MORRISON
FOERSTER

2016

M+A

SEMI-ANNUAL LEADERS SURVEY

M&A Leaders Survey

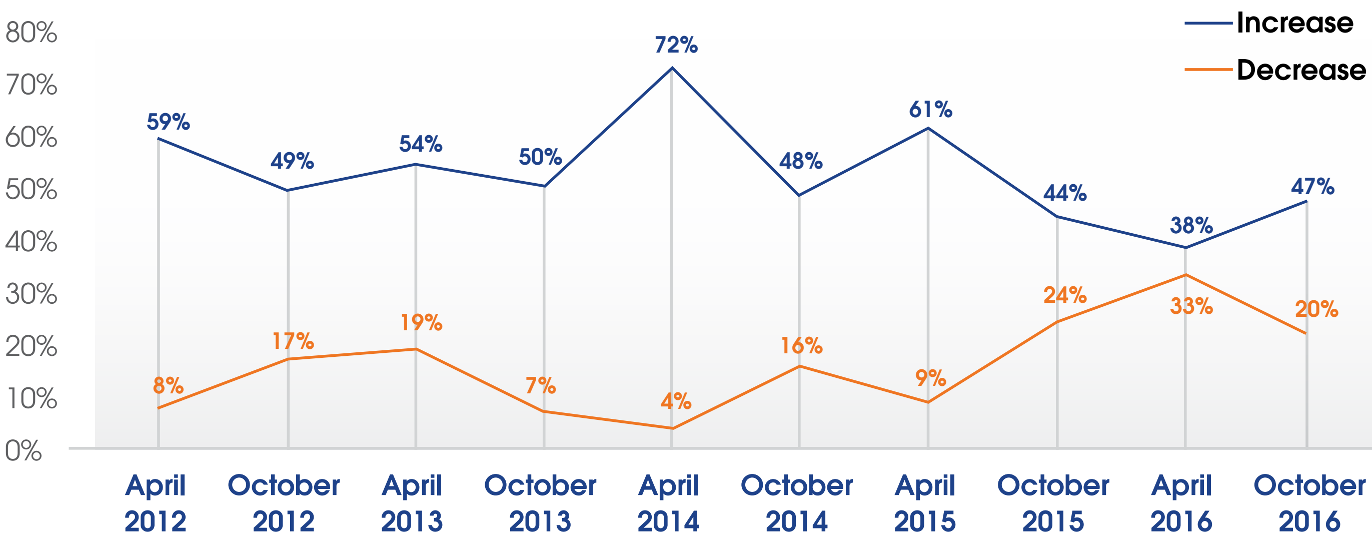
Morrison & Foerster / 451 Research

A reversion to the mean? Survey results point to a more normalized tech M&A market

After two straight forecasts of substantial deterioration in the tech M&A market, the outlook for activity has picked back up, according to the latest edition of the semiannual M&A Leaders' Survey from 451 Research and Morrison & Foerster. Nearly half of the respondents (47%) indicated that they would be increasing their activity in 2017 compared with 2016. On the other hand, 20% of respondents said they would be slowing down on dealmaking next year with the remaining one-third (33%) forecasting no change in their rate.

Forecast change in M&A activity

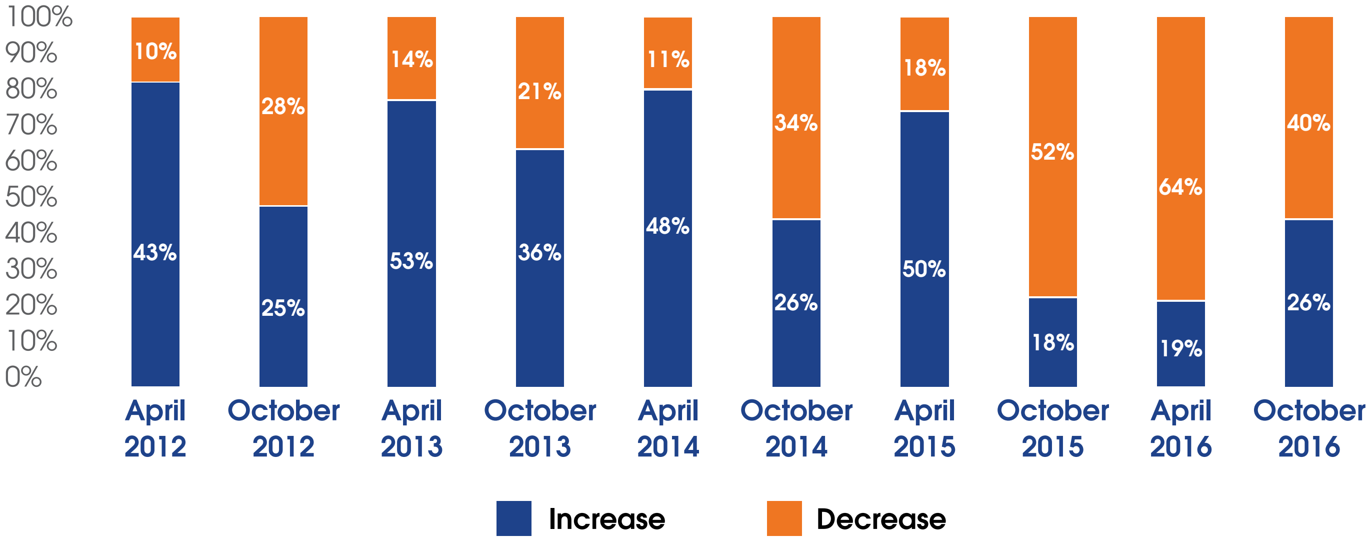
Source: M&A Leaders' Survey from 451 Research / Morrison & Foerster



Broadly, the latest top-level results of the tenth edition of the M&A Leaders' Survey from 451 Research and Morrison & Foerster represent a more 'normalized' forecast for activity, following the most bearish outlook we've ever recorded. In our previous survey last April, the number of respondents projecting an uptick in acquisition activity only slightly exceeded the number anticipating that they would be cutting back on their shopping. For comparison, in the just-completed survey, more than twice as many respondents said they would be accelerating acquisition activity than said they would be slowing down. The shift in sentiment comes as tech M&A spending accelerated dramatically through the summer, with the value of transactions announced in Q3 hitting the third-highest quarterly level since the end of the recent recession, according to 451 Research's M&A KnowledgeBase.

Forecast change in private company M&A valuation

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



Shifting from the forecast for M&A activity to M&A valuations, a plurality of tech buyers and advisers we surveyed forecast that private companies would be selling for lower valuations next year than they had this year. However, that is less bearish than the outlook we recorded in the two previous surveys, when a majority of respondents each time said startup M&A valuations would be ticking lower in the coming months. In the just-completed survey, 40% of respondents predicted declining valuations for startups in 2017, with 34% saying valuations would be holding steady and 26% having a bullish outlook.

End of an era?

Yet even as dealmakers forecast a return in 2017 to more typical activity levels, they did see larger forces at work in the M&A market. In addition to specific geopolitical events (see below), respondents also clearly indicated that cyclicality is running its course. About half of the respondents (48%) said the current M&A cycle is at the midpoint. However, of the remaining half, more than five times as many respondents said the tech acquisition market is in the waning days of the cycle as said it was just getting started (44% vs. 8%). That represents a slight 'aging' in responses from the year-ago survey.

Location in current M&A cycle

Survey date	At/near the beginning	In the middle	At/near the end
October 2016	8%	48%	44%
April 2016	9%	46%	45%
October 2015	8%	51%	41%

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

Consistent with the overwhelming view of respondents that tech M&A is moving into the twilight of the current cycle, private equity (PE) buyers are expected to play an increasingly significant role in the market, according to the M&A Leaders' Survey from 451 Research and Morrison & Foerster. Nearly half of respondents (45%) predicted that buyout shops would spend more in 2017 than they have in 2016, compared with just one-quarter (28%) who forecast lower spending. That bullish projection for PE spending comes as financial acquirers have accounted for roughly 20% of all tech M&A spending so far in 2016, including 20 transactions valued at more than $1bn, according to the M&A KnowledgeBase. Both the 'market share' and the number of big prints by buyout shops this year are well above post-recession averages.

If PE buyers are set to put even more money to work next year, what kind of deals might they be looking to do? Divestitures appear to be one likely source of deal flow for buyout shops. A majority of survey respondents (56%) said they expected to see more companies selling off business units in 2017 than they did in 2016. (Already this year, tech giants including Hewlett Packard Enterprise, Dell and Intel have all done multibillion-dollar divestitures.) The number of respondents forecasting an acceleration in divestitures next year was more than four times the number (12%) that envision a slowdown.

Current events

In addition to asking specifically about M&A plans and perceptions, we also asked about whether outside events – specifically, the upcoming US presidential election and June's Brexit vote in the UK – were impacting dealmaking. Respondents, about 90% of whom live in the US, indicated that the White House clash between Donald Trump and Hillary Clinton is slowing deal flow far more than any disruption caused by the UK effectively severing economic and political ties with the European Union.

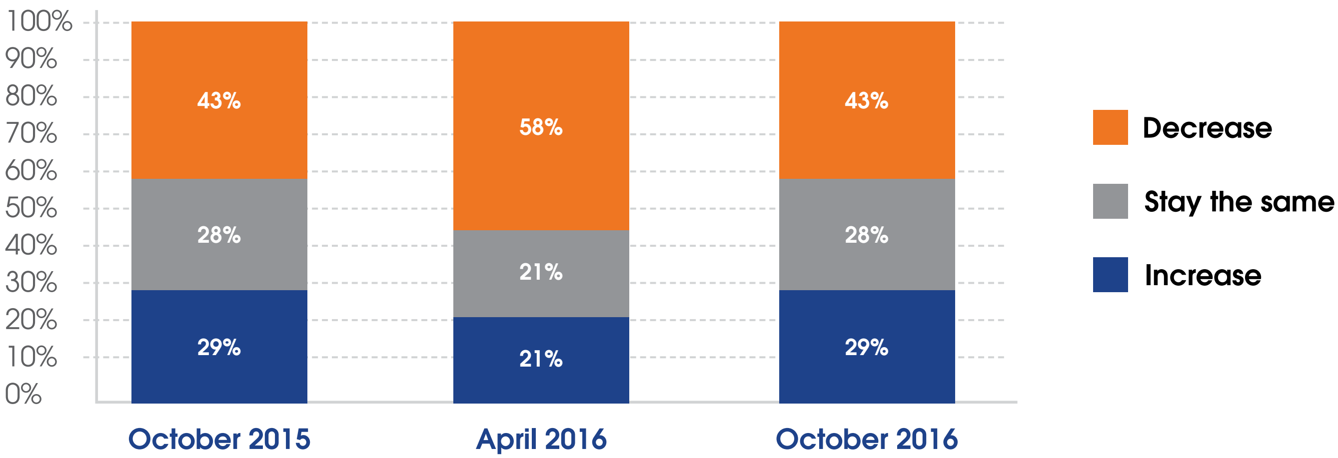
- Regarding the US presidential election,nearly two-thirds of dealmakers we surveyed (63%) said the contest between the two mainstream candidates – who are each viewed 'unfavorably' by a majority of voters, a first in modern US politics – isn't having any impact on their M&A plans. However, of the remaining one-third, respondents were five times more likely to say the election has slowed transactions than sped them up (31% vs. 6%). We would note that the finding from the M&A Leaders' Survey from 451Research and Morrison & Foerster lines up almost exactly with the results from a separate survey of consumers last month about planned discretionary spending ahead of the election by ChangeWave, a service of 451 Research.
- Despite the historic nature of the UK referendum to leave the EU,fewer than one in three respondents indicated that Brexit has dinged their deals. Excluding those who said the question wasn't applicable to them, a slight plurality of respondents (37%) said the vote four months ago hasn't had any impact on M&A, with a similar number (35%) saying they weren't sure of the impact. On the other hand, one-quarter (23%) indicated that Brexit has had a 'moderate' impact on in-process deals and just one in 20 (5%) said it has had a 'substantial' impact. For the most part, the prevailing view from our survey has been reflected in actual deal flow. Just weeks after the Brexit vote, for instance, one of the UK's premier tech providers (ARM Holdings) agreed to sell itself for $32.4bn, the largest tech transaction involving a UK-based company since 2002. And on the other side of a deal, the biggest British software vendor (Micro Focus) tripled its size in September as it bought HPE's software division in a transaction valued at $8.8bn.
- If geopolitical events aren't necessarily derailing M&A, respondents indicated overwhelmingly that another topic very much in the headlines these days is changing their approach to acquisitions. Concerns about potential liability due to cybersecurity (think: Verizon-Yahoo) are making buyers take a much closer look at the companies they plan to buy. More than eight out of 10 respondents (82%) said that over the course of this year they have placed greater emphasis on the cybersecurity policies and practices at target companies. Just 18% said there hasn't been a change in their levels of due diligence in 2017, while not a single respondent said they are giving it less attention.

IPOs set to go

Buoyed by a handful of strong recent tech offerings, the IPO market is expected to accelerate even more next year, according to a majority of survey respondents. The percentage forecasting an increase in IPO activity (54%) in 2017 compared with this year is more than twice the level that said the opposite (20% expect a decline). That's exactly the inverse of responses from last April's survey, which came after a sharp mid-February decline in the US equity markets and only one enterprise tech vendor going public in the first four months of 2016 (a lackluster offering by SecureWorks). Since then, the stock market has moved higher, drawing out five new enterprise tech offerings, including well-received IPOs by Twilio and Nutanix.

Forecast change in number of new offerings

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



Looking a little longer term, respondents predicted that the improving IPO market would extend beyond just next year. Nearly six out of 10 (58%) said the market for new offerings would improve over the next five years, compared with the previous five years. On the other side, just one out of five (20%) said it would deteriorate in the coming half-decade. The most recent survey results represent about a 10 percentage point swing to the bullish outlook from our previous survey last spring.

About the survey: Now in its tenth edition, the M&A Leaders' Survey from 451 Research and Morrison & Foerster drew 152 responses, primarily from corporate or M&A executives (46% of respondents) and investment bankers (30%), with the remaining responses coming from lawyers, VCs, PE professionals and others in the M&A community. Roughly nine out of 10 responses came from dealmakers and advisers based in the US; Silicon Valley represented the largest single location, accounting for 40% of the total.

MORRISON
FOERSTER