

US technology M&A insights

Q3 2012 update

October 2012

A publication from
PwC's Deals business

At a glance

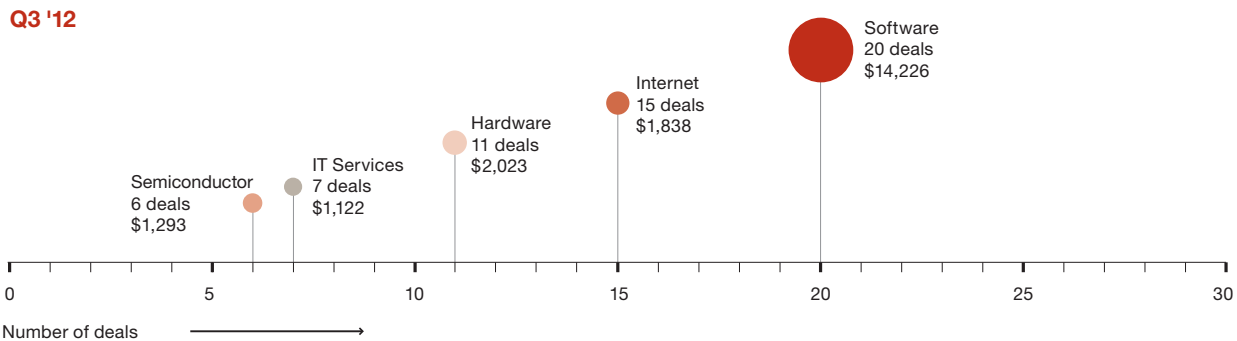
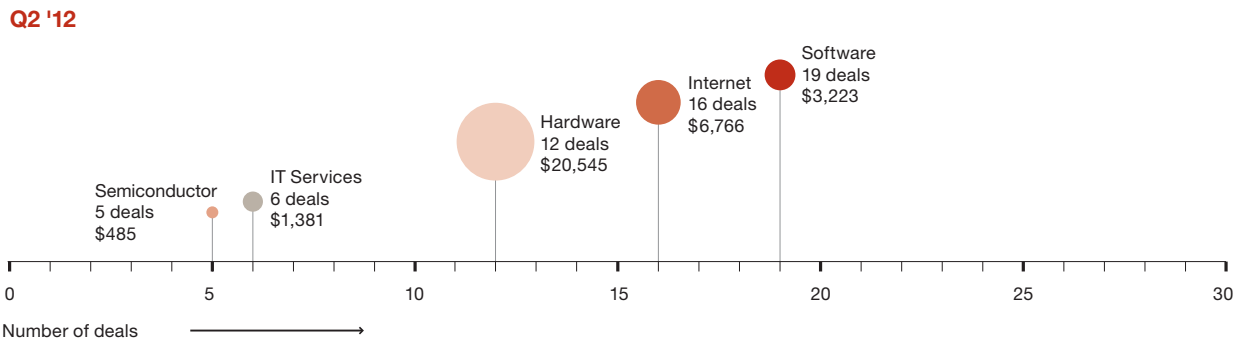
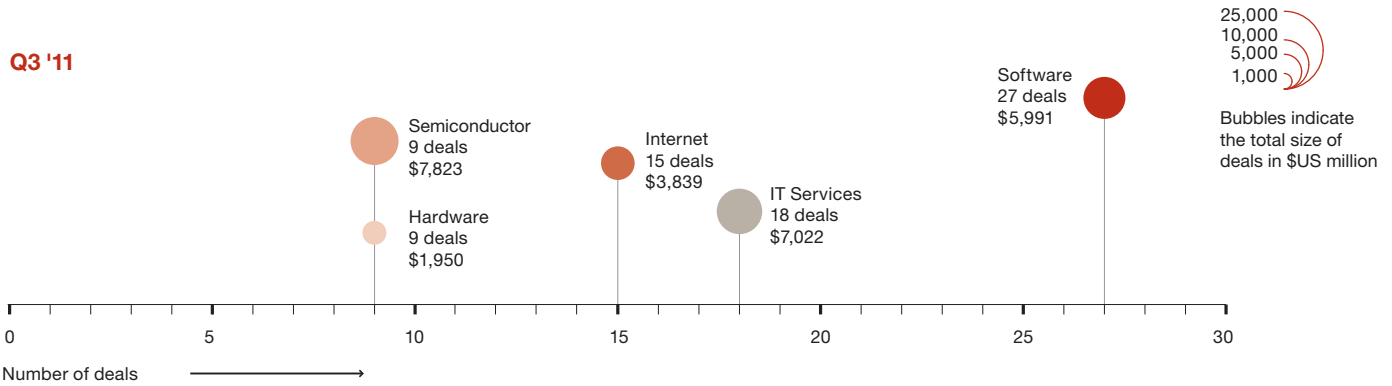
Technology deal volume levels off and deal value drops in the third quarter as larger technology players look inward and remain on the acquisition sideline.

Private equity investors stay active as technology corporates evaluate core product and service portfolios, signaling potential increased deal activity in 2013 spurred by divestitures.

Savvy technology executives looking to shed non-core assets after multiple quarters of consolidation will develop a robust divestiture process to ensure the highest value capture for their business.

Third-quarter deal volume flat compared to second-quarter and deal value down both year over year and sequentially.

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



Source: Thomson Reuters

Technology M&A levels off as larger players look inward, remain on sideline

Welcome to the third-quarter 2012 update of PwC's US technology M&A insights. After a slow decline in mergers and acquisitions (M&A) activity across US industries over the last several quarters, technology deal volume leveled off in the third quarter, hovering around 60 transactions. Once bolstered by a series of mega-deals in excess of \$10 billion, technology deal value decreased in the quarter as activity shifted to the lower end of the spectrum. Smaller IP deals and acqui-hires continued, but for the most part, larger technology players continued to focus on the complexity of their internal operations and thus remained on the acquisition sidelines.

An unusually brutal summer drought got the quarter off to an ominous start with images of yellowing crops and desperate farmers. The markets appeared to take notice with the Dow Jones dipping precipitously early in the quarter only to make up ground starting in August to finish the quarter up 4.3%. Other market indices fared as well with the Dow Jones, S&P 500, and NASDAQ all ending the quarter with year-to-date gains of 10.0%, 14.6%, and 19.6%, respectively.

The rebound was perhaps helped along late in the quarter when the Fed embarked on a third round of quantitative easing, announcing in September a plan for indefinite purchasing of mortgage-backed securities and a commitment to continued low interest rates in an effort to spur the housing and, thereafter, job markets.

Rising consumer confidence and improving housing market data, were not enough to combat continued weak employment data (subsequently revised upwards in October), especially as board rooms turn their attention to the impending fiscal cliff and its potential dire ramifications for the US economy in 2013.

Further weighing on board members' minds were reductions in the outlook for 2012 GDP growth to 6.1%, down from 7.2% in 2011. Primary drivers of the decline included continuing concern that Chinese reliance on exports and a lack of confidence in India's deregulation plans may slow growth in the face of a global reduction in demand. In Europe, the effects of the sovereign debt crisis continue, with most companies now predicting a long, slow struggle for the region's economies in the face of government austerity and low consumer confidence.

Technology IPOs looked ready to suffer a potential drought of their own, with new listings during the quarter still at second quarter levels. Yet, these figures were more impressive in the broader context, with technology listings making up 60% of total IPOs in the quarter. Sentiment on those that did go ahead has been more positive than experienced earlier in the year, in particular with enterprise technology companies such as Palo

Alto Networks notably gaining over 50% since going public.

As has been the case over the past several years, the technology industry has managed to navigate the unsure climate with relative skill. In the US, technology stocks fared well during the quarter with the S&P IT index up 7.0% compared to the S&P 500's 5.8%. Technology multiples are on the rise, spurred on by significant gains from Apple (which, by market cap, became the biggest US company in history) and Google reaching a historic market cap high of \$250 billion, passing that of Microsoft for the first time. For global technology companies, EBITDA multiples grew with the average multiple across the top 25 technology global tech companies increasing from 11.2x in the third quarter of 2011 to 12.8x in the third quarter of 2012.

Despite these positive factors, the technology industry continues to face specific challenges. While the demand for software and cloud-based services continues to grow (driving deals in the Internet and software space), PC sales are stagnant and IT departments are unlikely to receive increased budgets (dragging down hardware and IT services deal activity). Consolidation over the past several years has resulted in a small group of technology majors that are vying for position as the dominant ecosystem for both the enterprise and consumers. This has both reduced the available supply of mega-deal candidates and fueled the volume of smaller, IP-driven deals in the sector.

With no near-term end to the economic uncertainty in sight, and a pending US election that could have far reaching impacts on the business environment, we do not expect transformational deals to fill the headlines in the last quarter of 2012. Rather, look for technology companies to continue to focus on efficient delivery of their core offerings, investment in / acquisition of the next wave of innovative technologies, and evaluation of strategic alternatives for those portfolio products and services that are no longer core to their operations. In short, more of the same mid-market transaction volume with limited mega-deal activity through the end of the year, to be followed by a potential resurgence in larger transactions at the start of 2013.

Amid global economic turmoil, technology players will focus on core strengths and the next wave of innovative technologies to buy or build

Key announced transactions:

The third quarter of 2012 witnessed a decline in the number of deals in excess of \$1 billion completed or contemplated during the quarter. A small number of large corporate acquisitions greater than \$1 billion were announced in the quarter, including:

- Micron's \$2.5 billion offer to acquire troubled DRAM manufacturer Elpida Memory after the Japanese company filed for bankruptcy in February 2012.
- IBM's \$1.3 billion acquisition of talent management and recruiting company Kenexa Corporation. This will be the third major talent management software provider to change hands this year, following the acquisition of Success Factors by SAP and Taleo by Oracle.

Private equity firms proved to be an active player in the technology market, highlighted by several of the largest transactions announced during the quarter. PE deals in excess of \$1 billion announced during the quarter include:

- The Carlyle Group's \$3.3 billion acquisition of Getty Images, an online distributor of digital images and other media, from Hellman & Friedman. The hand-off from Hellman & Friedman to Carlyle represents the largest announced private equity deal of 2012.
- Blackstone's acquisition of Vivint Inc., a Utah-based provider of technology-based home automation and security systems, for over \$2 billion.
- Thoma Bravo's planned take-private transaction of Deltek, Inc, a niche ERP developer, for \$1.1 billion. In the same quarter, Thoma Bravo announced plans to acquire Mediware Information Systems, a healthcare software developer, for \$195 million.

In addition to these and other announced acquisitions, and consistent with activity in the second quarter, technology companies continue to employ alternative investments through joint ventures and smaller stakes in key interests.

Key closed transactions:

The volume of technology deals closed in the third quarter of 2012 was up marginally (2% increase) compared to deals closed in the second quarter and decreased 24% compared to deals closed in the third quarter of 2011. While cumulative quarterly deal value for the last eight quarters has been at or exceeded \$25 billion, the third quarter deal value dropped to \$20.5 billion, the result of fewer large acquisitions.

Deals during the third quarter shifted to transactions below the \$100 million mark, with such deals comprising 59% of transaction volumes. Average deal value of \$347 million for the quarter fell from the high levels experienced in the previous three quarters in the wake of several mega-deals and returned to levels typical of 2010 and 2011, which hovered around \$300 million.

Six deals greater than \$1 billion closed in the third quarter, the same volume as the second quarter, with total value of \$12.3 billion, a 47% drop from the second quarter.

The largest transactions closing in the quarter include:

- Cisco's acquisition of NDS Technologies, a provider of software to the satellite television industry, for \$5 billion. The NDS acquisition represents Cisco's largest acquisition since 2006.
- Dell's \$2.4 billion acquisition of Quest Software, a developer of application and database management utilities. This is Dell's sixth acquisition this year, following AppAssure, SonicWALL, Wyse, Clarity Solutions, and Make Technologies.
- Roper Industries' acquisition of laboratory software developer Sunquest Information Systems for \$1.4 billion.
- VMWare's acquisition of Nicira, a pioneer in software-defined-networking, for approximately \$1.3 billion.
- Microsoft's acquisition of Yammer, an enterprise social media platform, for approximately \$1.2 billion.
- The \$1 billion acquisition of Paradigm Ltd, a developer of software for the oil and gas industries, by Apax Partners and JMI Equity.

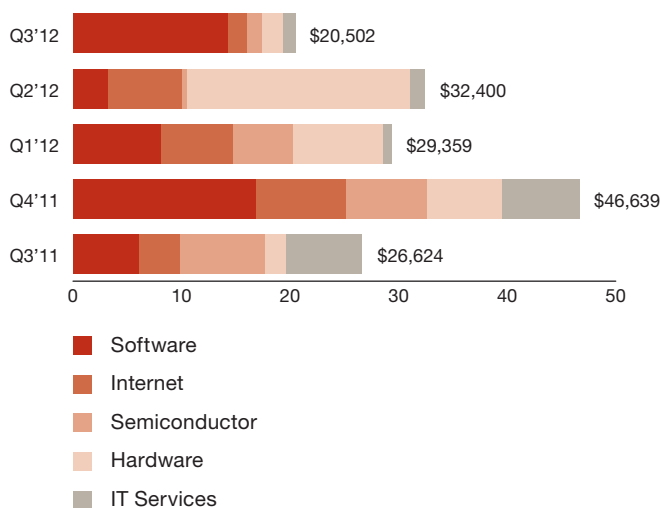
The third quarter seemed to place an exclamation point on the shift away from transactions in the hardware and traditional manufacturing-based technology businesses, as software and cloud-based companies dominated deal activity for the period generating a significant portion of deal value. Software and Internet transactions comprised 59% of deal volume and 78% of deal value in the quarter, representing the same number of transactions and a 61% increase of total deal value for the two sectors over the second quarter of 2012.

The hardware, semiconductor, and IT services sectors continued at similar transaction volume levels as the second quarter but dropped to 22% of total deal value for the quarter. As some of the large technology companies, evaluate their portfolios of hardware offerings and seek out potentially higher-margin software and service offerings, a wave of new acquisitions could be on the horizon as these traditional businesses exchange hands and new acquirers look to take advantage of potential cost efficiencies.

Conclusion

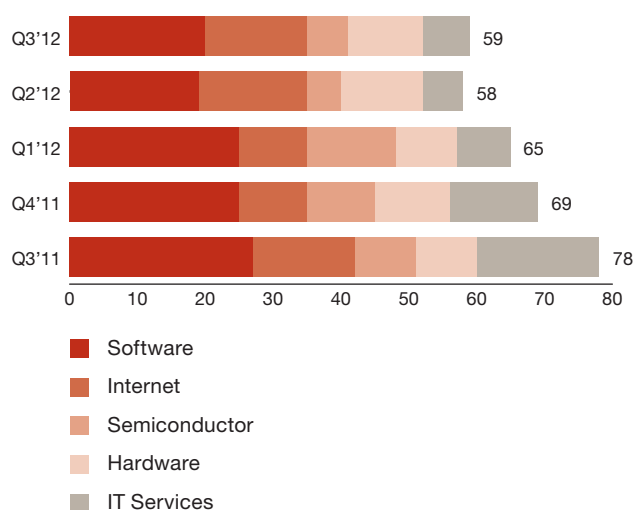
As has always been the case, a myriad of factors will combine to influence US technology M&A activity in the coming months. If financial markets stabilize post-election and the threat of a fiscal cliff is lifted, the IPO route may be back on the table for those VC-backed companies who have been holding on for better times, providing an alternative to traditional M&A. Rumblings of spin-offs and divestitures that may ultimately come to market after several quarters of corporate strategic evaluation could generate another wave of deal activity. As a result, we reiterate our view that mid-market activity, especially in the Software and Internet sectors, will continue unabated while mega-deals are more likely to wait until 2013.

Closed technology deal value by sector, \$US millions



Source: Thomson Reuters

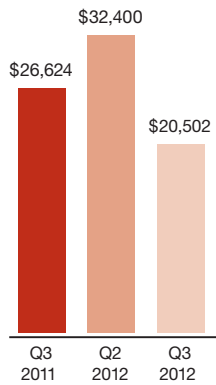
Closed technology deal volume by sector



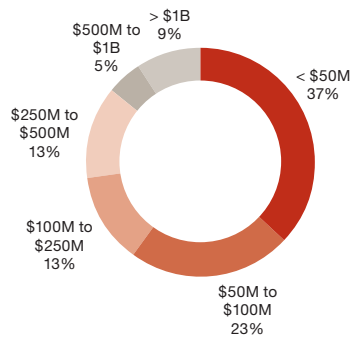
Closed US technology deals by value

Comparison of total deal value

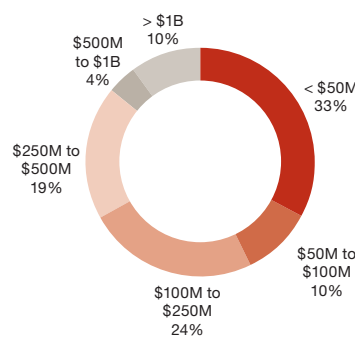
Transaction value
\$ in millions



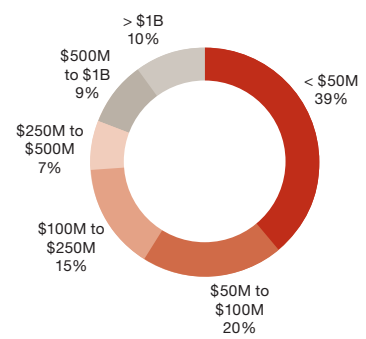
Q3 2011



Q2 2012



Q3 2012



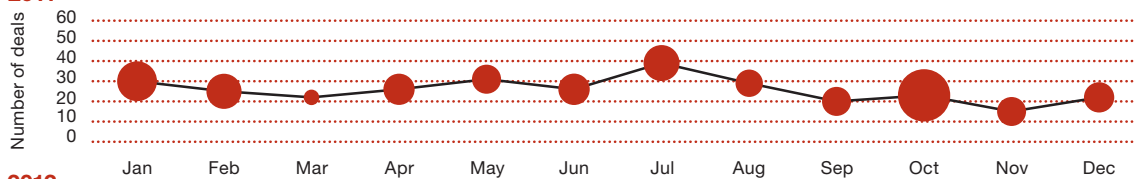
Source: Thomson Reuters

In USD million, except # of deals	Q3 2011		Q2 2012		Q3 2012	
	Number of deals	Total deal value	Number of deals	Total deal value	Number of deals	Total deal value
< \$50M	29	\$821	19	\$598	23	\$697
\$50M to \$100M	18	\$1,247	6	\$413	12	\$856
\$100M to \$250M	10	\$1,665	14	\$2,322	9	\$1,401
\$250M to \$500M	10	\$3,583	11	\$4,013	4	\$1,393
\$500M to \$1B	4	\$2,385	2	\$1,725	5	\$3,856
> \$1B	7	\$16,923	6	\$23,329	6	\$12,299
Total	78	\$26,624	58	\$32,400	59	\$20,502

Source: Thomson Reuters

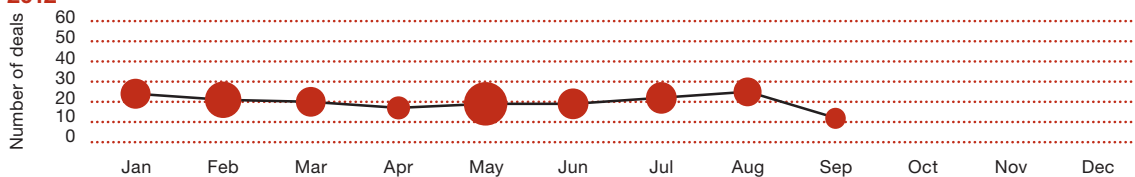
US technology deals by month

2011



Bubbles indicate the total size of deals in \$US million

2012



Source: Thomson Reuters

About PwC's Deals practice

Our deals professionals help clients understand the risks in transactions, so they can be confident they are making informed strategic decisions. From their deal negotiations, to capturing synergies during integration, we help clients gain value; and ultimately, deliver this value to stakeholders. For companies in distressed situations, we advise on crisis avoidance, financial and operational restructuring and bankruptcy.

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 divestiture process.

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 October 1, 2012, 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.

Spotlight article

Driving Divestiture Success—The 5 Critical Components

As noted in this and several of our recent quarterly M&A Insights documents, divestitures and divestiture planning activities are on the rise and expected to be primary contributors to deal volumes in the coming year. Divestitures are inherently difficult to execute, which makes it challenging to preserve value across the lifecycle of a transaction. Whether you are the parent company looking to dispose of assets or a buyer acquiring those assets, five separation fundamentals drive alignment between buyers and sellers, enhance the pace of separation activities, and contribute to a successful separation. These five separation fundamentals are:

1. Establish a Divestiture Management Office (DMO):

A DMO is the command center for driving the divestiture approach and processes across the different separation workstreams, the deal team, and executive decision makers. It is the hub for coordinating activities and resources across functions for both the seller and carve-out business. Having a DMO in place enables rapid decision making, allows for the timely identification and prioritization of issues and dependencies, and helps drive standardization across different separation workstreams through the deployment of standards, policies, guidelines, and tools across the divestiture. The DMO assembles, coordinates, tracks, monitors, reports, and distributes key project information across the lifecycle of the separation.

2. Develop the Target Operating Model: The Target Operating Model (TOM) defines the “to be” state of the parent and carve-out business through each phase of the transaction to their respective end states. Common divestiture phases include pre-signing, sign to close, close, transition, and ultimately complete separation.

Both sellers and buyers should focus on core infrastructure elements to understand the degree of change driven by each phase of the transition. At a high level, the core elements and questions to get to the TOM include:

- *Organization*—How does the organization of the parent and carve-out business evolve?
 - *People*—How are employees of the parent and carve-out business impacted?
 - *Processes*—Which processes of the parent/carve-out business are impacted and how do these need to change to support continued operations of the parent and carve-out business?
 - *Technology and Data*—Which systems of the parent/carve-out business are impacted? What changes need to be put in place to support continued operations of the parent and carve-out business? What data is needed to support the parent and carve-out business?
 - *Assets and Facilities*—How and when will assets, liabilities, and facilities be segregated?
- It is critical for both the parent and carve-out business to understand the changes brought with each transaction phase. Developing a TOM helps both the buyer and seller plan and assess the impacts of how they will operate during each phase and will also provide a roadmap for what activities need to be completed by phase.

3. Define Transition Service Agreements (TSAs): TSAs provide a robust definition and costing of services the seller will provide to the carve-out business in order to sustain operations after legal close until it is fully integrated into the buyer or operating on a stand-alone basis. TSAs offer several advantages to both the seller and buyer:

- *Faster close*—A TSA can accelerate the negotiation process and financial close by allowing the deal to move forward without waiting for the buyer to assume responsibility for all critical support services.
- *Smoother transition*—Although the time between announcement and close is often driven by the size of the deal, in many cases, the buyer does not have enough time to respond to the separation process, particularly when there are anti-trust concerns or confidential information that cannot be shared until after the deal closes. TSAs can become a vital part of allowing the business to transition or separate quickly.
- *Reduced transition costs*—Since the seller supports critical services for an agreed upon duration, the buyer is able to not only spread out, but often reduce, transition costs of supporting those services in-house.
- *Better end-state solutions*—The knowledge transfer process is gradual, giving adequate time to the buyer’s employees to take over the services.
- *Reduced risk*—TSAs are a legally binding obligation for the seller to complete the separation post close and after the purchase price has been paid, thereby minimizing legal and commercial exposure to both buyer and seller.

4. Establish a robust Financial Model: A detailed financial model not only captures GAAP and deal information, but also fully considers stranded-costs, transition costs, and one-time separation costs. While carve-out financial statements are critical for providing a true picture of the business being sold, it is equally important for the seller to understand the true nature of the costs required to separate and to stand up the carve-out business as an independently operating entity. Savvy buyers will develop their own models during diligence and pressure test the seller’s assumptions. Establishing a logical, data driven point of view will help bring quicker alignment between the seller and buyer.

It is also important for the seller to understand any stranded costs associated with the carve-out that will remain upon expiration of TSAs. Sellers will also need to understand the accounting implications associated with any post-separation restructuring.

5. Develop a change management and communication plan: Having a change management and communication plan in place for key stakeholders pre-announcement and then for each transaction phase is critical to overall transaction success. Considerations include:

- *Employees*—Messaging for employees who are part of the carve-out business as well as those remaining with the parent is important. Often an element of value is associated with retaining employees, and having proper messaging in place will help to keep people in their seats.

Be prepared to address labor issues and any collective bargaining agreements.

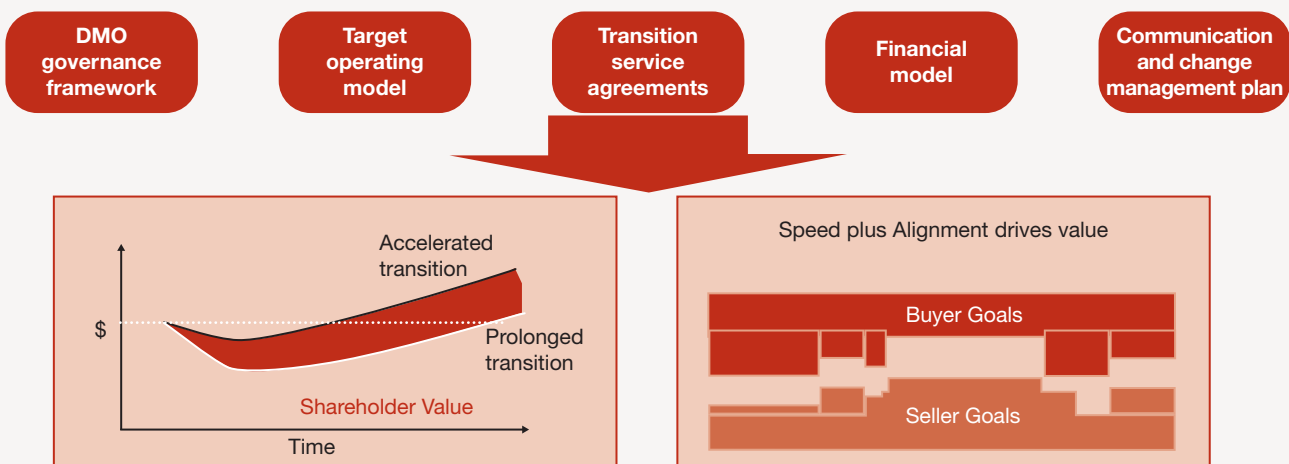
- *Vendors/suppliers*—Be prepared to work with vendors/suppliers to duplicate or assign contracts required by the carve-out business. Have a plan in place to address the likelihood vendors will use this as an opportunity to obtain more favorable pricing or terms.
- *Customers*—Articulating the value and impact of the transaction to customers is critical, particularly for the customers of the carve-out business. Customers will want to understand how service levels, quality, future product development, and overall support will be impacted. Not having a robust plan in place can lead to lost revenue with existing customers and impact in-flight deals or the acquisition of new customers.

Conclusion

Together these five components help make sellers more agile and informed, enabling them to bring their perspective to the buyer, highlighting sources of value and demonstrating they thought through risk associated with the transition. Buyers will engage more effectively with a prepared seller, which will lead to a more constructive separation process. Ultimately the transaction timeline will be accelerated through alignment around key transaction elements and will result in enhanced value for both parties.

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The five critical components of successful divestitures



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