

US technology deal insights

Q3 2013 update

October 2013

*A publication from
PwC's Deals practice*

At a glance

Third-quarter deal announcements rise as closed deal activity returns to historical levels and deal value reaches \$27.7 billion

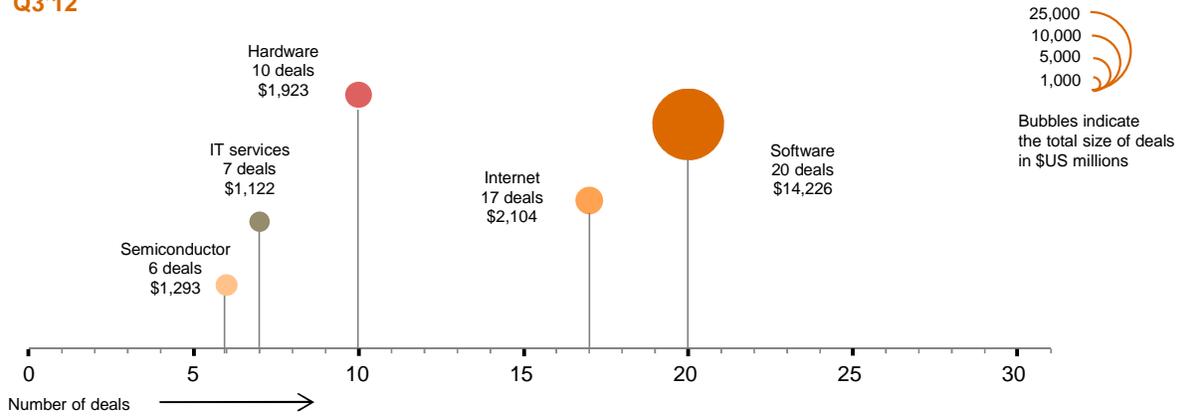
Private equity buyers take a more active role in technology M&A, with increased deal closures and numerous new deals announced

Rising deal volumes and values signal an increase in deal activity to close out 2013, with software returning to lead the charge after a temporary dip in volumes

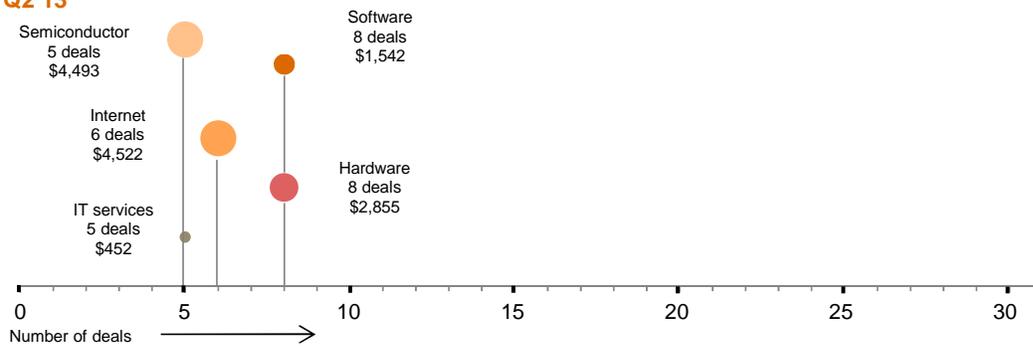
Technology transaction volume doubles the second quarter and returns to 2012 levels

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

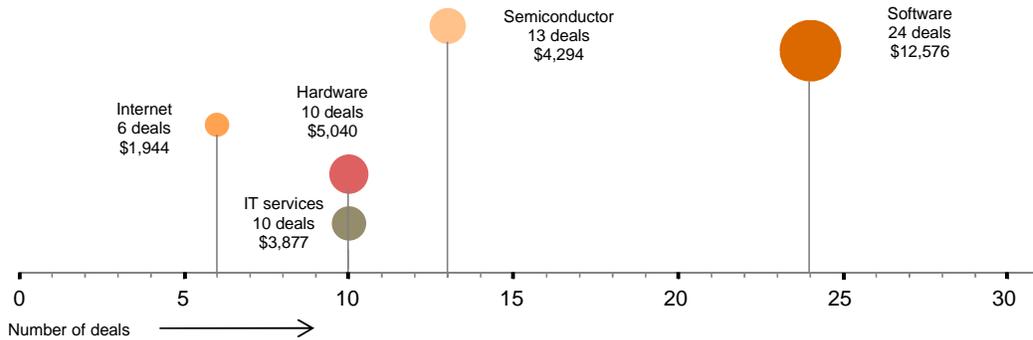
Q3'12



Q2'13



Q3 '13



Source: Thomson Reuters

A return to form as deal activity picks up pace and momentum builds for the remainder of 2013

Welcome to the third-quarter 2013 issue of PwC's *US technology deal insights*. After technology M&A activity stumbled along in the first half of 2013 amid a fog of market uncertainty, the third quarter brought clearer skies for technology deals, which accelerated the pace during the quarter. Along with the rise in volume of deals, increased IPO activity and robust market growth for US equities helped drive a level of positivism that was missing earlier in the year. All the while, interest rates remained low as the US Federal Reserve unexpectedly continued its bond buying program helping the US housing market to continue its rise and consumer confidence to be maintained. Cash balances at serial corporate acquirers continued to grow, private equity funds put some of their dry powder to use as both scoped out new opportunities, helping drive a jump in announced deals during the quarter and signaling improved deal activity as 2013 comes to a close.

Despite these positive signs, the third quarter was not without its challenges. Equity markets fluctuated during the quarter on concerns about war in Syria, US bond markets returned persistently low yields, and although unemployment rates remained steady at below 8%, concerns about the participation rate continued to hamper growth estimates. Earnings growth for the information technology sector was also hindered, dropping from 5.0% to 1.2% for the third quarter. The general slump in computer sales and IT spending has taken its toll on earnings and projections of continued declines may force participants to re-evaluate strategic plans to garner a larger share of the smaller pie.

Abroad, economists pointed to a slowdown in the growth rates of emerging economies as wages continued to rise with a growing middle class. With growth still projected in the high single digits for most BRIC countries, however, expansion opportunities in these countries remain a focus of US and European businesses. With continued quarterly declines in GDP in the Eurozone, deal activity in Europe has remained slow. While it is potentially on the mend, we are not likely to see a large increase in European deal activity in the near future. Rather, the United States and China are expected to drive global technology deals for the remainder of the year and into 2014.

Economic and earnings difficulties abroad have not undermined faith in the growth potential of the world's technology leaders if evidenced by trading multiples that

continued their rise after substantial growth in the last six quarters. The top 25 global technology businesses increased average enterprise-value-to-EBITDA multiples from 12.2x to 13.6x between the second and third quarters of 2013 on rising markets.

US Equities, once again, set record highs, with the Dow Jones, NASDAQ, and S&P 500 rising 1.5%, 10.8%, and 4.7%, respectively, by quarter end. Suffering a few losses at the end of the quarter with a looming government shut down, the markets closed out the quarter slightly down from their highest point. The continued growth in equities helped fuel additional technology initial public offerings (IPOs), which remained on par with the second quarter, adding 14 new pricings with proceeds exceeding \$1.3 billion. Technology IPO average one-day returns of 35% beat nearly all other industries, reaffirming long-term growth prospects for the industry. 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.

Despite this competition from the equity markets, technology deal activity returned to 2012 levels. Volume within the industry returned to relative historical distribution across sectors, with software deals returning strong to generate over a third of deal volume and nearly half of deal value during the quarter. As all technology sectors converge to deliver on-demand access to the technology tools that have become an integral component of our business and personal lives, we'll see continued volatility between the sectors.

While deal activity during the first half of 2013 struggled, the substantial increase in third quarter closed deals and new announcements points to a stronger finish to 2013. Amid this trend, the number of divestitures increased during the quarter, and while such transactions require more preparation and time to close, they may drive an increase in deals over the next 6 – 12 months. We expect this second-half momentum to carry over into stronger deal activity in the coming year.

Increased deal announcements and deal closures in the third quarter signal a strong finish to 2013

Closed transaction volumes increased 97% and value increased 100% versus Q2

Key announced transactions

Similar to the increase in the number of closed transactions, the number of third-quarter announcements grew substantially, paving the way to finish 2013 strong. Private equity funds played an active role in third-quarter M&A announcements, with Vista Equity Partners alone announcing three transactions totalling more than \$2 billion in deal value. The on-going negotiations on the Dell transaction seem to have finally come to an end, as shareholders approved the \$25 billion buyout by Michael Dell and Silver Lake Partners, which is expected to close in the fourth quarter, driving deal value totals to new heights.

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

- Privately held Koch Industries' \$7.2 billion acquisition of public electronics component manufacturer Molex Inc.
- Microsoft's proposed \$5.0 billion acquisition of a majority of Nokia's Devices & Services business, along with a \$2.2 billion payment to license its patents.
- A consortium deal, led by current BlackBerry investor Fairfax Capital, to acquire BlackBerry for \$4.7 billion.
- Cisco's agreement to acquire Sourcefire, a cyber security solutions provider, for \$2.7 billion, followed by the smaller acquisition of Whiptail for \$415 million.
- San Francisco-based Vista Equity Partners' \$1.0 billion acquisition of ActiveNetwork, in addition to acquisitions of Omnitracs from Qualcomm for \$800 million and Greenway Medical Technologies for \$644 million.

Other private equity transactions include announcements involving deals with TPG Capital, Sailing Capital Management, Equistone Partners, Warburg Pincus, Bain Capital, and several other firms. On the corporate front, in addition to the large deals noted above, announcements of acquisitions by Apple, Broadcom, EMC, SAP, and others are indicative of the increasing trend of technology deal activity.

The substantial increase in technology deal announcements during the third quarter, nearly doubling those of the second, provides ample reason to expect that the remainder of the year will be equally active as companies seek to close deals before the end of the year.

Key closed transactions

After a slow start to deal activity in the first half of 2013, the number of technology transactions rebounded during the third quarter, increasing 97% over the second quarter. Volume returned to 2012 levels with the number of deals relatively flat compared with a year ago, up 5% on volume and 34% on value thanks to a number of large transactions closed. The quarter ended with 63 transactions completed, closely in line with quarterly averages in 2012. Average deal value increased to \$440 million, up from \$253 million in the first quarter and \$433 million in the second quarter. Although increasing in number, the volume of deals in excess of \$250 million as a percentage of total deals remained relatively consistent with that of the second quarter, at 33%. Underlying the increase in sizable transactions was an increase in deals less than \$50 million. Deals of this size rose to 24 transactions in the quarter, the largest since the third quarter of 2011.

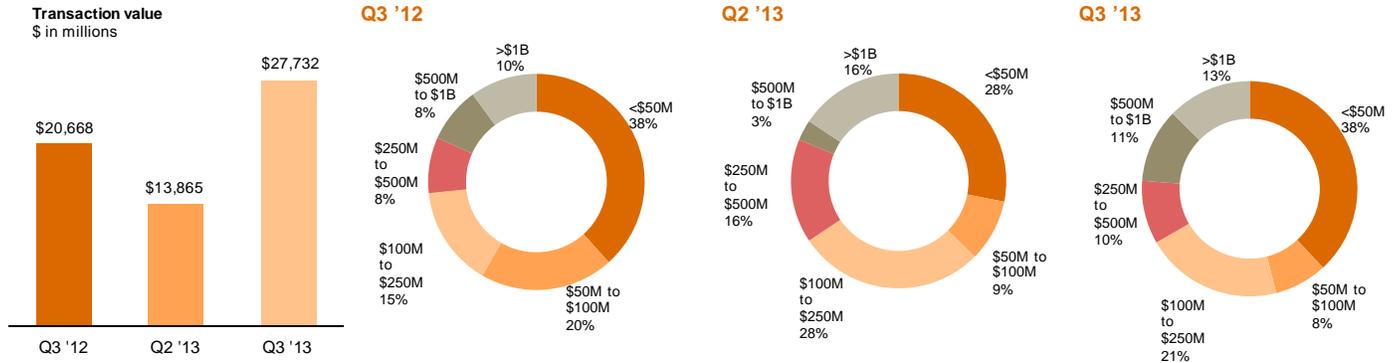
Deal value during the third quarter totalled \$27.7 billion and doubled that of the second. A total of eight transactions in excess of \$1 billion closed, including:

- The Bain Capital-led \$6.9 billion acquisition of BMC Software, which closed in September.
- Salesforce.com's \$2.2 billion acquisition of ExactTarget, a provider of a cloud-based digital marketing platform.
- Micron's long-awaited \$2.5 billion acquisition of Elpida Memory, a Japanese DRAM manufacturer publicly auctioned during the first half of 2012.
- IBM's \$2.0 billion acquisition of SoftLayer Technologies, a cloud computing infrastructure company.
- Information analytics provider IHS's acquisition of automotive market intelligence provider R.L. Polk for \$1.4 billion.
- The acquisition of Harland Financial Solutions, a technology provider to the financial services industry, by Davis & Henderson for \$1.2 billion.

Private equity funds directly acquired a total of five companies in the third quarter and backed an additional 12 via acquisition through wholly-owned portfolio companies or via divestiture of an existing portfolio business. Private equity activity is on the rise and expected to continue through the remaining months of the year.

Closed US deals by value

Comparison of total deal value

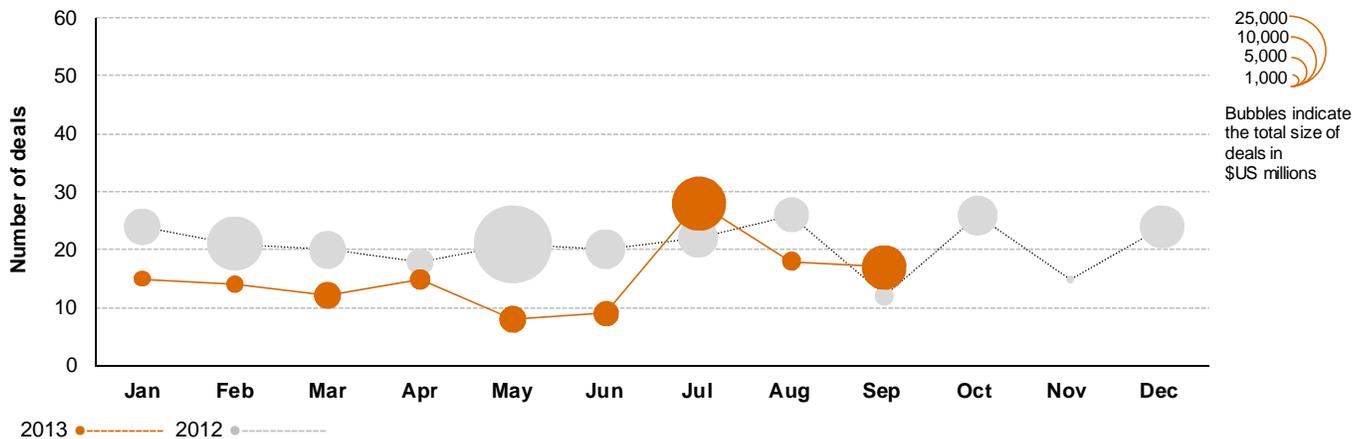


Source: Thomson Reuters

\$ in millions, except #	Q3 '12		Q2 '13		Q3 '13	
	Number of deals	Total deal value	Number of deals	Total deal value	Number of deals	Total deal value
<\$50M	23	697	9	187	24	610
\$50M to \$100M	12	856	3	193	5	325
\$100M to \$250M	9	1,401	9	1,104	13	1,882
\$250M to \$500M	5	1,773	5	1,690	6	2,190
\$500M to \$1B	5	3,642	1	986	7	4,456
>\$1B	6	12,299	5	9,706	8	18,269
Total	60	20,668	32	13,865	63	27,732

Source: Thomson Reuters

US technology deals by month, 2012 and 2013



Source: Thomson Reuters

Deal activity rises across sectors, with software leading the way

Growth in third quarter deal activity was driven by the software sector, recovering from a temporary drop in activity during the second quarter. Software deal volume tripled that of the second quarter and climbed to levels equal to those of 2011 and the first quarter of 2012, with 24 transactions closed. Deal value also increased 716% over the low value of deals in the second quarter, but was still down 12% from a year ago. Historically the most active sector, software transactions led the industry thanks in part to several billion-dollar transactions resulting in software transactions making up 38% of total deal volume and 45% of deal value in the third quarter. Companies from other technology sectors, as well as businesses outside of the technology industry, continue to leverage innovative software tools to expand and improve their product offerings. With software-driven products and services, M&A in the sector will remain at the forefront of deal activity.

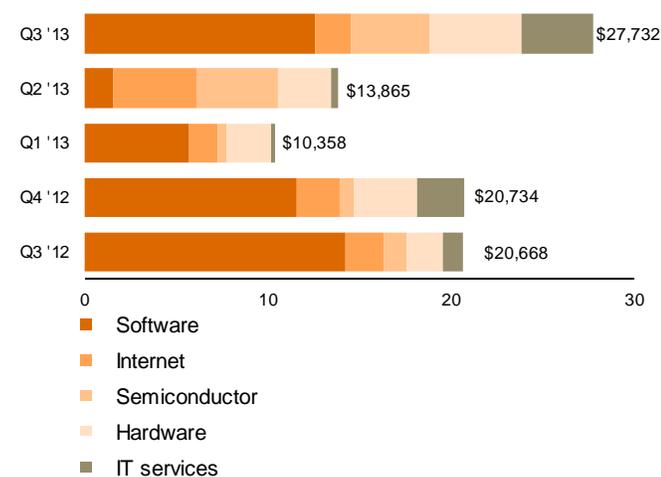
The number of Internet deals remained flat, and total deal value dropped as the third quarter saw only one deal in excess of \$1 billion closed, after a quarter of Internet transactions driven by the acquisitions of Waze, Tumblr, and KAYAK. While traditional software businesses identify ways to deliver services via the Internet, the lines between software and Internet transactions continue to blur.

While deals in the IT services, hardware, and semiconductor sectors all increased, their impact on total deal volume and value varied during the quarter. The number of IT services deals doubled in the third quarter, but deal value increased 758%, driven by two deals in excess of \$1.0 billion. Hardware volume increased 25%, but value increased 77% to \$5.0 billion due to a series of transactions in excess of \$500 million closed during the quarter. Semiconductor deal activity grew 160%, to 13 transactions, during the third quarter, but, with a lower average deal price, transaction value decreased 4% to \$4.3 billion.

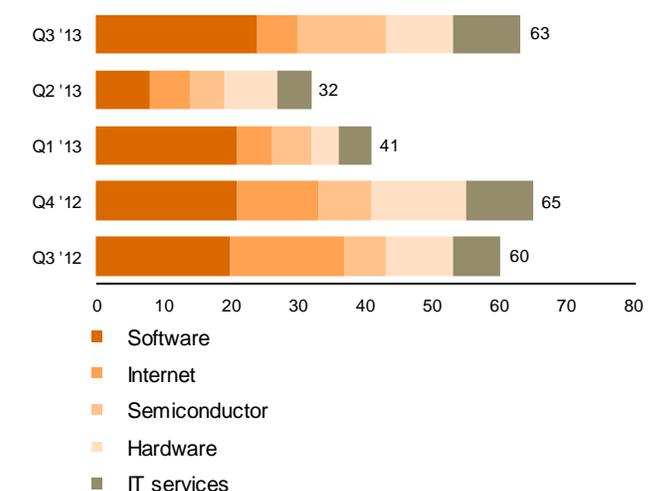
Conclusion

After a slow start to deals during the first half of 2013, the third quarter demonstrated strong growth in both volume and value and put technology on an upward trajectory for the fourth quarter. Despite some mixed sentiment on the US and world economies, rising US equity markets provide substantial opportunity for both deals and IPOs, and corporate technology giants remain rich with cash. A shifting IT landscape continues to cause executives to search for the right innovation to ignite growth, and the abundance of cash at home and overseas provides ample funding to drive deals in the months and quarters to come.

Closed deal value by sector, \$US millions



Closed deal volume by sector



Source: Thomson Reuters

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 October 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 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.

Focus article

Unlocking product development opportunities in M&A

Research and development (R&D) organizations and the products and intellectual property (IP) they develop are critical sources of value in deals, especially for technology-based companies. Many deals in the technology sector are done solely to gain access and ownership of R&D functions, products, and IP.

No matter what the rationale of the deal, most technology-based companies respect and highly value the R&D organization, making it a key priority in the deal. Restructuring the development organization, retaining key talent, rationalizing products, and maintaining delivery of key projects are the most common areas prioritized during the deal process. However, considerations should also be given to how development portfolios can be rebalanced, how technology platforms and IP can be leveraged, how product complexity can be reduced, and how product development can be accelerated.

Assessing and integrating an R&D organization is as much art as it is science. The successful launch of products requires a blend of invention know-how, development commercialization savvy, and knowledge of the underlying technologies. The right approach and a qualified team can help ensure that the value of the development organization is maximized in a transaction.

Planning for and executing integration of R&D, products, and IP

Depending on the deal situation, R&D information may not be readily available before the close of the transaction. Typically, target technology companies' R&D organizations are reluctant to share, or legally prohibited, from sharing detailed product strategies and roadmaps until after close due to IP protection concerns and anti-trust laws. Given this common limitation, integration teams should be in a position to quickly mobilize a robust methodology to rapidly assess and execute critical areas (see Table 1) on day one of integration.

Design and maximize future-state product development operations

R&D leadership and the integration team should focus on three primary areas:

1) *Create a blueprint for the future operating model* – The blueprint typically consists of an R&D organization structure, a site footprint, development process and

governance, partner strategy, and infrastructure (tools, systems, labs). In situations where R&D organizations are combined, a coordinated set of development procedures, metrics, and tools should be deployed.

2) *Create an integration plan and transformation roadmap focused on the “4 Ps”* – The transaction is an opportunity to transform new product development. A formal roadmap of initiatives related to portfolios, platforms, products, and processes should be developed.

- **Portfolios:** Align development resources with product strategy. Balancing limited R&D resources against projects with the highest return will improve portfolio value and improve time-to-market.
- **Platforms:** Reduce complexity and cost through product and technology platform management. For product-based companies, significant benefits can accrue if platform strategies are adopted in which multiple product families use a shared architecture and a common set of components.
- **Products:** Improve product and service margins. Design-to-cost, supplier negotiation tactics, or a shift to ODM/OEM arrangements can be used to reduce costs of production.
- **Processes:** Improve new product development practices. Benefits of adopting leading practices can be measured using PwC's Product and Cycle-time Excellence Maturity model and benchmarks.

3) *Track integration and deal value through metrics* – Integration milestones and operational metrics can be used to baseline and measure progress against integration plans and value realization.

Conclusion

Overall, an integration plan that addresses organization, product development processes, engineering IT systems, and products should be developed by those who understand the industry and technology. Deal teams that focus on the “4 Ps” when planning and executing the integration of a target's R&D organization will help maximize the post-deal value of the newly acquired business.

For more information about M&A and related services in technology, please visit www.pwc.com/us/deals.

Table 1: Focus areas for integration planning - R&D and products

R&D organization and talent	R&D organization	Select R&D leadership and draft a future state organizational chart. Include new roles to support product strategy. The leadership team should determine how the R&D organization will be functionally and geographically structured and what skill gaps need to be closed. Determine timing for structural changes or hiring needs.
	R&D talent	Technology deals are sometimes based on the acquisition of R&D talent alone. Identify key personnel and skill needs and define retention strategies to ensure minimal loss of talent. Evaluate potential R&D transition service agreements.
	R&D footprint and facilities	Determine the future R&D footprint to address where work needs to be performed based on customer, supplier, or partner locations. Specialized facilities, labs, and testing equipment should be assessed against future R&D needs.
Roadmaps and IP	Product line roadmaps	Determine the impact to legacy products of any changes to strategy. Communicate these changes to the marketplace and customers, particularly for support, maintenance, and end-of-life plans. Competitors often take advantage of marketplace uncertainty after a deal announcement to get customers to switch.
	Technology platforms	Define technology platforms to address in diligence. For example, will the underlying technology architecture of a SaaS solution scale to meet growing transaction volumes? Do electronic components in a consumer device nearing end of life need to be upgraded? Such questions must be addressed early on in the planning process.
	Intellectual property (IP)	Determine the strategy for IP and patents, estimate their value, and plan how to leverage them to accelerate time-to-market or create new monetization opportunities. Understand any potential IP risks or infringements.
Product development execution	New product development prioritization	Determine how new product development projects will be prioritized, resourced, and funded. The R&D organization should continue to make progress against key development efforts through the integration period. Any changes to priorities should be communicated across all involved functions.
	Engineering IT systems	Take an inventory of product lifecycle management (PLM) systems, collaboration tools, and specialized engineering software and workstations. Understand how bill of materials (BOMs) and other product data is stored and how it will be managed going forward, especially if systems are changing. Manage software license transfers, data migration, and data security protocols for R&D data.
	License cost and development partners	Evaluate current spend on technology licenses and external development partners. Reduce third party costs by adopting more favorable license terms or ownership rights. Consider ways to reduce the number of external development partners based on service levels, location, and legacy contract terms.
	Continuous improvement	Evaluate internal initiatives focused on improving R&D productivity, reducing product costs, or enhancing new product revenue.



Acknowledgments

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