

US technology M&A insights Q2 2013 update

July 2013

*A publication from
PwC's Deals practice*

At a glance

Second quarter deal announcements point to rising M&A activity despite sequential and year-over-year drops in closed deal volume

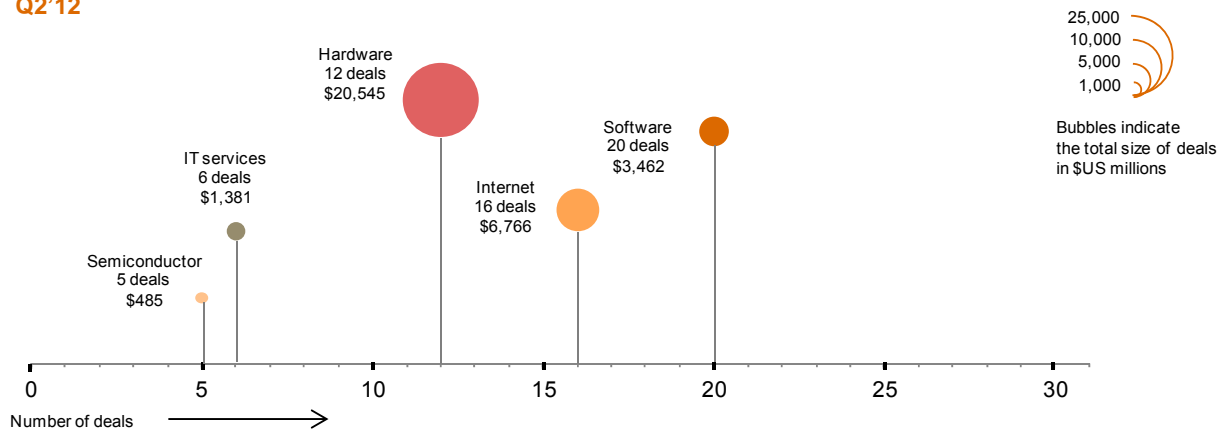
Private equity buyers take a more active role in technology M&A with new deals announced across the spectrum of deal size amid numerous bids by key technology corporates

Increasing market stability and positive deal momentum point to improved M&A activity in the second half of 2013 and the year to come

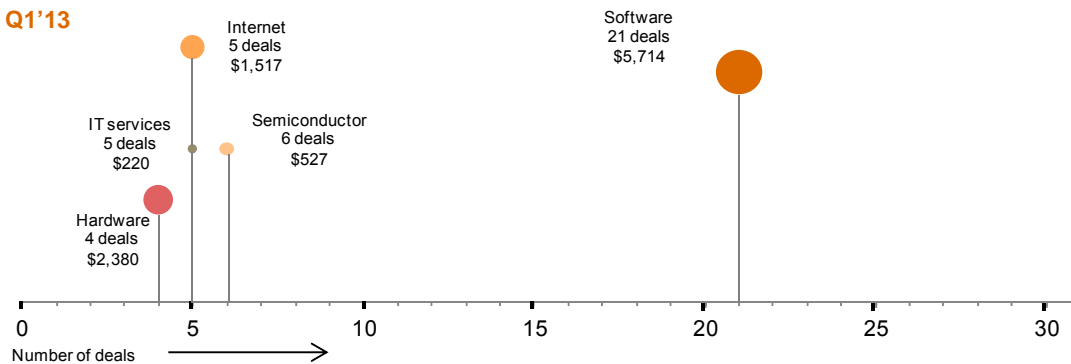
Technology transaction volume shrinks to 2009 levels with deals spread across sectors

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

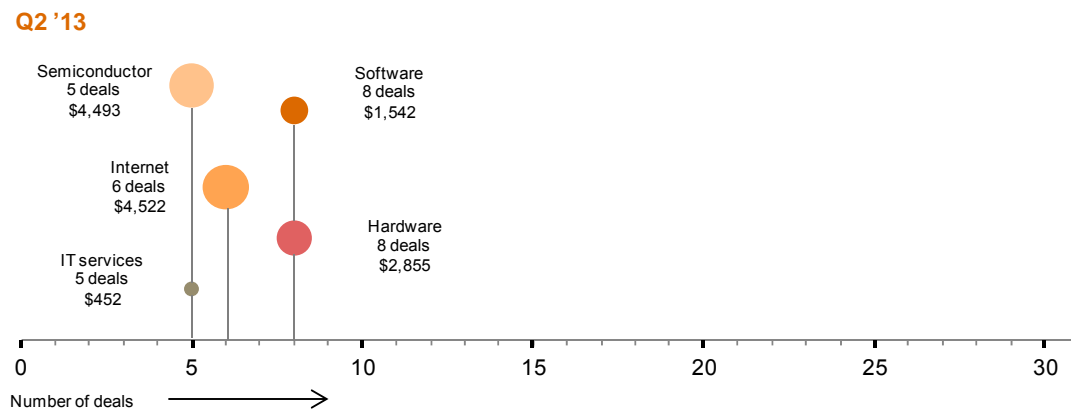
Q2'12



Q1'13



Q2 '13



Source: Thomson Reuters

Amid new deal announcements, closed technology deal volumes drop again in Q2

Welcome to the second-quarter 2013 issue of PwC's *US technology M&A insights*. While the positive economic momentum of the first quarter continued into the second, the full impact of a recovering US economy was certainly not visible in the level of technology M&A transactions closed in the second quarter. The US stock markets continued their upward climb, with IPO activity rising on the back of positive stock performance, but the volume of technology deals dropped precipitously again during the quarter. Amid signs of positive economic growth in 2013, IT businesses continue to face the conundrum of a need to balance key investment initiatives in cloud and mobile technologies and yet navigate fears of future downturns. While transactions declined to levels not seen since 2009, numerous new announcements and rumors of sizable technology transactions kept the level of interest high as technology businesses plot the next wave of deals.

US economic news was somewhat mixed during the quarter, with the US Federal Reserve announcing a discontinuation of its bond buyback program, driving mortgage rates back up slightly from previous historic lows, potentially dampening a US housing market that picked up pace in recent months. Unemployment rates remained below 8%, but many analysts continued to attribute the decline to disenchanted workers leaving the US labor force. The discussion of Obamacare and its impact to the US and state economies remained at the forefront of political debate with each side of the aisle touting its merits or failures. Although buyers successfully navigated the economic uncertainties of the first quarter and continued to accumulate stockpiles of cash, the first half of 2013 has been marked by a more governed approach to M&A after several acquisitions of the last decade spurred recent divestitures and write-offs.

Gartner contributed to the bad news, revising its 2013 global IT spend forecast downward, from 4.1% to 2.0%, citing currency movements as the primary driver and, to a lesser extent, consumer shifts towards less expensive tablet and mobile devices. Cross-border technology M&A activity felt the pinch of exchange rate fluctuations coupled with protectionist measures at home and abroad, posting activity declines. US buyers constituted the bulk of this decreased activity and, as Europe's debt woes continue, Japan tackles domestic stagnation, and the BRICs encounter more tempered growth rates, the US will likely continue to be the primary driver of global technology M&A throughout the remainder of the year.

Difficulties abroad have not hampered interest in the growth prospects of the world's technology leaders as evidenced by trading multiples at their highest in the last six quarters. To wit, the top 25 global technology businesses increased average enterprise-value-to-EBITDA multiples from 10.5x to 12.2x between the second quarter of 2012 and the second quarter of 2013.

In the US, the Dow Jones, NASDAQ, and S&P 500 rose 2.3%, 4.2%, and 2.8%, respectively, during the quarter, resulting in year-to-date double-digit gains at the close of June. Positive market performance continued to drive technology initial public offerings (IPOs), as the volume of new pricings more than doubled in the second quarter, to 15, with proceeds in excess of \$2.6 billion. Technology IPO average one-day returns of 21% beat out all other industries, helping to lay the foundation for future interest. New registrations followed suit, with publicly announced IPO registrations totalling 13 for the quarter and additional registrations filed confidentially under the rules of the US JOBS Act. The US JOBS Act and its provisions for emerging growth companies, along with positive market performance for recent pricings, are likely to fuel numerous technology IPOs in the latter half of the year and into 2014, with possible knock-on effects to M&A valuations.

Technology deals were spread across sectors during the quarter. Software transactions, a driver of technology M&A in prior quarters, just kept pace with hardware deals, which generated 25% of deal volume in the quarter. The drop in software transactions is likely temporary, as cloud, social, mobile, data analytics, and the software tools that enable these technologies can be expected to drive higher software deal volume going forward.

Although the second quarter saw a decline in closed deals, we are bullish on the second half of 2013 and the coming year of 2014. New announcements provide positive momentum, and as the US economy continues to improve, growth in emerging economies stabilizes, and difficulties in Europe and Japan are addressed, the improved clarity will create a fertile environment for technology volume to grow.

New announcements point to robust deal activity in the second half of 2013

Closed transaction volumes decreased 22% while value increased 34% versus Q1

Key announced transactions

Although the number of closed transactions slowed to a dismal pace, the number of announcements picked up speed in the second quarter, signaling robust future deal closures in the latter half of 2013. Private equity funds played an active role in second-quarter M&A announcements with some of the largest transactions announced so far this year. Negotiations related to the Dell transaction continued as activist investor Carl Icahn increased his proposed bid for a Dell recapitalization, after the company's board of directors approved a bid by Michael Dell and Silver Lake Partners valued at \$24.4 billion (subsequently increased after the end of the quarter). New deals above the \$1 billion mark announced in the first quarter included:

- A Bain Capital-led consortium of private equity buyers (including Golden Gate Capital) in a take-private bid for BMC Software valued at \$6.9 billion.
- Cloud-based services provider Salesforce.com's plans to acquire ExactTarget, Inc., a maker of digital marketing software based in Indianapolis, for \$2.6 billion.
- Colorado-based IHS Inc.'s proposed bid for online automotive information services provider RL Polk & Co. for \$1.4 billion.
- Swiss electronic equipment manufacturer ABB's plan to acquire Power-One Inc., a designer and manufacturer of power supplies and power management products based in California, for \$1.1 billion.

Other private equity buys include announcements by CITIC Capital Holdings, Vista Equity Partners, One Equity Partners, Altamont Capital Partners, and several other firms. On the corporate front, in addition to the large deals noted above, announcements of smaller acquisitions by Cisco, Microsoft, Yahoo!, LinkedIn, SAP, IBM, Avnet and others are indicative of increased deal closures in the months ahead.

The increase in announcements by both private equity and corporate buyers, coupled with rampant rumors throughout the quarter of proposed or attempted transactions by technology majors, provides ample reason to assume the second half of 2013 will see an increase in transaction volumes as these deals come to a close or result in official announcements.

Key closed transactions

After deal volume reached a four-year low in the first quarter of 2013, the number of technology transactions took another precipitous drop in the second quarter, decreasing 22%. Volume compared to a year ago was down 46% and value was down 58%. The quarter ended with only 32 transactions completed but at 34% higher cumulative deal value than the first quarter. Average deal value increased to \$433 million from the first quarter's average of \$253 million as the number of deals in excess of \$250 million doubled from 17% to 34%. Second-quarter cumulative deal value of \$13.9 billion included five transactions in excess of \$1 billion, still below the average quarterly volume in 2012 but higher than the three deals closed in the first quarter. The five billion-dollar transactions closed during the quarter include:

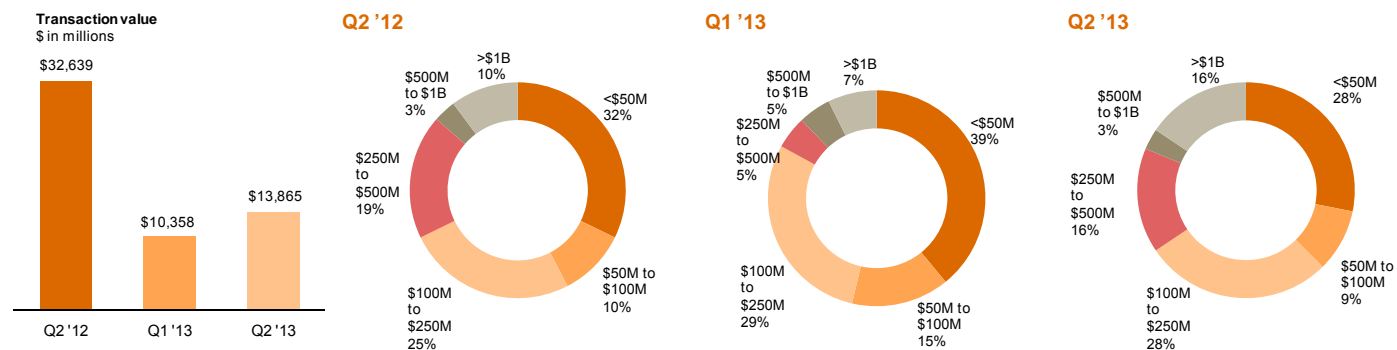
- ASML Holding's \$3.7 billion cash and stock deal for Cymer, a manufacturer and wholesaler of photolithography laser systems to the semiconductor industry.
- A Berkshire Partners-led \$2.0 billion acquisition of Lightower Fiber Networks, a provider of networking infrastructure and services founded in 2003, announced in November of last year.
- Priceline.com's acquisition of KAYAK Software Corp, a provider of online travel information, for \$1.8 billion.
- Yahoo!'s acquisition of private blogging site Tumblr, for \$1.1 billion, announced and closed in the second quarter.
- After rumors of previous attempts by Silicon Valley Internet majors to acquire the company, Google announced plans to acquire privately held Israeli social mapping start-up Waze for an estimated \$1.1 billion.

Oracle announced the completion of its \$1.7 billion acquisition of Acme Packet, a Massachusetts-based developer of Internet signaling systems. While the completion was announced in April, the transaction had been consummated in the month of March, adding to first-quarter closed transaction volume.

Direct private equity acquisitions were limited in the second quarter, with PE funds closing only three transactions (9%) during the quarter and PE sponsors backing five of the businesses being acquired by corporate technology buyers.

Closed US deals by value

Comparison of total deal value

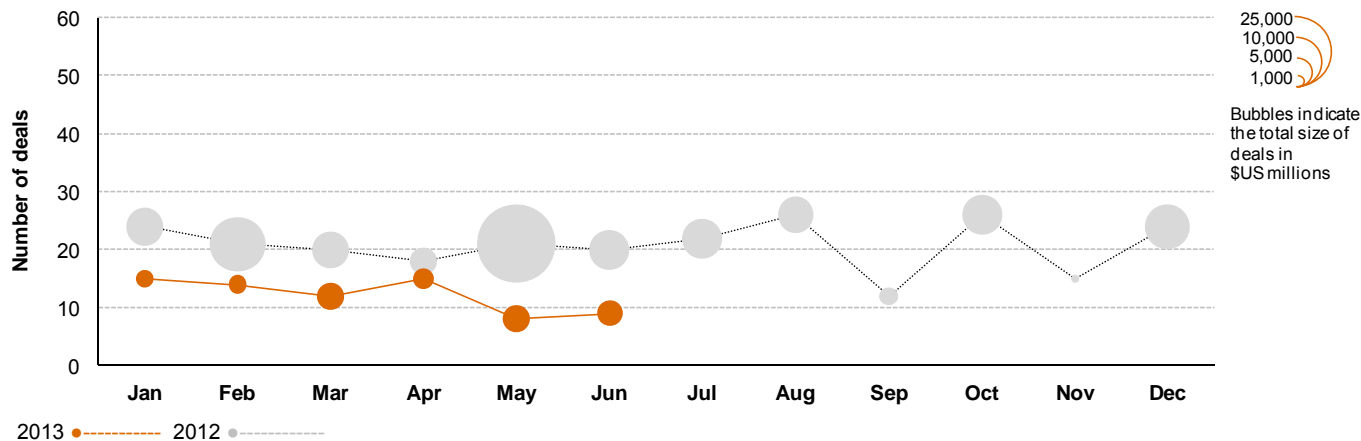


Source: Thomson Reuters

\$ in millions, except #	Q2 '12		Q1 '13		Q2 '13	
	Number of deals	Total deal value	Number of deals	Total deal value	Number of deals	Total deal value
<\$50M	19	598	16	387	9	187
\$50M to \$100M	6	413	6	442	3	193
\$100M to \$250M	15	2,561	12	1,804	9	1,104
\$250M to \$500M	11	4,013	2	768	5	1,690
\$500M to \$1B	2	1,725	2	1,521	1	986
>\$1B	6	23,329	3	5,435	5	9,706
Total	59	32,639	41	10,358	32	13,865

Source: Thomson Reuters

US technology deals by month, 2012 and 2013



Source: Thomson Reuters

Deal activity levels out across sectors as technology transactions decline

The low volume of transactions in the second quarter of 2013 was spread across sectors, with hardware deals generating 25% of deal volume (8 transactions) and 21% of deal value (\$2.9 billion). Although hardware deals doubled in volume from the prior quarter, activity was still down 33% from a year ago, and value dropped 86% following a year of transformative deals in 2012. The software sector, which had been the primary driver of transaction activity throughout 2012 and the first quarter of 2013, decreased 62% from the first quarter to eight deals, and value dropped 73% to \$1.5 billion (11% of deal value) in the second quarter of 2013. The decline in software transactions represents a decrease of 60% and 55% on volume and value, respectively, from the second quarter of 2012.

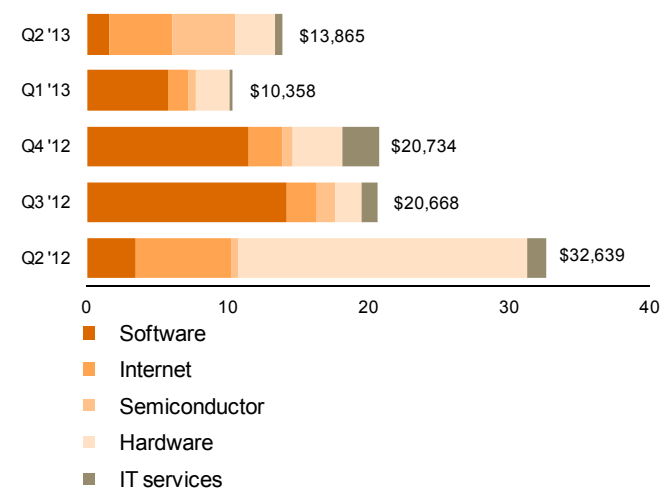
While the demand for software-driven functionality presumably remains high, given continued market pressure for higher-value devices and software functionality across industries, the number of successfully completed software transactions was remarkably low during the period. We expect the drop in second-quarter software transaction volume to be temporary. The ability of software to enhance the performance and enable more efficient delivery of products and services will drive a higher number of software transactions in the months to come.

A total of six Internet transactions closed during the period, generating \$4.5 billion (33%) of total deal value. Semiconductor and IT services transactions each generated five deals (32% of total deal volume) during the second quarter. Although not equal to the value contributed in the first quarter of 2012, the semiconductor sector generated the second-highest deal value during the second quarter with \$4.5 billion of closed transactions or 32% of total deal value. And IT services deal value remained low again this quarter, contributing 3% of deal value at \$452 million for transactions closed during the period.

Conclusion

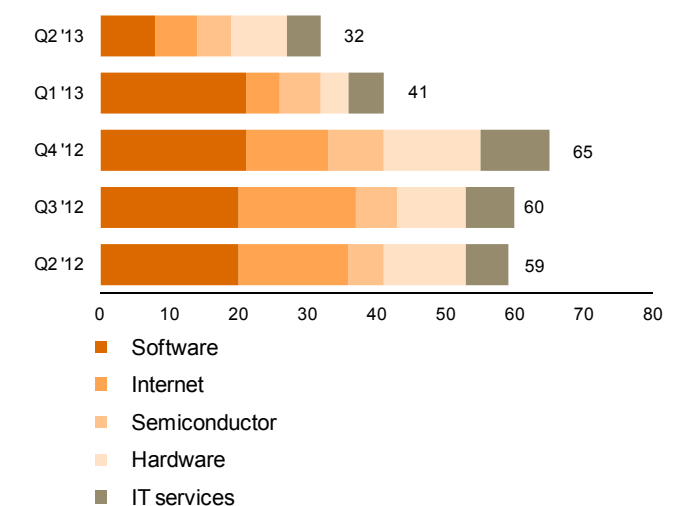
After technology deal volume reached a four-year low in the first quarter of 2013, the second quarter proved equally disappointing as volumes dipped again sharply and value recovered only slightly. Yet the fundamental drivers of technology M&A remain strong. With piles of unused corporate cash, increased momentum among private equity buyers, technology companies determined to fully embrace cloud and capture an increased share of mobile consumers, and executives eager to identify new avenues to fuel growth engines, technology deals may be down, but certainly not out. Recent deal announcements will help invigorate M&A in the technology industry in the latter half of 2013.

Closed deal value by sector, \$US millions



Source: Thomson Reuters

Closed deal volume by sector



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, through developing strategies for capturing post-deal profits, to exiting a deal through a sale, carve-out, or IPO. With more than 9,800 deals professionals in 75 countries, we can deploy seasoned deals 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 complete and 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 or 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 utilized 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 July 1, 2013, 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 others 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.

Focus article

Refining the price-value equation

"Price is what you pay. Value is what you get." - Warren Buffett

Warren Buffett, well known for the words above, has the right idea. The price versus value equation underlies every transaction. While price is what the market requires to effect a transaction, value depends on the intrinsic worth of an acquired asset. As a function of cash flows the acquired business or asset will generate, value derives from core operations, integration success, and synergies between the parties to a transaction. Although the price-value equation is fundamental to successful deal making in every industry, certain nuances apply to technology businesses.

Beware of bias

Perhaps the single biggest threat to successful transactions is a natural and unavoidable human condition: bias. In a recent PwC survey, a majority of respondents indicated bias posed the greatest risk to the success of prior transactions. While bias, or "judgment," as deal participants often describe it, exists in all transactions and industries, the margin for error is high in the technology industry.

Technology transactions are often driven by a company's need for innovative products to fill potential gaps in its product portfolio, to accelerate time-to-market of a product being developed in-house, or to acquire a pool of highly qualified employees. Each of these topics creates opportunities for bias to creep into a valuation process and potentially obscure a complete understanding of the associated risks and skew expected returns from a transaction. To counter this risk, deal makers should establish a robust, objective process to determine and challenge the assumptions underlying valuation.

A delicate balance of art and science

While many deal makers recognize the risks inherent in a valuation model, the methods of accounting for and mitigating these risks in the deal process are often imprecise and do not enhance the understanding of the value of the underlying asset. For instance, some deal practitioners rely upon "base case" or "most likely" cash flow projections in their valuation analysis. Base case projections may, for example, assume immediate successful integration and cross-selling of the target's innovative product, yielding a

"hockey stick" forecast. To account for the uncertainty associated with these events, a subjective "alpha" premium may be included in the assumed rate of return.

Valuation theory is premised upon "expected" cash flows, which represent a probability-weighted average of possible outcomes. Expected cash flows reflect measurable, company-specific risks and are therefore unconditional; achieving the forecast is not conditioned on an event that is ignored in the forecast. For example, an unconditional forecast would project cash flow as a probability-weighted average of cash flow with an immediate successful launch of the product and cash flow with a delayed time-to-market. Expected cash flows provide greater visibility into the potential risks in a forecast and enhance the understanding of the price-value equation.

Be careful with synergies

Many technology transactions in recent years have been "tuck-in" acquisitions designed to complement an existing line of business or product offering. Buyers in these types of transactions generally expect to realize significant value from synergies and often offer substantial premiums above listed prices on that basis. Premiums paid in technology transactions exceeded 40% in each of the last three years, based on information from S&P Capital IQ.

These synergies may represent incremental revenue from a more complete line of products, or cost savings achieved by using the existing sales or research and development (R&D) team. Buyers must be deliberate in their measurement and treatment of synergies, which often contribute to the gap between price and value. If cash flows are properly adjusted to account for company-specific risks, the discount rate, as measured by traditional CAPM theory, does not need to be subjectively adjusted.

Consider an example of bidders competing in a transaction for a technology company offering an innovative, next-generation product. While each bidder may bring similar synergies of scale, one is uniquely positioned in its ability to generate significant revenues from its existing product by bundling it with the target's product. In this example, the deal team may develop a framework that individually considers the various components of deal value, including 1) the value of the business on a stand-alone basis, 2) the value of the business through combination with any of the

potential acquirers, and 3) the value associated with the ability to generate significant revenues from the acquirer's own products by bundling it with the target's product. To the extent the buyer is able to retain the third component of value, the acquirer would be able to earn a return in excess of its cost of capital.

Success requires 1) a disciplined approach to quantifying synergy value, 2) diligence in identifying the costs necessary to achieve the projected synergies, and 3) smart negotiating, particularly in competitive transactions, to ensure the value associated with expected synergies is not lost through unfavorable increases to the purchase price.

Deal structures and tax matters

Structured transactions and contingent consideration prevail in technology transactions and provide deal makers with the tools to balance risk and reward in a highly uncertain environment. Buyers may be willing to share in the upside of a transaction in exchange for less risk in the event of a failure to successfully integrate the product quickly or lower-than-expected market potential. However, deal makers must approach such structures carefully to ensure balance between up-front and contingent payments to avoid paying twice for the asset. Striking this balance requires a solid understanding of the potential values of the asset and associated risks.

Potential tax costs or benefits also could be critical to bid pricing and structuring alternatives. A deal may not provide expected tax benefits, or the deal might have more tax risks than anticipated. Deal makers understand that the tax regulatory landscape constantly changes. Tax structures that were effective yesterday may not be effective today or tomorrow, making the valuation of a target and its potential cash flow uncertain.

Tax planning can yield significant savings by identifying future tax benefits or by rightsizing a deal price based on estimated future tax costs. Smart deal makers integrate tax planning and diligence with valuation processes before and during deal negotiation, not after tentative prices have already been established.

Not all models are created equal

Deal makers often take model integrity for granted, but not all models are created equal. Experienced deal makers understand the risks inherent in model building and design a modeling process with appropriate controls around scoping, version management, input management, and model review. While model reviews may include simple mathematical verification to address commonplace mathematical errors, a model integrity process incorporates a critical review of model structure, validation of data linkage (within models and to original source data), and agreement with the valuation methodology as applied in the model.

Developing a robust modeling process allows deal teams to easily and confidently integrate and assess new information that arises during the deal, such as findings from financial due diligence. A thorough modeling process also allows for flexibility in analysis and reporting to deal stakeholders, such as the board of directors.

Conclusion

The technology sector is fundamentally oriented toward deal making, which serves to accomplish several operational imperatives. Deals supplement the R&D innovation pipeline and help companies diversify into new markets and products and share risk. While M&A activity represents tremendous potential for growth and transformation, that potential can be realized only through robust valuation diligence that effectively considers the relationship between price and intrinsic value. As companies chart new courses for growth, with stock prices at near-record highs, deal makers can improve their opportunities for successful transactions by investing time and effort in a flexible valuation process.

For more information on the price-value equation and the full article from PwC on "***Uncovering blind spots in deal valuations***," please visit www.pwc.com.

Price versus value is the foundational equation in every transaction. Yet deal makers often skew this reality, at best, or at worst, simply ignore it.



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