



TECH M&A

Leaders' Survey
October 2017

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Tech M&A Leaders' Survey

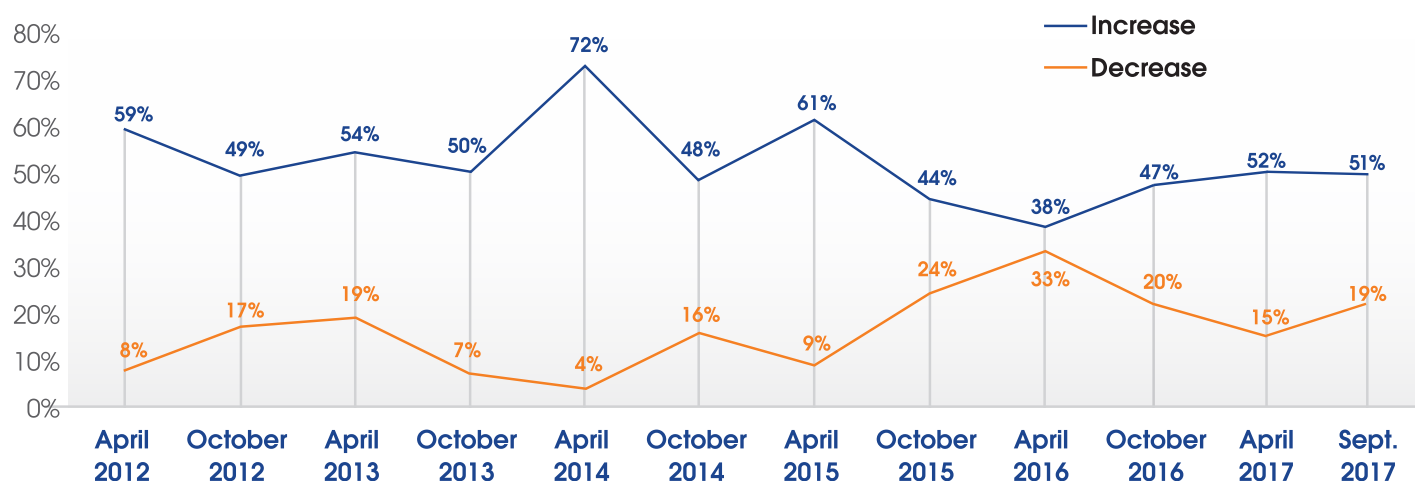
Morrison & Foerster / 451 Research

Undeterred by the recent slowdown in M&A activity, tech acquirers have largely left their bullish forecast for dealmaking unchanged. For the third consecutive time, essentially half of the respondents to the semi-annual Tech M&A Leaders' Survey from 451 Research and Morrison & Foerster indicated they expected an acceleration in acquisition activity. The 51% that forecast a pick up over the next year in M&A in our most recent edition is more than twice the 19% that projected a slow-down. The results lined up very closely with the sentiments from both the year-ago survey and our previous survey in April.

Tech M&A Activity Outlook

Forecast Change in Acquisition Activity

Source: Tech M&A Leaders' Survey from 451 Research / Morrison & Foerster



More broadly, the outlook from the three recent surveys reflects an unusual bit of stability in what is an inherently lumpy business. A bit of history: Over the previous half-dozen years of the Tech M&A Leaders' Survey from 451 Research and Morrison & Foerster, swings of 10 or even 20 percentage points from one edition to the next haven't been uncommon.

The only other similar plateau registered over three consecutive survey periods came a half-decade ago. It's worth noting, too, that the October 2012 - October 2013 block was followed by the April 2014 survey that marked the single highest outlook for activity that we've ever recorded. That effervescent forecast, in which 72% of respondents forecast they would increase acquisition activity, actually came through in deal flow, with spring 2014 marking the start of a roughly 30-month boom for tech M&A. Quarterly M&A spending topped \$100 billion on more than 1,000 transactions in six of the 10 quarters from mid-2014 to the end of 2016, according to 451 Research's M&A KnowledgeBase. That unprecedented streak included two of the highest quarterly spending totals we've ever recorded.

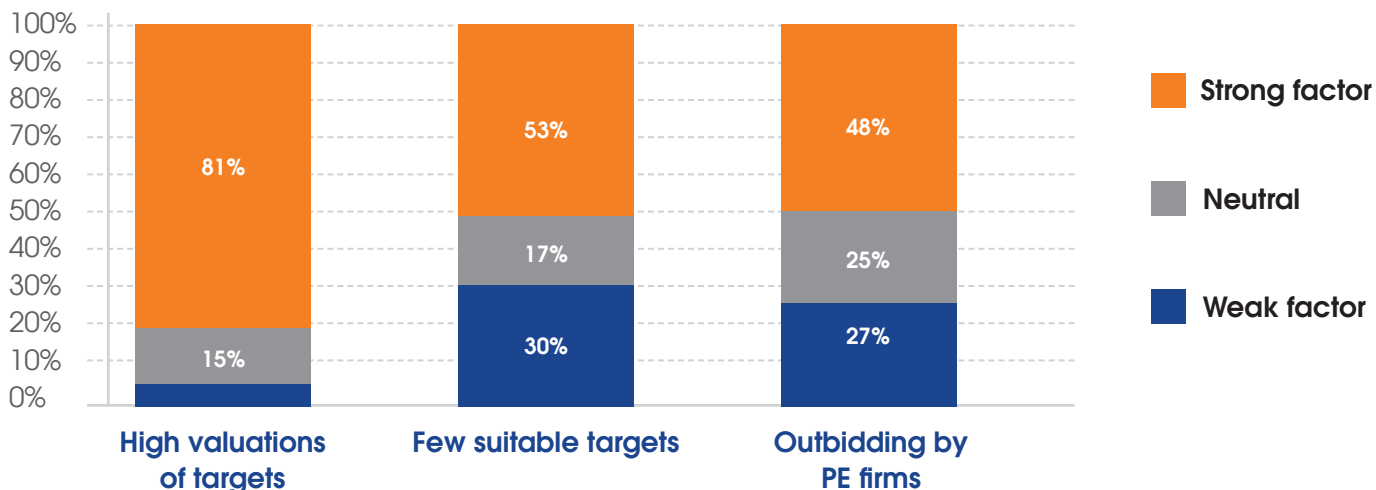
Mainstays are missing

Still, even as the upbeat view from many of the major acquirers in the tech market holds steady, deal volume is declining. So far this year, the number of tech and telco transactions announced across the globe is down 15% compared to the same time in the two previous years, according to 451 Research's M&A KnowledgeBase. The slump is almost entirely attributable to less shopping by corporate acquirers, including many of the mainstays of the market. For instance, our M&A KnowledgeBase doesn't have a single deal for IBM, Oracle or Salesforce.com since the end of May.

U.S. Public Company M&A

Top Reasons for Decline in Tech Deals by NASDAQ/NYSE Companies

Source: Tech M&A Leaders' Survey from 451 Research / Morrison & Foerster

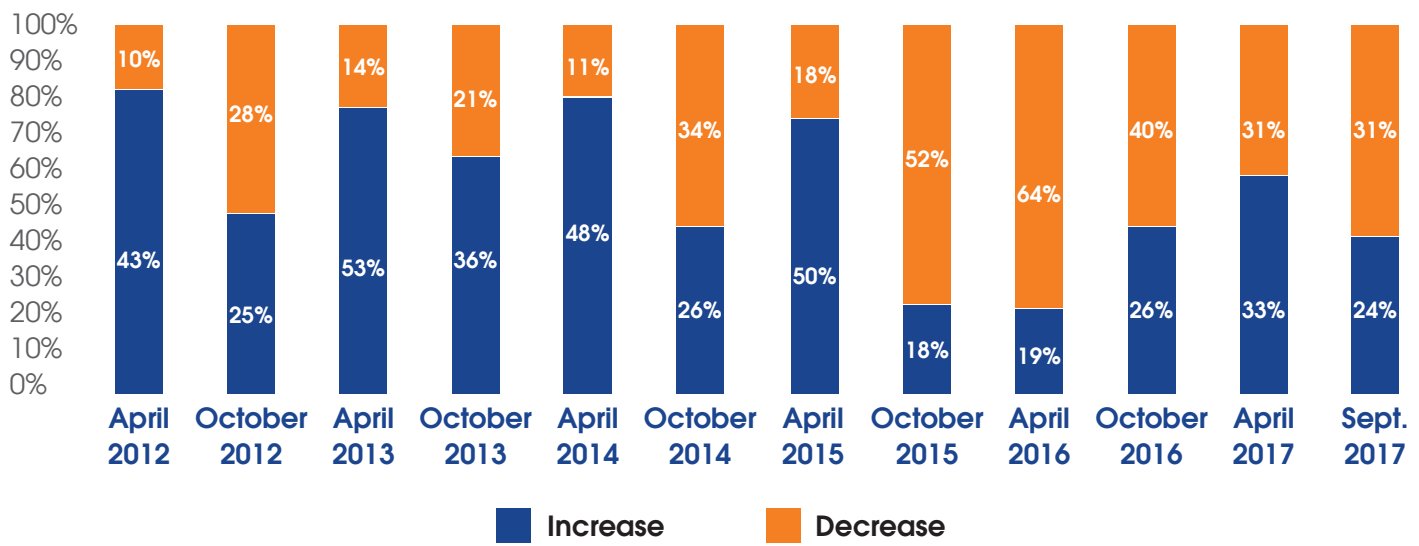


Corporate acquirers – including both C-level executives and corporate development officers – represent the largest single group of respondents to our survey. Asked why U.S. publicly traded companies are on pace in 2017 for a third straight year of declining deal volume, our respondents overwhelmingly responded with the familiar reason that the companies they wanted to buy are too expensive. Some eight of 10 (81%) said 'high valuations' of target companies are crimping deal flow, compared to just one in 20 (4%) who said pricing wasn't affecting deal.

Tech M&A Valuation Outlook

Forecast Change in Private Company M&A Valuations

Source: Tech M&A Leaders' Survey from 451 Research / Morrison & Foerster



Looking ahead, that pricing pressure isn't expected to ease, at least when it comes to the prototypical tech deal involving a private company target. A plurality of respondents (45%) to the Tech M&A Leaders' Survey from 451 Research and Morrison & Foerster indicated startup M&A valuations would remain unchanged over the next 12 months. Those who did forecast a change were slightly more likely to see startup pricing coming down (31%) than ticking higher (24%). Buyers have now voiced a bearish outlook for private company M&A valuations in four of the past five surveys.

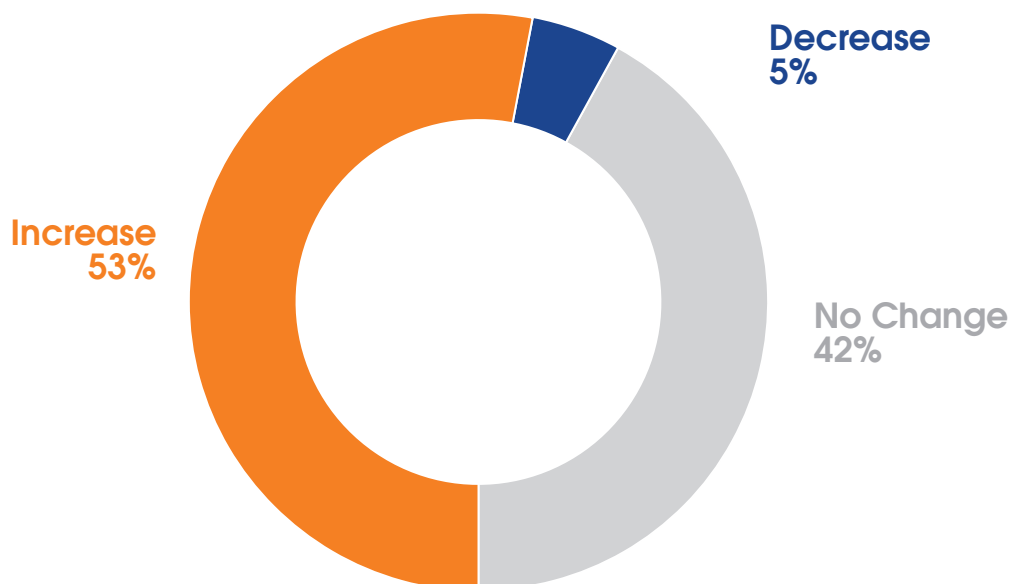
Financials vs. strategics

Returning to the specific question of why companies traded on the NYSE and NASDAQ aren't picking up more tech companies, valuation also figured into the third-highest ranked reason for the decline. However, it is a new trend that is shifting billions of dollars in acquisition spending. While the main reason (a large bid/ask gap) is the perennial complaint from dealmakers in any market, the third-ranked reason indicates a dramatic shift in the tech M&A market: corporate acquirers being outbid by financial acquirers. Nearly half (48%) of the respondents to the Tech M&A Leaders' Survey from 451 Research and Morrison & Foerster said 'outbidding by private equity (PE) acquirers' is a primary cause of the declining number of tech deals announced by US-listed acquirers.

Tech M&A Outlook

Forecast Change in PE Competition vs. Strategic Acquirers

Source: Tech M&A Leaders' Survey from 451 Research / Morrison & Foerster



What's more, our survey respondents overwhelmingly forecast PE firms over the next year will put even more distance between themselves and the long-time tech M&A market leaders, corporate acquirers. Ten times more dealmakers we surveyed said PE firms will be more competitive over the next twelve months than said the buyout shops would be less competitive. (Just 5% forecast corporate acquirers would face less competition from their financial rivals, while 53% forecast an increase.) According to 451 Research's M&A KnowledgeBase, 2017 marks the first year in history that PE firms have announced more tech acquisitions than companies listed on US exchanges. As recently as 2014, public companies announced twice as many deals as their financial rivals.

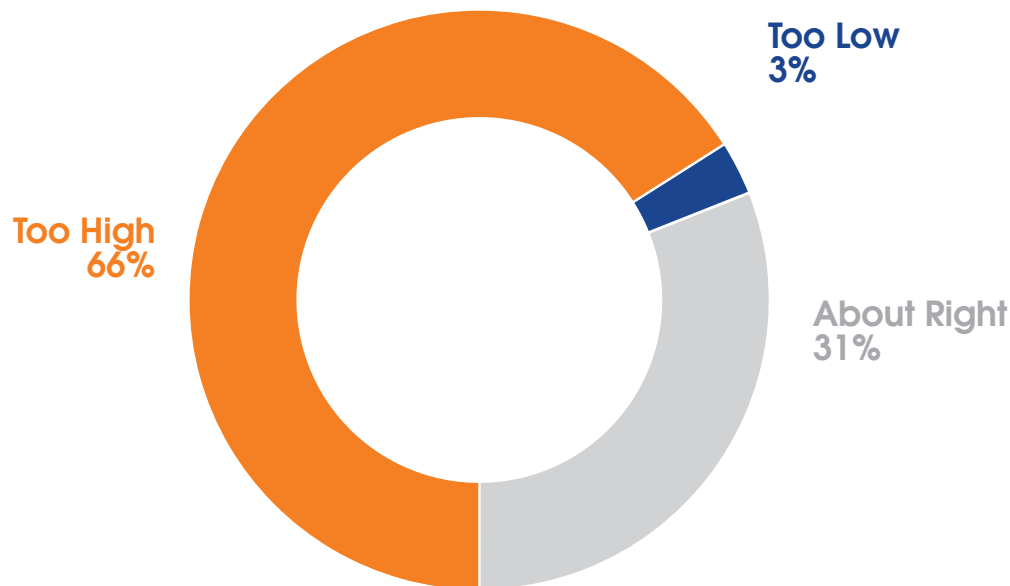
PE pays up

The main reason PE shops have been so busy, according to Tech M&A Leaders' Survey from 451 Research and Morrison & Foerster, is that they have done away with their traditional bargain-hunting. Fully nine of 10 (92%) of respondents said the surge of PE activity, which has seen deal volume double over the past half-decade, is largely due to buyout shops 'willingness to pay higher valuations.' Of course, the firms can only pay these higher prices because of the unprecedented amount of money they have to spend. (The exact amount of uninvested capital specifically dedicated to tech M&A isn't known, but most observers size it in the low hundreds of billions of dollars.) Nearly 90% of our survey respondents said the record cash holdings at PE firms are a strong contributor to their increased activity.

Tech M&A Valuations

Characterizations of Prices Paid by PE Firms

Source: M&A Leaders' Survey from 451 Research / Morrison & Foerster



In paying the prices they are paying, PE firms may be suffering a little irrational exuberance, according to our survey. Two-thirds of respondents (66%) said buyout firms are overpaying in their deals, including 12% who said valuations in sponsor-backed deals are 'much too high.' On the other hand, just 3% of respondents said valuations in PE deals are 'too low' with the remaining 31% saying pricing is 'about right.' A broad analysis of PE deals so far in 2017 in 451 Research's M&A KnowledgeBase indicates valuations have varied according to market segment. In transactions valued at more than \$1 billion, financial acquirers have actually paid lower multiples than strategics. On the other hand, PE firms paid above-market multiples in mid-market transactions, roughly defined as deals valued at \$200 million - \$800 million.

Exits not clearly marked

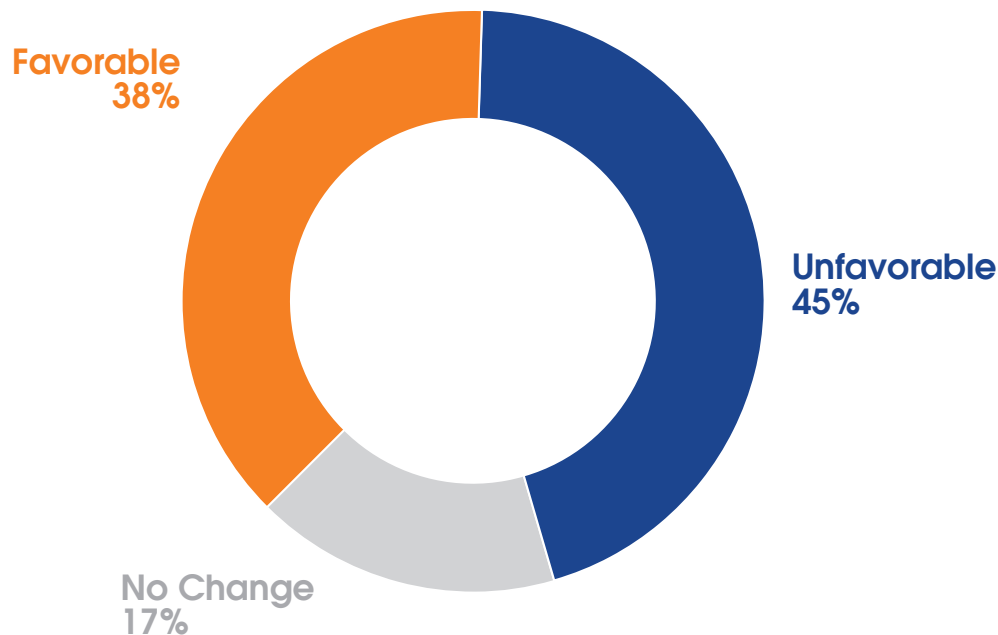
Beyond simply having more money to spend, PE firms have accelerated their activity by broadening the range of companies they spend their ever-increasing amounts of money on. Think of small software startups that are burning cash and are likely several years away from producing any significant EBITDA. (Historically, cash flow has been the key to PE deals, as a way to service the debt that almost invariably gets ladled onto the acquired company.)

In the Tech M&A Leaders' Survey from 451 Research and Morrison & Foerster, nearly three-quarters (72%) of respondents said the huge increase in deals in recent years has been strongly influenced by PE firms going after 'non-traditional' targets. For instance, in a separate question, 74% forecast an increase over the next two years in the number of PE acquisitions of 'growth' companies, as opposed to 'mature' businesses that buyout firms have targeted more often in past transactions.

Tech M&A Outlook

Forecast Exit Environment for PE Companies Through 2020

Source: M&A Leaders' Survey from 451 Research / Morrison & Foerster

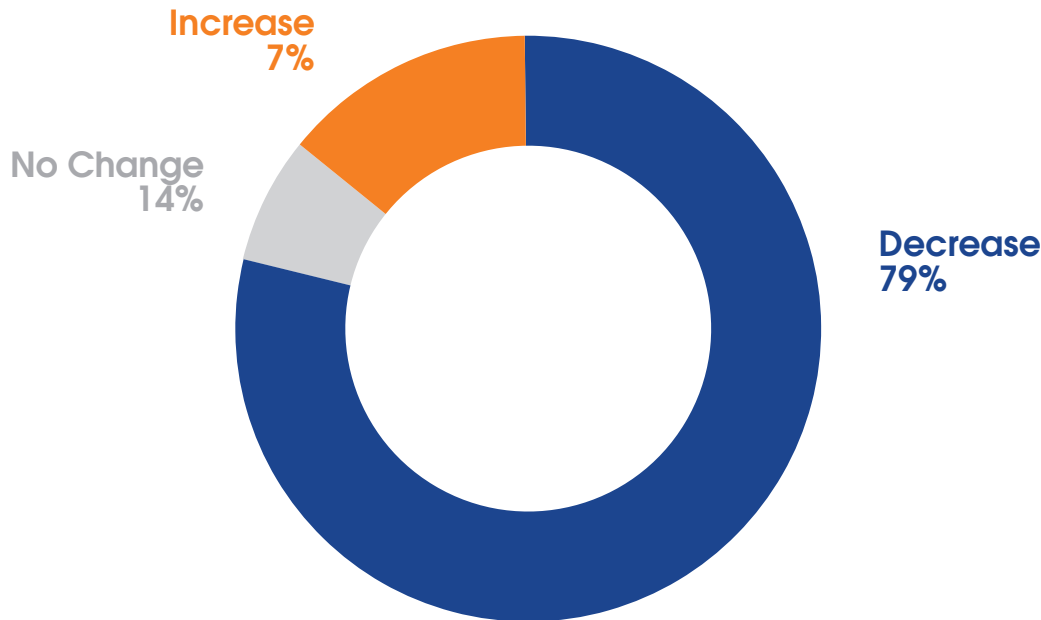


With buyout firms holding record levels of cash and enjoying an expanding pool of targets, the overwhelming sentiment from the Tech M&A Leaders' Survey from 451 Research and Morrison & Foerster is that PE shops won't have difficulties adding to their portfolios. However, our respondents weren't anywhere near as bullish on the ability of PE firms to reduce their holdings. More people said the exit environment for buyout shops over the next three years will be 'unfavorable' than 'favorable' (45% vs. 38%). In a separate question, respondents indicated sales of portfolio companies to corporate acquirers as the most likely exit path through 2020, followed by sales to fellow PE shops. Those so-called secondary transactions, which can be unpopular among the investors in the PE funds, have increased roughly tenfold since the recession, according to 451 Research's M&A KnowledgeBase.

U.S.-China M&A

Forecast for Chinese Acquisitions of North American Tech Companies

Source: M&A Leaders' Survey from 451 Research / Morrison & Foerster



A Great Wall for U.S.-Sino M&A

Finally, on a very timely topic, survey respondents overwhelmingly forecast that already-strained M&A ties between the world's two largest economies will likely deteriorate even more under the Trump administration. Nearly eight in ten (79%) respondents to our survey said Chinese acquisitions of North American tech companies will decline under the current presidency, more than ten times the 7% that expect an acceleration in deal making.

The most-recent outlook for U.S.-China M&A activity is even more bearish than the results of our April survey, when 65% forecast a decrease in outbound activity by Chinese buyers and 14% forecast an increase. One reason for the notable erosion in the outlook from spring to fall could have to do with the fact that, while we were surveying in our current edition, there was a direct example of why Chinese acquirers may hold off on U.S. acquisitions: In mid-September, President Trump officially killed the planned \$1.3 billion purchase of US firm Lattice Semiconductor by a Beijing-based fund on national security grounds.

About the survey: Now in its 12th edition, the Tech M&A Leaders' Survey from 451 Research and Morrison & Foerster drew 142 responses, primarily from corporate or M&A executives (40% of respondents) and investment bankers (29%), with the remaining responses coming from lawyers, VCs, PE professionals and others in the M&A community. Roughly three-quarters of responses came from dealmakers and advisers based in the US; Silicon Valley represented the largest single location, accounting for 35% of the total, followed by China, which accounted for 10% of respondents.



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