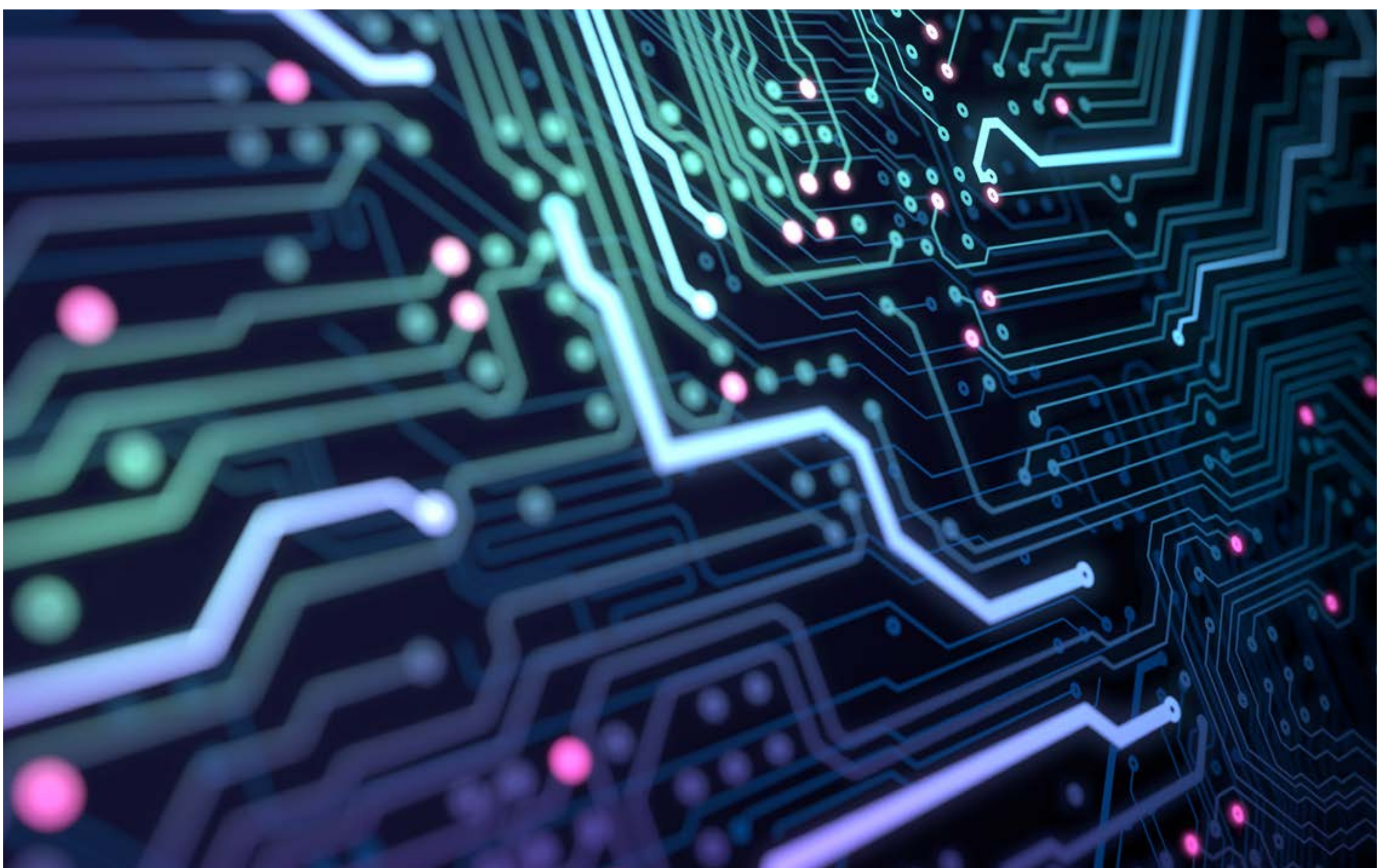
Morrison Foerster

Mergermarket

Cutting Edge: Tech M&A Is Powering Deal Markets



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Methodology

In Q2 2022, Mergermarket surveyed 300 dealmakers from around the world to gain insights into the future of technology-related M&A. Respondents were equally distributed among corporates with a minimum of $250 million in annual revenue and private equity (PE) firms with a minimum of $500 million in assets under management. In respect of geography, 30% of respondents were based in North America, 30% in Europe, 30% in Asia-Pacific (APAC), and 10% in Latin America. All responses are anonymous, and results are presented in aggregate.

Executive Summary

The inexorable rise of technology over the past decade has transformed the way we live and interact, both in our personal lives and in business. Digitalization was further accelerated by the COVID-19 pandemic, and it showed in equity markets. High-growth, tech-enabled companies ascended to new heights at a record pace.

So far, 2022 has been something of a reset period. High stock prices fell in the first six months as consumers pulled excess liquidity from markets and the real-world economy. Technology businesses have seen some of the steepest pullbacks. As the cost of capital has begun to rise in line with higher interest rates, the value of these businesses' future cash flows has come down.

Despite this asset repricing pressure, M&A in the technology, media, and telecommunications (TMT) sector marches on, fueled by a confluence of positive compounding factors. Corporates continue to retool themselves, upgrading and refining outmoded business models to unlock new phases of growth, as technology converges with practically every industry in one way or another. Simultaneously, well-capitalized PE players remain bullish and are actively seeking disruption. Truly innovative tech businesses are benefiting from S-curve effects by delivering goods and services that give their business-to-business clients a competitive edge, or which are riding long-term consumer trends, such as the rise of digital consumption and the ongoing evolution of the "Internet of Things."

This explains why deal activity has remained remarkably buoyant even in the face of the market sell-off and greater risk aversion. Through the opening three quarters of 2022, there were 5,499 TMT deals worth a combined $887.4 billion announced worldwide. Though below last year's breathtaking run, this is well ahead of any corresponding period in any other year.

Against this backdrop, Mergermarket surveyed 300 global dealmakers through Q2 2022. The purpose of this research was to gauge investor sentiment towards M&A in the TMT sector and understand where acquirers see the greatest potential for deals in the near term as they plot a path forward. As our study shows, corporates and financial sponsors alike have a firm eye on the future and are not averting their gaze.

Key Findings

80% of PE firms and 71% of corporates expect aggregate tech M&A deal volumes to increase over the next 12 months compared to the previous 12 months. Likewise, 82% of PE firms and 83% of corporates expect the value of the average tech deal to rise over the coming year.

When asked to identify the single most important deal structure that they might employ over the next 12 months, 44% of corporates cite joint ventures, whereas the largest share of PE firms reference club deals (25%).

Regarding the tech subsectors that respondents expect to offer the best M&A opportunities over the next 12 months, the largest share (51%) point to artificial intelligence (AI). This is a massive departure from last year's survey, when AI accrued just 3% of first-choice votes and cloud technology led the way with 54% of the overall vote share, falling to 31% this year.

Keeping up with the pace of technological advancement is by far the most frequently referenced driver of respondents' tech M&A strategy over the next 12 months, cited by 62% of corporates and 71% of PE firms as a top-three factor.

I'm emboldened by the results of this year's Morrison Foerster/Mergermarket Tech M&A survey. Despite market volatility, global dealmakers continue to prioritize technology acquisitions, especially in heated sectors like artificial intelligence and machine learning. While deal numbers for 2022 were never going to reach the historical peaks of 2021, deal activity remains steady, and dealmakers are cautiously optimistic for the future."

Brandon Parris, co-chair of Morrison Foerster's global M&A practice

A large share of respondents, including half of European respondents, 46% of North American dealmakers, and 43% of their peers in APAC, expect antitrust scrutiny of tech M&A to become significantly stricter over the next three years. This is compelling acquirers to target smaller startups rather than bigger organizations that woul. invite more scrutiny.

Respondents in all regions expect environmental, social, and governance (ESG) considerations to grow in importance when it comes to choosing their tech M&A targets, with the jump most pronounced among APAC respondents, who give an average rating of 7.3 out of 10 (versus 6.1 for the significance of ESG in their most recent tech M&A deal).

Most respondents expect shareholder activism related to tech M&A to increase over the next three years, including almost half of European respondents (47%) and 41% of their APAC peers who expect the increase to be significant.

SECTION 1:

Market Overview

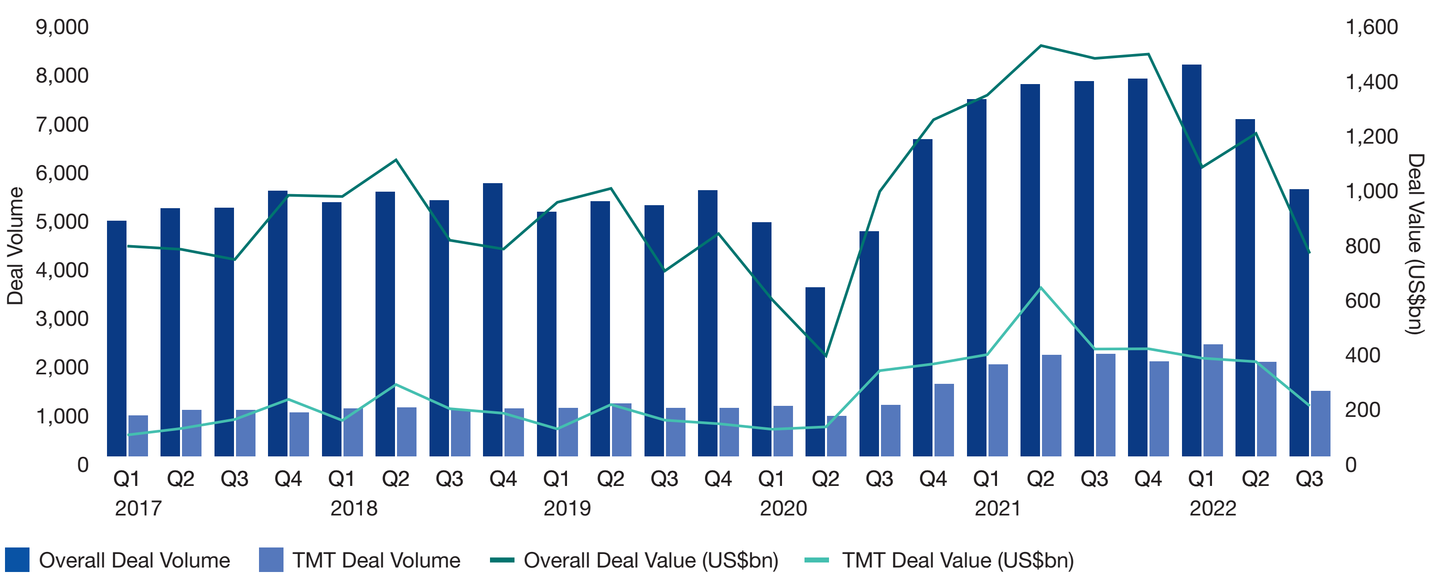
Despite the turmoil in equity markets, dealmakers are bullish about the future of tech M&A. Those with a long-term mindset are set to capitalize on robust tailwinds.

The past two and a half years have been a rollercoaster in global M&A markets. After a short, sharp collapse in activity in H1 2020 as the pandemic sent shockwaves around the world, dealmakers made up for lost time. Value and volume surged to deliver the biggest M&A year on record in 2021, peaking in Q2.

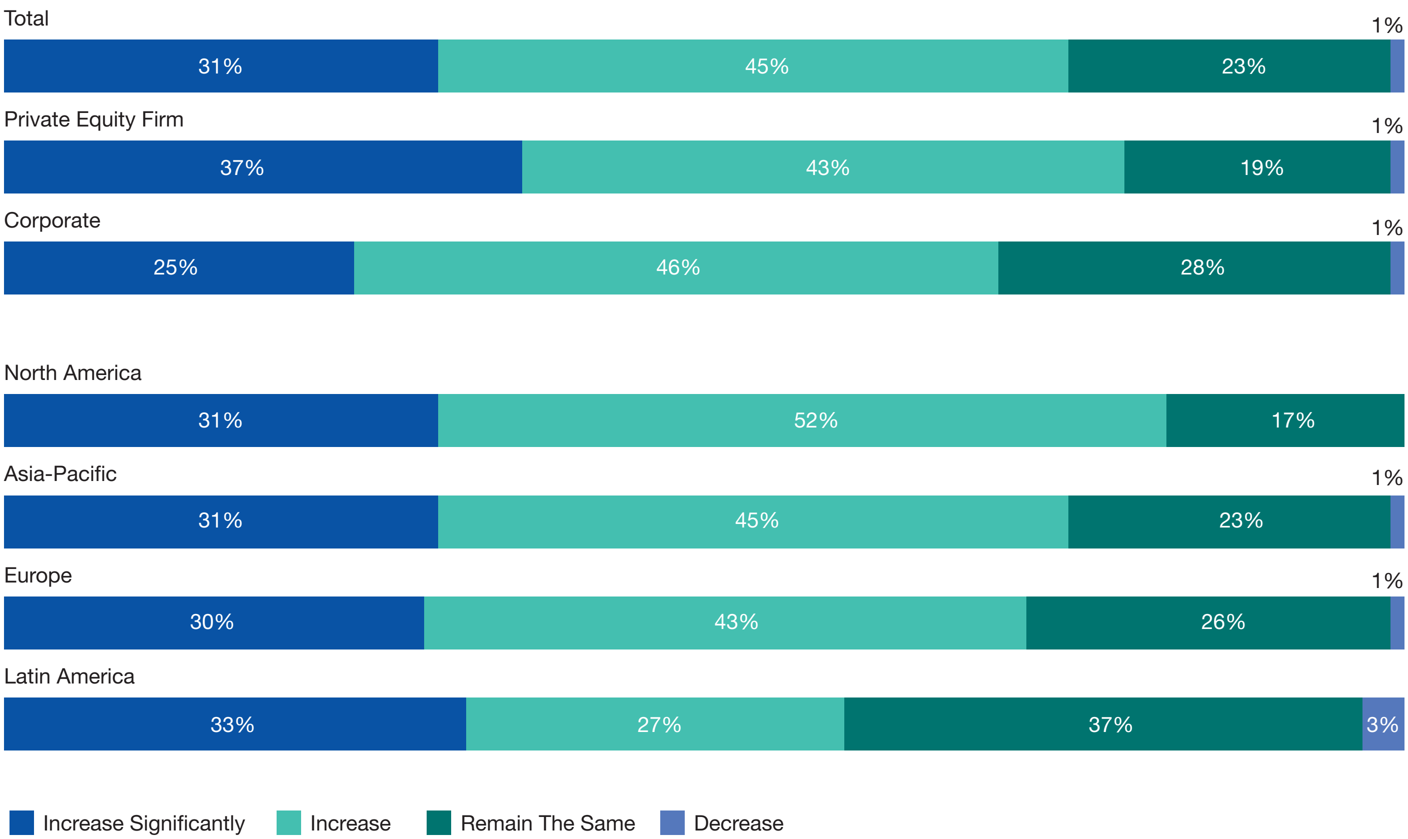
Though transaction activity remains above historical levels, the market has cooled off somewhat since Q4 of last year. Through the first three quarters of 2022, 20,476 transactions worth just under $3 trillion in aggregate were announced across all industries, respective falls of 10% and 30% compared to the same period last year.

The TMT sector, despite seeing its own dip in activity, has been propping up the global M&A market, having accounted for almost a third (29.9%) of activity by value between Q1 and Q3 2022, a marginal decline from the 32.3% of global M&A that it contributed during the first nine months of 2022. While the sector is down 36% to $890 billion compared to the same

M&A Activity By Value And Volume 2017-2022 Q3



How Do You Expect Aggregate Tech M&A Deal Volumes To Change Over The Next 12 Months Compared To The Previous 12 Months?



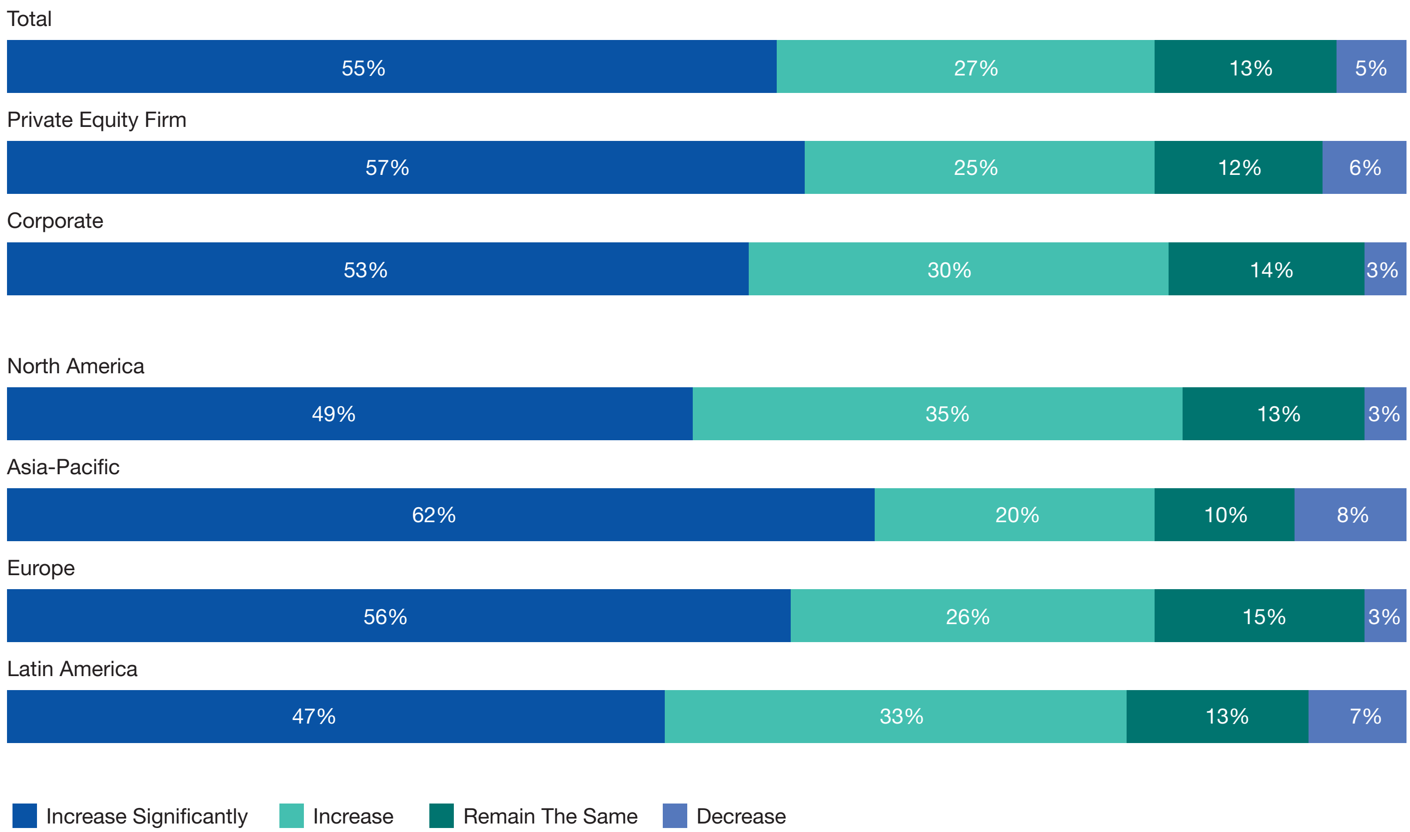
period last year, this relative underperformance was due to an exceptional spike in Q2 2021 ($616 billion). Deal volume has continued to show strength, down by just 8.3% compared to the first three quarters of 2021.

Germany and the UK, two key European markets for TMT activity, encapsulate this stable trend in M&A. Each recorded increases in aggregate TMT deal value in Q2 of this year compared to Q1, despite dips in transaction volume in both cases—the UK recorded $16.9 billion worth of TMT deals and Germany $4.6 billion, up from $12.5 billion and $2.7 billion, respectively, in the first three months of the year. Both sums, however, are down compared to Q2 of last year, when the UK logged $21.1 billion worth of TMT deals and Germany $8.7 billion. But conditions turned again in Q3, when Germany recorded a massive $15.3 billion worth of TMT deals, more than triple its output from the same period last year. The UK, for its part, recorded a small quarter-on-quarter decline in Q3 ($15.9 billion), though this sum does eclipse the $12.1 billion of TMT deals the region logged in Q3 of 2021.

“While European M&A markets have leveled after a record-breaking 2021, there is much to be optimistic about,” notes Andrew Boyd, co-managing partner of Morrison Foerster’s London office. “The UK tech scene is booming, with a significant number of companies now at ‘unicorn’ status, and we continue to see notable interest from both domestic and international acquirers and investors.”

Despite the cool-down in activity overall, dealmakers remain bullish about the future, with 80% of PE firms and 71% of corporates surveyed expecting aggregate tech M&A deal volumes to increase over the next 12 months. More than a third of PE firms (37%) expect this increase to be significant. In spite of the recent turmoil in equity markets, these figures are down only slightly from last year’s findings, when 78% of all

How Do You Expect Average Tech M&A Deal Values To Change Over The Next 12 Months Compared To The Previous 12 Months?



respondents said they expected aggregate tech M&A deal volumes to increase over the last 12 months.

Recent M&A figures give some credence to this hawkish attitude: Q2 2022 saw PE dealmakers strike $188.9 billion worth of TMT transactions globally, a 20% increase from Q1. That figure is the third-highest quarterly sum on record, trailing only the $194.4 billion and $213.8 billion posted, respectively, in Q1 and Q2 of last year, when dealmakers were still in the first stage of the post-pandemic rush to transact.

It is well accepted that the pandemic accelerated tech adoption and, although recent capital market volatility—interviews for this report were conducted in May and June 2022, an inflection point this year when markets again began to strengthen—has made investors somewhat more cautious, the ongoing pressure to digitalize business models and develop cutting-edge products via M&A has not abated. If anything, it is higher than ever. “Keeping pace with new technology is not easy. If we were to develop technologies internally, it would take a lot of time and we would have to spend a lot on internal resources,” comments the director of strategy of a U.S. corporate. “Acquisitions are the best way to advance.”

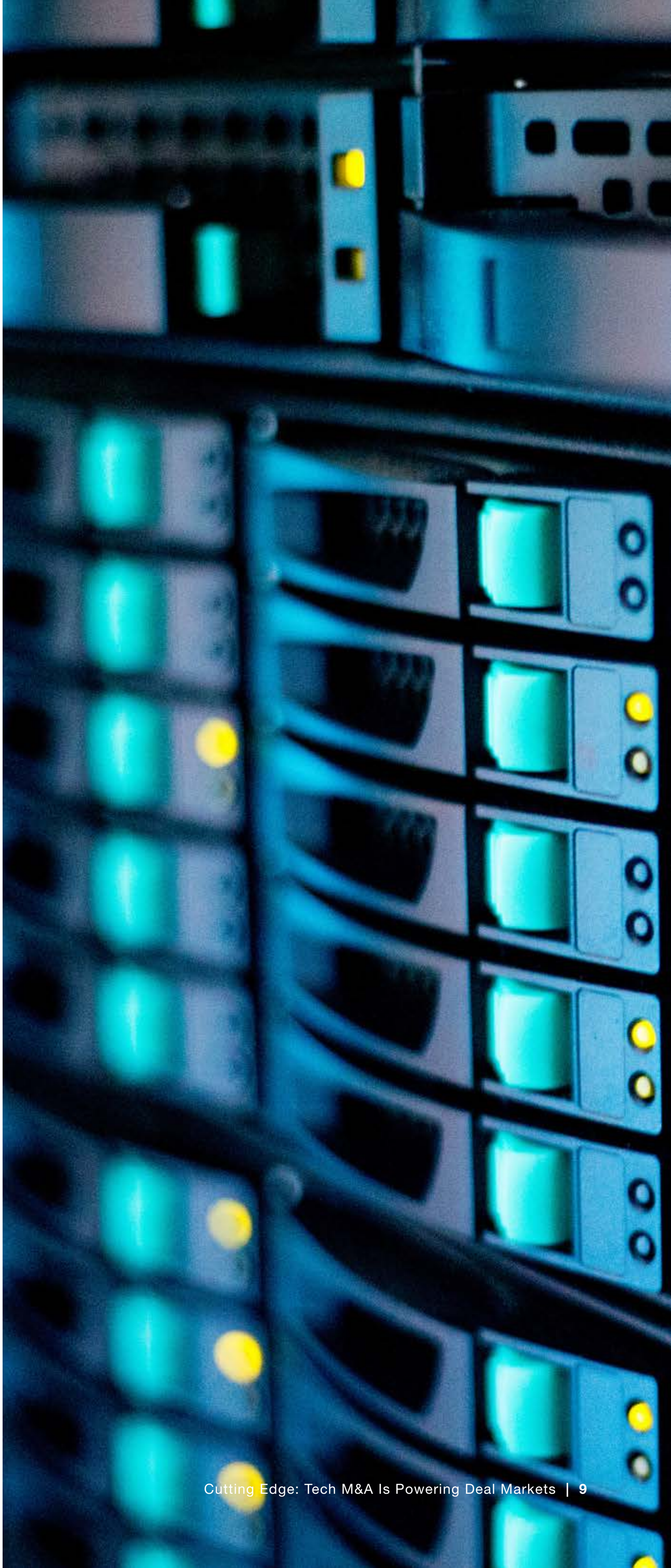
Positivity Across Regions

Regionally, respondents in North America have the most bullish outlook. A full 83% of this group expects a year-on-year increase in tech M&A deal volumes, followed by 76% of those in APAC, 73% in Europe and, at the more conservative end of the scale, Latin America acquirers, 60% of whom expect an uptick. Respondents are similarly sanguine about average tech M&A deal values, with 82% of PE firms and 83% of corporates expecting a rise over the next 12 months compared with the prior year. This is notably up from last year's report, when 54% of respondents overall said they expected average deal values to increase. Confidence is running especially high among APAC respondents, 62% of whom expect the value of the average tech M&A deal to increase significantly, well ahead of any other region.

This investor group may be justified in their expectations. Three years ago, growth equity firm Asia Partners forecast that Southeast Asia's annual tech deal market would run from $86 billion to $425 billion within a decade. Two years later and the fast-rising subregion was already halfway to meeting that goal, prompting the firm recently to revise its target to between $750 billion and $1.2 trillion by 2031. Software engineering skills in Southeast Asia are flourishing, as is its stable of technology unicorns, which has nearly tripled from 15 in 2019 to upwards of 39 today. In addition to its remarkable diversity, Southeast Asia also benefits mightily from having Singapore, with its already-advanced economy and history as an international melting pot, as its long-respected financial hub around which so much regional M&A can pivot.

Looking across regions, it may be easy to dismiss the widespread optimism of respondents in light of the bear market that played out in H1 2022. Certainly, current market and macroeconomic conditions continue to pose significant challenges. For one, high inflation and the attendant higher interest rates required to rein in spiraling prices are usually unkind to technology asset valuations. These companies are often pre-profit and valued on their future potential earnings. Discounted cash flow valuation models are highly sensitive to higher rates as they factor in the time-value of money. Nobody knows exactly how long inflation will persist, and this has the potential to vary between regions based on their monetary responses and domestic demand. The U.S. Federal Reserve has been especially tough—the central bank started slowly to raise its benchmark policy rate in March, before ratcheting things up and raising the rate by 0.75 percentage points in each of June, July and September.

Macroeconomic conditions notwithstanding, technology in the broadest sense benefits from some of the strongest tailwinds of any sector. Acquirers tend to be long-term investors, and tech-hungry buyers have an opportunity to purchase assets that carried significantly higher price tags just a year ago.



SECTION 2:

The Way Forward

Things change quickly in tech M&A circles. New favored acquisition targets are emerging—dealmakers have an appetite for startups, all the better if they bring some AI expertise to bear.

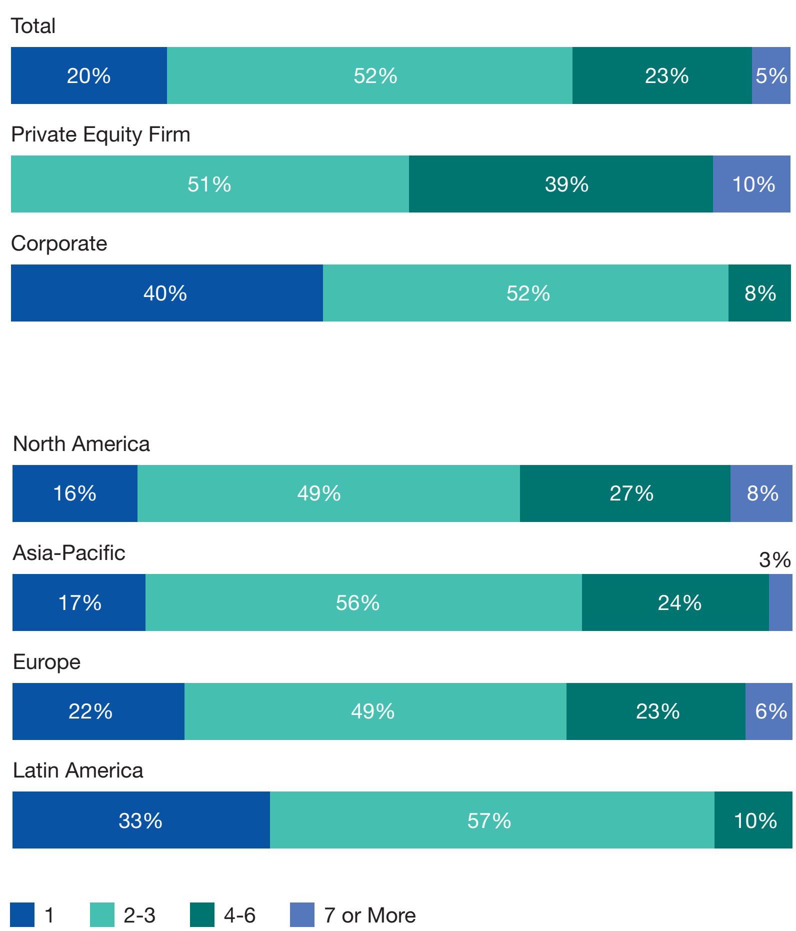
Looking across the market, acquirers are on balance confident about tech M&A activity for the next year. But what of their own recent activity, and do they themselves anticipate engaging in the market over the coming months?

PE firms have been especially active in the technology sector, with all financial sponsors responding to the survey reporting that they have completed at least two tech M&A deals in the past 12 months, and half of these (49%) have made four or more plays. Corporates responding to the survey have been a little more conservative, with just 8% having completed four or more transactions, 52% making two or three, and 40% having made just one tech deal over the period.

Marcia Ellis, chair of Morrison Foerster's global PE practice, comments: "We're seeing notable activity from PE investors across our jurisdictions, driven in part by the wealth of innovation in the global technology space. The bullish outlook of PE-focused survey respondents matches the sentiments we are hearing in the market."

This differential between PE and corporate players reflects past findings and is indicative of the more selective, concentrated bets that strategic acquirers typically make. Corporates are also more sensitive to the performance of their own valuation during times of market volatility and tend to be more invested operationally and financially when integrating deal

How Many Tech M&A Deals Did Your Organization Complete Over The Last 12 Months?



targets, a burden that PEs don't have to shoulder unless they are making bolt-on acquisitions.

Recent activity shows that investors have exceeded their expectations. This time last year, we found that across PEs and corporates, 47% of respondents, the largest share, anticipated making two or three tech deals over the last 12 months. That compares with 72% who secured this number of deals.

On average, North American respondents have been the busiest, with 27% saying they completed four-to-six tech M&A transactions and an additional 8% having completed seven or more. Meanwhile, a third (33%) of Latin American buyers have made a single tech transaction in the last year, and 10% have made between four and six deals.

Great Expectations

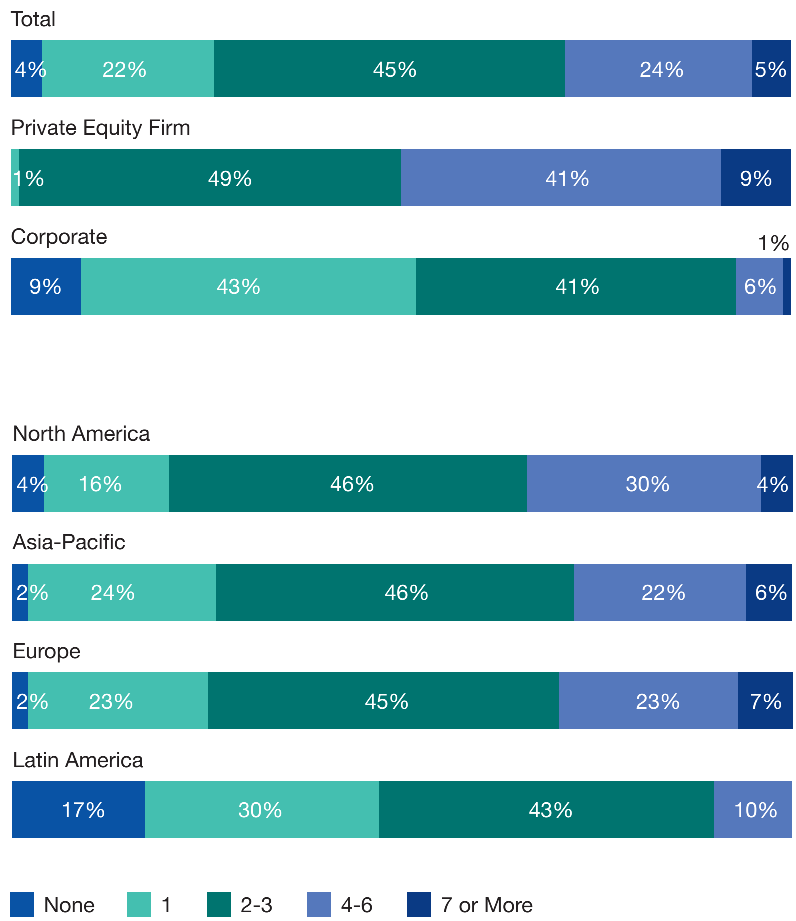
Investors appear to have realistic expectations over their forthcoming engagement in the market, with their anticipated activity falling almost perfectly in line with their experience of the past 12 months.

Exactly half of PE respondents see themselves doing between one and three technology deals, and the remaining half predict that their funds will make upwards of four technology transactions. "PE firms continue to display tremendous buying power, especially in the technology realm. The sector is incredibly resilient, so I would expect PE deal activity to keep pace in the coming months," notes U.S. PE partner Patrick Huard.

In comparison, the bulk of corporates (43%) expect to undertake just one tech M&A deal over the next 12 months, and 9% admit they won't undertake any such transactions. This further illustrates corporates' selectivity compared with deal-hungry financial sponsors who have a far more singular modus operandi.

The geographic biases are once again reflected in these dealmaking prognoses. Just over a third (34%) of North American respondents expect to undertake at least four deals over the forthcoming year, with European and APAC respondents closely following at 30% and 28%, respectively.

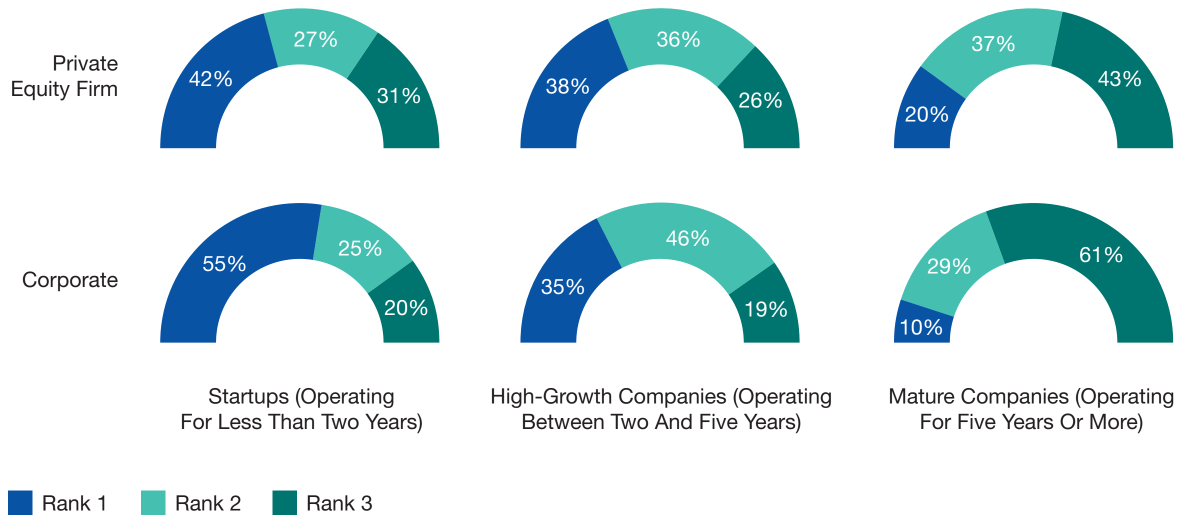
Roughly How Many Tech M&A Deals Does Your Organization Expect To Complete Over The Next 12 Months?



> PE firms continue to display tremendous buying power, especially in the technology realm. The sector is incredibly resilient, so I would expect PE deal activity to keep pace in the coming months."

Patrick Huard, U.S. PE partner, Morrison Foerster

At Which Stage Of Development Does Your Organization Typically Target Tech Companies For Acquisitions?
(Rank 1-2-3, With 1 Being The Stage Of Development That Your Organization Targets Most Frequently)



Startups In Focus

Tech companies come in all shapes and sizes. While headline-snatching deals are what get people talking, the reality is that swathes of activity feature tech businesses that aren't even close to this size or maturity. In September 2021, an analysis by the U.S. Federal Trade Commission (FTC) showed that 39.3% of the 616 deals made by "Big Tech" firms between 2010 and 2019 involved companies that were less than five years old.

For corporates, in many cases they are simply buying intellectual property and patent portfolios or a single product rather than a target's distribution network or customer base. Our research shows that mature companies are the least likely to be respondents' primary targets—only 20% are chiefly seeking tech companies that have been in operation for five years or more. Instead, both PE firms (42%) and corporates (55%) say they most typically target tech companies that are less than two years old.

This aligns, too, with the strong seed funding seen in the first half of this year. According to Crunchbase data, global early-stage venture funding in Q1 and Q2 2022 reached a combined $97.9 billion, up marginally in spite of the macroeconomic turmoil, from the $92.4 billion posted during the same period last year. In comparison, late-stage funding saw a year-on-year decline of 26%, falling to $143.1 billion in H1 of this year from $180.6 billion through the first six months of 2021.

Seizing Opportunities

The pandemic threw a wrench in the works of cross-border deal activity. Travel restrictions impeded in-person site visits and due diligence, with investors resorting to digital tools that allowed them remote access to companies' physical assets and people. However, dealmakers soon adjusted to these limitations and now seem as comfortable, if not more, playing by these rules, even though restrictions on movement have been lifted and travel has opened back up.

Most respondents (61.5%) say that traveling at their organization has significantly increased over the past 12 months, though it is not quite back to pre-pandemic levels. COVID-related travel restrictions remain in place in some jurisdictions—particularly in parts of Asia, including China, Japan and Hong Kong—meaning some dealmakers remain dependent on technology solutions to facilitate cross-border M&A. Almost no respondents, however, have retained the primarily remote environment that was ever-present during the heights of the pandemic.

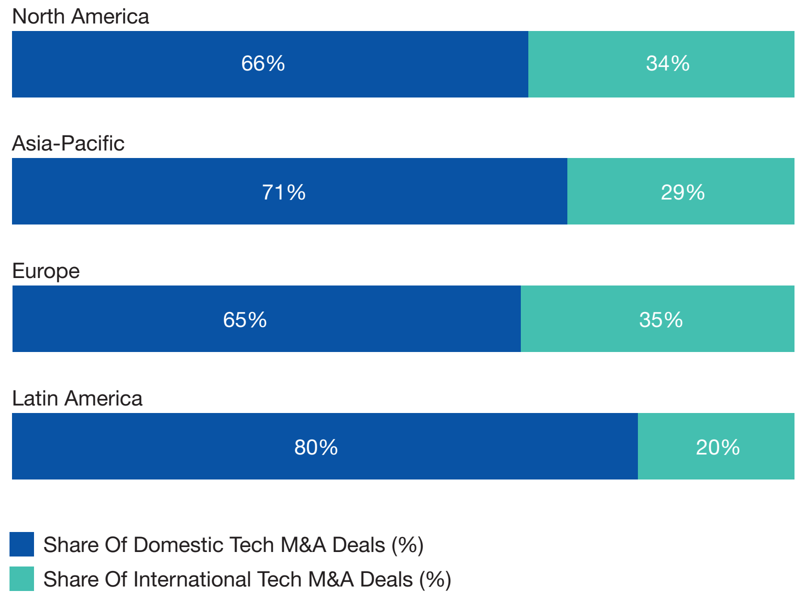
Overall, cross-border activity seems to be on an upward trajectory as dealmakers look for high-potential assets beyond their home markets, in many cases at more competitive entry prices. European and North American respondents, on average, expect a higher share of their tech M&A to be cross-border, at proportions of just under 35% and 34%, respectively. This signals a marked shift from last year, when respondents across geographies expected less than a quarter of their deals to traverse borders. Overall, then, capital should flow more freely between jurisdictions.

Respondents naturally have a home bias, an effect that was identified decades ago in institutional equity portfolios. It stands to reason that companies and financial investors seek opportunities they are in close proximity to and where they have advisory networks and better understand the market dynamics and regulatory landscape. This bias aside, North America is the most hotly anticipated region for M&A by Latin American respondents (93%) and by more than half of European (59%) and APAC respondents (57%) as well.

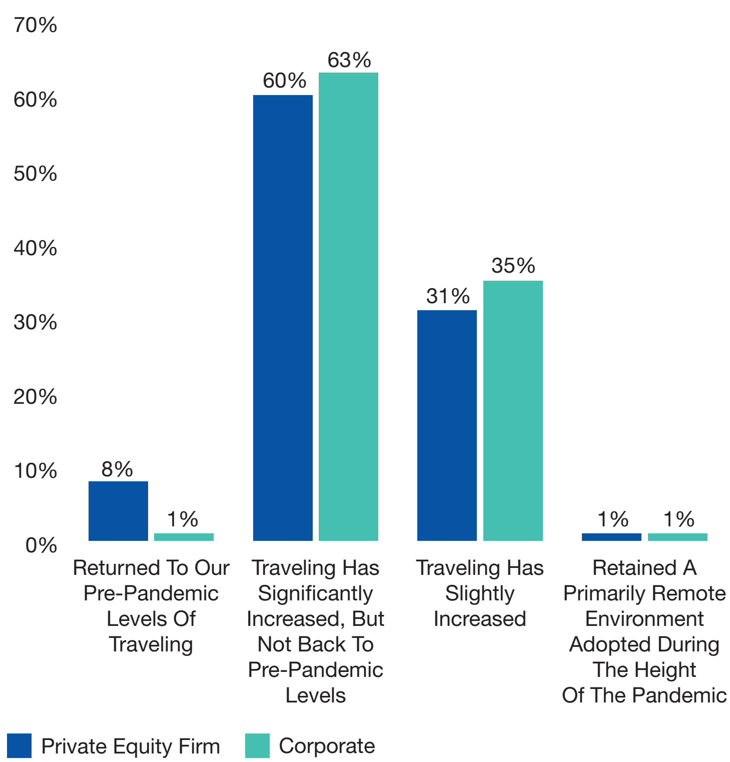
The U.S. has a deep pool of potential tech targets, offering notable opportunities for global acquirers. Asia (excluding China and Japan) is the second-most selected geography, with as much as 71% and 70% of North American and Latin American acquirers, respectively, pointing to the fast-growing region as a treasure trove of potential tech deals, in addition to almost all (97%) of APAC executives surveyed.

Southeast Asia and India, while still in the early stages of their development, are emerging as tech cornucopias, so much so that Asia (excluding China and Japan) has overtaken Greater China as a prospective generator of tech M&A opportunities. In last year's edition of this study, Greater China received the second-largest share of first-place votes with 14%, equal with Europe and trailing North America, but double the 7% first-place votes that Asia (excluding China and Japan) accrued. This inversion reflects, at least in part, ongoing political tensions between China and the West. M&A regulators in Beijing, Washington and Brussels have inaugurated various protectionist measures to guard domestic companies from cross-border takeovers, especially in the technology sphere.

Approximately What Proportion Of Your Expected Tech M&A Activity Will Be Domestic (I.e., Occurring In Your Home Market) Versus International? Average Percentages Shown



How Do Your Current Travel Arrangements Associated With Dealmaking Compare To Pre-Pandemic Levels?



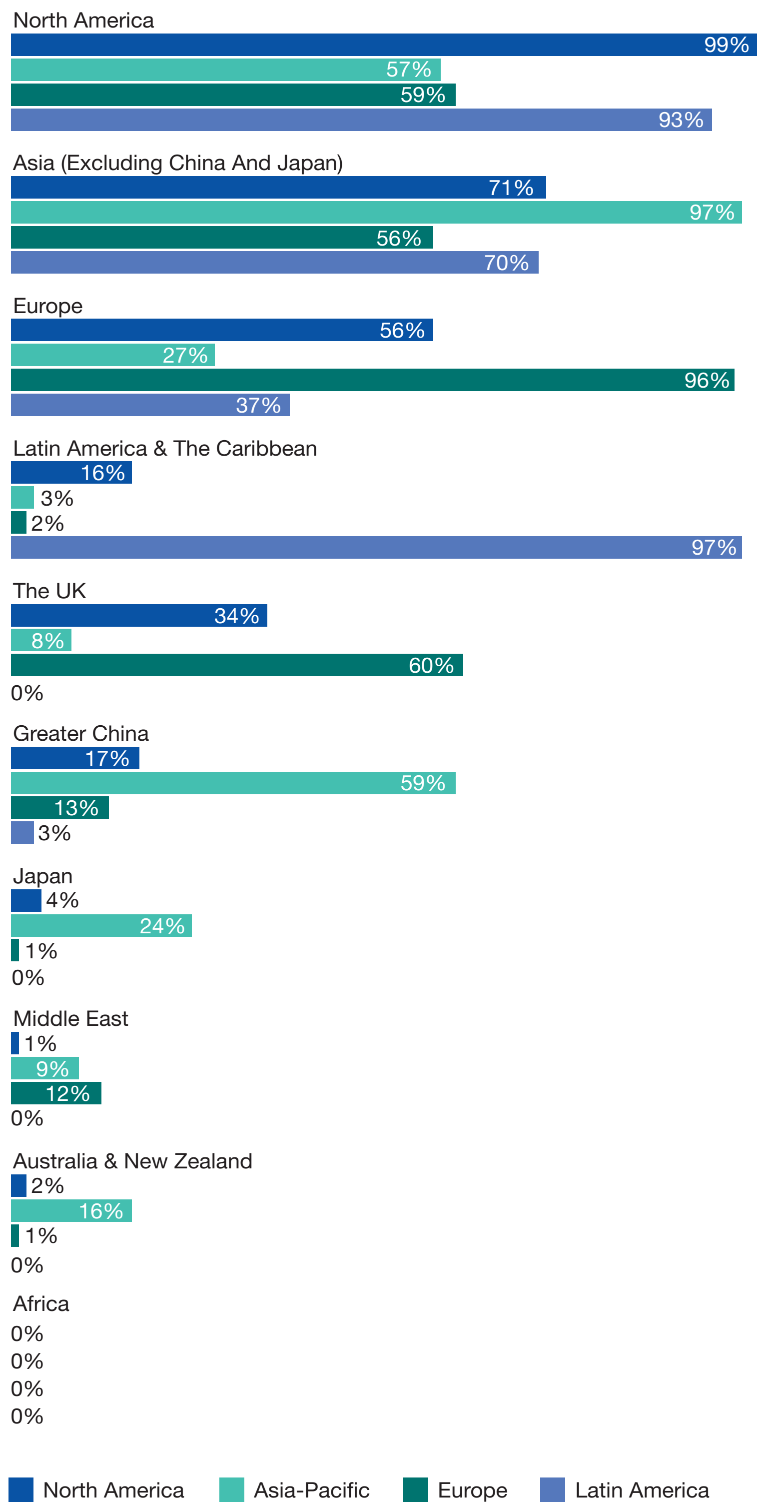
Paul McKenzie, managing partner of Morrison Foerster's Beijing and Shanghai offices, notes: "China's increasingly restrictive regulatory environment represents a concern for dealmakers. Evolving restrictions on exports of personal data and an ill-defined scope of 'important data' complicate diligence of Chinese targets by foreign acquirers, not to mention integration on closing of the purchase of a Chinese business."

Still, large subsets of the APAC respondents to this year's survey do continue to identify Asia's more advanced economies, specifically Greater China and Japan, as appealing tech M&A markets. The former attracts 59% of APAC respondents' top-three votes (exceeding the 57% score this group gives to North American opportunities) and the latter garners 24% (on par with their affinity for European opportunities, at 27%).

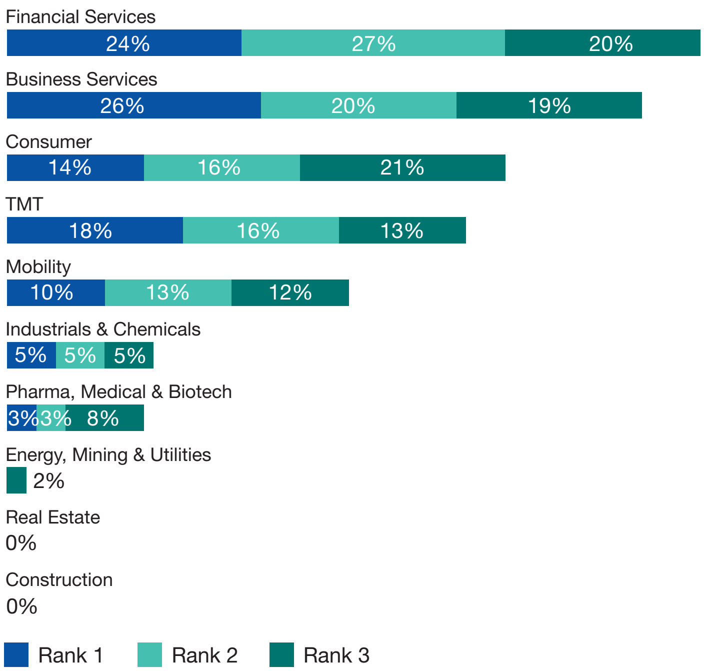
These APAC-specific scores speak to the resilience of these advanced economies' domestic M&A markets, even as Western dealmakers turn increasingly towards emerging Asia. For instance, intra-China TMT M&A logged $13.1 billion worth of deals, a 27% increase from the previous quarter and—excluding the immediate post-pandemic period from the end of 2020 through the first six months of 2021, when figures were skewed by the release of pent-up demand—the highest such quarterly sum since Q3 2018. More to the point, that $13.1 billion accounted for 78% of the $16.8 billion total of Chinese TMT M&A in Q2, underscoring the significance of domestic bidders over international ones. Japan's TMT market has also enjoyed consistent increases in deal activity, with the vast majority of this driven by domestic M&A. Of the 148 deals involving Japanese TMT companies announced between Q1 and Q3 of 2022, only 13 were attached to overseas bidders, with that low figure hardly anomalous. From 2011 to 2021, cross-border bidders contributed only around 10 deals annually to Japan's TMT M&A market.

"Technology continues to be a focus for Japanese acquirers, with substantial interest in a variety of technology sectors such as AI," notes Randy Laxer, Morrison Foerster M&A partner and co-head of the firm's Asia PE practice.

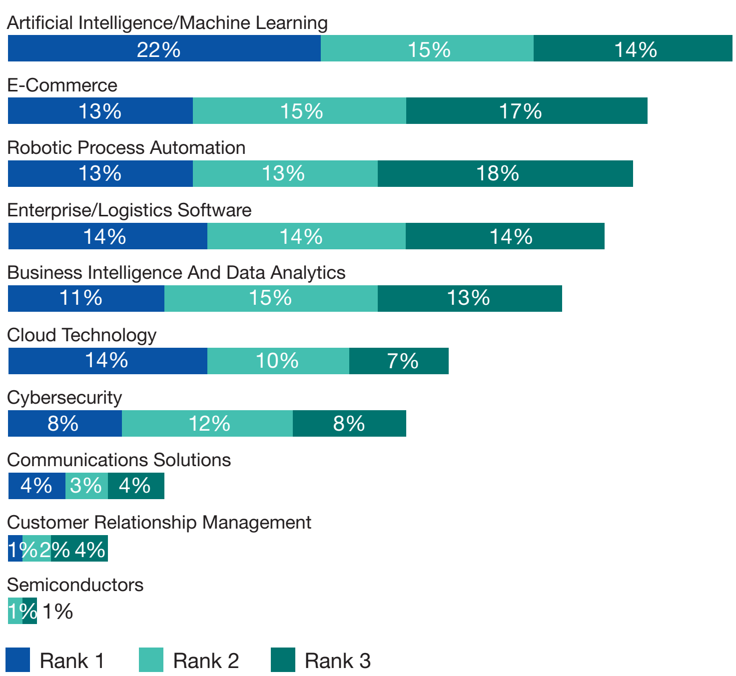
Which Of The Following Regions Do You Expect To Offer The Best Opportunities For Tech M&A Over The Next 12 Months? (Select Top Three)



When Acquiring A Tech Company, Which End-User Industries Hold The Most Interest? (Select Top Three And Rank 1-2-3, With 1 Being The Industry In Which You Are Most Interested)



Which Of The Following Tech Subsectors Do You Expect To Present The Best Opportunities For Dealmaking Over The Next 12 Months? (Select Top Three And Rank 1-2-3, With 1 Being The Subsector Presenting The Best Opportunities)



Latin America, likewise, has a rich domestic TMT market. In our survey, almost all respondents from the region (97%) identify it as offering some of the best opportunities globally for tech M&A. But international acquirers, particularly from North America, are increasingly turning their attention to Latin America and the Caribbean. Recent M&A figures bear this out: 40 TMT deals involving Latin American targets and North American bidders were announced in H1 2022, tied for the second-highest six-month total on record, behind only the 41 announced in H2 2021. The annual volume of Latin American TMT deals involving acquirers from North America has risen every year since 2016, with 2021 marking the apex with 68. These bidders are set to come close to, if not surpass, that mark this year.

Randy Bullard, partner and co-chair of Morrison Foerster's Latin America practice, notes, "We continue to see significant interest in cross-border deal activity into Latin American technology companies. We're regularly advising international acquirers and investors interested in being a part of the LatAm tech scene. More interestingly, we are also advising fast-growing LatAm technology companies looking to expand domestically and beyond their borders in other Latin American markets."

Sectors And Subsectors

Technology converges with countless sectors and, as such, dealmakers have plenty of options for tech-enabled businesses in which to invest. In a departure from last year's findings, the financial services sector is the most commonly selected end-user industry that holds the most interest, chosen by 71% of survey participants overall. This is closely followed by business services (65%), which in fact accrued more first-choice votes (26%) than financial services (24%).

TMT was not only by far the clearest top option last year, garnering 49% of first-place votes, but a full 73% had the sector among their top-three options a year ago, putting it well in the lead. The sector has since fallen to fourth place, with only 18% selecting it as their first choice and 47% citing it as a priority.

There has been a similarly large swing from last year regarding the subsectors and tech applications that present the most compelling dealmaking opportunities. Acquirers are looking further out along the adoption curve than they were a year ago, with

51% highlighting AI/machine learning as among their top-three favored segments, including 22% who believe it offers the single-best opportunities, above any other subsector on both counts. E-commerce, robotic process automation, and enterprise/logistics software are also expected to present some of the best opportunities, with overall votes ranging between 42% and 45% across these various technologies.

A year ago, cloud technology was respondents' leading choice, with not only the most first-choice votes (19%) but also the most overall (54%). At that time, AI/machine learning was barely given any consideration, with a mere 3% of first-choice votes. It would appear that investors are quickly becoming accustomed to investing in these technologies as their end-use potential becomes less speculative.

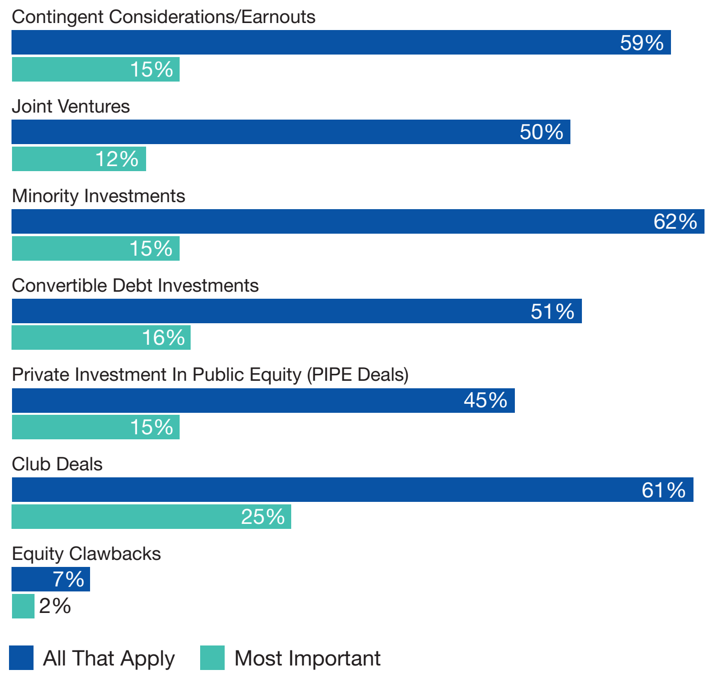
"AI is having a profound effect on many industries. The incorporation of AI solutions increases the scalability and automation levels of businesses, and provides vital dealmaking opportunities," comments a managing partner of a UK-based PE firm. This scalability and the efficiency gains that come from automating operational processes that will keep interest in machine learning high as real-world adoption accelerates.

Deal Structures

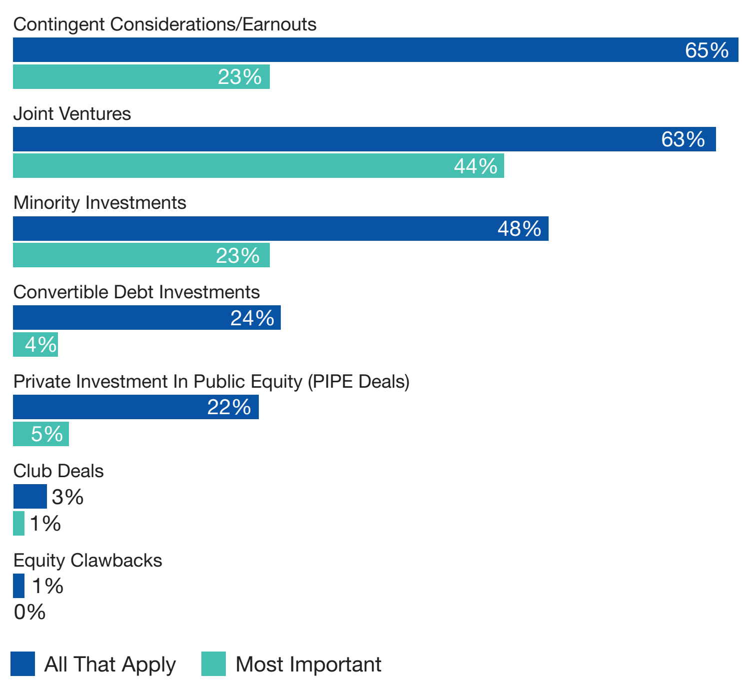
There is a range of deal structures that investors can employ to mitigate their downside risk while also increasing the likelihood that a deal pays off. Contingent consideration and earnouts are a firm favorite among PE firms (59%) and corporates (65%) alike in their tech dealmaking approaches, and it is not hard to understand why. Carefully constructed earnout milestones help buyers to see whether a business and its management team can live up to a vendor's claims—and this financial incentivization offers a clear alignment of interests.

Minority investments are also a popular option, with 62% of PE firms and 48% of corporate respondents considering employing them over the next 12 months, limiting their equity exposure. While financial sponsors are best known for majority buyouts, in many cases it is possible for investors to negotiate anti-dilution and drag-along rights, as well as board participation to exert some degree of influence over important decisions, affording them a greater level of influence.

Are You Considering Employing Any Of The Following Deal Structures In Your Tech M&A Plans In The Next 12 Months? (Select All That Apply And Most Important) - Private Equity Firm



Are You Considering Employing Any Of The Following Deal Structures In Your Tech M&A Plans In The Next 12 Months? (Select All That Apply And Most Important) - Corporate



On being asked to identify the single-most important deal structure that they might employ over the next 12 months, 44% of corporates cite joint ventures (JVs), whereas the largest share of PE firms (25%) reference club deals. This is a clear case of deal structures that are most suited to acquirer types. PE funds have been known to form JVs with corporates on occasion—with this model particularly popular at the moment in Asia for rolling out corporate products in the pharma, medtech and other technology spheres—though these are typically reserved for 50/50 deals involving two strategics. Club deals, meanwhile, are the preserves of financial sponsors. In practice, however, these two deal variations offer investors many of the same advantages—sharing expertise and know-how while spreading risk exposure.

In the light of ongoing macroeconomic squalls, dealmakers might be especially inclined in the short term to pursue transaction structures that mitigate risk, rather than swinging for the fences. As Mitchell Presser, New York M&A partner and co-chair of Morrison Foerster's global corporate department, notes: "Given the choppiness of the markets and the related conservatism that has entered the financing market, combined with the growing need for additional capital, we expect that 2023 will see more structured investments aimed at reducing risk while improving the likelihood of returns. Structures like preferred securities and debt securities that sit ahead of prior invested capital and have minimum returns are likely to be a theme playing out in the next year."

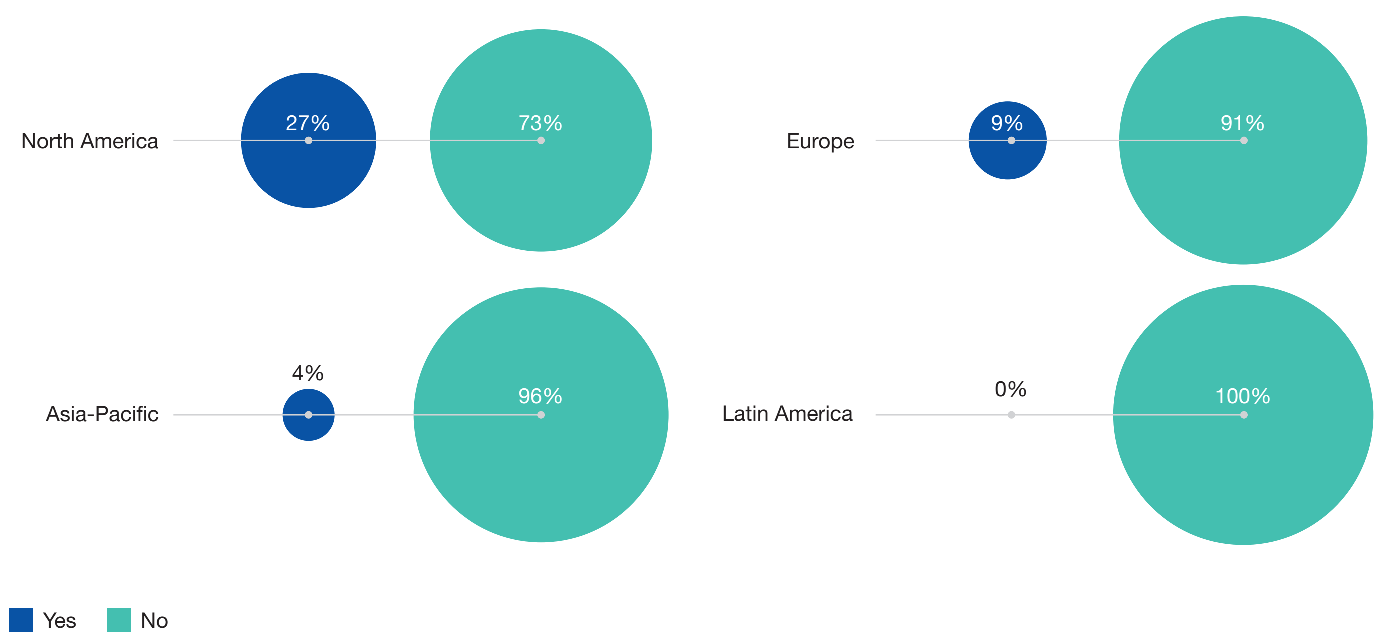
A Special Purpose

H1 2021 saw a flurry of special purpose acquisition company (SPAC) listings as liquidity-rich markets vied for deals. All told, 362 SPAC initial public offerings (IPOs) were launched, raising a combined $106.7 billion, an all-time record. But conditions have cooled off—H1 2022 saw little over 10% of this capital raised, $11.6 billion from just 68 offerings.

It was a similar picture on the dealmaking side of the ledger. There were $26.3 billion worth of U.S. de-SPACs in H1 2022, again around 10% of last year's record of $231.3 billion. This means cash shells have accounted for only 2.6% of all U.S. M&A value compared with 7.6% in the same period last year.

Tighter regulation and underwhelming post-deal share price performance have inhibited investor appetite for SPACs. Banks have also been treading carefully,

Did Any Of Your Tech M&A Deals Over The Last 12 Months Involve A Special Purpose Acquisition Company (SPAC)?



analyzing their potential risk exposure in light of plans by the U.S. Securities and Exchanges Commission (SEC) to introduce greater stakeholder accountability for financial statements and representations.

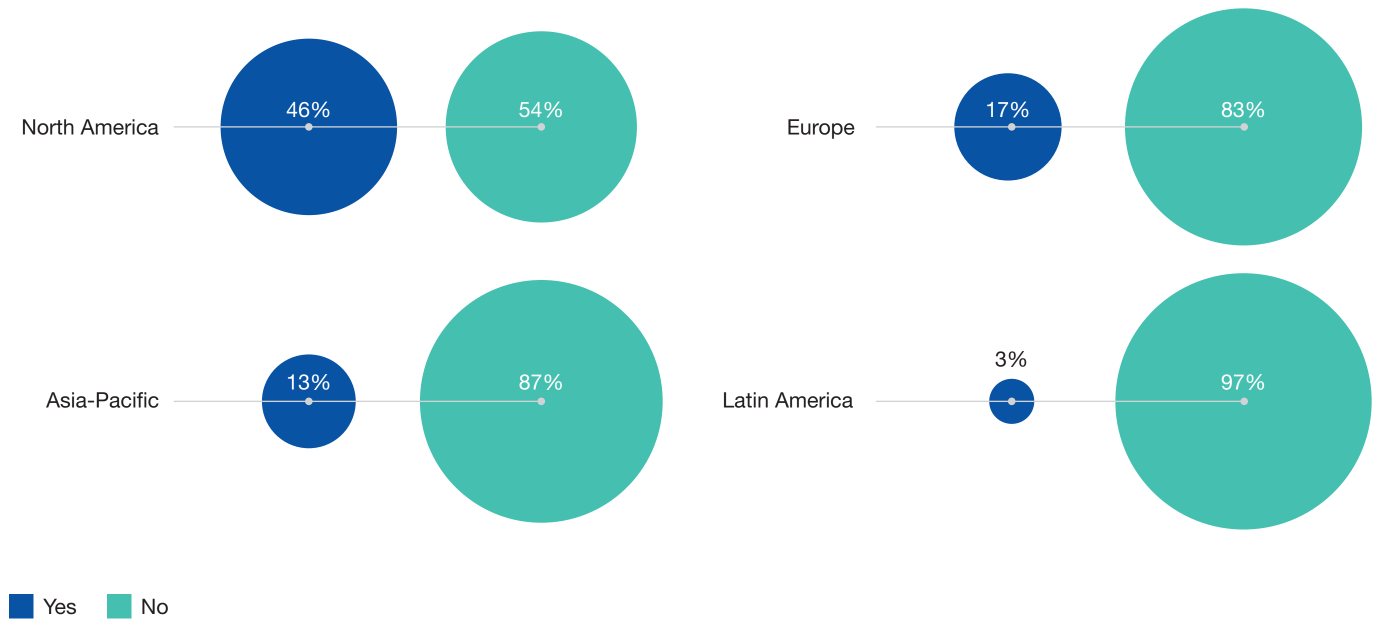
SPACs have also seen increasingly high redemption rates, making it more challenging to meet minimum cash conditions to complete a transaction. According to SPAC Research, median redemption rates soared to 91% in Q3 2022, compared to just 64% in Q3 2021. Furthermore, 19 SPAC transactions were terminated in Q3 2022, the highest number since the start of the SPAC resurgence in 2021.

Despite these challenges and the recent doom-mongering headlines, the blank-check route still offers speed and certain advantages with which traditional IPOs cannot compete. According to figures from SPAC Analytics, at the time of writing SPAC IPOs have contributed 75% of all U.S. IPOs in 2022 so far—last year and in 2020, they comprised 63% and 55%, respectively, of all U.S. IPOs. There are also some signs that deals are tentatively coming back to market, proceeding with caution and over-compliance. Moreover, of the 1,317 total SPACs, more than 40% (539) are still looking to de-SPAC, and a further 124 have announced an acquisition.

Just over a quarter of North American respondents (27%) in our survey say that one of their tech M&A deals over the past 12 months involved a SPAC. This reflects, in great part, the U.S.'s first-mover status as far as these vehicles are concerned, whereas SPACs have only relatively recently become viable or even legal options in Europe and APAC. This helps explain why just 9% and 4% of respondents, respectively, from these regions report that one of their tech deals over the past 12 months involved a SPAC.

Expectations suggest that SPACs are still credible deal instruments, particularly in North America, where 46% of respondents say they are considering employing a blank-check company in the next 12 months. And 17% and 13% of European and APAC respondents, respectively, are considering the same. However, expectations have clearly tempered since the SEC has borne down on SPAC sponsors and their practices. Last year, 49% of respondents overall reported that a SPAC would be an option they might pursue, with as many as 68% of North American acquirers indicating this as a possibility at the time.

Are You Considering Employing A SPAC In Any Of Your Tech M&A Deals Over The Next 12 Months?



As Justin Salon, partner in Morrison Foerster's Washington, D.C. office, notes: "While there remains activity in the SPAC market, the current economic and political environment, coupled with enhanced SEC scrutiny and skepticism from investors, has created extremely unfavorable conditions for most SPACs, although deals are still getting done. In 2022, the median redemption levels for SPACs in de-SPAC transactions has exceeded 90%, and we expect similar redemption levels into the foreseeable future, especially given the cautiousness of the financing markets. From what we are seeing, the de-SPAC transactions that are having the greatest success raising private capital involve highly structured securities. And while we believe SPACs as a product likely will be around for years to come, we would expect to see fewer SPACs come to market—likely consistent with what we saw before the SPAC boom in 2020 and 2021—and for de-SPAC transactions to require significant structuring in order to complete the deal and raise capital. Creativity will be the hallmark of success."

There is rational optimism for greater activity in Europe and APAC, which are starting from a low base. Regulators in the UK, Singapore, and Hong Kong introduced new SPAC regimes in 2021 or at the start of this year in a bid to woo investors to their local stock exchanges, albeit that some of these are rather strict as currently formulated. Since the launch of the Hong Kong regime on January 1, 2022, for instance, just four SPACs have listed on the local bourse, and there is yet to be a successful de-SPAC. The stock exchange maintains tight controls over who may qualify as a SPAC promoter, with all except the largest PE funds coming under heavy scrutiny.

Nonetheless, in markets with less rigid rules in place, the benefits of SPACs as another element of dealmakers' toolboxes are clear. "Having worked on Silver Crest's business combination with TH International ('Tims China'), I know the power and utility of a tool like the SPAC and I expect it will remain an important option for Chinese companies to consider," says Ruomu Li, partner in Morrison Foerster's Shanghai office.

There is also reason to expect a cautious uptick in SPAC activity in the U.S. from the low base set in H1 2022 as the market feels out the tightening regulatory environment, finding a more sustainable footing compared with the all-out mania that peaked in Q1 2021.

SECTION 3:

Outlook

Consolidation and increasingly strict regulation are the order of the day. Add the pace of tech innovation to the agenda, and it's clear that dealmakers have a lot to be mindful of.

Buyers may have numerous motivations for pursuing technology deals, few of which are mutually exclusive. The key driver for tech M&A strategies among those surveyed, however, is keeping up with the pace of technological advancement, cited by 62% of corporates and 71% of PE firms as a top-three factor. This is followed by scaling up to increase competitiveness, reported as a primary motivator for 49% of corporates and 61% of PE firms. This marks an inversion of last year's findings, when scaling up accrued 57% of top-three votes and keeping up with technological advancements was highlighted by 41% of respondents.

"Our technology dealmaking is mostly to advance and keep pace with the fast-changing technology environment," says the managing partner of a PE firm in Brazil. "Older technologies are rapidly becoming obsolete, and we have to look for newer ones that are more relevant in current markets."

Investors are in broad agreement on this point. At least 60% of respondents from each region highlight the importance of keeping up with technological advancements as a top-three driver of their near-term dealmaking strategies, with European respondents the most emphatic about this trend (69%). Clearly, the COVID-19 crisis was an accelerant for tech adoption and focused investors' minds on the opportunity in front of them.

"Advancements have been fast in the wake of the pandemic. It was the need of the hour and there were many effective solutions developed during that period. We have to keep pace with this, and dealmaking is the optimal way to achieve success," says the CFO of a corporate in Japan.

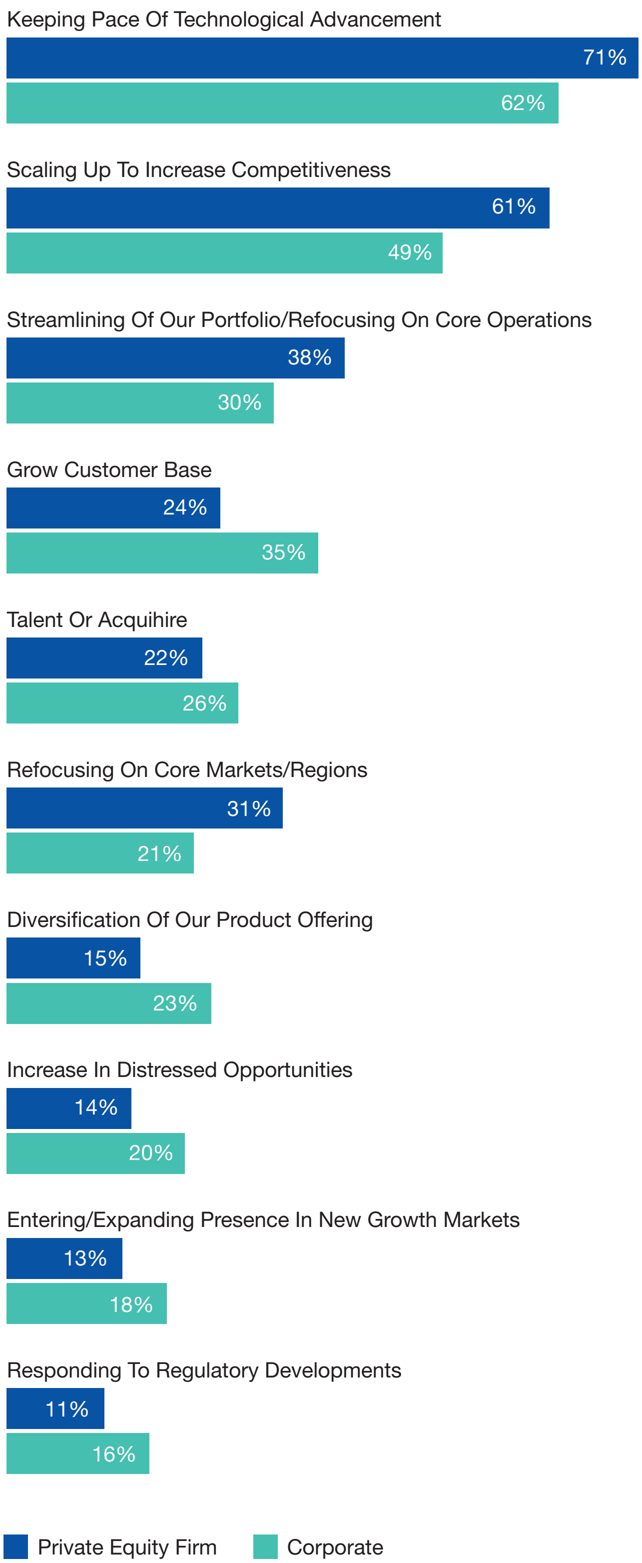
This does not mean that scaling opportunities are being underestimated. Two-thirds of APAC respondents (66%) and more than half of those from North America (56%) underscore scaling up to increase competitiveness as a primary driver for committing to a tech M&A strategy. This is less of a priority for European (47%) and Latin American (43%) survey participants, but still important and arguably more so in the face of slowing global GDP as a means of unlocking new growth.

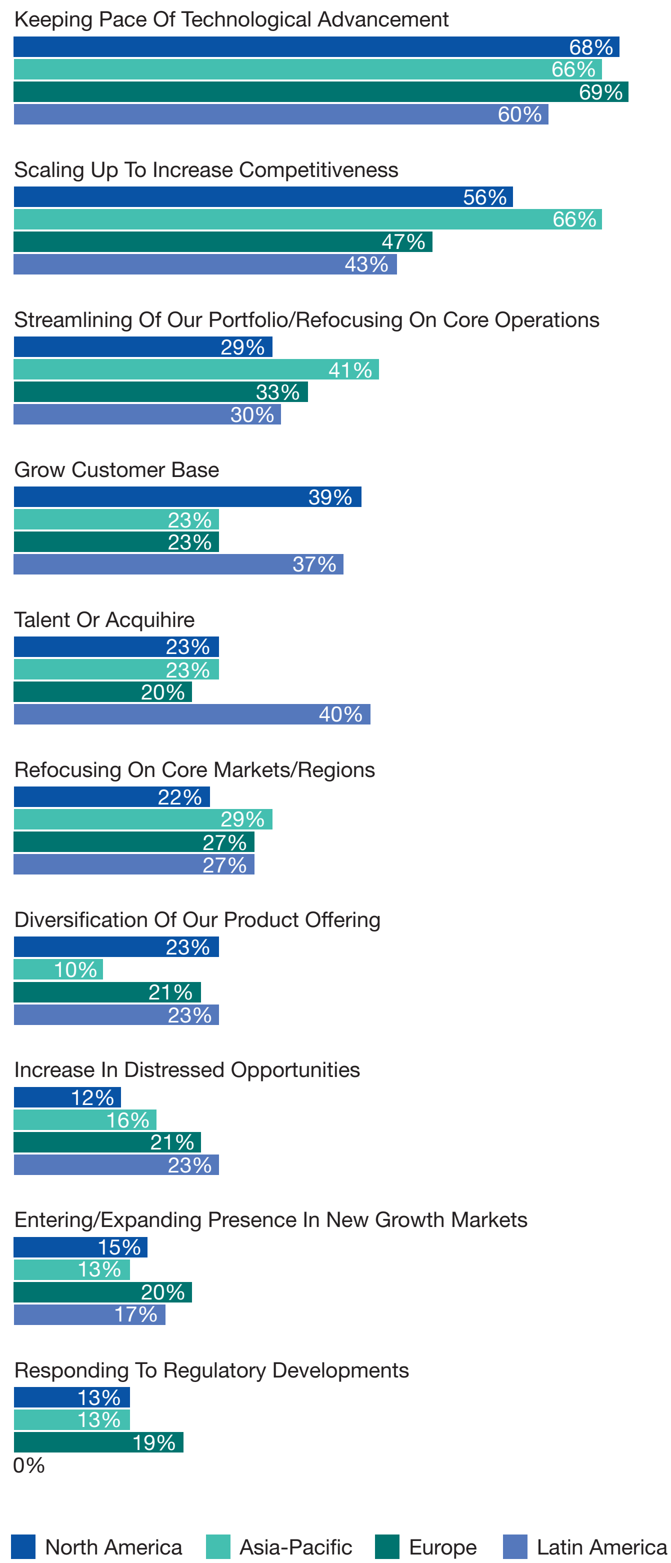
Overcoming Challenges

Keeping pace with innovation and rapidly scaling up do not come without their challenges. There are any number of potential threats to buyers' tech M&A strategies that are currently simmering. The rout in equities so far this year is what is weighing most heavily on respondents' minds, as investors question whether the market has bottomed out or has further to go following the market recovery in the beginning of H2.

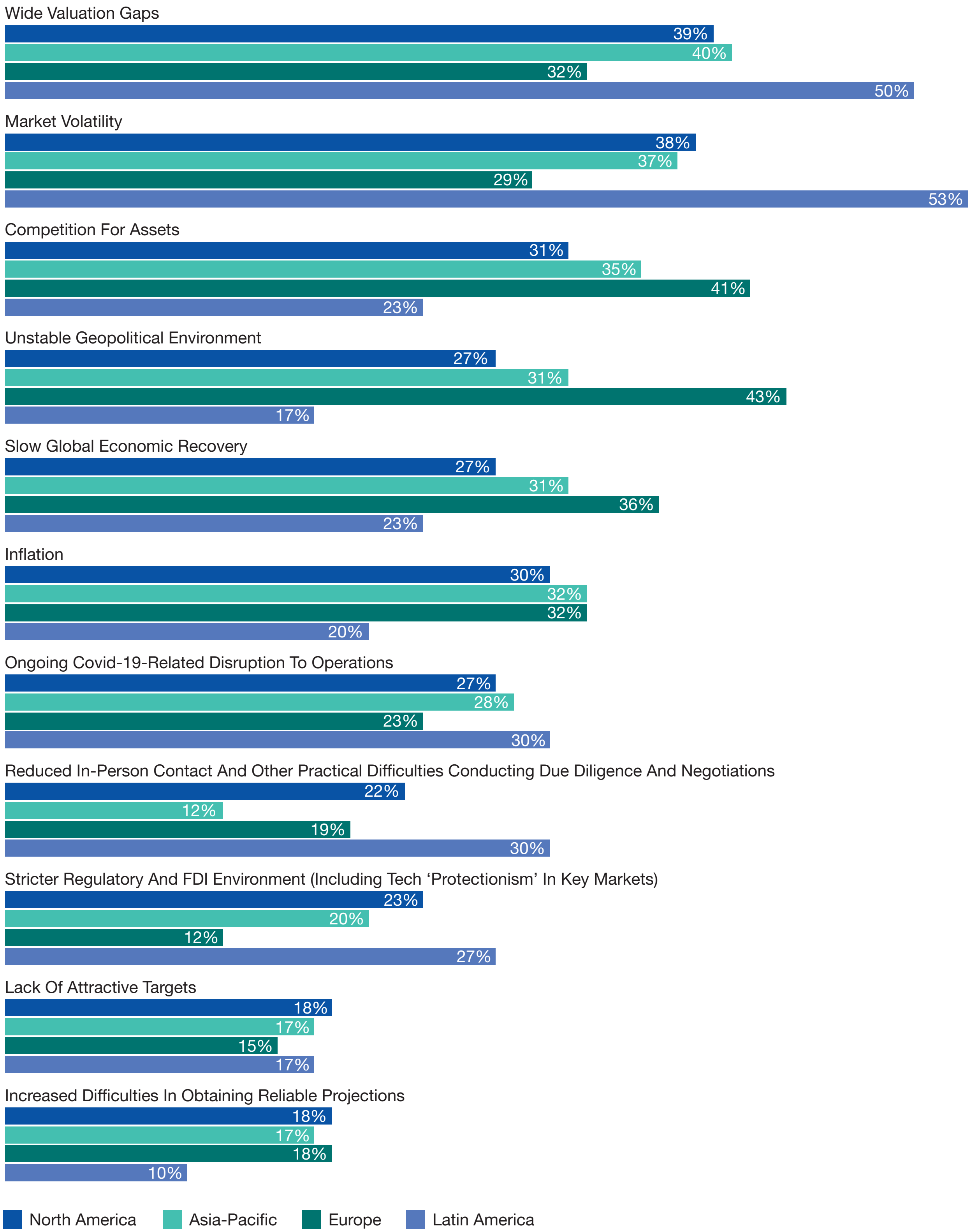
Across geographies, market volatility and valuation gaps were cited by almost equal proportions of the overall respondent group, at 32.2% and 31.9%, respectively. The two are clearly intertwined. Market turbulence scares liquidity away from markets as

What Will Be The Key Drivers Of Your Tech M&A Dealmaking Over The Next 12 Months? (Select Top Three)





What Will Be The Greatest Challenges To Tech M&A Over The Next 12 Months? (Select Top Three)



investors take risk off the table, denting mark-to-market M&A valuations and widening the bid/ask spread in the process as sellers refrain from divesting below their desired valuations.

These volatility and valuation concerns reflect the more challenging macroeconomic environment of today, with supply and demand struggling to find equilibrium following global lockdowns and unprecedented monetary and fiscal stimulus, which is now unwinding.

Last year, when GDP was growing at a decent pace, the largest share of respondents (25%) were most worried about the risk of a stricter regulatory and foreign-direct-investment environment. This is still a concern, as the key trends data illustrates. Indeed, acquirers have a number of risks on their radars, even if recent market conditions have taken precedence. "Volatility, especially stock market corrections and declining prices, will be the greatest challenge to deal with. The geopolitical environment will also give rise to more protectionism. There is a lot to think about," notes the partner of a PE firm in Sweden.

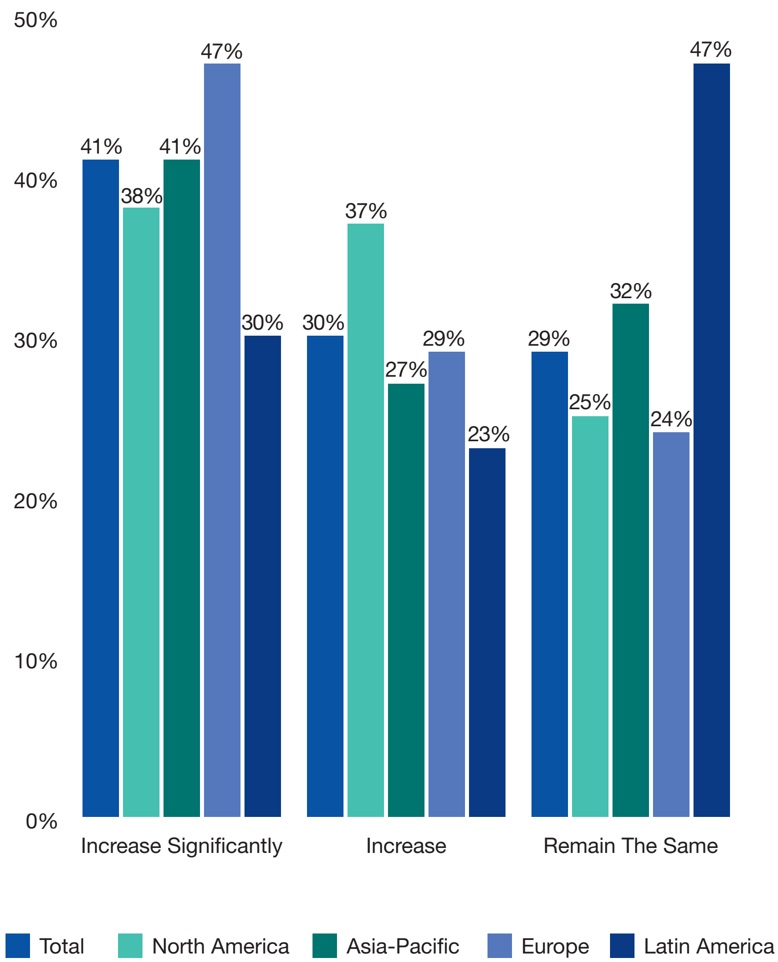
Active Duty

Shareholder activism is yet another consideration and can be a catalyst for M&A activity. The ultimate objective of these activists is to force change that can deliver greater shareholder value in languishing companies or in those that are not, activists feel, reaching their potential. Part of that change could be selling a non-aligned business arm or acquiring a strategically relevant, high-potential business that can positively transform the buyer. Activist activity has in fact been trending down since peaking in 2018, when there were 249 campaigns, according to independent investment bank Lazard. Last year, that fell to a five-year low of 173.

However, shareholder activists have been making inroads more recently. New campaigns launched in the U.S., the number-one location for this activity, increased 14% year on year, and 2021 drew to a close with a highly active Q4 that saw 50 new campaigns launched, resulting in numerous live situations heading into 2022.

On the other hand, deal participants should be aware that activist investors may also interfere with their best laid M&A plans. "We have seen an increasing number of instances where activists have campaigned in opposition to announced M&A deals, with some notable success," says Spencer Klein, co-chair of Morrison Foerster's global M&A practice. "Deal participants need to plan proactively for the possibility of activist involvement."

Do You Expect Shareholder Activism Connected With Tech M&A To Increase Or Decrease Over The Next Three Years? (Select One)



Most respondents, regardless of region or organization type, expect shareholder activism related to tech M&A to increase over the next three years. What's more, a large proportion expect it to increase significantly, particularly among respondents based in Europe (47%) and APAC (41%), with North America not far behind (38%).

ESG On The Agenda

There is a clear through-line between activism and ESG issues. During this year's proxy season from mid-April to mid-June, when most large publicly traded companies hosted their annual meetings and shareholder votes, there were a record number of successful resolutions on ESG issues. Investors took votes on 282 ESG-related resolutions, 34 resulting in majorities, according to Proxy Preview.

No matter whether investors operate in public or private markets, are passive minority or active majority shareholders, ESG matters. Regionally, Europe is leading in this respect, which can be seen in the regulatory push and government support for change—and is also reflected in our survey feedback. Asked to give their answer on a scale of 0 to 10, European respondents give the highest rating for the importance of ESG considerations when they selected their most recent tech deal target, assigning an average score of 7.8 out of 10. This is closely followed by North American respondents' average rating of 7.4.

One major green flag when reviewing a potential deal is the level of oversight and governance committed to ESG. Without this, it is not possible to track the company's progress over time. "The important thing for us was to analyze whether the company had a dedicated committee to regularly review and monitor the business's ESG performance. The overall ESG incorporation into the governance structure was mostly positive and we proceeded," observes the group head of strategy and development of a Swiss corporate.

Suz Mac Cormac, chair of Morrison Foerster's ESG practice, adds: "In M&A deals, it's important to ensure that ESG is not just an extension of compliance; otherwise, you will miss most of the assessment of current and future risk and opportunity."

ESG is an unstoppable business trend, and respondents recognize this fact. Across all regions, ESG considerations are expected to grow in importance in the selection of tech M&A targets, the anticipated increase in significance being most pronounced among APAC respondents. This group assigned an average rating of 7.3 out of 10 for the importance of ESG for their future deals, versus 6.1 for their most recent tech M&A. This likely reflects the fact that this region has been slower to adopt this

How Important Were ESG Considerations When Selecting The Target Of Your Most Recent Tech M&A Deal? (Answer 0 To 10, Where 0 Is Not Important At All, And 10 Is Extremely Important/Top Priority)

How Important Do You Expect ESG Considerations Will Be When Selecting The Target Of Your Next Tech M&A Deal? (Answer 0 To 10, Where 0 Is Not Important At All, And 10 Is Extremely Important/Top Priority)

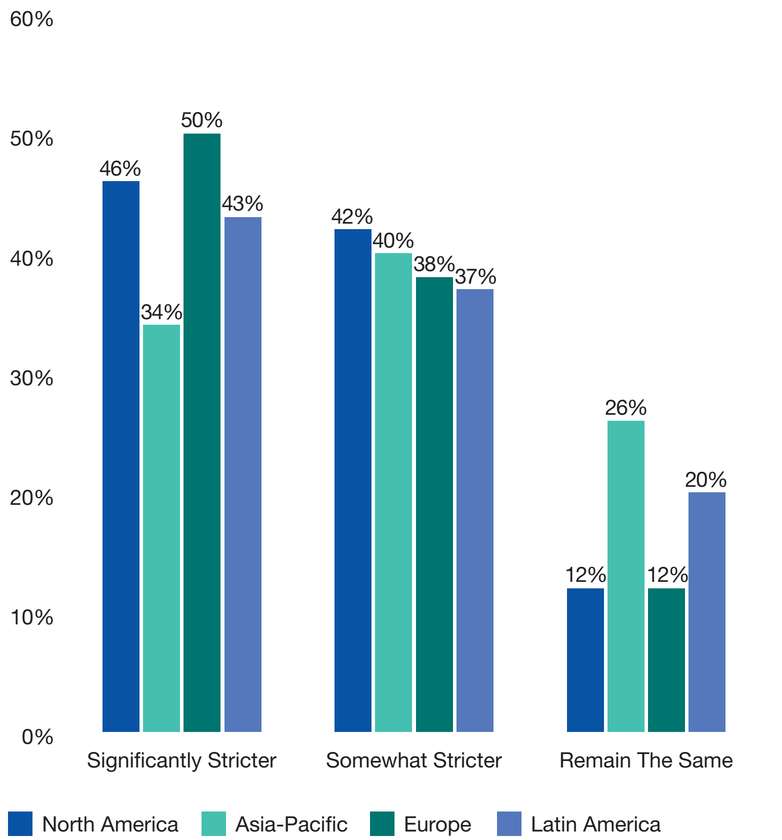
mindset than others, in particular Europe. However, in the grand scheme of things, all regions are only at the beginning of their ESG journeys.

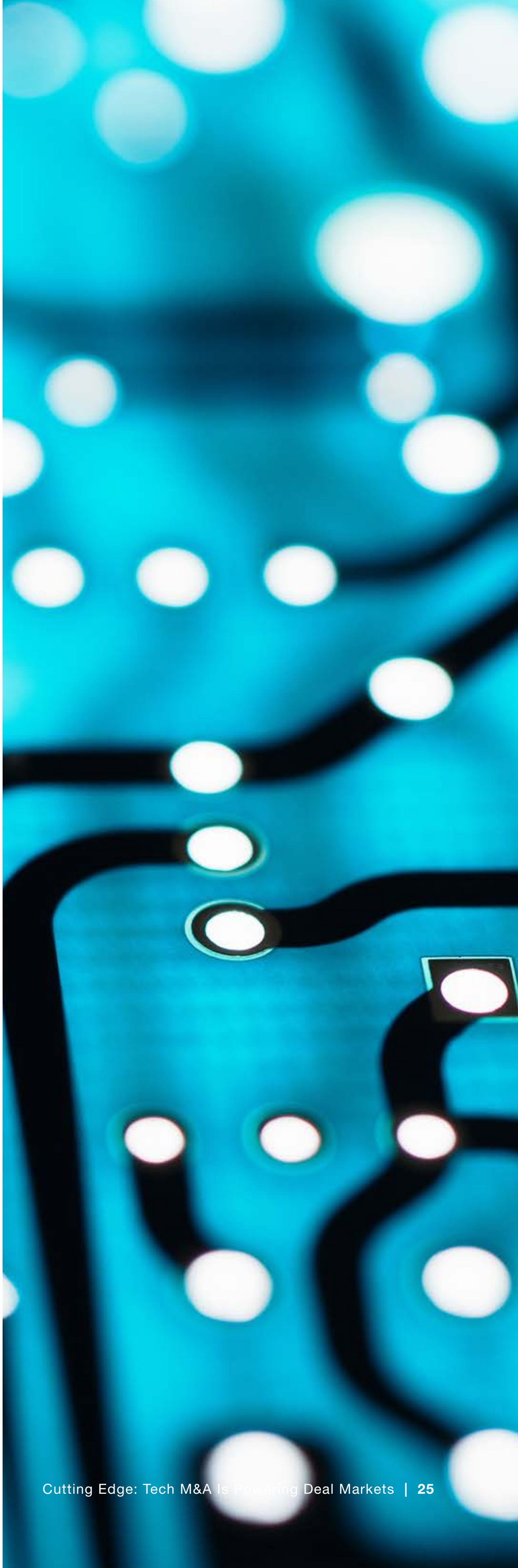
As the vice president of corporate development and strategy at a U.S. corporate says: “We will be investing more time and resources to evaluate ESG factors. It may be difficult because this is fairly new for us. We might even enlist the help of local evaluators to understand the ESG presence in the company.”

Competition Concerns

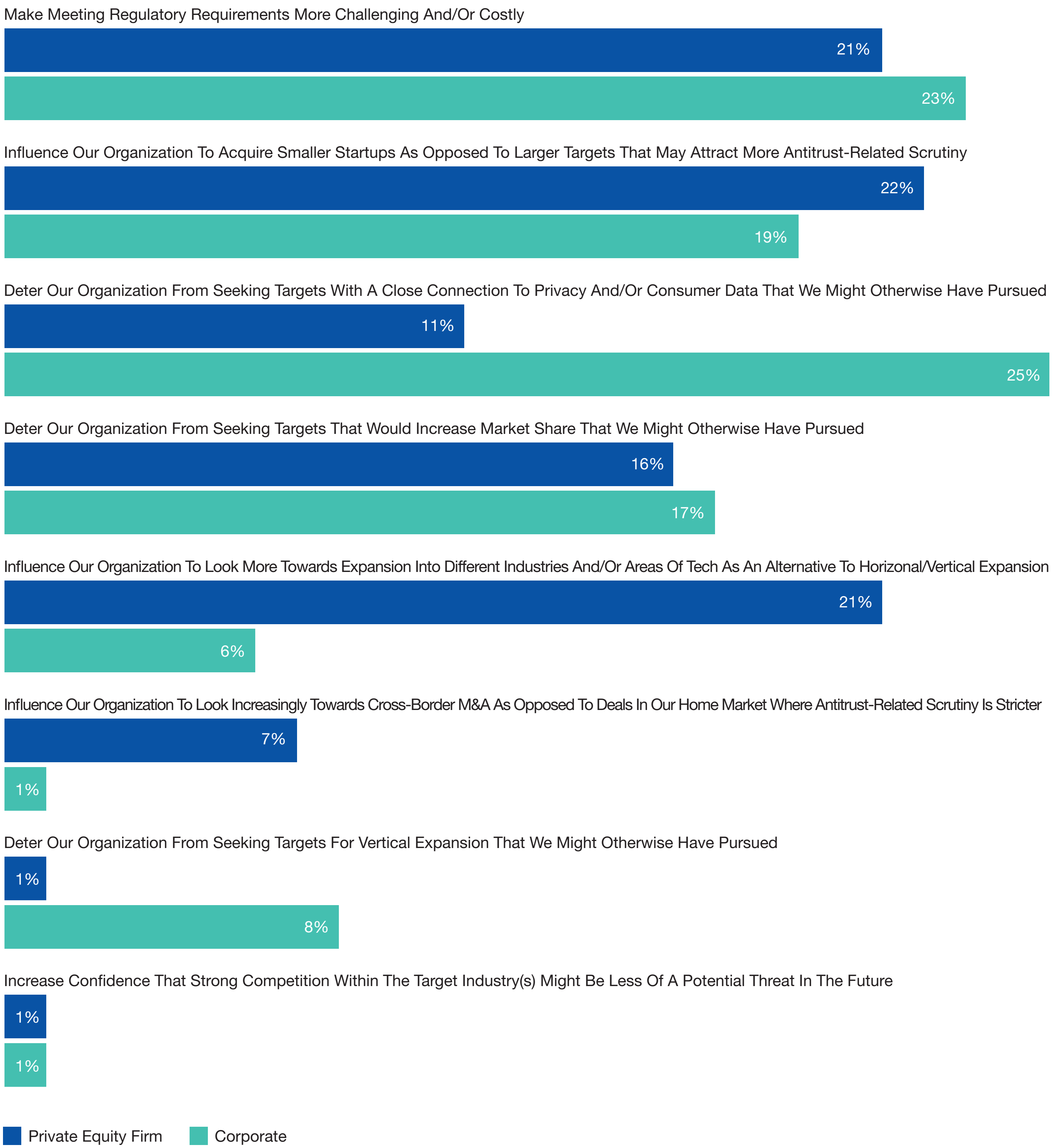
Antitrust enforcement has become a considerable burden for dealmakers recently as agencies more closely scrutinize transactions. Last year in the U.S., President Biden signed an executive order squarely aimed at tackling monopolies and anticompetitive corporate behavior. Some of this year’s largest tech deals, and indeed largest M&A transactions of any sector, have come under review in multiple jurisdictions.

How Much Stricter Do You Expect Antitrust Scrutiny Of Tech M&A To Become Over The Next Three Years? (Select One)

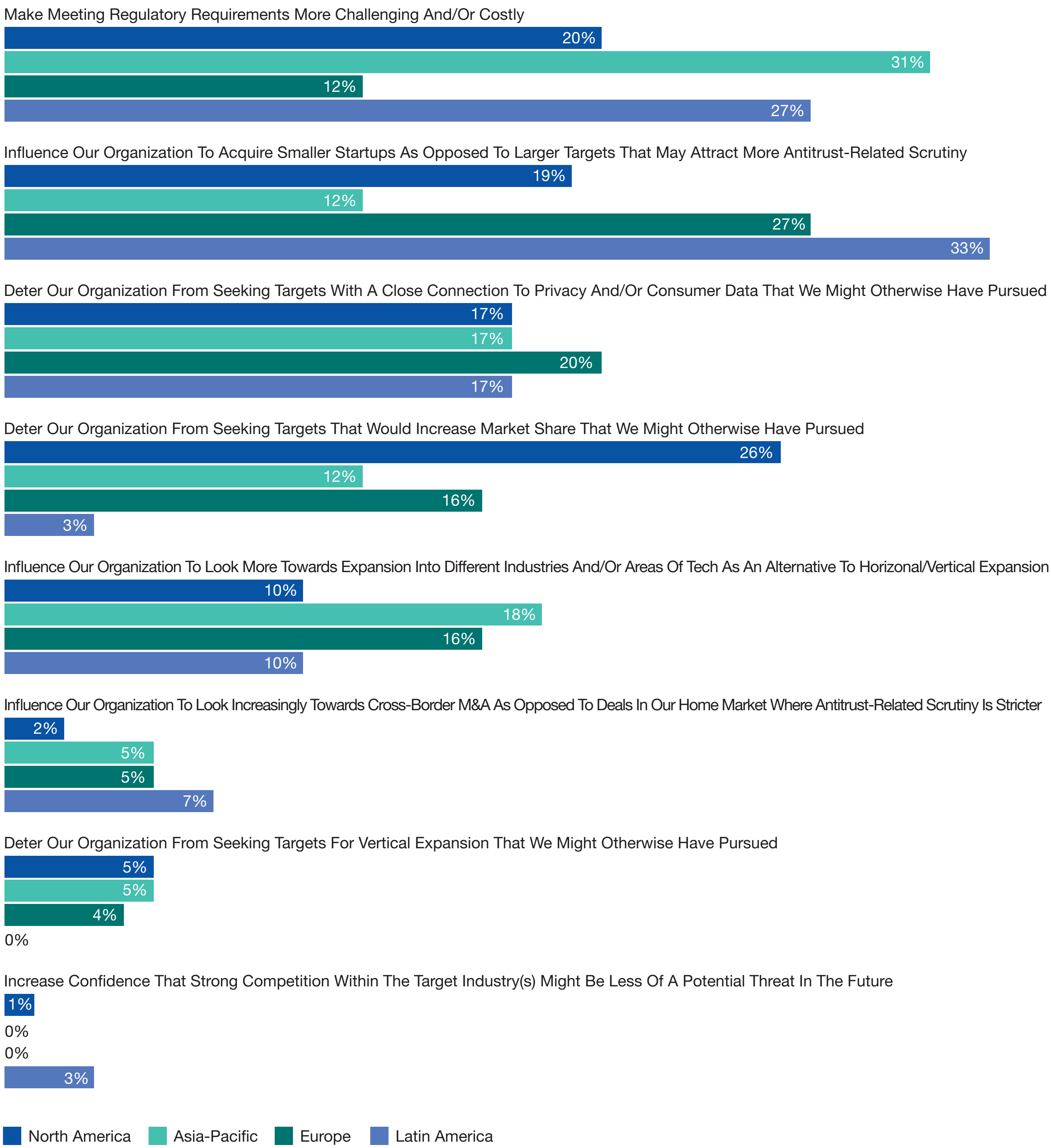




In Which Of The Following Ways, If Any, Would A Tightening Of Antitrust Law And/Or Scrutiny Most Impact Your Future Tech M&A Transactions? (Select The Most Important) BY RESPONDENT TYPE



In Which Of The Following Ways, If Any, Would A Tightening Of Antitrust Law And/Or Scrutiny Most Impact Your Future Tech M&A Transactions? (Select The Most Important) BY RESPONDENT REGION



Very large shares of respondents, including half of European respondents, 46% of North American dealmakers, 34% of APAC respondents, and 43% of Latin American survey participants, expect antitrust scrutiny of tech M&A to become significantly stricter over the next three years.

Respondents feel that tighter antitrust scrutiny could have several major consequences for their future tech dealmaking. For the largest share of respondents (22%), the single-most important impact would be more challenging or costly regulatory requirements, followed by influencing their organization to acquire smaller startups rather than larger targets that would invite more scrutiny (20.5%).

Even with this expectation of targeting smaller assets, buyers are cognizant of the fact that the FTC is training its sights at the lower end of the market, the agency having recognized that M&A involving startups has the potential to smother competition as possible tech disruptors are adsorbed before they can scale.

Indeed, acquirers believe that this loophole may be closing. “Even if the deals are under the antitrust threshold, the smaller deals are being scrutinized more closely. The trade commission is reviewing these deals even though they’re smaller, and even if they’re passed, the approvals will take longer to come through,” observes the managing director of a U.S. PE firm.

Another trend that investors should be mindful of is the increasing collaboration between data protection regulators and their antitrust counterparts, which is particularly relevant for tech companies that amass personal data.

European acquirers are especially cognizant of this, with 20% of this cohort reporting that data privacy risk exposure is likely to be the single greatest impact of tighter antitrust scrutiny on their tech dealmaking, more than in any other region. Although this is playing on the minds of European respondents, the biggest consequence of closer competition oversight is that it would lead them to pursue startups and smaller deals. Meanwhile, 26% of North American respondents, the largest share of this group, see interventionist actions by antitrust agencies as being a potential deterrent from them increasing their market share within a given industry.

Trending Points

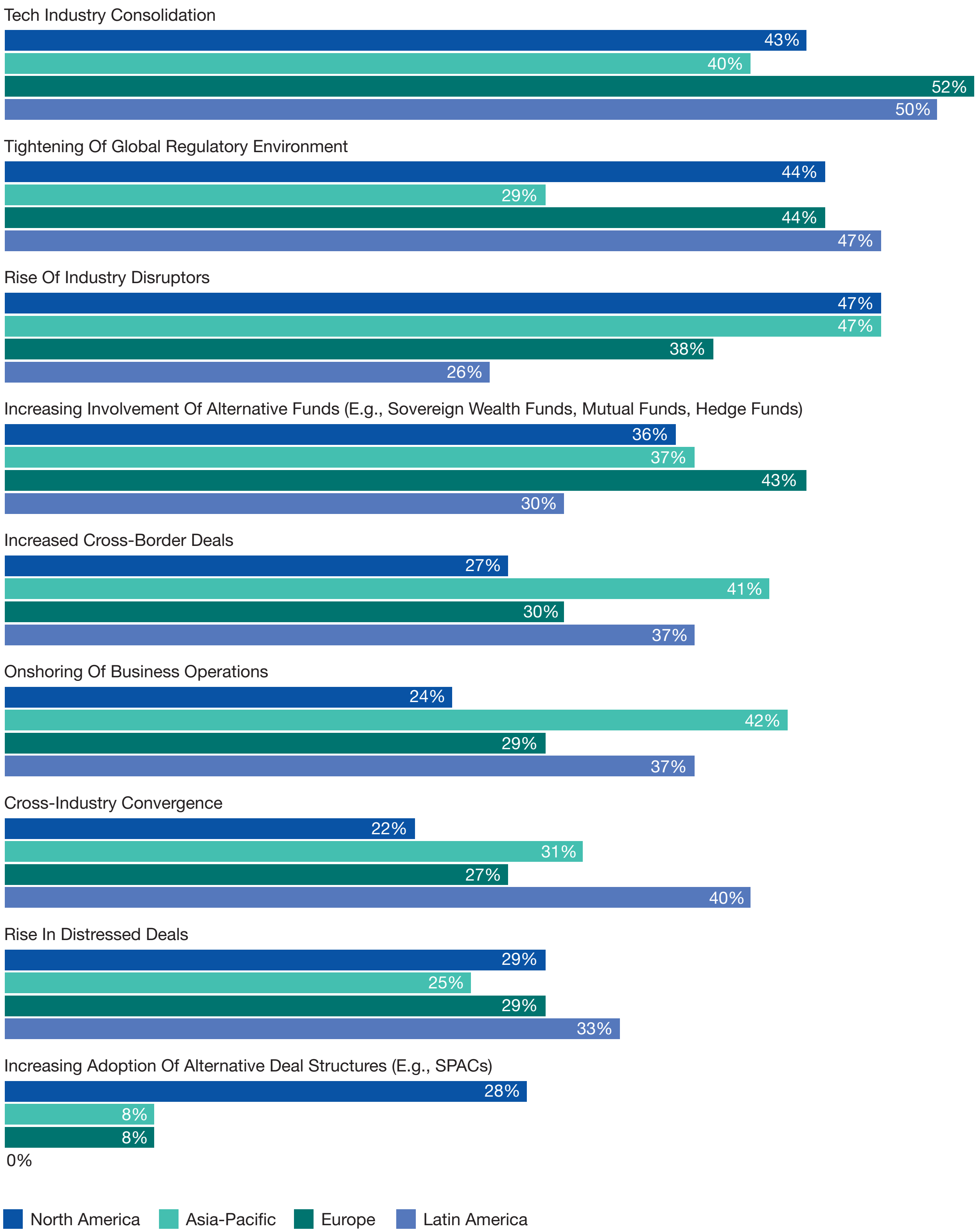
Consolidation and disruption are expected to define the medium-term outlook, according to our respondents. At least half of European and Latin American respondents expect tech industry consolidation to be a top trend (52% and 50%, respectively), while North American and APAC respondents are more likely to highlight the rise of industry disruptors (both 47%). This partly reflects our findings from last year when consolidation was the prevailing trend, cited by 31% of respondents as the number-one factor to bear in mind moving forward.

“These results correlate with our experiences across Europe,” says Dirk Besse, managing partner of Morrison Foerster’s Berlin office and head of the firm’s European corporate and M&A groups. “Consolidation is a big topic for startups that experience pressure on their pandemic-boosted business models and a more difficult financing situation. Players in high-end technology and software remain notably active with cross-border deals to adapt their business models to market trends.”

And it is not only pure-play IT and computing firms that have been getting in on the action. Some of the “Big Four” accounting firms, as well as other major professional services groups, have of late been leaning heavily into cybersecurity deals to cement their expertise in the fast-growing subsector.

Another theme that respondents see shaping forthcoming tech M&A activity is the tightening of the global regulatory environment. As many as 44% of North American and European respondents, as well as 47% of their Latin American counterparts, cite this as being a key market trend. With antitrust regulators bearing down, authorities taking a more protectionist view of cross-border activity, and the SEC enforcing stricter oversight of SPACs, it is easy to see why regulatory creep is dominating acquirers’ thoughts.

What Will Be The Key Trends In Tech M&A Over The Next Three Years?
(% Represents Top Three Trends By Region)



Conclusion

The cutting edge can go blunt relatively quickly. While navigating macroeconomic squalls, dealmakers must keep watch for the next revolution in tech.

In the past year, the narrative has shifted from the challenges of negotiating the pandemic to achieving growth and returns amid a tightening monetary environment, geopolitical uncertainty, an unpredictable U.S. economy, and China's commitment to a zero-COVID policy. The evolution of digitalization and tech adoption is continuous, catalyzed by bursts of disruption, ensuring its place as a prime source for value creation, even if recent volatility in equity markets has complicated assigning fair value to assets.

For corporates and PEs, tech M&A is usually a long-term investment subject to financial modeling and its ability to produce an acceptable rate of return and enhance the products and services offering. However, technology has the unique potential to disrupt industries, redefine social habits, reshape economic activity, and deliver blockbuster returns. For that reason, tech M&A is here to stay and in a big way.

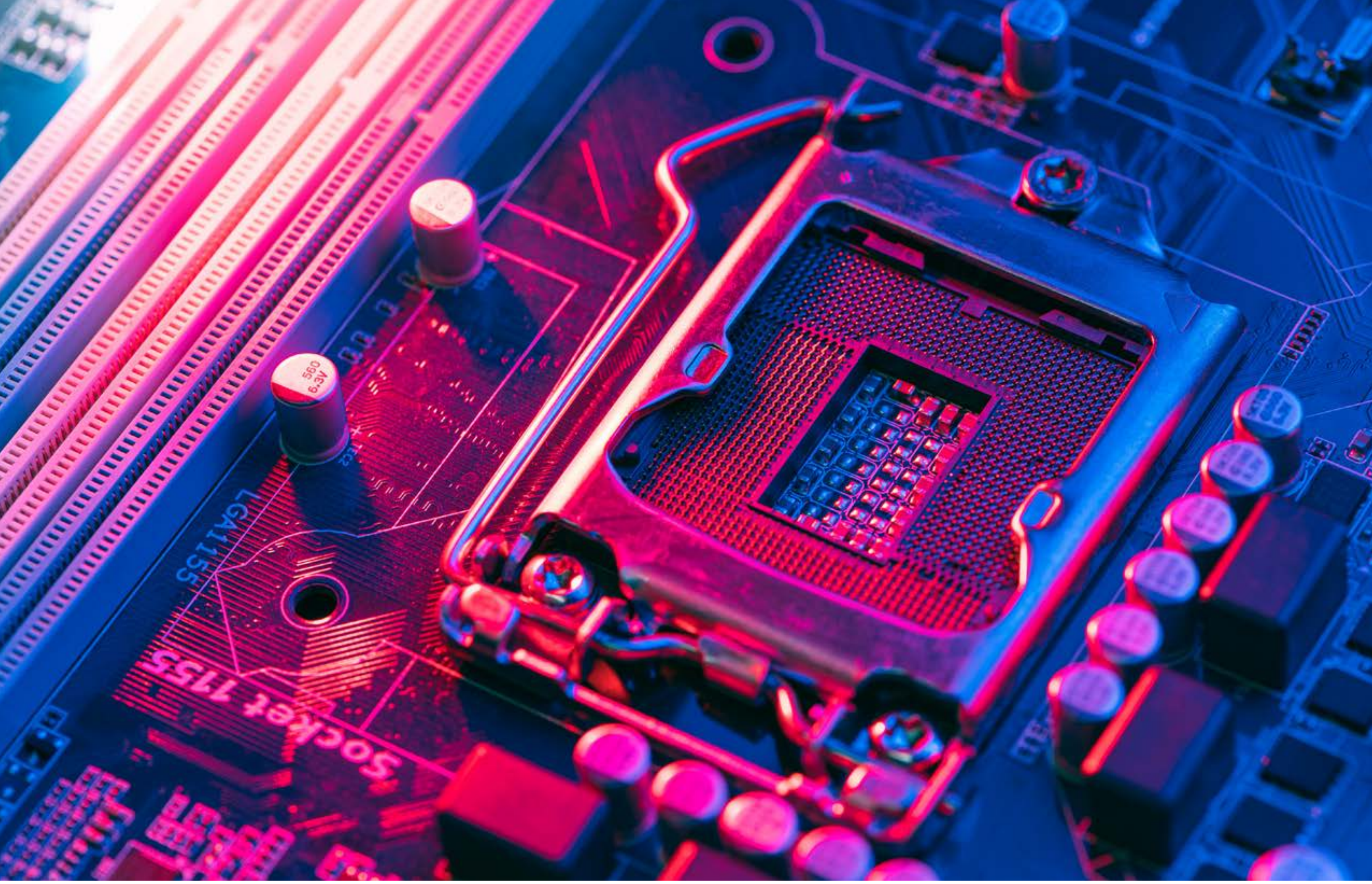
With the survey's findings in mind and evaluating what lies ahead, we offer the following takeaways that may help investors assess their priorities as they look to the future.

1

AI was the big winner among tech subsectors in this year's research, climbing to the top from the bottom of the heap in last year's report. So, what's next? Most Western nations face an existential plateauing, and in some cases decline, in their populations. This has major implications for economic productivity and society at large. Machine learning and related technologies such as robotic process automation will undoubtedly play an increasing role, and tech M&A in this area is sure to lead the way.

2

The financial services sector continues to see major disruptions, particularly from regions that have a higher proportion of the world's unbanked and the digital assets space. Huge swathes of the global population remain unbanked, but rampant digitalization is seeing more and more customers brought into the fold. The big takeaway is that tech is converging with anything and everything. Acquirers need to focus on how end markets are being disrupted before identifying industry disruptors.



3

Stricter antitrust rules are a major concern for dealmakers. There may be more incentive to pursue smaller, strategic deals that draw less scrutiny, but buyers are aware of the widening set of global regulators who are now more closely probing even startup acquisitions. Acquirers should also be mindful of the continued collaboration between data regulators and competition commissions, which is especially relevant for consumer technology companies that deal with large volumes of personal data.

4

ESG will play an increasingly significant role in the selection of tech deal targets. Technology is not the first sector that comes to mind when mitigating for ESG. However, tech's long supply chain and ubiquity in our personal lives mean that embedding ESG considerations can protect tech companies from risk arising from climate change by selecting vendors with sustainable processes or using climate change maps to assess new facility locations. Incorporating ESG can also create equity value through market differentiation, consumer preference, and talent acquisition. Direct-to-consumer tech companies and those that explicitly focus on sustainability or emissions reductions are at an advantage.

5

Wide valuation gaps and market volatility are expected to pose a challenge over the coming year. While acquirers have no control over the macroeconomic and geopolitical context, what they can control is the quality of their research and due diligence—do your homework early and go as deep as is practically possible. Use ESG considerations in risk assessments for acquisition targets. Greater diligence in the first stages of the process can put dealmakers in a more competitive position when they reach the negotiating table.

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