TECH M&A

Leaders' Survey
October 2018

MORRISON FOERSTER

Tech M&A Leaders' Survey

Morrison & Foerster / 451 Research

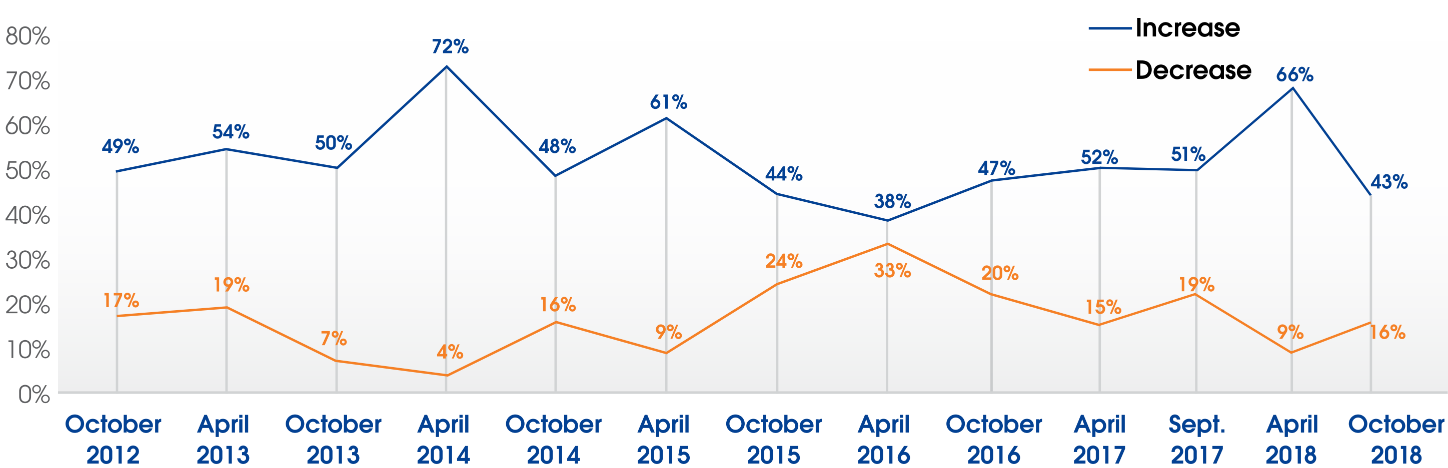
As the tech M&A market tracks a new record, the buying community has turned in a sobering forecast for the future. In the semi-annual M&A Leaders' Survey from 451 Research and Morrison & Foerster, fewer respondents predicted a rise in tech M&A activity than at any point in the previous two years. In this iteration, those with a bullish outlook (43%) decreased from 66% six months earlier, marking the second-lowest reading since the survey's launch in 2012.

The most pessimistic responses came in April 2016 when just 38% forecasted an increase in dealmaking. Still, the comparison to the survey from two years ago ends there. In that earlier run, 33% expected a decrease in tech acquisitions, whereas this time, only 16% expect a drop. Looking at the background of the most recent prediction, a less bullish outlook isn't entirely surprising as the market nears a fresh record. According to 451 Research's M&A KnowledgeBase, $425 billion worth of tech companies have changed hands through the third quarter. That's higher than all but two full years since the dotcom crash and is on pace to finish near the industry's highwater mark of $575 billion in 2015.

Tech M&A Activity Outlook

Forecast change in acquisition activity

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



Activities of the current US administration may have tilted fewer respondents away from forecasting an increase. Just like in our April survey, respondents expect scrutiny from CFIUS and trade disputes to hamper M&A. In the recent run, an identical number (54%) said each of those would result in decreased activity. While each of those percentages are down just a few points from the spring, there was a dramatic drop to just 34% of respondents who anticipate that antitrust actions will hinder dealmaking, down from 50% in the previous survey—likely a result of the Trump administration's failure to block AT&T's acquisition of Time Warner.

Higher valuations on both sides of a deal

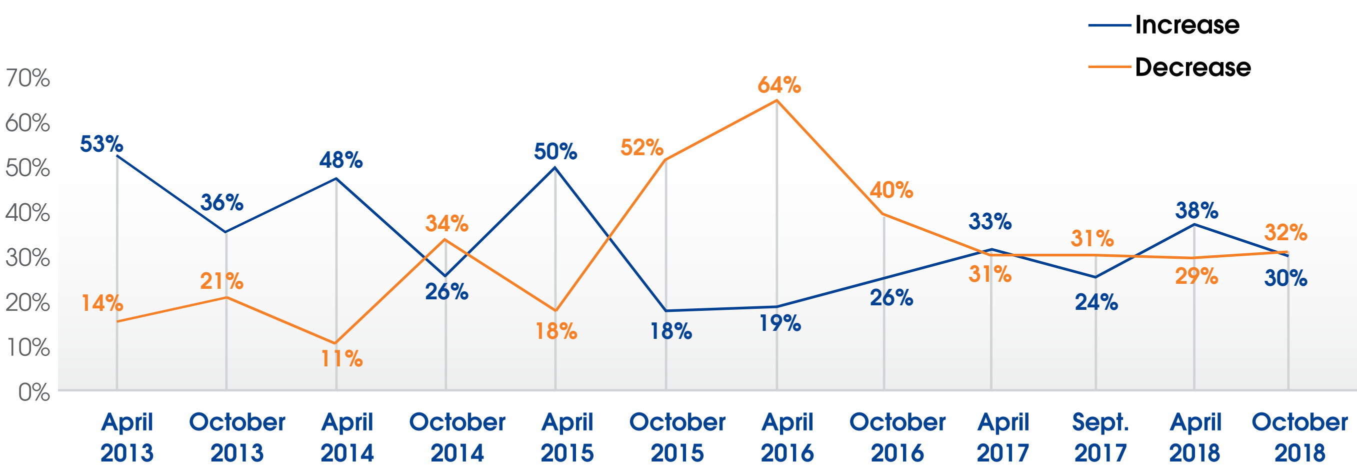
The somber outlook for M&A activity came with a balanced valuation outlook. Nearly as many respondents (32%) told us to expect a decrease in private company M&A valuations in the next twelve months, as told us to expect an increase (30%). Though it's worth noting that in recent iterations, our panel tends to deliver a tepid outlook on private company exit valuations. Only on two of the previous six surveys did more than 30% of respondents expect rising valuations. Despite those predictions, valuations for private companies are unnaturally high. According to 451 Research's M&A KnowledgeBase, buyers of private companies have paid a median 2.7x trailing revenue through the third quarter of the 2018—the highest level since 2014.

Climbing valuations of public companies have propelled strategic acquirers back to the M&A market. According to 451 Research's M&A KnowledgeBase, strategic acquirers have already paid, cumulatively, more for tech targets ($324 billion) through the third quarter in 2018 than in all of 2017, reversing a two-year decline. Our respondents overwhelming cited record equity valuations as a factor in the reversal, with 71% of them saying it played a "strong" or "very strong" role in increased corporate buying. Improving corporate growth outlooks garnered nearly as many responses, with 65% citing that as a significant factor.

Tech M&A Valuation Outlook

Forecast change in private company M&A valuations

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



PE exit window widens

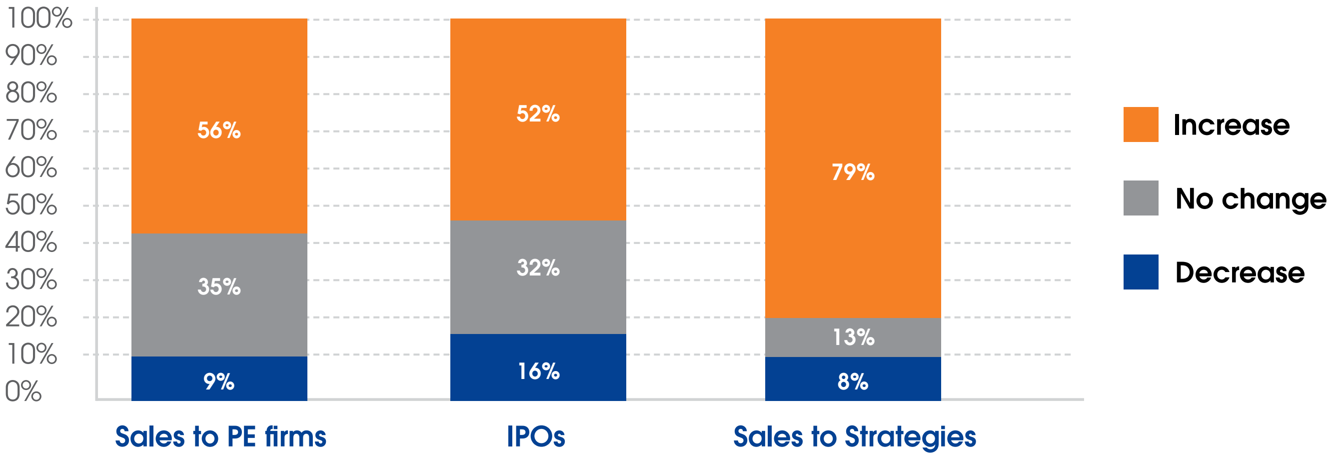
The rise in corporate acquiring could serve to line the pockets of private equity (PE) firms. When asked about the path to exit for PE portfolio companies, 79% expected sales to strategic acquirers to increase—a trend we've already seen playing out. All told, strategics have printed 15 purchases of PE-portfolio companies worth $1 billion or more, so far this year, compared to just 11 in all of last year. Still, more than half of the tech M&A community also expects sales to other PE firms (56%) and IPOs (52%) to increase as well in the next 12 months.

Despite the increase in acquisitions of PE portfolio companies, buyers expressed mixed feelings about the quality of such companies. More than half (53%) said they disagree with the statement "All else being equal, buyers prefer to acquire companies from PE-owners," while just 16% agreed. Still, 67% admitted that PE-backed companies tend to be "operationally optimized." Although, they were almost as likely to agree with the opposing sentiment that PE companies are also more likely to be "hollowed out by excessive cost-cutting"—55% agreed with that. Despite the mixed perceptions about these companies, 60% of respondents don't expect them to sell at a discount.

Private Equity Exit Outlook

Forecast change in PE exit by type, next 12 months

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



Globetrotting dealmakers

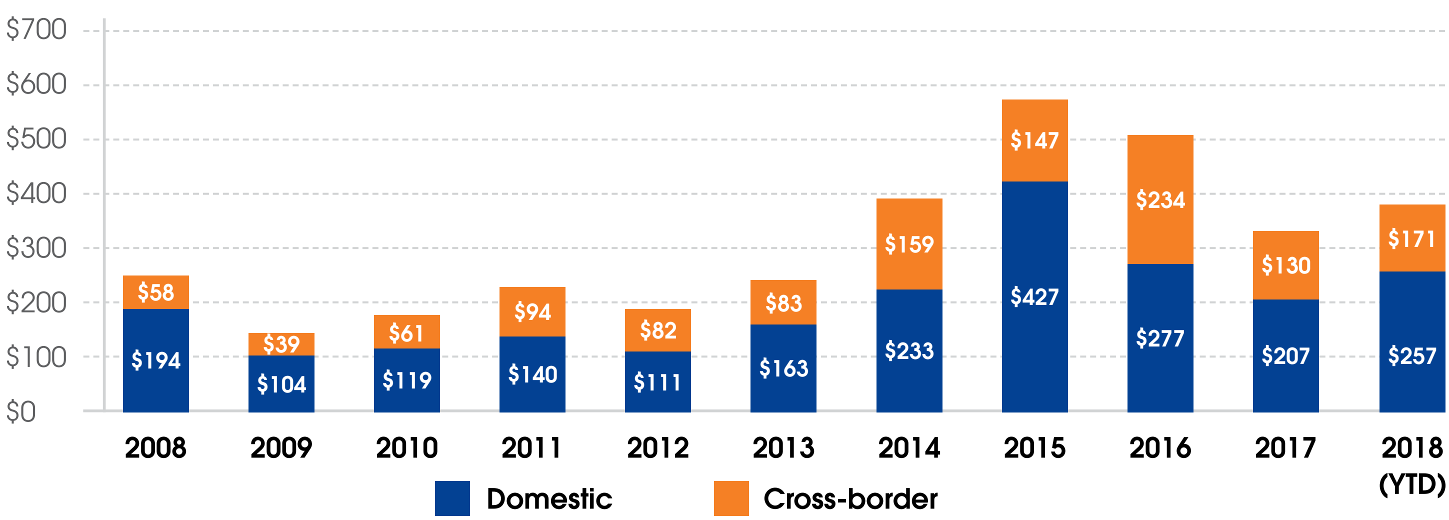
The outlook for cross-border M&A holds steady from our last survey. This time around 42% expect international dealmaking to increase over the next 12 months, up just one percentage point from April, while 35% anticipate a decrease (two points higher than April's result). The cross-border dealmaking matches the consistency of the survey. While the value of international acquisitions has already surpassed last year's total, the proportion of international to domestic M&A is in line with 2017, when cross-border transactions accounted for almost 40% of total tech deal value.

The escalating tariffs between the US and China made for a negative outlook for deals that cross their borders—78% expect such deals to decrease—and that's somewhat surprising since there's little room for such deals to go down. According to 451 Research's M&A KnowledgeBase, the year has seen just 10 announced deals where the target was based in China and the buyer in the US or vice-versa.

Cross-border Tech M&A

Annual worldwide tech deal flow ($bn)

Source: 451 Research's M&A KnowledgeBase



Machine learning

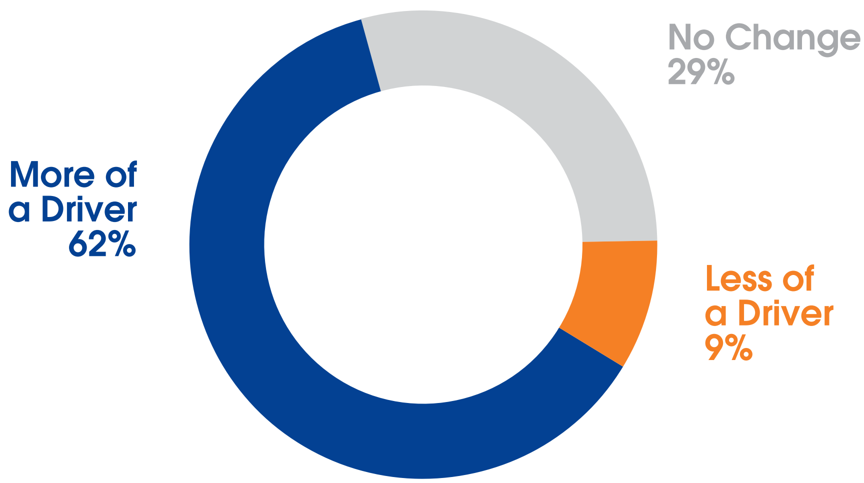
Buyers continue to harbor an appetite for targets with machine learning technology. Nearly two-thirds (62%) of respondents said machine learning has been more of a driver of M&A this year, while just 9% said that the technology was less important. When asked about specific applications that are propelling machine learning M&A, a full 80% cited security as "very" or "extremely" important, with business analytics close behind with 62%. Fewer respondents attached such importance to sales and marketing (47%) and customer service (39%).

When it comes to over-hyped technology, crypto takes the crown. When asked to name, without prompting from us, the most inflated or over-hyped technology in the last 20 years, nearly one in five respondents (19%) stated cryptocurrencies in general, or bitcoin more specifically. Not far behind was the overlapping category, blockchain, which garnered 15%. Machine learning and artificial intelligence was the only other tech to be named by more than one in ten respondents, as 11% cited it.

Machine Learning: M&A Activity

Changes in ML as a driver for acquisition activity in 2018

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



Non-techies aren't just tourists

Strategic acquirers from outside the tech market have now spent more than $40 billion on tech M&A in each of the last three years. Prior to that period, according to 451 Research's M&A KnowledgeBase, such non-tech acquirers never spent more than $35 billion in any single year following the dotcom bubble. This year, however, such acquisitions are slightly (5%) lower than 2017's record amount. According to our respondents, rising valuations are to blame for keeping a lid on this corner of the market—41% cited valuations in an open-ended question asking for the cause of the decline, with a lack of technical knowledge cited by 20%.

Despite the deaccelerating of such deals, respondents anticipate non-tech companies will become a permanent fixture of the tech M&A market. Looking further into the future, more than three times as many respondents (68%) told us they expect the number of such deals to increase to a higher level three years from now, compared to those anticipating a decrease (19%).

Three-year Forecast for Non-Tech Acquirers

Predicted change in acquisition activity three years in the future

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

Greenlight for IPOs

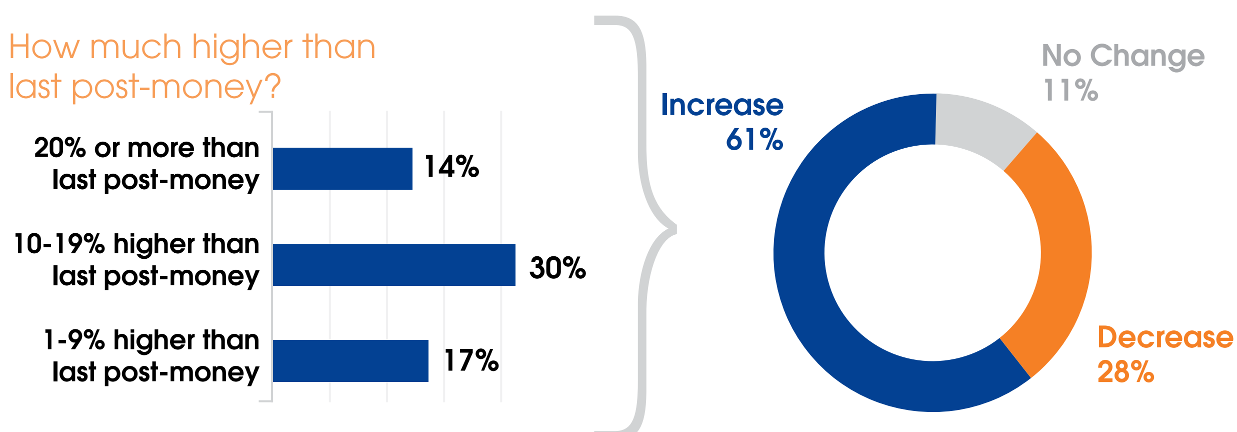
Tech companies have an abundance of liquidity options. Alongside a bustling M&A market, there's a high demand for IPOs. Through the first three quarters of the year, 12 enterprise tech companies held a public debut—the same number as the total debuts that took place last year. When asked to estimate the number of tech offerings to list on the NYSE and NASDAQ in the next 12 months, tech leaders offered up a median response of 20, up from 15 when we last asked the question 18 months ago. Within that 20, respondents collectively predict seven unicorns—companies with a valuation north of $1 billion in their most-recent venture round—would come to market.

The outlook for public valuations of that vaunted set of startups increased notably in just six months. More than twice as many respondents (62%) expect the average unicorn IPO to finish its first day of trading above their last post-money valuation than the number who predicted down-round IPOs. Back in April, just 48% anticipated the value of the average unicorn would rise in its public offering, with 44% expecting average declines.

Expectation for Unicorn Debuts

Forecast change in valuation for average unicorn on day of IPO

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



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About the survey: Now in its fourteenth edition, the M&A Leaders' Survey from 451 Research and Morrison & Foerster drew 115 responses, primarily from investment bankers (40%) and c-level or M&A executives (38%), with the remaining responses coming from lawyers, venture capitalists, private equity professionals and others in the M&A community. Roughly 85% came from dealmakers and advisers based in the US; Silicon Valley represented the largest single location, accounting for 39% of the total responses.

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