Dealmakers are forecasting a frosty follow up to an unusually chilly summer for the tech M&A market. In the latest iteration of the M&A Leaders’ Survey from 451 Research and Morrison & Foerster, respondents handed in the most pessimistic report we’ve seen in any previous fourth quarter. The 40% of tech M&A practitioners that told us deal activity would increase represents only a slight drop from our year-ago reading, when 43% predicted an increase. Yet, in this survey, 28% said deal activity would decrease, nearly double the rate of the previous survey and only the second time that more than one in four respondents have forecast a decrease.

The results come as acquirers delivered their lightest level of spending on tech M&A targets in two years. As we discussed in our most recent quarterly M&A report, summer spending on tech M&A targets dropped 25% below the previous two quarters. Economic worries helped drive the droopy M&A forecast. More than half of the respondents (61%) said that “fear of a recession” could weigh on deal flow in the next 12 months.

Even many of those respondents forecasting an increase in deals didn’t put forth a rosy outlook on pricing. At a rate of five to one, respondents predicted that private company M&A valuations would decrease in the next 12 months. Prices have already come down a bit from last year’s record levels. According to 451 Research’s M&A KnowledgeBase, among private tech companies selling for $100 million or more, the median multiple stands at 5x trailing revenue in 2019, down from 5.3x last year. The last time our survey respondents voted overwhelmingly for a decline in valuations, in April 2016, the annual median multiple tumbled by a full turn in the following year.
Peak private equity

A modest deceleration in tech acquisitions by private equity (PE) firms translated into a tempered outlook on that sector. Our data show that financial sponsors have executed 7% fewer deals this year, compared with last year’s record haul. A bit more than one out of every three (35%) respondents to our survey expect PE spending to pick up in the next 12 months, compared to 28% projecting a decline. The last time we asked that question, in early 2018, three times as many respondents called for an uptick as those calling for a decline (47% to 13%).

Dip in PE Purchases

Causes of the decline in PE tech acquisitions in 2019

Expect to see tighter pricing on those PE deals that get done. More than half (56%) of deal makers expect PE firms to pay lower multiples in the next 12 months than they did in the previous period. Only 15% said such prices will increase. Dropping prices on PE deals would continue a decline that began in 2019. According to 451 Research’s M&A KnowledgeBase, the median trailing revenue multiple on PE purchases hit an annual record 3.8x in 2018 and has fallen to 3.2x since the start of the year.
Private Equity Valuations

**Annual median price-to-sales ratio on PE acquisition**

Source: 451 Research’s M&A KnowledgeBase. Includes disclosed and estimated deal values.

Like the broader market, macro-economic fears played a role in the dour outlook for PE deals, though it was the tightening market for leveraged loans that drew the most responses. More than two-thirds (68%) cited the loan market as a factor that would push down PE deals in the next 12 months. Nearly the same number (67%) said “economic uncertainty” would hamper PE deals.

Respondents were fairly split about the prospects for exiting those purchases. When asked about the exit environment for the next three years for PE portfolio companies, 54% said it would be unfavorable, while 46% anticipate a favorable market. Though already in 2019 PE exits appear harder to find. According to 451 Research’s M&A KnowledgeBase, PE firms are on pace to sell 24% fewer portfolio companies than they did in 2018.

Though respondents didn’t deliver a clear forecast about the favorability of the PE exit environment, there was more consensus on the sources of those exits. According to the survey, 59% of our respondents expect an increase in secondary sales (acquisitions of PE portfolio companies by other firms)—only 7% anticipate a decrease. Indeed, our data show secondary sales becoming the preferred path to exit as PE firms have sold nearly twice as many companies to their peers as they’ve sold to corporate acquirers in 2019. Still, more than half (53%) forecast a rise in exits to corporate acquirers. Exactly half said exits via bankruptcy would increase in the next 12 months.

**PE Exit Activity**

**Annual worldwide acquisition of PE portfolio companies**

Source: 451 Research’s M&A KnowledgeBase. Includes disclosed and estimated deal values.
Corporate acquirers go quiet

While there’s a bit of a funk expected in PE deals, the outlook for acquisitions by corporate acquirers looks outright sick. Nearly half (43%) said tech purchases by corporate acquirers will decline in the next 12 months, with just 25% expecting an increase. Deals by both PE and US-listed companies are down slightly this year, yet the projection for PE activity is comparatively rosy. The grim forecast comes after US-stock indexes slid 3% in the month leading up to the survey, dropping the value of would-be buyers and making acquisitions seem more expensive.

US-Listed Acquirers

**Forecast change acquisitions by US-listed acquirers, next 12 months**

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

As strategic acquirers make fewer deals, there’s a widespread belief that they’ll pay less for those that do. More than half (55%) said corporate acquirers will pay lower multiples in the coming 12 months than they did in the prior period. Only 7% of respondents expect that they’ll pay more. This would mark an abrupt turn from the trend we’ve seen in recent years. According to 451 Research’s M&A KnowledgeBase, corporate acquirers have paid consistently higher multiples for deals valued at nine figures and up. The median trailing revenue multiple has ticked up in each of the previous two full years and continues to rise, standing at 4.1x for 2019.

Buy local

Across almost all regions, cross-border M&A is expected to decline. North America fetched the brightest forecast, with 32% saying acquisitions by foreign acquirers of North American targets will increase and the same number projecting a decrease. In each of the other regions we asked about—South America, Western Europe, Eastern Europe, Asia-Pacific, and Middle East and North Africa— more respondents expect companies to draw fewer foreign acquirers. Indeed, our data show that international M&A is already on a downswing, accounting for just $1 of every $3 spent on tech M&A in 2019, the lowest annual ratio since 2015.
Trade wars drew much of the blame for an anticipated decline in cross-border M&A. Almost three in four (73%) of respondents said trade disputes would result in a decrease in cross-border M&A in the next 12 months. Closely related to that, scrutiny from CFIUS was cited by 70% and Brexit 58%. Indeed, the day our survey closed, the Trump administration, citing humanitarian concerns, blacklisted eight Chinese AI companies, prohibiting US firms from doing business with them.

The reach of CFIUS, however, extends beyond acquisitions and into investments. When asked about the impact of CFIUS and its increased scope under the Foreign Investment Risk Review Modernization Act (FIRRMA), 63% said the law will make it harder to raise capital or find a buyer, double the number that said it would have no impact. Another 5% said it won’t be any harder to find investors and buyers under FIRRMA, though there will be an impact on valuations.

**Machine learning at the top of its class**

Machine learning has, arguably, become the most widespread theme in tech M&A. More than eight in 10 respondents (84%) said machine learning has become more important to acquirers’ strategic goals. The acceleration of machine learning has been dramatic indeed. Already this year, we’ve seen more acquisitions of targets with machine learning technology than in all of 2018. In fact, one in every 14 deals in 2019 has a machine learning element to it. Information security and cloud computing were also called out, with 74% and 71%, respectively, saying that those themes more important to acquirers over the last year.
Emerging Technologies

Changes in strategic importance to acquirers in last 12 months
Source: M&A Leaders’ Survey from 451 Research / Morrison & Foerster

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<th>Emerging Technologies</th>
<th>More Important</th>
<th>No Change</th>
<th>Less Important</th>
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<td>Machine Learning</td>
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Unicorns lose their glamour

Despite a surge in high-priced enterprise debuts, the poor performance of consumer tech IPOs colors the outlook for unicorn offerings. In a five-month stretch between April and September, 11 enterprise companies went public, often sporting valuations north of 20x trailing revenue. Yet, down-round IPOs from consumer tech companies gave deal makers doubts about the prospects for future offerings from startups valued north of $1bn.

More than half (52%) said the average unicorn would finish its first day of trading with a valuation below its previous post-money. Only 38% expect valuations to rise. That’s the inverse of last year’s responses, when 62% projected an increase and 28% a decrease.

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

- **OCT. 2019**
  - Increase 38%
  - Decrease 52%
  - No Change 10%

- **OCT. 2018**
  - Increase 62%
  - Decrease 28%
  - No Change 11%
About the survey: Now in its fifteenth edition, the M&A Leaders' Survey from 451 Research and Morrison & Foerster drew 101 responses, primarily from investment bankers (36%) and c-level or M&A executives (35%), with the remaining responses coming from lawyers, VCs, PE professionals and others in the M&A community. Roughly 79% came from dealmakers and advisers based in the US; Silicon Valley represented the largest single location, accounting for 37% of the total.