US technology deals insights
Q1 2015 update

May 2015

A publication from PwC's Deals practice

At a glance

First quarter deal volumes remained active, while values declined.

Software and IT services sectors drove deal volumes.

Deal activity shifted toward middle market transactions across technology.

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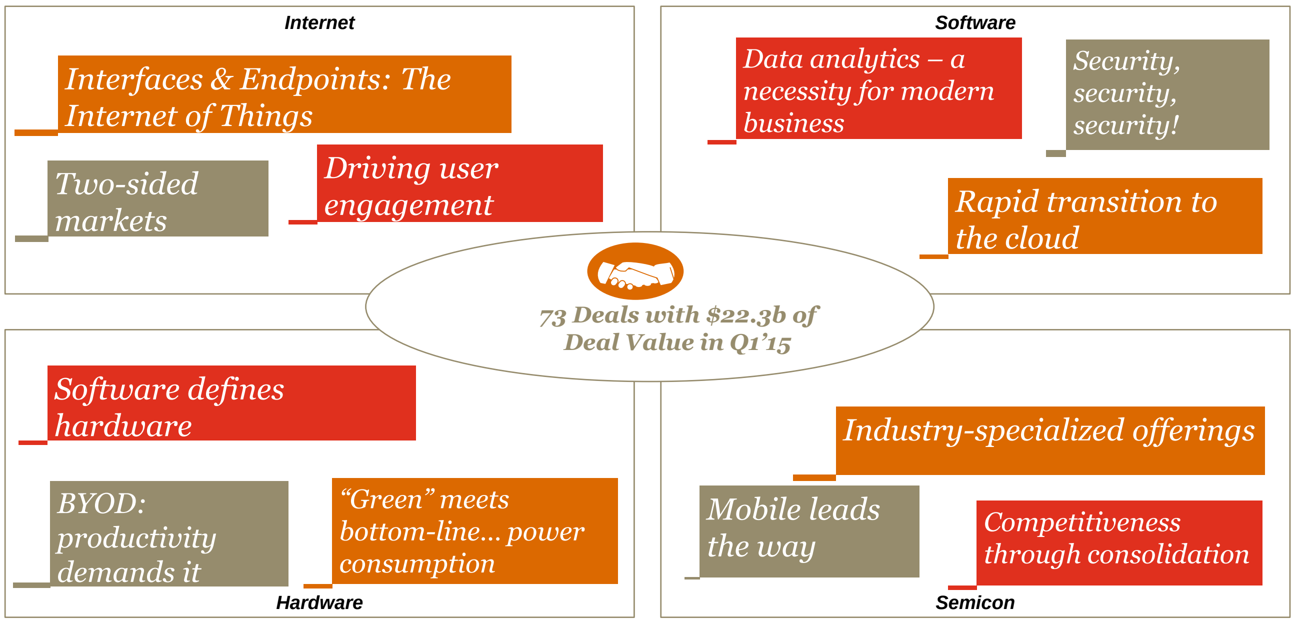
Momentum continues apace with shift toward smaller transactions

First Quarter 2015 Highlights



US technology deal concentration by geography

Technology deal volume remains active amid mixed market conditions

Welcome to the Q1 2015 issue of *PwC's US technology deals insights*. The first quarter maintained the momentum seen over the past several years, albeit a decline from the peaks witnessed at the end of 2014. With a clear return toward the middle market, deal volumes were prominent but megadeals were scarce, resulting in a noticeable decline in total value. Equity markets remained at near-record highs, VC investment exhibited a modest decline, and IPO markets stayed active, although noticeably slower than 2014. The mixed results of the first quarter were in part due to a residual effect from the flurry of activity over the past few quarters and from the companies who are realigning their near-term goals with competitive shifts in the marketplace.

Speaking of mixed results, the global economy fared no better. The headline 3.5% global growth forecast belies significant variation in the outlook for individual constituents. The US remains a bright spot; however the rising value of the dollar has caused the IMF to downgrade US GDP growth estimates to 3.1% for 2015. Similarly, the rising dollar is considered the main driver of lowered IT spending projections, now forecast to decline 1.3% in 2015. In US labor markets, unemployment continued to remain at 5.5%; however, labor participation also remained at a 30-year low of 62.7%, pointing toward an increase in long-term unemployment. As for monetary policy, uncertainty around the timing of interest rate hikes remains subject to debate. While the US Federal Reserve has signalled intentions to increase rates, most economists do not see those taking effect until the latter part of 2015 or after.

Abroad, China's GDP growth contracted again to 7.0%, down from 7.3% in the fourth quarter. Despite being the lowest rate of growth for the nation in six years, many leading economists question the validity of the statistics and speculate even lower growth. Nearby, low oil prices have contributed to a 3.8% contraction in Russia amid ongoing turbulence in Ukraine. On a positive note, forecasters reinforced a 3.5% growth rate in Japan, as well as accelerating growth of 7.5% in India. Europe, on the other hand, remains sluggish; the IMF raised Eurozone projections to 1.5%, with mixed expectations between countries. In other emerging markets, growth forecasts were generally cut, although still expected to surpass that of advanced economies.

US equities rose to record highs throughout 2014 despite sluggish global economic sentiment, and continued to push to new highs shortly after the first quarter of 2015 ended. However, not all boats rose with this tide. The NASDAQ and S&P 500 were up 3.5% and 0.4%, respectively, but the Dow exhibited a slight decline of 0.3%. The top 25 global technology businesses continued to hold increasing war chests of cash, in excess of $370 billion, providing ample ammunition for strategic acquisitions if not diverted to dividend payments and share buybacks at the behest of activist shareholders.

Technology initial public offerings (IPOs) demonstrated a noticeable decline in the first quarter, potentially as a result of competition with growing private markets wherein would-be newly public companies are able to raise large amounts of capital at high valuations. There were 5 total IPOs in the first quarter with $1.3 billion in proceeds, as compared to 13 new pricings in the first quarter of last year and an average of 15 per quarter throughout 2014. One-day returns averaged 13% and current year-to-date returns exceeded 9%, both well-surpassing the overall growth of market indices. New registrations followed suit, with publicly-announced IPO registrations totalling 6 for the quarter.

Cross-border deal activity increased during the first quarter, with US acquirers leading by way of investment into Europe. The software sector continued its historical dominance of deal volume, while the hardware sector posted a notable decline. In contrast, IT Services demonstrated a level of resurgence not seen since mid-2011.

Divestitures exhibited a slight decline in the first quarter, but we expect continued portfolio pruning to contribute to a healthy level of divestitures throughout 2015.

Middle market deals – always the mainstay of technology volumes – are expected to continue, but likely at the smaller end of the spectrum as high-valuation private rounds provide an attractive alternative to M&A exits. Underlying all of these movements, enterprise software and data center systems remain the areas of highest growth potential as cloud offerings continue to pervade the market. While there is no guarantee of a repeat of 2014's record-breaking buying spree, 2015 is poised to continue the longer-term momentum in technology deals.

IT Services leads deal values for the first time

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

Source: Thomson Reuters

Deal volumes and announcements remain active, while values decline and reflect a shift toward the middle market

Key announced transactions

With fewer megadeals hitting headlines during the first quarter of 2015, the number of technology deal announcements mirrored the averages we saw during 2014, one of the most active years in technology M&A in the past decade. Notable during the first quarter was a shift toward middle market transactions, common after a series of large transactions that have altered the competitive landscape while companies revaluate their portfolio offerings. Strategic buyers led the way in the new year while private equity remained active on both the buy and sell side.

During the first quarter, 8 deals in excess of a billion dollars were announced but had not yet closed, including:

- NXP Semiconductor's $11.3 billion acquisition of Freescale Semiconductor, a manufacturer of microcontrollers and digital networking processors.
- CommScope's $3.1 billion acquisition of the Broadband Network Solutions business unit of TE Connectivity.
- Hewlett Packard's $3.0 billion acquisition of Aruba Networks, a wireless networking company.
- The $2.4 billion acquisition of Advent Software, a provider of software products and services, by SS&C Technologies, a financial software provider.
- Bain Capital's $2.4 billion acquisition of Blue Coat Systems, a provider of enterprise security solutions.
- Expedia's $1.3 billion acquisition of Orbitz Worldwide, a global online travel company.

Private equity transactions included announcements from Insight Venture Partners, KKR, Siris Capital, Thoma Bravo, Vector Capital, Vista Equity Partners, and several other firms. On the corporate front – in addition to the large deals noted above – announcements of acquisitions by Adobe, Hitachi, Lattice Semiconductor, OpenText, Sony, and others highlight the broad activity across the technology industry.

Key closed transactions

Closed deal activity in the first quarter carried forward the same level seen throughout 2014, though deals shifted more toward middle market transactions. With 73 transactions completed during the quarter for a total of $22.3 billion, average deal value totalled $305 million, a 27% decrease from $415 million in the first quarter last year. While deal values are virtually incomparable to that of the prior quarter given the number of megadeals, deal values declined 20% compared to that of the first quarter last year.

There were 5 deals closed in excess of $1 billion during the first quarter, a notable decrease compared to an average of 9 per quarter over the last 12 months. Closed billion dollar deals in the first quarter included:

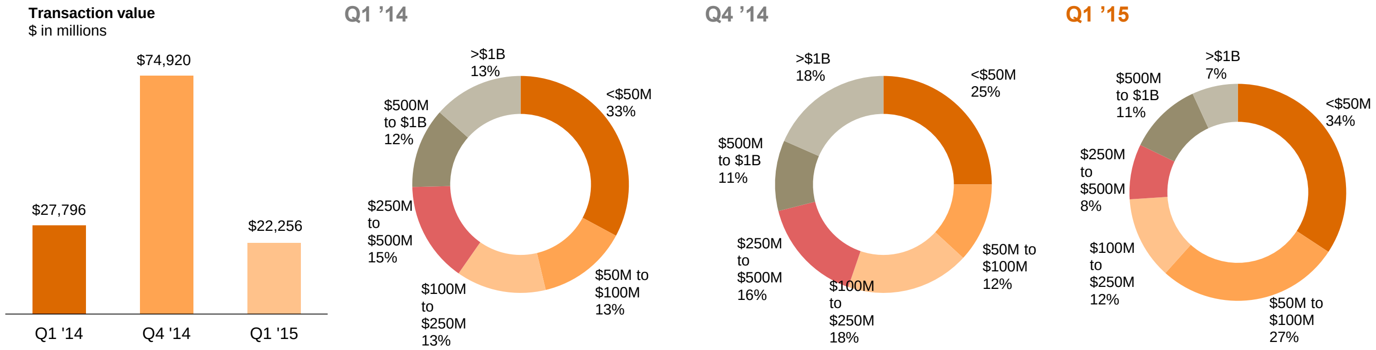
- Publicis Groupe's $3.5 billion acquisition of Sapient Corp., a business, marketing and technology integration services company.
- Infineon Technologies' $3.0 billion acquisition of International Rectifier, a power management semiconductor manufacturer.
- Cypress Semiconductor's $1.7 billion acquisition of Spansion, a semiconductor manufacturer of flash memory and other specialized products.
- The $1.3 billion acquisition of Siemens' health information technology business unit, by Cerner Corp., a healthcare IT services company.
- The $1.1 billion acquisition of TASC, a US-defense IT services and engineering provider, by Engility, also a US-defense services firm.

2015 is poised to continue the long-term momentum in technology deals

Average deal sizes decline from a record 2014, while quarterly volume maintains

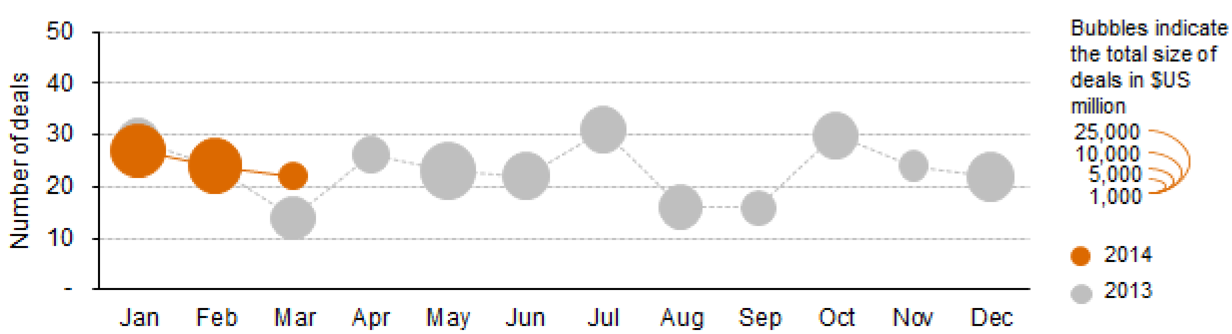
Closed US deals by value

Comparison of total deal value



	Q1 ’14		Q4 ’14		Q1 ’15	
$ in millions, except #	Number of deals	Total deal value	Number of deals	Total deal value	Number of deals	Total deal value
<$50M	22	624	19	548	25	656
$50M to $100M	9	693	9	653	20	1,399
$100M to $250M	9	1,296	14	2,471	9	1,319
$250M to $500M	10	3,673	12	4,298	6	2,127
$500M to $1B	8	5,033	8	6,079	8	5,942
>$1B	9	16,477	14	60,871	5	10,813
Total	**67**	**27,796**	**76**	**74,920**	**73**	**22,256**

US technology deals by month, 2014 and 2015



Source: Thomson Reuters

Software and IT Services drive deal volumes, while Hardware lags behind historical levels

Sector focus

While first quarter deal volume remained at a similar level as the past year, 2015 deal values declined as we saw a notable shift toward middle-market transactions. The software sector remained the most active, at 26 transactions closed with an aggregate deal value of $3.5 billion. Volume grew 13% while deal values declined 85% over the fourth quarter for 2014. As such, average transaction size declined from $992 million in the fourth quarter to $136 million in the first quarter. A sector typically characterized by smaller average deal values than the rest of the industry, the fourth quarter of 2014 was filled with multi-billion dollar transactions, while the first quarter of 2015 fell short of an average quarter over the past few years. Compared to the same quarter a year prior, first quarter activity represented a 37% increase in volume and 57% decrease in value.

The number of Internet deals declined 52% and values followed with an 87% decline compared to the fourth quarter, largely skewed by the $22.0 billion WhatsApp transaction. While deal activity in the sector tends to fluctuate between quarters, the first quarter remained in line with the average seen over the past several years.

Hardware fell to the lowest level since early 2013 as deal volume and values declined 36% and 89%, respectively, in the first quarter. While Q4 2014 closed four separate billion dollar transactions, including Lenovo's acquisition of both Motorola Mobility and IBM's x86 server business, the largest deal in the first quarter was KKR's $551 million acquisition of Pioneer Corp. DJ equipment.

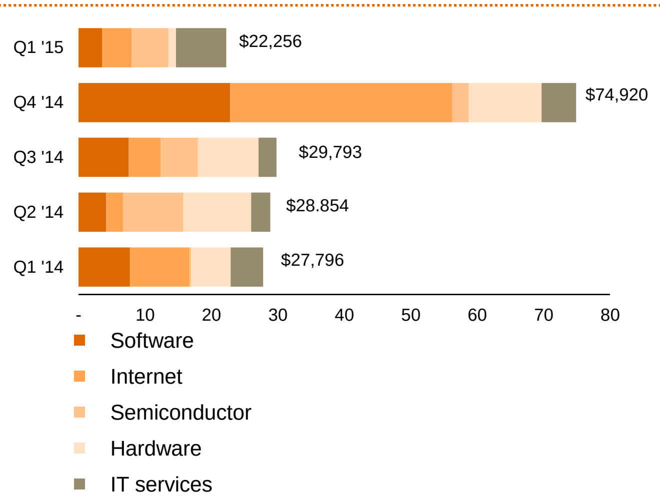
In the semiconductor sector, consolidation continued. Volume remained flat while values more than doubled, largely due to Infineon Technologies' $3.0 billion acquisition of International Rectifier, and Cypress Semiconductor's $1.7 billion acquisition of Spansion.

Last but most notably, IT services volume more than doubled and deal values increased 46%. While there were billion-dollar transactions of similar values in the fourth quarter as well, middle-market deal volumes drove the uptick in deal activity during Q1 2015.

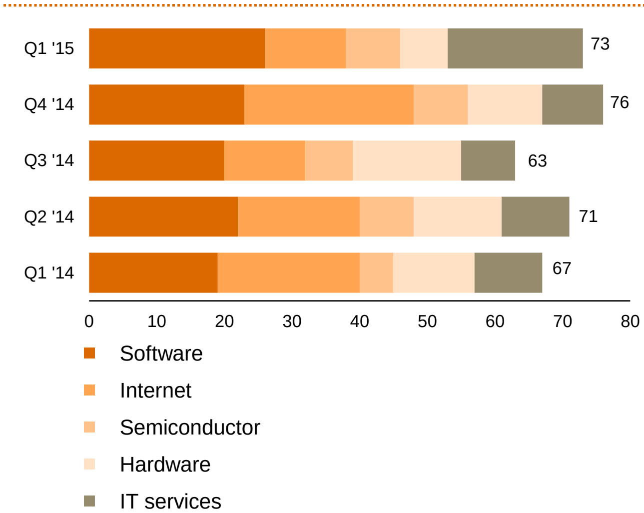
Conclusion

The first quarter of 2015 continued the same cadence we've seen over the past 18 months in terms of transaction activity; however, deal values exhibited a steep decline from the series of megadeals throughout 2014. We expect software to continue to play the most prominent role in technology, and semiconductor consolidation to continue. While appearing slower at first glance, 2015 has started off the year highly active and has set the stage for another interesting year in the technology sector.

Closed deal value by sector, $US millions



Closed deal volume by sector



Source: Thomson Reuters

Focus article

Shareholder Activism: Strategies for mitigating risk and responding effectively

Over the past four years, there has been a substantial increase in shareholder activism. Assets under management by activist vehicles grew from approximately $30 billion in 2008 to over $100 billion in 2014.[1] In 2014 alone, these funds raised $14 billion of new money, which represented 20% of all the inflows into the hedge fund market.[2]

Activists are achieving significant returns for their funds' shareholders and outperforming the market. As a result, there has been a shift in shareholder sentiment. Activists are often no longer seen as villains or corporate raiders. Instead they are viewed as legitimate investors who are seeking broad increases in shareholder value. Today's activists are both sophisticated players and can be successful in exerting influence. They have shown that they can not only propose highly qualified board members, but that they have the clout to get them elected. Activists can also be adept communicators, providing detailed roadmaps for how companies can optimize performance and improve business value.

The increase in shareholder activism has placed many companies on notice, motivating them to become more proactive about examining their portfolios and capabilities and determining what fits both strategically and financially.

The fallout from being targeted

When an activist reveals their interest in a company, the impact is sometimes substantial. For one, management distraction is inevitable. These are public battles that tend to be played out on the front pages of the business press, and the public relations toll can be devastating. When the activist's position is that the management team is underperforming, this can become a self-fulfilling prophecy if management, in an effort to respond, takes its eye off the day-to-day running of the business.

There is also a financial impact. The legal and advisory costs of a proxy battle can soar into the $10 to $20 million range—not including the internal resources and time spent interacting with advisors, which can potentially double the cost. Finally, there is the business disruption itself. Relationships with suppliers and customers can be negatively influenced. Employee morale suffers, and top talent may start heading for the exits. It can also be difficult for management to attract top talent during periods of uncertainty.

On average, it takes about eight months for a full proxy battle to be resolved. Given the associated costs and potential damage that can occur over such a protracted period, it is critical that management make a concerted effort to mitigate the risk of attracting activist attention and prepare for the possibility by assessing exposures, evaluating strategic alternatives, and formulating a response in advance.

Why activists come knocking

There is no typical target profile for activist investors, either in terms of size or industry. Rather, activists are looking for companies where management is either unable or unwilling to address issues that seem apparent to the market, investors, or analysts. There are a number of indicators activists tend to look for (see "Activist targeting criteria"), from poor stock or financial performance to a suboptimal capital structure.

But the story goes beyond financial metrics. For example, when a company has a weak pipeline of new products, coupled with a lackluster track record for innovation, it can become a potential candidate for activists. The absence of a coherent strategy also puts companies in the running. Turnover in leadership is another red flag, and an activist threat can be a particular challenge for an incoming management team, because it can take time for a new team to get its bearings and articulate a strategy. If an activist comes in and tells a better story than the one management is telling, management's hands may be tied before they can throw the first pitch. Of course, transparency, consistent messaging, and open communication are important, regardless of whether management is old or new. Without these, companies can be fairly certain that they have a target on their backs.

Activist targeting criteria

- *Poor market performance* versus peers
- *Poor financial performance* versus peers
- *Lack of new products or innovation* (propensity to update existing products versus bringing new products to market)
- *Lack of coherent strategy* for portfolio of business
- *Suboptimal capital structure*
- *Turnover in leadership*
- *Lack of transparency* and communication

[1] David Benoit, "Activists Are on a Roll, With More to Come," The Wall Street Journal, January 1, 2015.
[2] "Activist funds: An Investor Calls," The Economist, February 7, 2015.

Activist-proofing the organization

A company that can align its strategy with its most important capabilities, optimize its portfolio of businesses, and develop an articulate shareholder communications approach, can not only avoid an activist attack but is well positioned to outperform the competition.

Capabilities-driven strategy

We use a framework called a "capabilities-driven strategy" and a concept that we refer to as "coherence" to illustrate how companies can win in the marketplace. Examining strategy through a coherence lens will surface the same threats and opportunities that are likely to occur to activists. Coherence describes the close meshing of three important elements of a company's strategy: its core value proposition to customers, the products and services that fit within this model, and its capabilities system – the things it is able to do in delivering those products and services to customers that set it apart from the competition.

Capabilities are the glue that holds the business system together, and getting them aligned is extremely important. Capabilities must be a combination of things that, when assembled in a particular way, can be hard to replicate. These can include processes, tools, knowledge, skill sets, human capital, or even how a company is organized. Grouped together, capabilities define the way that work gets done, and they become a part of a company's DNA. And only a handful of capabilities are truly differentiating.

For example, in the food industry, a leading snack food company has built up an efficient direct-to-store delivery system that can reach even the tiniest channels. It uses very small trucks to deliver to outlets such as convenience stores and gas stations, and it has devised a logistics system that allows it to do this economically. Being able to service channels of this size gives the company an enormous amount of control over what goes on the shelf and how much shelf space it gets versus the competition, which uses a different, less accommodating delivery approach.

A number of studies, including several conducted by Strategy&, have concluded that companies with a coherent strategy, and those that factor capabilities into their dealmaking, tend to outperform their peers. This also holds true for companies that choose to split into separate businesses. Such business separations are a sweet spot for shareholder activists, and within the past few years, external pressure on companies to consider separation has increased substantially.

Proactive portfolio optimization

Of course simply describing a strategy is the easy part. Where companies tend to fall down is in effective execution – especially when deciding on the three or four things that matter the most and committing to invest disproportionally in those areas. This is the essence of strategy coherence, and using coherence as the yardstick for determining capital allocation is at the heart of portfolio optimization. Portfolio optimization is also important in dealmaking: Companies should be looking at acquisitions with an eye towards how the target company's capabilities match up with their own and can be used to create value. Finally, one of the most important aspects of portfolio optimization is being proactive. Portfolio optimization can only deliver on its potential as a strategic tool if it is an ongoing activity that can reveal opportunities before they come to the attention of others.

Communication and transparency

Open communication is one of the best antidotes to activist scrutiny. Companies need to start thinking about how they are going to engage with shareholders via more open, two-way forms of communication. In the case of shareholder activists, company management needs to seek them out so they can understand their perspectives and concerns. A chief weapon of activists is their ability to tell a better story than a company's management. Companies that can articulate their strategy – and make a compelling case for why it's the best approach — are far more likely to convince shareholder activists to choose a different hunting ground.

Conclusion

Shareholder activism is on the rise. To avoid disruption, corporate executives need to think like activists. A well-articulated strategy supported by a proactive assessment of the company's existing portfolio is central to this approach. By telling a clear story and openly communicating with shareholders and investors, companies can minimize the risk of becoming an activist target and make sure their strategic agenda remains front and center.

More recently, a number of activists have advocated the divestiture or break-up of one or more business lines as a way to unlock shareholder value and generate cash that can then be allocated to higher-growth areas of the business or returned to the shareholder. Lastly, listed here are the 5 reason for increased activism:

1. *Delivering returns:* and outperforming the market
2. *Market place acceptance:* no longer viewed as corporate raiders but as the good guys, pushing for shareholder value
3. *Sophisticated approach:* highly qualified director nominees, detailed plans for improving value supported by robust analysis and models
4. *Effective messaging:* activists excel at effectively communicating their strategy to the market
5. *Big impact with low investment:* in terms of capital invested and time required to achieve required return

To learn more about shareholder activism, please read:

- www.pwc.com/us/activism
- www.pwc.com/us/en/transaction-services/publications/shareholder-activism.jhtml

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 March 31, 2015, 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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