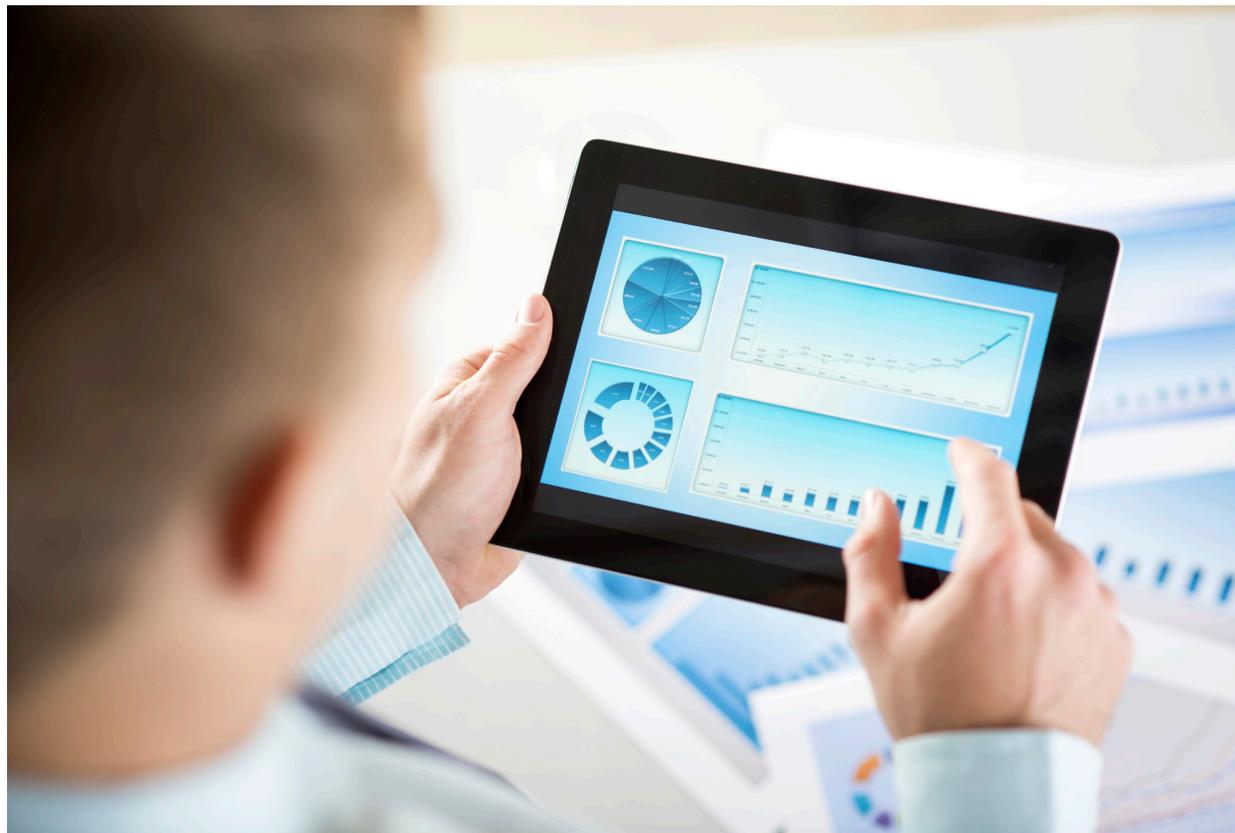


Top 10 Issues for Technology M&A in 2014



Contents

1 Overview

2 Top 10 Issues for Technology M&A in 2014

- 3 **1**  Volume and valuation
- 6 **2**  Focus on growth
- 8 **3**  TMT convergence
- 10 **4**  Monetizing tech trends
- 12 **5**  Cross-border M&A
- 13 **6**  M&A to drive business transformation
- 14 **7**  Divestitures
- 15 **8**  Talent management
- 16 **9**  Cyber-security
- 17 **10**  Rules and regulations

19 Contacts

Overview

Perspectives on technology sector M&A for 2014 are mixed. A number of industry trends are prompting stakeholders to anticipate greater deal volume in the coming year; however, other forces are challenging this optimistic outlook, with some analysts projecting a flat or downward trend in tech M&A.

There is no dispute, however, that the technology landscape continues to change rapidly. The growing availability of Internet access around the globe, proliferation of alternative access channels such as mobile devices, social media networks, and spread of user-generated content have led to an increasingly connected consumer base. This increase in connectivity, along with advancements in processor speed and storage, opens up new market opportunities but also drives significant disruption at an accelerating rate. As a result, technology companies are responding to customer and market needs — often through M&A — in four primary areas: scale, cloud services, mobility, and big data.

- At a high level, technology companies are rapidly trying to build scale to take advantage of shifting customer expectations and defend their position in the value chain. We see the underlying strategies diverge between mature market segments and growth segments. In mature markets such as semiconductors and hardware (PC, servers, tablets) there is ongoing horizontal consolidation focused on scale, market relevance, and cost structure. The Tokyo Electron and Applied Materials merger is an example of this underlying strategy. A second strategy uses M&A to move into new markets, fill product/solution gaps and accelerate research and development (R&D) initiatives. Examples include Cisco's acquisition of Sourcefire to move deeper into security and Microsoft's acquisition of Nokia's handset business. As markets continue to mature and evolve, we expect to see continued M&A driven by consolidation.
- The worldwide market for cloud computing services is expected to grow from \$59 billion in 2009 to \$149 billion in 2014,¹ as an increase in Internet usage combined with globalization is producing large amounts of data that need to be managed, stored, and accessed from numerous locations and devices. The move from premise-based solutions to on-demand cloud services is expected to make Software as a Service (SaaS) offerings the dominant factor in the industry

within five years. According to an IDC report, there may be over \$25 billion in SaaS acquisitions over the next 20 months, up from \$17 billion in the past 20 months. As cloud services become the center of competition in many IT market segments, it is critically important for incumbent IT suppliers to get more "cloud DNA" into their organizations and to accelerate the growth of their cloud services platforms and customer bases.²

- Advances in mobile technology have given consumers a greater level of control over when, where, and how they consume information and interact with media and brands, boosting on-the-go digital commerce. Innovation in mobile payments is also continuing to evolve and is expected to drive M&A in the future as large tech titans are eager to own a meaningful share of internet-based transactions. According to Gartner, mobile bill payment transactions are expected to reach \$721 billion in 2017, up from \$163 billion in 2012, representing a CAGR of 35 percent.³
- Taking unstructured data and turning that into digestible analysis is central to the exploding "big data" trend. There are many examples of companies which successfully pull dispersed data and structure it to create high-quality predictive modeling tools. These companies could become major acquisition targets for buyers looking to build out their enterprise IT capabilities for the future. Hand in hand with the proliferation of data might be increased demand and requirements for advanced security solutions.

Despite these positive trends, headwinds such as uncertain consumer spending, declining revenue/growth rates, shortage of attractive acquisition targets, moderate growth in the United States, and overall slowed economic growth in China, EMEA, and BRIC countries could put a damper on sector M&A in the coming year. Technology companies should consider the following ten issues when developing their 2014 M&A strategies.

¹ "Salesforce.com Needs Greater Share of Cloud to Justify \$140 Price Tag," *Forbes*, 2011

² *IDC Predictions 2013: Competing on the 3rd Platform*

³ "Forecast: Mobile Payment, Worldwide, 2013 Update," *Gartner*

Top 10 Issues for Technology M&A in 2014



Volume and valuation

Slowing growth and higher cash reserves for large technology companies may drive higher deal volumes and valuations, and prompt increased M&A activity in 2014.

Volume

Deal volume for the technology sub-sectors of software, IT services, Internet/e-commerce and hardware increased 3.6 percent in 2013 versus 2012.⁴ From a multiples perspective, technology enterprise value to LTM EBITDA varied across the four subsectors, increasing or staying constant in IT services and software, while decreasing in Internet/e-commerce services and hardware. Additionally, average deal value increased in 2013 versus 2012 across the four technology sub-sectors.⁵ This trend is due primarily to an increase in "mega deals" — transactions with deal values in excess of \$1 billion. The technology sub-sector with the greatest change was hardware, which more than doubled the number of deals completed versus 2012.⁶

There were 1,080 software sub-sector M&A transactions in 2013, representing a 5.6 percent decrease in the total number of deals compared to 2012.⁷ The total disclosed deal value of approximately \$54.8 billion was a 16.2 percent increase from the approximately \$47.2 billion disclosed in 2012 (Figure 1).⁸ The software sub-sector transactions with the largest deal values in 2013 were:

- Hellman & Friedman, LLC's November announcement of its acquisition of Applied Systems, Inc. for \$1.8 billion
- Cisco Systems, Inc.'s July announcement of its acquisition of SourceFire Inc. for \$2.4 billion in cash
- Nokia Corporation's July agreement for a 50 percent stake in Nokia Siemens Networks B.V. for \$2.2 billion
- Bain Capital Partners, LLC's May announcement of its acquisition of BMC Software, Inc. for \$6.9 billion in cash⁹

⁴ Capital IQ

⁵ Ibid

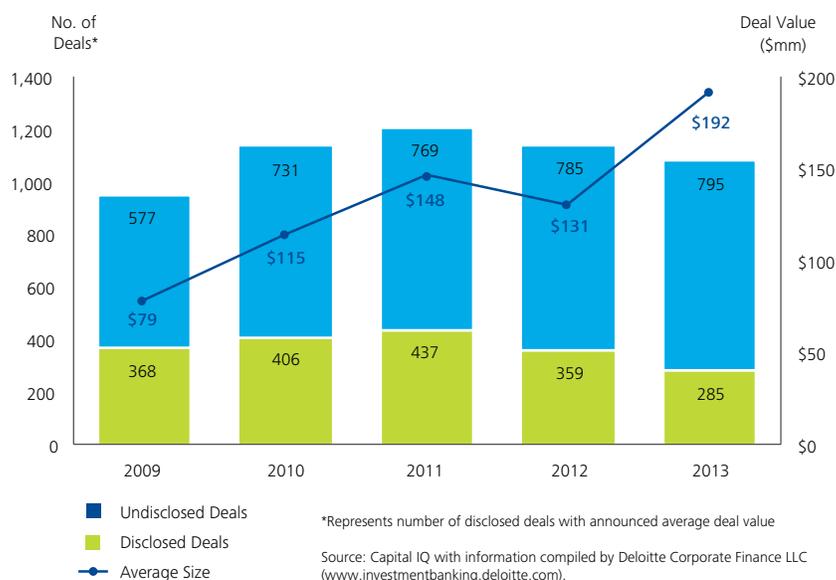
⁶ Ibid

⁷ Capital IQ with information compiled by Deloitte Corporate Finance LLC

⁸ Ibid

⁹ Capital IQ

**Figure 1: Software M&A Activity
Average Deal Value of Disclosed Deals**



Volume and valuation (cont.)

In 2013, there were 726 deals in the IT services sub-sector, representing a 4.7 percent decrease in the total number of deals compared to 2012.¹⁰ The total disclosed deal value in 2013 was approximately \$13.3 billion, which was a 2.4 percent decrease from the total disclosed deal value of approximately \$13.7 billion in 2012 (Figure 2).¹¹ The IT services sub-sector transactions with the largest deal values in 2013 were:

- PayPal, Inc.'s September announcement of its acquisition of Braintree Payment Solutions, LLC for \$800 million in cash
- Thomas H. Lee Partners, L.P.'s April announcement of its acquisition of CompuCom Systems, Inc. for \$1.1 billion

Internet/e-commerce continued to be one of the most active deal spaces within technology, led by large players such as IBM and Yahoo. The average 2013 deal size was \$101 million, a 36.1 percent increase compared to 2012.¹² There were 1,470 deals in 2013, representing a 14.0 percent increase versus 2012. The total disclosed deal value of approximately \$32.8 billion was a 59.7 percent increase compared to the approximately \$20.5 billion disclosed in 2012 (Figure 3).¹³ The Internet/e-commerce sub-sector transactions with the largest deal values in 2013 were:

- Hellman & Friedman, LLC's November agreement to acquire a 70 percent stake in Scout24 Holding GmbH for \$2.1 billion in cash
- International Business Machines Corp.'s June agreement to acquire SoftLayer Technologies, Inc. for \$2 billion
- Salesforce.com, Inc.'s June announcement of its acquisition of ExactTarget, Inc. for \$2.4 billion in cash¹⁴

¹⁰ Ibid

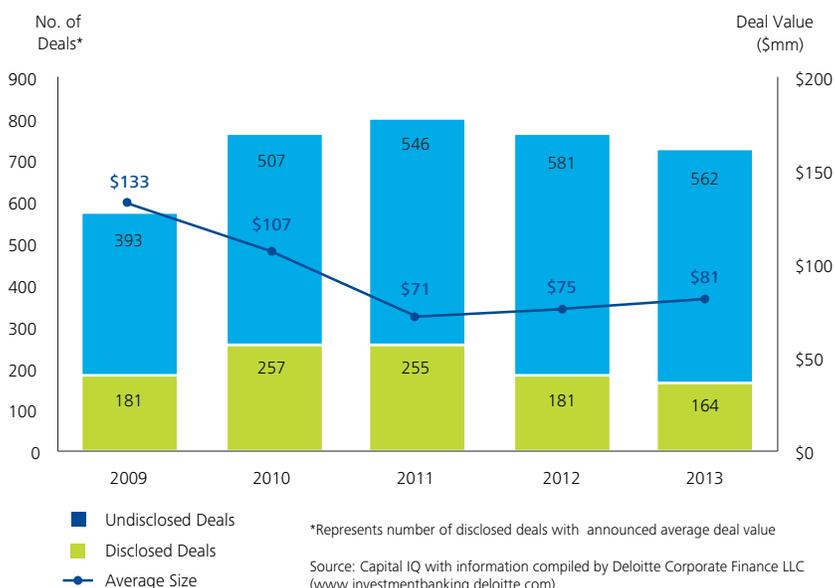
¹¹ Capital IQ with information compiled by Deloitte Corporate Finance LLC

¹² Capital IQ

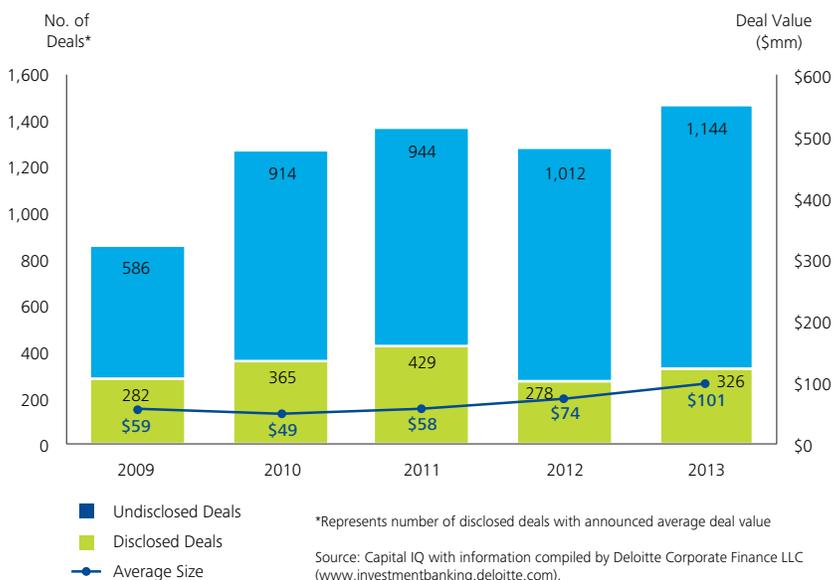
¹³ Capital IQ with information compiled by Deloitte Corporate Finance LLC

¹⁴ Capital IQ

**Figure 2: IT Services M&A Activity
Average Deal Value of Disclosed Deals**



**Figure 3: Internet / E-Commerce M&A Activity
Average Deal Value of Disclosed Deals**



Volume and valuation (cont.)

Hardware sub-sector deal volume in 2013 increased significantly, to 60 deals from 24 in 2012. Total disclosed deal value equaled \$5.6 billion in 2013, up from \$0.9 billion in 2012, a 514.1 percent increase (Figure 4).¹⁵ The hardware sub-sector transactions with the largest deal values YTD in 2013 were:

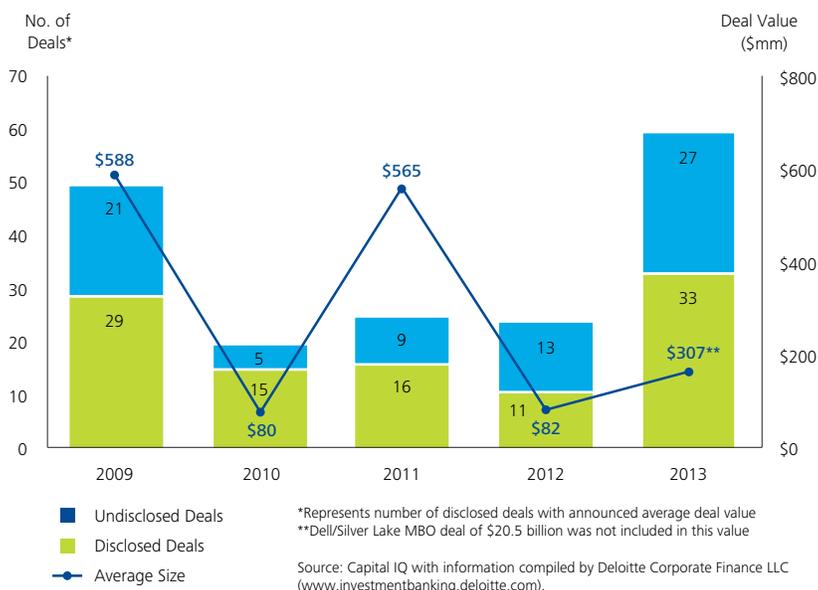
- Koch Industries, Inc.'s September announcement of its acquisition of Molex Incorporated for \$6.9 billion in cash
- Microsoft International Holdings B.V. September transaction to acquire Nokia Corporation's Devices & Services business for \$5.0 billion
- Michael Dell and Silver Lake Partners' February merger agreement to acquire the remaining 84.57 percent stake in Dell Inc. for \$20.5 billion in cash¹⁶

Valuation

While technology sector earnings have grown substantially since 2010, the price-to-earnings multiple (P/E) — or the value that investors place on earnings growth — continues to decline sequentially year-on-year. From 2010–2013, the technology sector has traded at an average 14-times P/E — a step-down from pre-recession 2004–2007, when the S&P 500 technology index traded at an average 24-times P/E — which mirrors the overall slowdown in technology sector revenue growth.¹⁷

Among the major technology sub-sectors — software, IT services, Internet/e-commerce and hardware — the highest valuations in recent years appear to have been for companies affiliated with cloud-based solutions versus traditional business models, emphasizing the importance of enterprise value to trading multiples. A tech firm providing a licensed product may trade at three to four times revenue; however, a cloud-based company offering a similar solution may trade at a multiple of six to eight times. Why? Because the cloud-based company's business model is considered more scalable and typically features a subscription sales model: Customers sign annual or multi-year contracts, which provide more predictable revenues, earnings, and cash flows versus license sales. There is generally greater visibility into the revenue pipeline and relatively less earnings volatility, enabling these companies to command higher multiples from investors.

**Figure 4: Hardware M&A Activity
Average Deal Value of Disclosed Deals**



Yet, high multiples can generate risks for tech companies engaging in M&A. In their desire to supplement internal R&D efforts and speed new offerings to market, some buyers overpay, a practice that can come back to haunt them three to four years later when analysts look at underperforming acquisitions and ask: "You paid a huge premium for this company two years ago; where's the ROI?" Some organizations can answer the question effectively; others can't.

Bottom line

The investment community should welcome technology companies redeploying their cash reserves to fund M&A and other innovative growth pursuits. In fact, investors already are rewarding high-growth technology IPOs and industry growth leaders such as Google and Facebook with premium valuations.¹⁸ Successful companies differentiate themselves by creating, communicating, and tracking the value from their M&A activities and/or making sure their investment model reflects rigorous consideration of specific drivers as well as ongoing identification of potential operating levers in order to minimize loss of value.

¹⁵ Capital IQ

¹⁶ Capital IQ

¹⁷ *Redeploying Cash to Jumpstart Growth in Technology Companies: Flush with Cash: How did technology companies get here?*, Deloitte University Press Review, 2013

¹⁸ *Redeploying Cash to Jumpstart Growth in Technology Companies: Flush with Cash: How did technology companies get here?*, Deloitte University Press Review, 2013



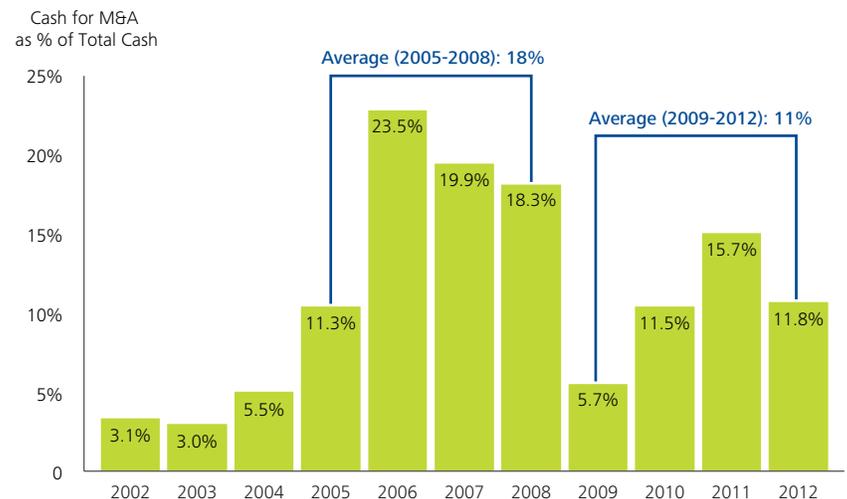
Focus on growth

During the recession of 2008–2009, technology companies appear to have prioritized profitability and cash over growth. Many lean organizations realized significant operating margin increases and historic highs in earnings, yet barely attained double-digit topline growth. As a result, post-recession, technology companies compiled cash reserves at an unprecedented rate, growing to account for 41 percent of total cash (including short-term and long-term investments) held by U.S. non-financial corporations in 2012.¹⁹ In addition, there was a significant slow-down in M&A activity. When compared to 2005–2008, technology companies spent an average of 18 percent of total cash on growth acquisitions, which declined to 11 percent of cash levels during 2009–2012 (Figure 5).²⁰

While curtailing M&A, lowering overhead and stockpiling cash provided short-term stabilization, the industry is now feeling the aftershocks of slower sector growth in the form of stock valuation multiple compression. Moving forward, macroeconomic forces and Wall Street's growth expectations make a "cash-rich" but "growth-poor" strategy unsustainable.²¹ In 2014, we anticipate that technology companies may increasingly consider redeploying their cash reserves to reinvest in growth; M&A and other partnering arrangements are among specific strategies to do this.

Technology sector P/E has moved inversely with cash levels, and Wall Street is looking for companies to grow, highlighting the need to redeploy accumulated cash and renew investments to enhance shareholder value. Typical paths to do this are to invest internally to grow the business organically; buy companies and bring external technology in-house to fill real or perceived gaps in product offerings or speed time to market; or give the cash directly to shareholders via periodic share buybacks or raising dividends.

Figure 5: Cash used for M&A as percentage of total cash
Technology sector, 2002-2012



Source: Deloitte Analysis; Underlying data sourced from Capital IQ
[Note: % Cash used in M&A = Cash used for M&A as % of Total Cash plus Short-term investments]

Increasingly, M&A has become a preferred growth strategy, enabled by a liquid capital market, the strongest equity market in a decade, and low interest rates for well-capitalized buyers. Companies have been making a variety of acquisitions: large industry incumbents are adapting their portfolios, talent, and capabilities with post-start-ups, middle market companies and "acqui-hires." Private equity (PE) firms have been raising significant sums of capital and are very active in the M&A market — Software as a Service (SaaS) is particularly attractive to PE investors because of the increased visibility it provides into revenue streams.

¹⁹ Agustino Fontevecchia, "U.S. Companies Stashing More Cash Abroad As Stockpiles Hit Record \$1.45T," *Forbes*, March 19, 2013, <http://www.forbes.com/sites/afontevecchia/2013/03/19/u-s-companies-stashing-more-cash-abroad-as-stock-piles-hit-record-1-45t>

²⁰ *Redeploying Cash to Jumpstart Growth in Technology Companies: Flush with Cash: How did technology companies get here?*, Deloitte University Press Review, 2013

²¹ *Redeploying Cash to Jumpstart Growth in Technology Companies: Flush with Cash: How did technology companies get here?*, Deloitte University Press Review, 2013

Focus on growth (cont.)

Recently, many acquirers have placed increasing focus on revenue growth through convergence and software-defined innovation. In addition, many companies appear to be pursuing growth agendas in specific verticals or service categories.

A cautionary note for those tech companies acquiring organizations with different business models — for example, a hardware-centric company buying a software firm: Past success in one area doesn't ensure future success in combined domains. There are major differences in hardware and software go-to-market, pricing, and sales strategies that should be reconciled and leveraged within the single, more diverse business an acquisition creates before growth synergies can be realized. This challenge is spawning new and interesting organizational and governance models: When hardware giant Dell purchased Quest it gained significant scale via a new set of software offerings. Dell was very thoughtful about how to integrate the acquisition; rather than fold it wholesale into the organization, Dell established a software operating division to give the new entity the autonomy it needed to be successful.

The level of competition and technology industry disruption is extremely high. Due to the accelerating pace of technological progress, there is relentless pressure on companies to constantly innovate at both the consumer and enterprise levels to survive. Large incumbents looking to add to their portfolio and grow revenues will likely need to stay alert to companies working on the next disruptive innovation. Fortunately, M&A drives a constant search for new start-ups and fairly young, well-run small companies that are working on these next-generation technologies.

Bottom line

Aggressive revenue targets may lead to deal-making in 2014 with a primary focus on achieving growth versus reducing costs. The rotation of value and margin is already present in some sectors as certain products become commoditized (e.g., hardware) and new innovations (e.g., software) are sought to heighten growth and margin opportunities. As acquirers purchase companies to grow revenue, there could be overlaps in the proprietary technology offerings and/or emerging business models that need to be mixed with traditional business models. These factors could require complex integration strategies that include a clear vision of how the new business can operate, a broad roadmap for the future, and significant resources (people, money, time).





TMT convergence

Disruptive technologies and the increasing influence of digital channels are expected to drive continued convergence and M&A activity within the Technology, Media and Telecom (TMT) space. As a result, new business models that combine multiple technologies and sectors are rapidly emerging.

Two trends are driving M&A activity: 1) Large, incumbent players that started as a technology, media, or telecommunications company are merging into a converged space as the market continues to evolve. For example, Apple is a high-tech company that now has business components which look much like media or telecom entities. 2) Companies that started as a mixture of the three subsectors are growing in size and influence. Google, for instance, has been a converged software, high-tech, media, and telecom company and is achieving huge scale by combining TMT capabilities and engaging in M&A transactions, such as its 2014 acquisition of Nest Labs Inc.²² Similarly, Microsoft announced its intended purchase of Nokia's Devices & Services business in September 2013²³ (as of early 2014 that deal has yet to close).

A prime example of TMT convergence that is generating interest among strategic buyers and PE firms is the burgeoning retail payment and processing arena. The online payment processing software industry has experienced rapid growth over the past five years, with revenue expanding at a CAGR of 30 percent.²⁴ Much of this growth stems from the rapidly expanding online marketplace and the growing comfort consumers have with purchasing goods and services online.²⁵ In one recent example, Intuit sold its payments processing business to PE firm Thoma Bravo, which then proceeded to sell it to NCR about four months later for a ~60 percent premium.²⁶

Dynamic changes have created new technologies such as mobile payment apps for specialty markets; digital and mobile wallets; Near Field Communication (NFC); cloud-based point-of-sale (POS) solutions; Quick Response (QR) codes; and location-based targeted advertising and loyalty programs.

The merging of these technologies with POS and online platforms, Consumer-to-Business (C2B) and Peer-to-Peer (P2P) uses, new payment methods (virtual prepaid, direct

carrier billing [DCB]), and the participation of many cross-industry players further changes the market for mobile payments, leading to detailed growth projections: Gartner forecasts that the worldwide mobile payment market may have over 450 million users and a transaction value of more than \$721 billion in 2017.²⁷ This represents anticipated compound annual growth rates of 18 percent and 35 percent, respectively, for the period 2012 to 2017.²⁸ Many companies are likely to be looking for acquisition opportunities to catch a ride on this technology wave.

The fast-growing, Bring Your Own Device (BYOD) movement is indicative of a broader trend that is leading to the "consumerization" of IT and could bring enterprise innovation, cross-sector convergence, and increased M&A activity. This global phenomenon is being driven by employee demands to use the devices, applications, and cloud services they prefer²⁹ — the back-end systems will likely operate with whatever device they bring into the workplace.

BYOD devices are projected to more than double, from 198 million in 2013 to 405 million by 2016.³⁰ The most common BYOD programs based on the platform being used are tablets (offered by 54 percent of enterprises, on average), smartphones (offered by 34 percent of companies), and PC programs (14 percent allow casual usage of a secondary PC).³¹

²² <https://investor.google.com/releases/2014/0113.html>

²³ <http://www.microsoft.com/en-us/news/press/2013/sep13/09-02announcementpr.aspx>

²⁴ IBISWorld; Visiongain; Ponemon Institute

²⁵ *Ibid*

²⁶ "Sale to NCR Is a Quick, Profitable Flip for a Private Equity Firm," *The New York Times DealBook*, December 2, 2013

²⁷ "Forecast: Mobile Payment, Worldwide, 2013 Update," Gartner

²⁸ *Ibid*

²⁹ Cisco, IBSG, May 2013

³⁰ Cisco, IBSG, May 2013

³¹ Gartner, April 2013

TMT convergence (cont.)



According to Gartner, 38 percent of companies expect to stop providing devices to workers by 2016 and only 15 percent of companies may never provide any BYOD option.³² Cisco's Internet Business Solutions Group estimates that U.S. companies can save as much as \$3,150 per employee per year by shifting costs to them (an average \$1,700 of voice and data) and through productivity increases — BYOD employees are gaining a global average of 37 minutes of productive time per week.³³ Even without factoring in productivity increases, researchers found that companies with BYOD programs were still coming out ahead in savings on hardware, software, telecommunications, and support costs assumed by employees who regularly want the "latest and greatest" smartphones, tablets, and apps for their personal use.

Interesting convergence is also taking place between TMT and other industries, prompting non-TMT businesses to make acquisitions in the sector. As companies in industries as diverse as medical devices and automotive manufacturing increasingly incorporate sophisticated software into their products, they are acquiring specialized software companies rather than developing the solutions in-house. Yet, these cross-industry acquisitions can add to the complexity of integrating dissimilar business models and successfully operating a newly combined company.

Bottom line

Tremendous convergence is happening within TMT; solutions increasingly are being implemented in other industries, as well. Large incumbents are looking across the TMT sector to buy start-ups or young proven companies that enable them to add disruptive innovations, expand/enhance their portfolios, or put a foot in a geography, ecosystem, or industry vertical they're not currently in. And while M&A provides speed to market for next-generation technologies, it also is a vehicle for future strategic options: Since the pace of technology change is so rapid, it is getting more and more difficult to predict where the industry may be in two years, let alone five. To hedge their bets, some tech companies are starting to preemptively buy start-ups or small-to-medium niche players in case the products or technology they offer become the next "hot" thing. With the increase in cross-sector deals, however, it is important to remember that convergence can add complexity to the M&A process; acquiring and integrating companies with different revenue and/or business models can be challenging, and should be addressed early in the deal lifecycle.

³² *Ibid*

³³ Cisco IBSG, May 2013



Monetizing tech trends

Increasing numbers of technology M&A deals are focused on capturing and monetizing industry growth trends. Because many purchased companies are not large, however, it becomes a revenue synergy play: How does an acquirer quickly extract value from an acquisition, especially if they paid a lot for it, to meet shareholder and Wall Street ROI expectations?

Three tech trends are capturing the attention of strategic buyers who are looking to quickly monetize their acquisitions: the mainstreaming of cloud computing; the rapidly emerging concept of mobility; and the growing use of big data/business analytics to improve enterprise performance.

Cloud computing

The global cloud computing market is expected to grow at 30 percent CAGR, reaching \$270 billion in 2020.³⁴ North America is the largest region in the cloud services market, accounting for 63 percent of new spending on cloud services from 2013 through 2016.³⁵ Gartner predicts continued strong growth in public cloud services, with a CAGR of 17 percent from 2011 through 2017. End-user spending on public cloud services is expected to grow 18 percent in 2013 to \$131 billion. By 2017, the public cloud services market is predicted to exceed \$244 billion.³⁶ In addition, the emergence of cloud computing for enterprises is increasing the popularity of SaaS as a distribution method. SaaS revenue is forecast to grow at 16 percent annually through 2014 for the aggregate enterprise application market.³⁷

Cloud computing often allows different forms of technology and data to be delivered in a more efficient and cost-effective way to businesses of various types and sizes. The business model for cloud services typically is subscription based, with clients paying a monthly fee — quite different from the tech industry's historically dominant license-based, download-and-run model. The segment continues to grow as Business Process Outsourcing (BPO) vendors introduce new cloud-based

business process services and/or convert existing, legacy offerings to cloud-based ones that minimize the need for capital investments while reducing operational expenses. Cloud-based advertising is another growth area. According to Gartner's Public Cloud Services Update, by 2016, the share of cloud advertising may constitute 45 percent of the total public cloud services market. Cloud advertising is expected to continue strong growth through 2016 with a CAGR of 15 percent, growing from \$52.8 billion in 2012 to \$101.5 billion in 2017.³⁸

Large industry incumbents are investing heavily in the cloud — Amazon, for example, is building massive data centers around the world to provide hosting services to middle-market companies. Oracle has a variety of cloud-related ERP interests: HR and finance applications, inventory management, and manufacturing systems technology, among others. Some industry giants are shopping for small-to-medium companies offering next-generation hosted capabilities, software-defined networks, and hosted intelligence in the network. Concurrently, software-defined businesses are looking to disrupt data networking and other traditionally hardware-based solutions, making them likely deal-makers or targets.

³⁴ Forrester

³⁵ Gartner; Forecast Overview: Public Cloud Services, Worldwide, 1Q13 Update

³⁶ Gartner; Forecast Overview: Public Cloud Services, Worldwide, 1Q13 Update

³⁷ IBISWorld; Visiongain; Ponemon Institute

³⁸ Gartner; Forecast Overview: Public Cloud Services, Worldwide, 1Q13 Update



Monetizing tech trends (cont.)

Mobility

Sales of smart mobile devices — smartphones, tablets, and e-readers — are expected to grow by 20 percent to reach \$431 billion in 2013.³⁹ Sixty-two percent of U.S. mobile users aged 25–34 own a smartphone with online capabilities.⁴⁰

The proliferation of new mobile devices and software applications is radically changing the way people are computing and staying connected. It is also creating systems-level challenges in managing information flow, collecting data, and securing the devices and their content. E-commerce companies, for example, may need to enhance their website so that it is user-friendly on phones, tablets, and PCs — and make sure that personal and payment information is safeguarded during transactions. In addition, some companies may face ongoing weakness in the PC space as the computing market continues its transition to mobile smartphone and tablet devices at a faster-than-expected rate; hence, Lenovo's recently announced acquisition of Motorola from Google.⁴¹

Big data

The use of big data and business analytics is becoming a key way for leading companies to outshine their peers by helping to generate better performance, products, and profitability. IDC estimates that spending on big data technologies and services will grow by 30 percent in 2014, to more than \$14 billion, as demand for big data analytics skills continues to surge.⁴² Although more small and medium businesses (SMBs) use big data analytics with the help of cloud providers, financial services is one of the leading industries driving the demand for big data as companies require larger market data sets and deeper granularity to feed predictive models, forecasts and trading.

Big data is likely to create new growth opportunities and new categories of companies in data storage and management, analytics and visualization, data processing, and integration. According to an IDC report, expect to see M&A targets in the visual discovery, predictive analytics, and text and rich media analytics areas.⁴³ Although big data pure-play vendors account only for about five percent of big data-related revenues, they are responsible for the vast majority of new innovations and approaches to data management and analytics that have emerged over the last several years and made big data the hottest sector in IT. Those companies are natural acquisition targets.⁴⁴

Bottom line

Without the right fuel for growth, many companies have a fixed life: an organization has to come up with its own products and services or buy them. M&A can help fuel a tech company's competitive advantage by speeding time to market for new offerings but it is only part of the equation; generating revenue from those offerings is the other. The need to monetize acquisitions, particularly as tech company valuations begin to creep up, forces companies to be more disciplined early in the M&A cycle to understand, assess, and articulate the rationale and value drivers behind a potential deal; build a strong business case based on a potential acquisition's strategic fit; and determine how and when to unlock value after the deal.

³⁹ IBISWorld; Visiongain; Ponemon Institute

⁴⁰ Ibid

⁴¹ "Google to sell Motorola Mobility unit to Lenovo," CNN Money, January 30, 2014, <http://money.cnn.com/2014/01/29/technology/mobile/motorola-lenovo/index.html>. Accessed January 31, 2014

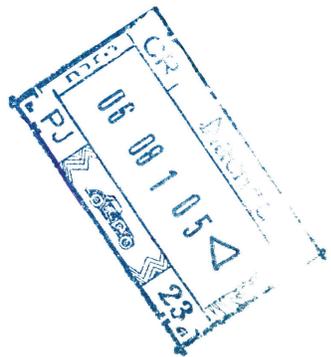
⁴² "IDC Predicts 2014 Will Be a Year of Escalation, Consolidation, and Innovation as the Transition to IT's "3rd Platform" Accelerates," press release, IDC, December 3, 2013, <http://www.idc.com/getdoc.jsp?containerId=prUS24472713>. Accessed February 13, 2014

⁴³ IDC Predictions 2013: Competing on the 3rd Platform

⁴⁴ alakhverma, "Harnessing Collective Intelligence in Decision Making through Big Data Analytics"



Cross-border M&A



Faster technology adoption and greater innovation in emerging markets is leading to more cross-border M&A deals as geographic boundaries disappear amid the pursuit of market and revenue growth. Also, since 2010, some major technology firms have been shifting their portfolio mix to include more international acquisitions.

Four cross-border trends are noteworthy: First, an uptick in inbound M&A is expected to continue, with Chinese, Brazilian and, potentially, Japanese firms buying U.S.-based companies. For example, Japan's SoftBank Corp. finalized its \$21.6 billion merger with Sprint Nextel Corp. in July 2013, acquiring approximately 72 percent of current Sprint shares in the transaction.⁴⁵ SoftBank also has made a \$1.26 billion investment — a 57 percent stake — in wireless distributor Brightstar.⁴⁶ Second, hotbeds of innovation outside Silicon Valley, especially those specializing in location-based, social, and cloud-based technologies, are generating M&A activity. Technology companies in Israel, Russia, Japan, China, India, and other emerging markets generally are less expensive acquisition targets than those in developed markets. For example, Cisco has acquired several Israeli-based companies. Similarly, Berlin is emerging as a center of innovation and seeing more M&A, especially venture capital-based deals. Third, as the trend of “acqui-hires” grows, especially for smaller acquisitions, it could drive more cross-border acquisitions. Finally, some technology companies interested in expanding their geographic footprint are engaging in less risky options than outright acquisitions, such as forming joint ventures.

Before engaging in cross-border M&A, companies should consider tax minimization opportunities that may help to bolster their innovation and growth initiatives. For example, many countries and governments — both in developed and emerging markets — offer favorable tax rates or other incentives for large multinationals to set up business there. However, there also may be tax costs involved in acquiring non-U.S. targets and integrating their intellectual property (IP) into the buyer's current business. Google, for instance, will pay the Israel Tax Authority an additional \$230 million for its June 2013 acquisition of Waze to export Waze's intellectual property. The company is expected to register Waze's IP to one of its foreign subsidiaries to avoid the relatively high U.S. tax rate for IP-generated licensing fees.⁴⁷

Yet, no matter how attractive the acquisition targets and growth opportunities, cross-border M&A can pose daunting regulatory, tax, and IP protection implications. In addition, buyers need to be aware of labor laws and other regulations that might make their optimization/rationalization plans difficult or impossible to achieve (or extend the timeline of implementation/realization), and should consider any local tax holidays or other economic development and/or investment incentives that may not be sustainable following a change in ownership. Finally, integration can be far more complicated for cross-border deals than domestic ones. Buyers should be respectful of existing cultural and business models that have worked well in local markets and carefully ease new employees into the larger enterprise.

Bottom line

Buyers, especially those entering foreign markets for the first time, should go into cross-border deals with their eyes open, leverage local resources to their advantage, and assess available tax optimization opportunities. They also should consider the potential for considerable benefits and less risk by not “going it alone.”

⁴⁵ “Sprint and SoftBank Announce Completion of Merger,” *Sprint Newsroom*, July 10, 2013. <http://newsroom.sprint.com/news-releases/sprint-and-softbank-announce-completion-of-merger.htm>. Accessed January 6, 2014

⁴⁶ “SoftBank Invests \$1.26 Billion in Wireless Distributor Brightstar,” *WSJ.com*, October 18, 2013. <http://online.wsj.com/news/articles/SB10001424052702304410204579143721068074500>. Accessed January 6, 2014

⁴⁷ “Google to pay USD 230 mln to export Waze IP,” *Telecompaper Middle East*, January 14, 2014. <http://www.telecompaper.com/news/google-to-pay-usd-230-mln-to-export-waze-ip--989943>. Accessed January 22, 2014



M&A to drive business transformation

M&A is being used by some technology companies to drive broader business transformation. Organizations are trying to expand their product and/or market footprint, as evidenced by hardware companies moving into software, and incumbent license + maintenance model software firms moving into more nimble cloud and SaaS offerings, and non-tech companies entering the industry. As examples, Level 3 Communications was founded as a wholly owned subsidiary of a construction, mining, information services, and communication company;⁴⁸ and Danaher Corporation was an Aerospace & Defense company that now touts itself as a “science and technology leader.”⁴⁹

Companies frequently view M&A as a key to business transformation, particularly when they want to make a convergence play: The relentless pace of technology change and the constant convergence of different business models across technology/media/telecom prompt a “buy versus build” decision to generally result in “buy,” even for those companies with broad R&D programs. Sought-after assets can include hardware, software, and the employees who develop them.

Increasingly, tech company business units and corporate development are collaborating on sourcing and due diligence, especially in large, transformational deals, to work diligently towards alignment with broader corporate strategies. Also, there is evidence of a greater focus on value drivers in the early stages of conceiving a deal as well as using an integrated operating model to drive and streamline the post-M&A process.

When undertaking transformational M&A, buyers should not underestimate the challenges of integrating diverse sales and delivery models into their organizations while also minimizing the risk of customer confusion in the marketplace, which competitors may likely look to exploit. Even software incumbents looking to acquire cloud-based offerings should focus on the nature and status of a target company’s own potential transition of business models and the related implications on revenue and earnings, both historically and prospectively. Additionally, notwithstanding the extent of convergence between U.S. GAAP and IFRS in certain areas of accounting, revenue recognition is still a topic presenting meaningful differences, and the

significance of pending changes to U.S. GAAP in this area should not be overlooked by either corporate buyers (for purposes of assessing future potential EPS implications) or private equity investors (for purposes of assessing potential impacts at anticipated exit).

Sometimes, full assimilation of an acquisition is not appropriate. In bigger and more operationally diverse deals, realizing value is more dependent than before on preserving the capabilities and culture of the target company. The technology sector is seeing a more specialized and complex series of integration strategies emerge where not all the capabilities of a target company are assimilated into the buying company. This trend may manifest itself as establishing the acquired company as a separate business unit with autonomy and flexibility in product engineering, and how products are sold, serviced, and supported in the marketplace, but retaining the typical integration in back-office functions.

Bottom line

Acquirers may need to scale-up their M&A capabilities as they concurrently transact larger, transformational deals and make smaller acquisitions that address talent and IP goals. Hardware companies may face integration challenges as they seek to bundle software and service acquisitions with their hardware customer offerings. Software companies, in turn, may look to acquisitions to develop and integrate comparable cloud offerings. Transformational M&A also may pressure incumbents to invest in new infrastructure capabilities and transition to new revenue streams and sales models.

⁴⁸ Level (3) website, <http://www.level3.com/en/about-us/company-information/company-history/>

⁴⁹ Danaher Corporation website, <http://www.danaher.com/about-us>



Divestitures

Many companies continue to use divestitures as a means to unlock value from past acquisitions, unload underperformers, and fund new M&A activity. The maturing of certain tech sectors is resulting in some companies streamlining their product and services portfolios to focus on redefined “core” offerings and sell those that have become tangential (e.g., Intuit selling its Health Group and Financial Services businesses).

Historically, technology was a one-way street of companies using M&A to add to their product and service mix. However, as the sector matures and companies re-evaluate their portfolios according to what’s core and non-core to their business strategy, divestitures have increased.

Divestitures also appear to be losing their stigma as an indication of failure. Rather, as the technology industry matures, serial acquirers or diverse organizations are likely to reassess and attempt to rationalize their portfolio of product and service offerings, which may present buying opportunities. Also expect a continuation of the trend towards more rigorous preparation on the part of sellers with respect to the divestiture process as a way of defending value and maximizing proceeds that can be better deployed elsewhere (versus the historical tendency to just want to be rid of an operation identified as non-core). Given the degree to which valuation of technology companies is based on intellectual property and/or “human capital,” it is likely that PE firms could continue to compete for deals since corporate buyers in the technology space may have less of a potential cost saving and synergy advantage versus traditional “brick-and-mortar” or capital-intensive businesses.



Bottom line

The technology sector should continue to see an increase in divestitures of underperforming or non-core assets as companies rethink their market position and streamline portfolios to align with evolving strategies and directions. Since the divestiture cycle is relatively new to the technology sector, however, companies may not be familiar with the process; to heighten the value of a divestiture, they should use the same rigor to become a prepared seller as they do to become a prepared buyer.



Talent management

Many tech companies are using M&A to win the talent battle, as they seek to increase and strengthen their employee base (particularly engineers and developers). Yet, while talent-focused acquisitions may look great on paper they are often daunting to execute. Retaining, managing, and developing the talent that comes with an acquisition can create different management challenges that may frustrate new employees, integrated organizations and, very possibly, customers. As technology companies scale across the globe and increasingly operate as virtual, on-demand employers their management, tax, financial, and HR challenges may continue to evolve at very rapid speeds.

Talent development is particularly relevant given the pace at which the technology industry evolves and the fact that innovation is a key driver of many workforce challenges and trends. Large investments in new technology, products and applications may make the difference between achieving cutting-edge margins or huge losses. This innovation imperative can create enormous “right skills at the right time” pressure on workforce recruiting and skills development.

Many tech companies promote a “campus culture” in which employees are expected to spend large amounts of time at the company’s primary worksite. While there is clearly perceived value in creating a people hub, today’s workforces are becoming more distributed, mobile, and remote. When dealing with Internet-based business models it can be easier in one respect to manage an organization, develop capabilities, and hire talent because the location where work takes place is irrelevant. People can be productive working from any place on the globe at any time of the day or night. However, having virtual teams, managers, and employees can result in unintended consequences during integration or divestiture. Virtual employment models are based on a mutual trust in a strategy, a performance expectation, an environment, and a certain set of employment terms. During an acquisition, that trust can be in question. If core competencies reside in virtual employees, the risk of talent flight, disengagement, and passive resistance may be almost unmanageable.⁵⁰

In addition, organizations require a pool of leaders with diverse skills, personalities, experiences, and capabilities to address the different challenges facing the industry (globalization, acquisitions, disruptive innovation, etc.). In order for technology companies to drive their organizations forward, leaders should be flexible, adaptable, creative and assertive — skills necessary to challenge the status-quo and innovate faster than the competition.

Bottom line

Many companies are taking a page out of the 1990s M&A experience when using M&A to bolster their talent base: isolate core competencies, leverage innovation, retain people and unique knowledge as creatively as possible, and keep close tabs on the workplace and its ability to secure valuable talent from any place on earth.

⁵⁰ “Yahoo Orders Home Workers Back to the Office,” *The New York Times*, February 25, 2013. <http://www.nytimes.com/2013/02/26/technology/yahoo-orders-home-workers-back-to-the-office.html?pagewanted%253Dall&r=0>





Cyber-security



Cyber-crime per company per week has jumped 44 percent since 2010, according to a survey conducted by the Ponemon Institute,⁵¹ a situation complicated by rapid expansion of e-commerce, cloud-based computing infrastructure and services, and the growth in mobile. In response to growing cyber-threats, the Global IT Security Spending market is forecast to grow at a CAGR of 9.3 percent over the period 2012-2016, according to TechNavio analysts.⁵²

Increasingly, cyber-criminals attack organizations using sophisticated techniques that evade many of the security controls established over the last several years. Recognizing this reality, leading organizations are approaching cyber-risk more broadly by utilizing both defensive and “offensive” capabilities. In the landscape of cyber-intelligence, mere deterrence is no longer sufficient. Companies should be able to identify threats before attacks occur — and defend themselves proactively.

To support this approach, IT and security teams are adopting forensic, logistics, and analytic capabilities and techniques to mine intelligence from both internal and external sources. By doing so, they are able to develop a deeper understanding of the origin of attacks and track specific adversaries to enhance future risk analysis. If a security breach occurs, they can move quickly to detect, isolate, and contain it.

Moreover, companies may soon be able to add new tools to their cyber-intelligence arsenals, including technologies that support real-time sharing of threat information within industries; digital identity programs to validate employees and other users working both internally and externally; improvements in the way companies recruit and retain cyber-intelligence talent; and bold new approaches to office design that promote privacy and compliance with security policies.

The number of cyber-security companies and advisors is growing as the need to protect sensitive data (e.g., personally identifiable information [PII], payment card data, intellectual property, etc.) across high-risk sectors — government, financial services, technology and others — becomes a front-burner issue.⁵³ For example, the Global Mobile Security market was projected to reach \$3.5 billion in 2013 and is set for substantial growth over the next five years.⁵⁴ In addition, cyber-security companies have become

attractive M&A candidates. FireEye’s December 2013 acquisition of Mandiant⁵⁵ merges a provider of attack-detection security software with a company best known for emergency responses to computer network breaches. This deal is indicative of a developing cyber-security market in which many companies are acknowledging that strategies around perimeter security (i.e., keeping hackers out) may likely need to be supplemented by better strategies around response to breaches.

Bottom line

The vulnerability of business and consumer information, including credit card and social security numbers, is expected to drive new and more stringent government regulations to protect that data, as evidenced by President Obama’s Improving Critical Infrastructure Cybersecurity Executive Order and the National Institute of Standards and Technology’s (NIST) development of a Cybersecurity Framework, “which will be a set of voluntary standards and best practices to guide industry in reducing cyber risks to the networks and computers that are vital to the nation’s economy, security and daily life.”⁵⁶ Ongoing cyber-threats also serve as potential drivers for security software sub-sector growth and associated M&A plays by tech firms and non-industry players seeking a foothold in this fast-growing market.

⁵¹ *Second Annual Cost of Cyber Crime Study, August 2011, Ponemon Institute*

⁵² *Global IT Security Spending Market 2012-2016, TechNavio, October 25, 2013, <http://www.technavio.com/report/global-it-security-spending-market-2012-2016>. Accessed January 22, 2014*

⁵³ *IBISWorld; Visiongain; Ponemon Institute*

⁵⁴ *Global Mobile Security (mSecurity) Market 2013-2018, Visiongain, March 13, 2013, [http://www.visiongain.com/Report/1000/Global-Mobile-Security-\(mSecurity\)-Market-2013-2018](http://www.visiongain.com/Report/1000/Global-Mobile-Security-(mSecurity)-Market-2013-2018). Accessed January 22, 2014*

⁵⁵ *“FireEye Computer Security Firm Acquires Mandiant,” The New York Times, January 2, 2014, http://www.nytimes.com/2014/01/03/technology/fireeye-computer-security-firm-acquires-mandiant.html?_r=0. Accessed January 22, 2014*

⁵⁶ *“National Institute of Standards and Technology Initiates Development of New Cybersecurity Framework,” NIST Information Technology Laboratory, February 13, 2013, <http://www.nist.gov/itl/cybersecurity-framework-021313.cfm>. Accessed January 17, 2014*



Rules and regulations

Technology companies should beware of the long arm of the law. Increasingly active regulators, including compulsory notification to China's Ministry of Commerce (MOFCOM) of planned mergers even when the parties' exposure to China is relatively low, will likely continue to impact deal decision-making. Conditional approvals and "hold separate" requirements can delay and/or limit the realization of anticipated value creation and impact deal valuation to the buyer or seller due to intervening foreign currency fluctuations between a deal announcement and eventual closing. In the U.S., the federal government's Committee on Foreign Investment in the U.S. (CFIUS) has been active in placing costly requirements on inbound investments.

In addition, uncertainty around the potential impact of significant changes in U.S. GAAP revenue recognition guidance under the convergence standard (expected to be issued in late Q1 or early Q2 2014), as well as possible tax code changes, may cause companies to reallocate capital rather than invest in M&A.

Supply chains in the TMT industry are becoming highly vulnerable due to the threat posed by human rights issues associated with conflict minerals — columbite-tantalite (coltan or tantalum), wolframite (tungsten), cassiterite (tin), and gold (collectively, the "3TG") — which are critical to certain elements of technology production.⁵⁷ More than 5.4 million people have died within the countries that make up the conflict mineral zone since 1996.⁵⁸ It is estimated that armed rebels have generated nearly \$1 billion from minerals extracted and stolen from mines located in the conflict mineral zone.⁵⁹ Dodd-Frank aims to deter — through increased transparency of companies' sourcing practices — the extreme violence and human rights violations in the Democratic Republic of the Congo (DRC) and neighboring countries,⁶⁰ which are funded by the exploitation and trade of certain minerals. Dodd-Frank Section 1502 is a disclosure requirement that calls on companies to determine whether their products contain conflict minerals, and when applicable, perform due diligence of their supply chain, followed by reporting to the Securities and Exchange Commission (SEC).⁶¹ The final rule requires publicly listed companies which file with the SEC to follow a three-step process for evaluating the use of conflict minerals and to file a new form (Form SD) commencing with the calendar year ending December 31, 2013. This form must be filed annually by May 31 and will cover products manufactured in the prior calendar

year, if the registrant determines that such minerals are necessary to the functionality or production of a product it manufactures. In certain circumstances, registrants are required to include a conflict minerals report and to have an Independent Private Sector Audit (IPSA) performed.⁶² The OECD Due Diligence Guidance for Responsible Supply Chains of Minerals from Conflict-Affected and High-Risk Areas⁶³ has become one of the most globally recognized frameworks for performing a conflict minerals due diligence. Many technology companies and those from a variety of other industry sectors are relying on this framework to assess the risk that conflict minerals pose to their supply chains.

Bottom line

Existing and new regulations may impede large, transformational deals and complicate cross-border M&A. Technology companies need to be aware of the extent to which regulatory bodies can exercise their approval authority — there could be jurisdictions where a merger may be subject to a particular country's approval process even if neither party has feet on the ground there. Companies also should incorporate regulatory considerations in their due diligence process to mitigate risks from potential acquisitions, such as companies that may not have capable conflict minerals compliance programs.

⁵⁷ *Conflict minerals and technology, media, and telecommunications companies: Readiness for 2014 Requirements*, Deloitte, December 2013

⁵⁸ *Global Citizen*, <http://www.globalcitizen.org/Content/Content>

⁵⁹ *Enough Project for Africa*, <http://www.enoughproject.org/conflict-minerals>

⁶⁰ *Angola, Burundi, Central African Republic, the Republic of the Congo, Rwanda, South Sudan, Tanzania, Uganda, and Zambia*

⁶¹ *Conflict minerals and technology, media, and telecommunications companies: Readiness for 2014 Requirements*, Deloitte, December 2013

⁶² *Ibid*

⁶³ *Downstream Implementation of the OECD Due Diligence Guidance for Responsible Supply Chains of Minerals from Conflict-Affected and High-Risk Areas*, January 2013



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