

US technology deal insights

Q2 2014 update

August 2014

*A publication from
PwC's Deals practice*

At a glance

*Second-quarter deal
volumes and value
remain at historical
norms while
announcements show a
noticeable increase*

*Hardware and
Semiconductor sectors
drive increase in deal
value*

*Expect increased levels
of deal activity for
technology over the
coming quarters*

Technology deal market thrives amid improving macroeconomic conditions

Welcome to the second-quarter 2014 issue of PwC's *US technology deal insights*. The technology industry continued to thrive in the second quarter of 2014. Extending the positive momentum from the second half of 2013, equity markets set new highs, IPO markets reached activity levels not seen in years, VC investments harkened back to 2000 levels, and economic outlooks remained modestly optimistic across sectors. Cash balances among the top 25 technology companies grew in excess of \$350 billion, providing ample opportunities for corporate buyers while high debt leverage ratios continued to enable technology-focused private equity acquisitions.

Despite these positive forces, US economic growth thus far in 2014 has trailed below expectations, though GDP forecasts for the full year remained steady. IT spending forecasts, too, have dipped from previous estimates of 3% to just over 2% for the year. While unemployment continues to decline, many raise concerns at the level of underemployment that may be embedded within. With the US Federal Reserve planning to end quantitative easing later in 2014, we may see an increase in interest rates over the coming year. Ahead of knock-on mortgage rate increases, the US housing market continues to improve in the current rate environment.

Abroad, global economic sentiment continues to remain tempered but optimistic. In China, slower than expected quarter-over-quarter growth resulted in many small stimulus measures that are expected to enable the nation to reach its 7.4% projected GDP growth for 2014. Projections for 2015 assume lower growth, which may negatively impact trading partners in emerging economies. Across the Atlantic, Europe is notably hindered by a persistently high euro, creating inconsistent growth between nations and hindering nations like Greece in their efforts to reduce debt. Economists currently project a 1.2% GDP growth rate in the European Union, which is expected to accelerate in 2015 and provide opportunity for technology companies. BRIC countries continue to remain a source of growth for all industries, but at a decelerating pace.

US Equities, once again, set record highs with the Dow Jones, NASDAQ, and S&P 500 rising 2.2%, 3.3%, and 4.0%, respectively. Surpassing the 17,000 mark for the first time in history shortly after quarter end, the Dow reflects the booming IPO market and broader valuation in equities. The top 25 global technology businesses maintained average

enterprise-value-to-EBITDA multiples of 10x. Technology initial public offerings (IPOs) accelerated pace, adding 22 new pricings with proceeds exceeding \$5.1 billion. Technology IPO average one-day returns neared 16% and current year-to-date returns averaged 18%, both surpassing the overall growth of 2014 market indices. New registrations followed suit, with publicly announced IPO registrations totalling 20 for the quarter and additional registrations filed confidentially under the rules of the US JOBS Act.

With market valuations at historical highs, sellers' valuation expectations continue to increase toward dot.com era levels. Despite these high valuations, transaction volume remained active with the software and internet sectors leading the way in terms of deal volume, but hardware and semiconductors drove transaction value in the second quarter with some large deal closures. With the proliferation of internet-connected and wearable devices, we see the Internet of Things continuing to evolve. Increasing competition among B2C hardware necessitates inorganic growth strategies to accelerate time-to-market. These trends are driving demand for specialized semiconductor components and software to enhance them. Further, cloud, mobile, and social are clearly focal areas driving new forms of innovation at a more granular level and are prime M&A targets for technology players across sectors.

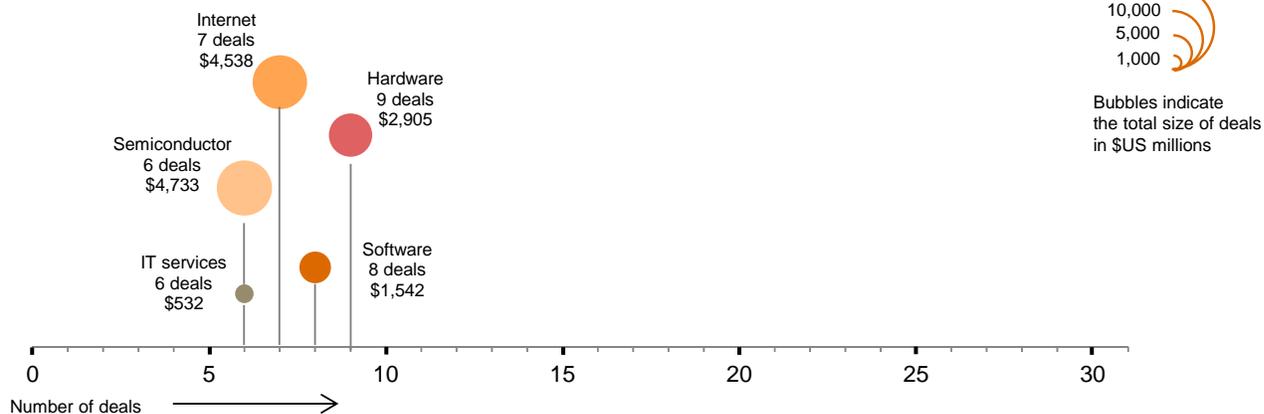
While cross-border deal activity exhibited a slight decrease in the second quarter and valuation pressure from the IPO markets continue to compete with deal volumes, divestitures are setting a pace not seen in recent years and some newly public registrants are quickly leveraging their newfound capital and valuable equity currency to engage in deal making. As we enter the second half of the year, we expect a continuation, if not acceleration, of the current momentum to drive elevated levels of deal activity throughout the technology industry.

Deal momentum is expected to continue or even increase in the second half of 2014

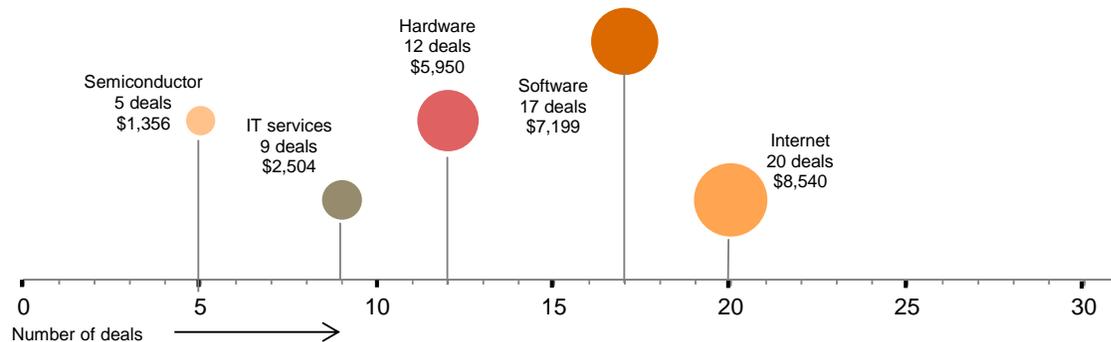
Volume remains consistent over the last 4 quarters, compared to an 87% increase over Q2

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

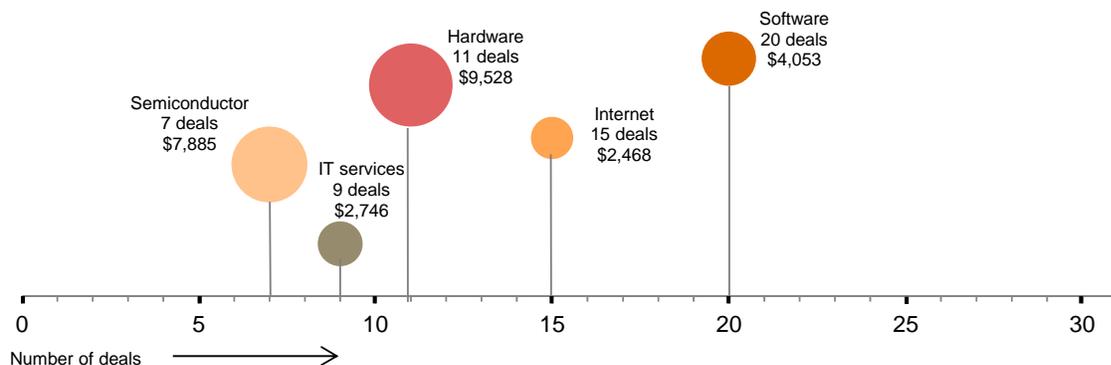
Q2'13



Q1'14



Q2'14



Increase in announced deal activity signals a strong second half of 2014

Key announced transactions

After a strong start during the first quarter of 2014, the second quarter followed suit with an increase in the number of technology deal announcements. While the number of new billion-dollar deals announced remained in line with the first quarter, the volume of smaller and middle market transactions notably grew. Private equity continued to play an active role in technology, though challenged by strategic buyers able to leverage healthy valuations and substantial war chests of cash.

During the second quarter, 7 deals in excess of the billion-dollar mark were announced but had not yet closed, including:

- Oracle's \$5.3 billion acquisition of MICROS Systems, a software solutions provider to the retail and hospitality industries.
- The \$3.5 billion acquisition of Motorola Solutions' enterprise business by Zebra Technologies, a company specializing in barcode printing and asset tracking.
- Apple's \$3.0 billion acquisition of Beats Electronics, an audio equipment maker and recent music subscription service provider.
- Priceline's agreement to acquire OpenTable, an online restaurant reservation company, for \$2.6 billion.
- Analog Devices' \$2.4 billion acquisition of Hittite Microwave, a designer and manufacturer of electronic components.
- The \$1.4 billion acquisition of Aeroflex, a wireless communications solutions provider, by Cobham, the UK aerospace and defense firm.
- The \$1.2 billion acquisition of Fusion-io, a developer of flash-based PCIe hardware and software solutions, by SanDisk.

Private equity transactions include announcements from GI Partners, GTCR, Insight Venture Partners, Summit Partners, Warburg Pincus, and several other firms. On the corporate front, in addition to the large deals noted above, announcements of acquisitions by Google, Intuit, Palo Alto Networks, Seagate, TIBCO Software, Xerox, and others highlight the broad activity across the technology industry.

We expect the increased momentum of deal announcements to continue through the remainder of the year. On a closed-

basis alone, the combination of second quarter announcements with the pending closure of nearly \$30 billion in value between 2 notable transactions – Facebook's \$19 billion acquisition of WhatsApp, and Applied Materials' \$9.5 billion merger with Tokyo Electron – positions the remainder of 2014 to exceed any average quarter or second half over the past several years.

Key closed transactions

Closed deal activity in the second quarter of 2014 mirrored that of the first quarter, continuing the momentum of 2013's second-half surge. With 62 transactions completed during the quarter for a total of \$26.7 billion, average deal value totalled \$430 million, a slight increase from \$406 million in the first quarter, and down from \$510 million average over the last 12 months. In comparison to the second quarter a year earlier, one of the worst in recent years, transaction activity grew substantially with volume up 72% and value nearly doubling at 87%. There were 4 deals in excess of \$1 billion during the second quarter, slightly down compared to an average of 6 per quarter over the last 12 months. Deals in the second quarter included:

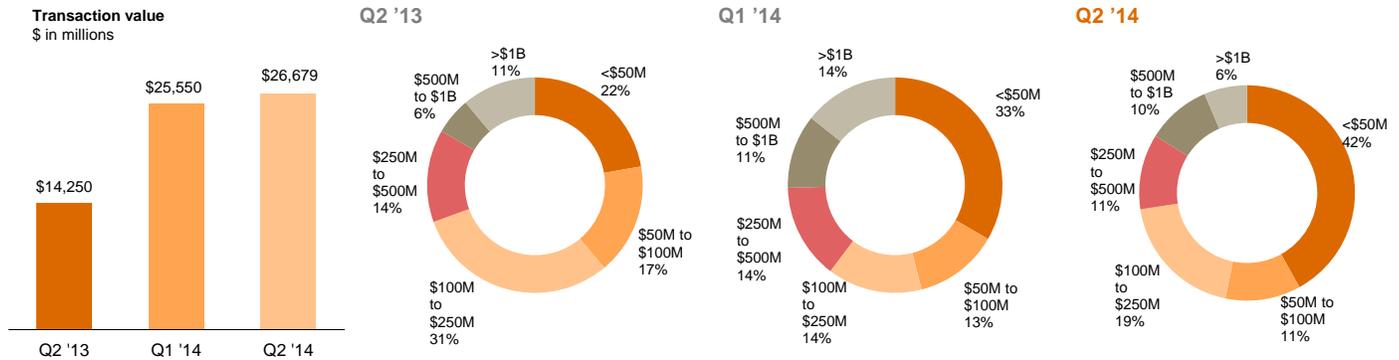
- Microsoft's \$7.2 billion acquisition of Nokia's devices and services business.
- Avago Technologies' acquisition of LSI, a storage and networking semiconductor manufacturer, for \$6.6 billion.
- Payment processor, Vantiv's acquisition of Mercury Payment Systems, a payment systems technology company, for \$1.7 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.

We expect the increased momentum of deal announcements to continue

Monthly deal activity has remained steady the past 12 months

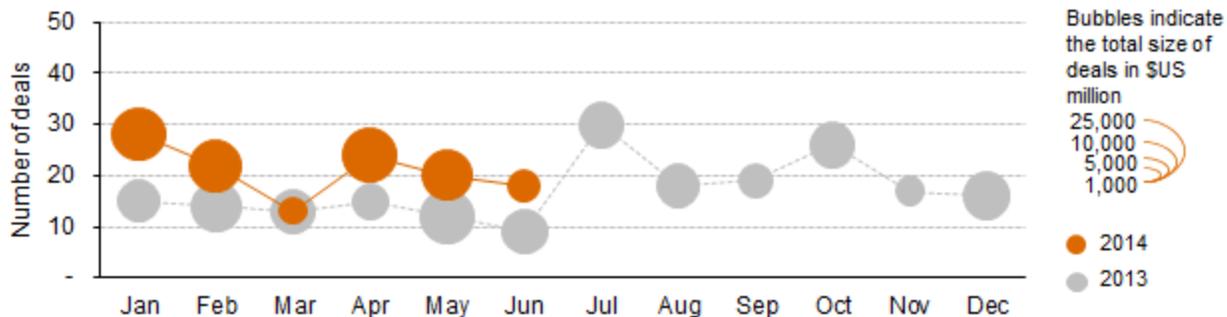
Closed US deals by value

Comparison of total deal value



\$ in millions, except #	Q2 '13		Q1 '14		Q2 '14	
	Number of deals	Total deal value	Number of deals	Total deal value	Number of deals	Total deal value
<\$50M	8	165	21	585	26	758
\$50M to \$100M	6	384	8	641	7	544
\$100M to \$250M	11	1,454	9	1,296	12	2,095
\$250M to \$500M	5	1,690	9	3,283	7	2,461
\$500M to \$1B	2	1,952	7	4,519	6	4,270
>\$1B	4	8,606	9	15,227	4	16,550
Total	36	14,250	63	25,550	62	26,679

US technology deals by month, 2013 and 2014



Source: Thomson Reuters

Software and Internet continue to thrive, while Hardware and Semiconductor drive increased deal values

Sector focus

While overall second quarter deal volume remained in line with that of the first quarter, the software sector saw an increase in the number of closed deals. At 20 transactions closed with an aggregate deal value of \$4.1 billion, volume grew 18% while value declined 44% over the first quarter. Lacking as many headline billion-dollar transactions, average deal value declined to \$203 million compared to \$423 million in the first quarter. The software sector continues to remain at the forefront of deal activity but has traditionally been comprised of smaller-sized deals. Second quarter activity represents a 150% increase in volume and 163% increase in value over the same quarter a year ago.

Despite the recent trends in hybrid business models adjoining software and Internet companies, second quarter Internet deal activity reflected more transactions focused on traditional e-commerce deals. With fewer large acquisitions in the sector, such as those of Scout24 and Digital Insight, value declined 71%, while volume declined 25%, to an average deal value of \$165 million.

Perhaps most notable in the second quarter is deal activity in the hardware and semiconductor sectors. After making headlines for months, Microsoft's \$7.2 billion acquisition of Nokia's devices and services business closed in the second quarter. With volume down 8% and value up 60%, this

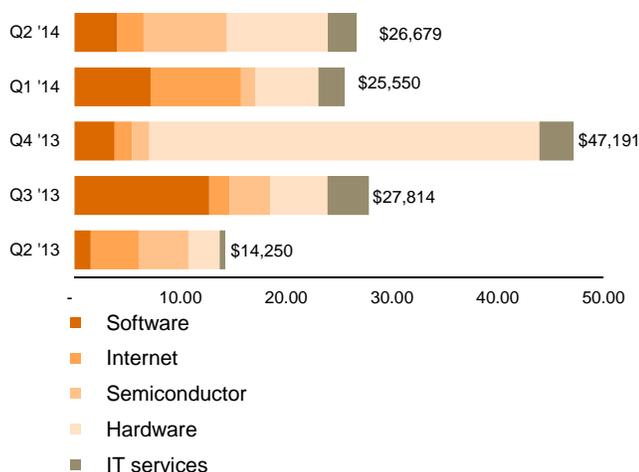
transaction individually increased the average deal value for hardware to \$866 million from \$496 million in the first quarter. As wearable devices become an increasingly hot topic, and as ecosystem providers leverage consumer products to increase engagement, innovative hardware companies will likely remain a focal area for deals.

In the semiconductor sector, volume increased 40%, while average deal size quadrupled, largely due to Avago's \$6.6 billion acquisition of LSI. While exhibiting some volatility between quarters, consolidation continues to remain the topic of conversation for semiconductor companies. Lastly, IT Services volume remained flat and values grew 10%, resulting in an increase in average deal value from \$278 million to \$305 million.

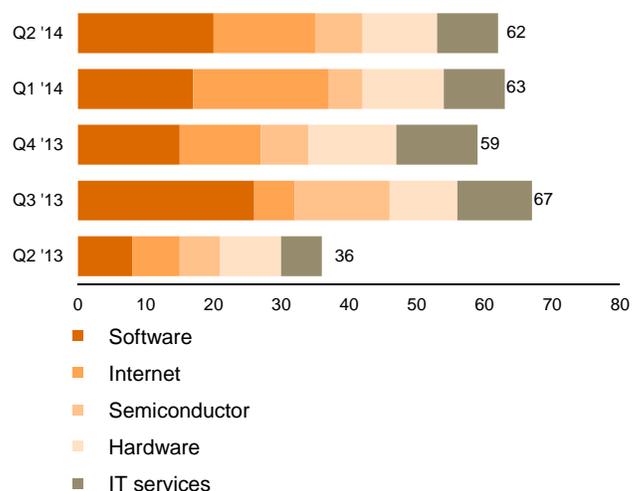
Conclusion

The second quarter of 2014 continued to keep pace with 2013's rebound finish and the end is not yet in sight. As the year progresses, look for Software and Internet deals to play an active role, especially as enterprise software is positioned as the highest growth area within technology. Broader IT spending increases beyond 2014 will nudge leading companies to start positioning now through inorganic growth to capture future value. All of these factors will combine to deliver robust technology deal activity in the second half of the year.

Closed deal value by sector, \$US millions



Closed deal volume by sector



Source: Thomson Reuters

Focus article

Buying Behaviour Analysis Sets The Tone For Go-To-Market Integration

The acquisition of a like-sized target is a complex and multi-faceted exercise, particularly in the first few critical quarters after close. Similar product portfolios and common customer focus typically support shorter transitions and tighter integration, while any differences extend the effort and increase integration risks. Differences in the Go-To-Market model are particularly critical, because the revenue of the combined entity hinges on identifying opportunities and risks early, and on putting in place suitable mitigation strategies to address risks, as well as appropriate market penetration strategies. Identifying a lack of basic fit early in the evaluation process serves as a warning sign that the acquisition is on shaky ground and may need to be carefully reconsidered.

Customer buying behaviours as the basis for Go-To-Market comparison

To evaluate the integration risks and ensure that the integration plan appropriately reflects the Go-To-Market profiles of the two entities, the integration team has to go beyond an account level comparison of the installed base or even of the pipeline. They must also evaluate the buying behaviours supporting each business model. Two entities that sell to the same customer list may approach it in completely different ways, with a diversity of skills, tools and risks that defeats the common wisdom of “right sizing” the staff behind each territory and “aligning” channel partner programs. A simple template, such as Fig. 1, can visually capture the main elements. Examples typically include:

- **Buyer personas** - Identifying the economic buyers and the influencers relevant for the Target is the first step to track the customer footprint of the new business model.

Each persona plays a role at a different step in the decision process and responds to a specific value message. Before the two field organizations can be merged, the Acquirer needs to understand how to reach out to any constituents new to their stand-alone business development cycle.

- **Competition** - Industry peers recognize that their product offering can shape company culture, Sales character and management style. Competitors continually influence each other in many ways, including an “arms race” of promotion strategies and pricing policies, as well as direct exchange of staff.
- **Sales cycle duration** - A longer cycle will create a team of “farmer” sales people, while a shorter cycle will favour “hunters”. The dominant typology in each company will shape expectations on territory allocation, account tenure, quotas and compensation. Trying to export the Acquirer’s standards on some of these elements without addressing the others will effectively break a fragile balance and cause a rapid exodus of key resources.
- **Initial sale value** - A lower value requires “low touch” repeat transactions, particularly if combined with a longer cycle, and impacts Q2C process requirements. The necessary systems platform offers comprehensive capabilities, a high level of integration both with other internal applications and with portals of commercial partners. Process re-engineering become an enabling factor of the customer integration, while territory and account reassignment is enough to reap first level synergies in cases where the typical sale value is higher.

Figure 1 – Comparing buying behaviors provides insights into Synergies and Fit

	Acquirer	Target	
Target Customers	Large Enterprises above \$1B	Mid-sized Enterprises above \$250M	Similar
Competitors	Company 1, Company 2	Company 3	Different
Business Model	Perpetual licenses, Support	Usage-based subscription model	Different
Delivery Model	On Premise, Server-based	Hosted Cloud	Different
Sales cycle duration	New names: 4 - 6 months	New names: 1 – 3 months	Different
Typical initial sale	\$300k - \$500k	\$100k - \$150k	Similar
Buyer personas	CIO & Procurement	CIO & Business Sponsor	Different
Buying decision	Control and Customization	Reduced TCO and ease of implementation	Similar
Sale type	Business benefits	Business benefits	Identical

- **Sale type** - A technical sale can be more readily outsourced to channel partners around the world, while a solution sale may require a deeper commitment of time and resources that is more suitable for a direct sales force. Similar to a sales cycle duration, the sale type has strong implications on company culture.
- **Revenue elements** - The mix between product and support sales and the respective allocation of sales responsibilities for each can drive organizational differences that otherwise hard to pinpoint. An example of a typical disconnect is a lower commission rate for support renewals. As a high value cash flow, integration teams face a challenge: align commissions upward and raise costs for the same revenue, or lower them and risk increased turnover of Sales high performers.
- **Channel engagement** - Channel mismatches are a common challenge as no two companies deploy commercial partners in the same way across their customer segmentation. Segment level re-alignment becomes more challenging if one company requires demand fulfilment only, and the other expects active business development from their VARs.

Implications for integration

The buying behaviour analysis provides guidance in each of the three typical phases of a Sales integration after close [Fig. 2].

- **Protect the Franchise** – The Acquirer’s priority is to establish revenue continuity, keep the competition out of the installed base, and harvest the existing pipeline with minimal distractions to the Target’s sales force and leadership. The Acquirer should identify the more vulnerable elements of the two Go-To-Market models – recognizing the differences in the customer buying behaviours above - and safeguard the Target from interference.
- **Leverage the Scale** – The two companies have the opportunity to build on each other’s strengths, and to pursue the revenue synergies of the original investment

thesis. The integration team will focus on the commonalities in the customer buying behaviours to pursue revenue synergies. At the same time, the Acquirer will have had an opportunity to review the differences in detail, enlisting the collaboration of Target stakeholders. With a playbook of common solutions, the integration team can start the necessary convergence plans with the buy-in of all stakeholders.

- **Operate as One** - The Acquirer will merge processes, streamline the ERP, operationalize cost synergies, and raise the productivity of the combined entity to the next level. This is the time to reap benefits by addressing differences with the most appropriate mitigation strategies and by building a robust set of processes on top of them. In this last stage, the new leadership team should have answers for all differences in the buying behaviors. In some cases, the solution may be simply to keep the go-to-market efforts separate, supported by an adequate narrative for customers and commercial partners. Overlaid Sales organizations can provide an effective and proven approach for a hybrid integration solution.

Conclusion

Go-to-Market and Sales organization decisions are critical in an acquisition, because they will make-or-break the investment thesis before product integration and other structural decisions have had a chance to impact the augmented entity. The extend of the Sales integration and its timing are tightly linked to how each entity has addressed the specific buying behaviours of their customer base, and what internal culture they have developed to sustain their positioning. We recommend an in-depth analysis of these buying behaviours as a due diligence step, in order for the integration leadership to identify opportunities and pitfalls. The more common risk factors and their implications can be summarized in a simple template for executive review. During the three key phases of a Sales integration, the findings of the buying behaviour analysis will set the tone for structural decisions underpinning organizational stability and synergy capture.

Figure 2 – Phases of Sales Integration

Protect the franchise	Leverage the scale	Operate as one
<ul style="list-style-type: none"> • Retain customers, sales skills • Compare Buyer demography • Pursue separate pipelines • Establish Rules of Engagement 	<ul style="list-style-type: none"> • Align go-to-market and territories • Launch training and SPIF programs • Enable the Channel • Identify top synergy sells 	<ul style="list-style-type: none"> • Merge pipelines, reassign quotas • Integrate back-office processes • Rationalize organization • Actively target for cross-selling

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 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 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 June 30, 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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