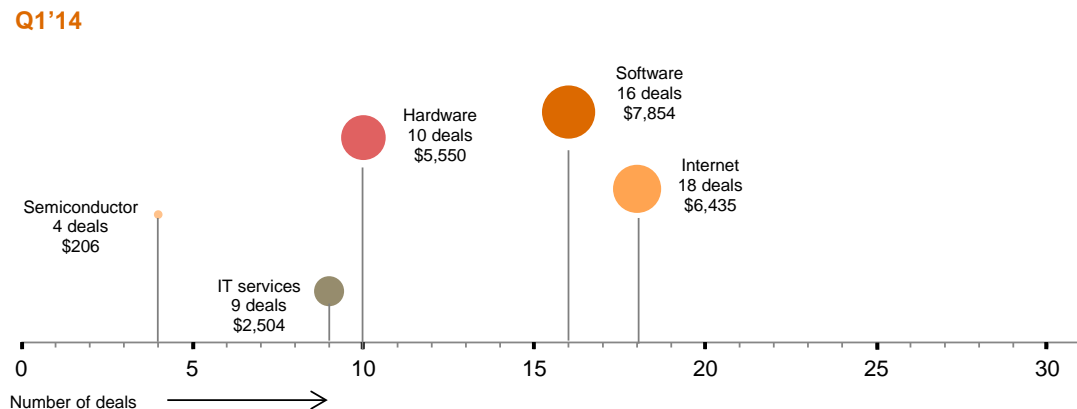
Q1'13



Q4'13



Q1'14



Source: Thomson Reuters

# Closed transaction volumes and announced deal activity continues

## Key announced transactions

Commencing a strong start to 2014, the first quarter continued to pave the way with several more billion dollar deals making headlines. Private equity continued to play an active role in technology, with Hellman & Friedman announcing another billion dollar transaction less than two months after closing a \$1.8 billion investment. While not quite as large of the \$25 billion Dell acquisition in the fourth quarter, Facebook has been competing for the most headline coverage with its \$19 billion announced acquisition of WhatsApp, expected to close mid-2014.

Several deals in excess of the billion-dollar mark were announced during the first quarter, including:

- Facebook's proposed \$19 billion acquisition of global messaging platform, WhatsApp, as well as the \$2.0 billion acquisition of Oculus VR, a virtual reality technology.
- The unsolicited and ongoing \$3.4 billion offer for Riverbed Technology, an application infrastructure provider, by hedge fund Elliott Management.
- Lenovo's \$2.9 billion acquisition of Motorola Mobility from Google, and \$2.3 billion acquisition of IBM's x86 server and maintenance business.
- RF Micro's agreement to acquire TriQuint Semiconductor, a radio frequency semiconductor company, for \$1.6 billion.
- San Francisco-based Hellman & Friedman's \$1.1 billion acquisition of Renaissance Learning, a provider of online assessments and data-powered teaching and learning solutions.

Other private equity transactions include announcements involving deals with Thoma Bravo, Blackstone, Platinum Equity, Siris Capital, HGGC, and several other firms. On the corporate front, in addition to the large deals noted above, announcements of acquisitions by Palo Alto Networks, Dolby Labs, Rovi, and others highlight the diverse and active level of technology deal activity in the market.

The number of technology deal announcements during the first quarter increased slightly compared to that of the fourth, suggesting a similar level of deal volume in the months ahead.

## Key closed transactions

The first quarter of 2014 started strong, continuing the momentum of 2013's second-half surge. Transaction volume and value remained on par with the fourth quarter of 2013, after adjusting for the fourth quarter's \$25 billion acquisition of Dell, one of the largest technology acquisitions in recent history. Compared to the abysmal first quarter a year earlier, transaction activity grew substantially with volume up 36% and value more than doubling at an increase of 113%. With 57 transactions completed during the quarter for a total of \$22.6 billion, average deal value totalled \$396 million, down from \$800 million in the fourth quarter and the \$489 million average for 2013. Despite the decline in overall deal value given the impact of Dell on 2013 aggregate values, the number of billion dollar deals doubled that of the fourth quarter. There were 7 deals in excess of \$1 billion during the first quarter, compared to an average of 4-5 per quarter throughout 2013. The top five transactions closed in the first quarter of 2014 include:

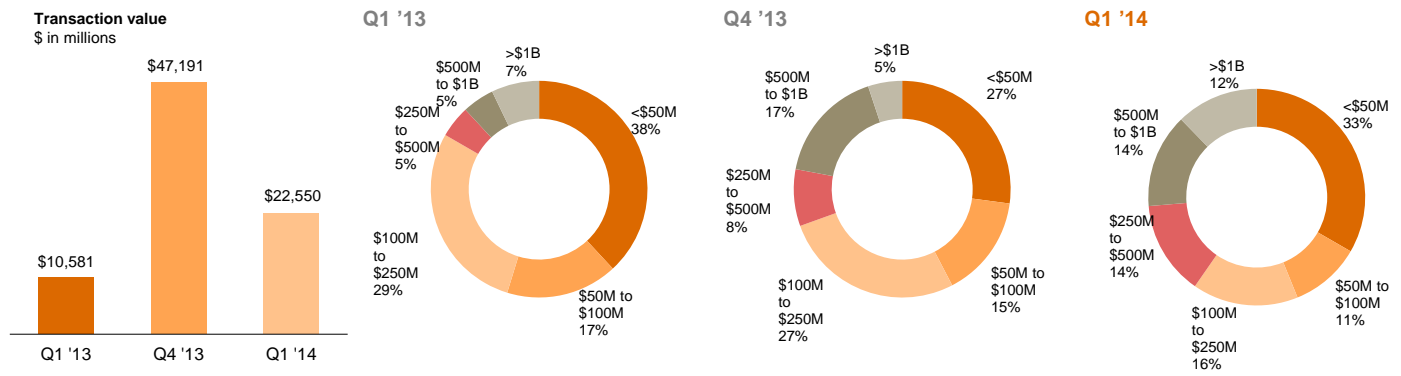
- Google's \$3.2 billion acquisition of Nest Labs, an internet-connected maker of home devices.
- Hellman & Friedman and JMI Equity acquired Applied Systems, a provider of insurance software, for \$1.8 billion from Bain Capital.
- NCR Corp, a provider of consumer transaction technologies, acquired Digital Insight, an online and mobile banking service provider, for \$1.7 billion.
- The \$1.5 billion acquisition of publically traded cloud-based B2C marketing software provider, Responsys, by Oracle.
- VMWare's \$1.5 billion acquisition of AirWatch, a mobile device management company.

*Announced deals in the first quarter point to large technology closures in the quarters to come*

# Monthly deal activity in 2014 continues on pace with 2013

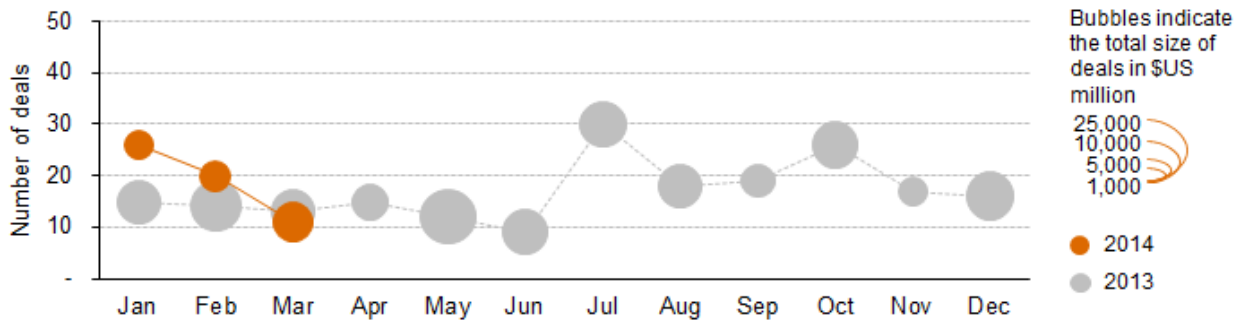
## Closed US deals by value

### Comparison of total deal value



\$ in millions, except #	Q1 '13		Q4 '13		Q1 '14	
	Number of deals	Total deal value	Number of deals	Total deal value	Number of deals	Total deal value
<\$50M	16	387	16	499	19	532
\$50M to \$100M	7	511	9	646	6	482
\$100M to \$250M	12	1,778	16	2,485	9	1,287
\$250M to \$500M	2	768	5	1,522	8	2,886
\$500M to \$1B	2	1,702	10	7,240	8	5,308
>\$1B	3	5,435	3	34,800	7	12,055
<b>Total</b>	<b>42</b>	<b>10,581</b>	<b>59</b>	<b>47,191</b>	<b>57</b>	<b>22,550</b>

## US technology deals by month, 2013 and 2014



Source: Thomson Reuters

# Deal activity in the software and internet sectors continues to thrive

While first quarter deal activity remained on a similar level with the prior quarter, both volume and value remained slightly lower than that of an average quarter in 2011 or 2012. The Software and Internet sectors continue to stand out as the most active, both in terms of volume and value during the first quarter. With a combined 34 transactions closed for total deal value of \$14.3 billion, volume grew 26% and value grew 62% over the fourth quarter. The positive growth is similarly a 26% increase in volume and 92% increase in value over the same quarter a year ago. Courtesy of the increase in billion dollar transactions, average deal value increased to \$420 million in the first quarter, compared to an average of \$333 million in 2013 for these two sectors.

Whether investing in growing IT budgets, or engaging in similar acquisitions, companies from a variety of industry sectors continue to hone their interests in software and cloud services to improve product offerings. While we continue to see hybrid business models, software-driven products and services are likely to remain at the forefront of 2014 deal activity.

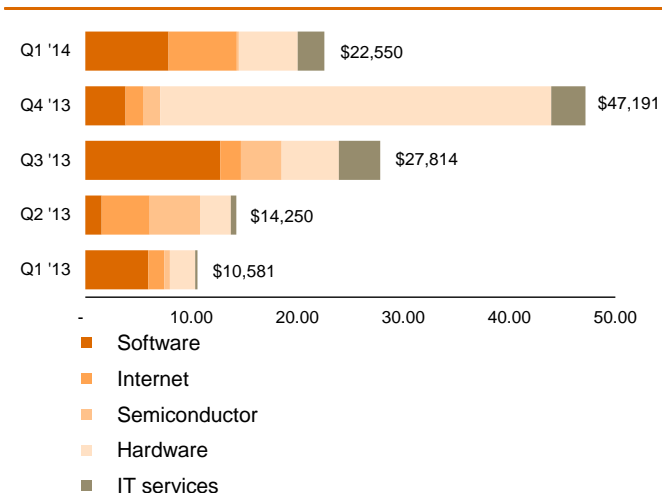
Countering the growth in both Software and Internet, each of the Hardware, Semiconductor, and IT Services sectors experienced declines in both volume and value compared to the fourth quarter. The biggest change in the first quarter

was the lack of a \$25 billion Hardware deal – Dell – that single-handedly accounts for a 53% decline in total technology deal value during the first quarter. Even with Google's \$3.2 billion acquisition of Nest Labs, value declined 85% for the Hardware sector, with volume down 23%, to 10 transactions. Average deal size remains highest in Hardware at \$555 million, compared to an average of \$396 million for first quarter across technology deals. After several notable Semiconductor deals in the fourth quarter and Avago's acquisition of LSI closure expected in May, volumes slid 43% and values 87% in the first quarter to an average deal size of \$51 million. In IT services, volumes declined 25% and values declined 22%, while average deal size increased from \$269 million to \$278 million.

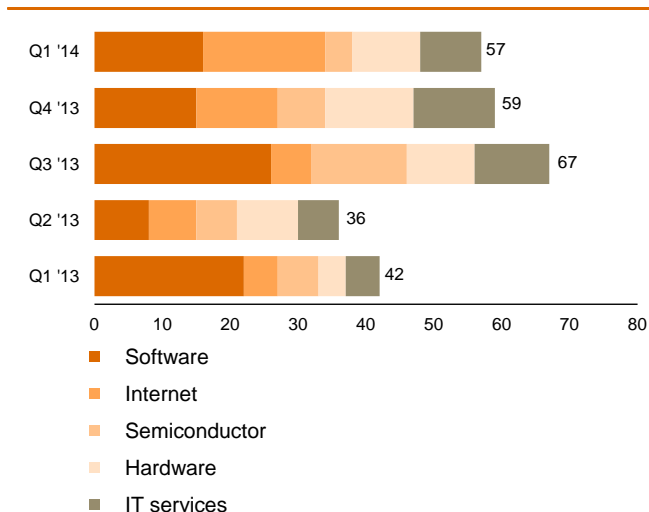
## Conclusion

2014 is off to a strong start, actively maintaining the pace of 2013's rebound finish. Software and internet deals will continue to increase, alongside recent needs and forecasted trends for technology, while other sectors are expected to remain as lesser contributors to the whole (with Semiconductor as the notable possible exception). Strong expectations for capital markets and IPOs, coupled with increased economic optimism all point toward an active deal market as companies seek to keep pace with the continuing fundamental shifts in the IT landscape.

Closed deal value by sector, \$US millions



Closed deal volume by sector



Source: Thomson Reuters

## Focus article

# Acqui-hires: Maximizing their value and managing their risk

Perhaps more than any other sector, technology companies are under relentless pressure to innovate and decrease their time to market cycles. It's not surprising then that accelerating innovation through acquisition has been an important avenue to filling portfolio gaps, raising the competitive bar, and relieving pressure from threatening disruptive market forces. In an industry built on these principles, acquisitions of technology and talent are, simply put, a necessity.

As talent-based deals have become more commonplace, the term "acqui-hire" was coined to describe these efforts to acquire a company solely for the talent and not for the business itself. Recent announcements highlight the perceived value of these acquisitions, and acqui-hires have increased among leading technology companies. Although many aspects of an acqui-hire are similar to typical technology deals, they can create their own set of challenges, which should be specifically addressed to capture deal value.

### Why do an acqui-hire?

Technology companies have a variety of reasons for obtaining talent via acqui-hire but we find some common characteristics among the companies they purchase. Targets are typically venture backed start-ups and, once acquired, the existing business is wound down. Often times the identification of suitable candidates originates outside of the corporate development process and is driven by champions within the product development and engineering organizations. Acqui-hires are largely designed to:

- **Accelerate recruiting and onboarding of key talent** – An acqui-hire shortcuts the process of searching the market for the right skills. Further, an entire team can be integrated into the organization at once rather than individually over an extended period.
- **Address a shortage of available talent** - With engineering expertise in high demand, finding available talent can be difficult. Such acquisitions provide a vehicle to meet a severe shortage of targeted workers.
- **Reap the benefits of a proven, cohesive team** – Acquiring a team with an established record of success provides a significant benefit to the acquirer. A team that has created marketable output reduces the risk of hiring individual members, which while talented individually, may not function successfully as a group.

### Challenges for acqui-hires

Although acqui-hires address key business needs, there are several distinct challenges related to these acquisitions that must not be overlooked:

- **Process rigor** – Acqui-hires are often taking place "on the fly" and outside of the normal acquisition process. As a result, the level of rigor applied during the diligence, execution, and integration processes is less than normal, resulting in deal teams not identifying and properly mitigating deal risks.
- **Cultural fit** – Due to their smaller size, issues related to cultural and geographic "fit" within the acquiring company are often not addressed in advance of the acquisition, leading to post close difficulties and attrition.
- **Employee retention** – The recently acquired talent, now enriched from the deal, may leave the business after the acquisition unless a well-designed work environment and incentive structure is put in place.

### Getting acqui-hires right

We recommend four guiding principles to getting acqui-hires right. These include 1) make the right deal, 2) maximize the value of new resources, 3) manage employee risks, and 4) create a measurable, replicable process. These principles are summarized into key action steps in the table to the right, titled "Ten Rules for Getting Acqui-Hires Right" and represent practical steps that corporate development, HR, finance, and other professionals charged with maximizing value and managing risks can take to ensure the success of their acquisition.

### Conclusion

Despite their smaller size, acqui-hires require the same level of rigor as a typical technology acquisition (e.g., a defined deal team and robust deal evaluation process). In addition, addressing other unique challenges, including the retention of acquired talent and ensuring the right cultural fit with the acquiring organization, are critical to ensuring the success of these deals. With careful planning and appropriate rigor, acqui-hires can be a critical addition to any company's innovation and talent strategy.



**Table 1: Ten Rules for Getting Acqui-Hires Right**

<i>Make the Right Deal</i>	<b>Analysis of the acquisition process</b>	Acqui-hires often side-step the rigorous acquisition process given their size, yet they are a high-cost investment if not well-planned. Subject these deals to valuation, diligence, and negotiation. Value firms using time-to-market acceleration and a total cost approach, and compare costs against the next logical alternative: recruitment.
	<b>Conduct an integration audit</b>	Analyze the people, culture, and location to ensure the target's fit into a larger, more structured organization to minimize "flight risk." Involve HR early in the process, conduct interviews, and analyze any culture gaps. Be realistic about separate locations and evaluate the necessity of relocation.
	<b>Understand contingent liabilities</b>	It's easy to underestimate the liabilities of small companies in "people acquisitions," yet they remain active and present. Investigate non-competes, investor obligations, intellectual property infringement, customer obligations, tax positions, etc.
<i>Maximize the Value of New Resources</i>	<b>Create a connected experience</b>	Aligning the needs and expectations of acquired employees to the business needs is critical when delivering talent is a deal driver. Target employees aren't just about the money; they are driven by what they can accomplish, the intellectual challenge, and the drive to succeed. Acquiring firms need to align interests to make it all happen.
	<b>Create a cross-functional view of the new team</b>	Acqui-hiring is not employee on-boarding. Teams from the business, HR, IT, and finance organizations should meet early to determine how acqui-hires align in the new organization. From job title and reporting managers, to training, budgets, and security access, advanced planning accelerates ramp-up time and increases retention potential.
	<b>Align the operating model to the new firm</b>	Development methodology, tools, and applications can all create a different work environment. Focusing on transition and migration will improve deal goals and highlight the legacy intellectual capital critical to capture and archive.
<i>Manage Employee Risks</i>	<b>Structure employee retention into the deal</b>	Acqui-hires present special "flight risk". They are in demand, enriched by the deal, and they are mostly the acquired assets driving deal success. HR's focus on the recruiting process and defining desirable roles are essential. As part of the deal, leverage retention payments over time, as large up-front payments create incentives to move on.
	<b>Don't alienate your core employees</b>	Core employees have paid their dues, and are sensitive to newcomers with higher titles, compensation, and special treatment. Level salaries, titles, and compensation, and treat deal consideration as a one-time event, even if vested over time.
<i>Create a Measurable, Replicable Process</i>	<b>Define and measure success</b>	Without success metrics and deal sponsors to take responsibility, acqui-hires are simply expensive hiring exercises. Thoughtfully defining KPIs, such as retention terms, technology integration, or even a wind-down plan for the old business are critical to turning the investment into shareholder value.
	<b>Capture lessons learned into a deal process</b>	Although smaller than large acquisitions, acqui-hires can be made up in volume. Developing an acqui-hire "playbook" that collects the lessons learned and templates for the process can increase the retention and integration of new hires for future deals.

# About PwC's Deals practice

Smart deal makers are perceptive enough to see value others have missed, flexible enough to adjust for the unexpected, aggressive enough to win favorable terms in a competitive environment, and circumspect enough to envision the challenges they will face from the moment the contract is signed. But in a business environment where information can quickly overwhelm, the smartest deal makers look to experienced advisors to help them fashion a deal that works.

PwC's Deals group can advise technology companies and technology-focused private equity firms on key M&A decisions, from identifying acquisition or divestiture candidates and performing detailed buy-side diligence, to developing strategies for capturing post-deal profits and exiting a deal through a sale, carve-out, or IPO. With more than 9,800 deals professionals in 75 countries, we can deploy seasoned teams that combine deep technology industry skills with local market knowledge virtually anywhere and everywhere your company operates or executes transactions.

Although every deal is unique, most will benefit from the broad experience we bring to delivering strategic M&A advice, due diligence, transaction structuring, M&A tax, merger integration, valuation, and post-deal services.

In short, we offer integrated solutions tailored to your particular deal situation and designed to help you extract peak value within your risk profile. Whether your focus is deploying capital through an acquisition or joint venture, raising capital through an IPO or private placement, or harvesting an investment through the divesture process, we can help.

For more information about M&A and related services in the technology industry, please visit [www.pwc.com/us/deals](http://www.pwc.com/us/deals) or [www.pwc.com/technology](http://www.pwc.com/technology).

## About the data

We define M&A activity as mergers and acquisitions where targets are US-based companies acquired by either US or foreign acquirers or foreign targets acquired by US technology companies. We define divestitures as the sale of a portion of a company (not a whole entity) by a US-based seller.

We have based our findings on data provided by industry-recognized sources. Specifically, values and volumes used throughout this report are based on completion date data for transactions with a disclosed deal value greater than \$15 million, as provided by Thomson Reuters as of March 31, 2014, and supplemented by additional independent research. Information related to previous periods is updated periodically based on new data collected by Thomson Reuters for deals closed during previous periods but not reflected in previous data sets.

Because many technology companies overlap multiple sectors, we believe that the trends within the sectors discussed herein are applicable to other sectors as well. Technology sectors used in this report were developed using NAIC codes, with the semiconductor sector being extracted from semiconductor and other electronic component manufacturing codes by reference to SIC codes. In certain cases, we have reclassified deals regardless of their NAIC or SIC codes to better reflect the nature of the related transaction.

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# Acknowledgments

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