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A Look At Tech M&A In 2019 And What Lies Ahead

By **Michael O'Bryan** (January 1, 2020, 12:29 PM EST)

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2019 started off strong for mergers and acquisitions in the technology space, with value in the first quarter beating the equivalent quarter in 2018.

Software led the way, with deals like the $11 billion buyout of human resources software maker Ultimate Software Group Inc. led by Hellman & Friedman LLC and Salesforce.com Inc.'s $15.7 billion all-stock acquisition of data visualization company Tableau Software, along with financial technology, with deals such as Fidelity National Information Services Inc.'s $35.5 billion acquisition of Worldpay Group PLC and Fiserv Inc.'s $22 billion acquisition of First Data Corp.

The number of deals, though, was falling, continuing a trend from 2018, and second quarter value fell.

The second half of 2019 did not start as well, with third-quarter deal value declining compared to the first two quarters of the year and even more compared to the third quarter of 2018.

Results were buoyed by the announcement of several large deals, including Broadcom Ltd.'s $10.7 billion acquisition of Symantec Corp.'s enterprise security business, VMware Inc.'s acquisitions of cybersecurity company Carbon Black Inc. for $2.3 billion and the remainder of Pivotal Software Inc. at a $2.7 billion value, the $4.3 billion buyout of LogMeIn Inc. by Francisco Partners and Evergreen Coast Capital Corp. and the $4 billion purchase by PayPal Holdings Inc. of venture capital-backed Honey Science Corp.

Nonetheless, as of this writing, deal value does not seem likely to catch up to the first half.

The tech M&A market during 2019 faced economic uncertainty and regulatory challenges, including threats of trade wars and new tariffs and other trade actions, which seem certain to continue into the new year. For 2020, we also need to consider the impact of the U.S. presidential election. While macroeconomic signals are mixed, and to some extent existed during 2019 as well, deal makers must also be prepared for an economic downturn and the challenges and opportunities that might bring.

But companies continue to have substantial cash reserves, financial sponsors have more dry powder than ever, and debt remains relatively cheap. While 2019 will not beat 2018, it will have a strong result, and eyes now turn towards 2020. Lawyers will need to structure and document deals that will succeed in a variety of environments and circumstances.

Overall Market Sentiment

Morrison & Foerster LLP, in conjunction with 451 Research, conducts regular surveys of tech M&A deal makers. Our most recent survey, reported in November, found sentiment for the next year somewhat cooler than that found in our last survey in October 2018. However, that's coming off the record results of 2018, and the biggest group of deal makers (40%) still responded that they expect activity to increase over the next 12 months, with another 32% predicting that activity will remain the same and 28% anticipating a decline.[1]

Reflecting the attention on the overall macro environment, our survey found that economic factors accounted for many of the deal makers' concerns, with 61% citing fears of a potential recession and 57% citing tariffs or trade disputes as possible deterrents to future deals. Resolution or other changes in those factors are likely to affect sentiment further.

Private Equity Activity Continues

Private equity investors have been quite active in 2019. According to 451 Research, as noted in our survey report, U.S. tech deals by private equity buyers are currently at a slight decline this year, with financial sponsors having completed 7% fewer deals in 2019, compared with last year's record activity.

Still, private equity buyers are expected to outpace corporate acquirors in the total number of U.S. tech deals, continuing the trend from 2017, when private equity first surpassed strategic buyers in the number of total U.S. tech acquisitions. With respect to take-privates of public companies, private equity buyers have increased the number of tech company deals, even though the number of take-privates by private equity firms more generally has fallen from last year's levels as firms face high prices, as reflected in high public stock prices, and other factors facing M&A.

Going forward, private equity investors have a reported $1.3 trillion in dry powder, and debt remains relatively cheap, so funding should not be an issue as long as attractive deals can be found.

Respondents to our survey, however, were split on how they think tech acquisitions by private equity firms will proceed in the next 12 months, with 35% expecting an increase in activity, 37% predicting activity will stay the same and 28% anticipating a decrease. Higher pricing was cited by 80% of survey respondents as a cause for this year's dip in deals.

Cross-Border M&A

Like the overall market, cross-border M&A in 2019 declined somewhat from the strong performance of 2018. In addition to the macro factors affecting the overall M&A market, companies considering cross-border deals (either into or out of the United States) faced increasing trade tensions, with tariffs and other sanctions imposed and retaliatory acts taken or threatened.

Regulations focused on cross-border investment also continued to evolve, raising hurdles to completion of some deals and creating continued uncertainty as to deal closing or timing. In the United States, interim regulations under the Foreign Investment Risk Review Modernization Act, enacted in August 2018, expanded the scope of deals that may be reviewed by the Committee on Foreign Investment in the United States, and proposed regulations could continue the expansion (including for certain noncontrol investments).

Most deals submitted to CFIUS continue to be approved, though some parts of the market, such as acquisitions of control interests in certain kinds of U.S. tech companies by Chinese investors, have been significantly impacted and some buyers have had to implement mitigation measures to obtain approval.

Respondents to our tech M&A survey expected cross-border M&A to decline across most regions, with targets in Asia-Pacific most likely to be affected, according to 48% of respondents, who expect a decrease in deal flow into the region by international acquirers. The number is slightly less for Western Europe, where 42% of respondents predicted a decline. Respondents were evenly split about their predictions for North America, with 32% predicting acquisitions of North American targets by international acquirers will increase, while the same number projected a decrease.

Trade disputes are considered the biggest potential hindrance to future international acquisitions, with 73% of deal makers citing it as a concern. Deal makers are also taking Brexit into account, with 58% anticipating it having a negative impact.

Parties will need to think carefully about the overall environment for cross-border deals, including regulatory approaches and potential mitigating measures that may be required and about what to do if a deal cannot proceed as contemplated.

The Effects of Shareholder Activism

Shareholder activists continue to encourage, and sometimes complicate, M&A deals. Activists often advocate for companies to sell themselves or to divest noncore assets. Their targets increasingly seem to include even relatively large companies (such as Elliott Management Corp.'s campaign at AT&T Inc.) and overseas companies.

Even where activists have not advocated expressly for such steps, companies where activists have joined the board seem more inclined to consider or pursue strategic transactions. Some activists have also encouraged companies to act as acquirors, or to engage in "mergers" with other companies.

Activists have also taken positions against announced deals, resisting the transaction from both the acquiror side and the target side (such as Rivulet Capital LLC's opposition to education software developer Instructure Inc.'s $2 billion agreement to be taken private by Thoma Bravo LLC) and pushing for higher prices on behalf of targets.

Activists are expected to continue emphasizing M&A themes, in the United States as well as abroad, and to continue to be a cause for companies to actively consider M&A opportunities.

Antitrust

Although the U.S. Department of Justice failed in its attempt to block the vertical merger of AT&T and Time Warner Cable and lost its appeal of that decision in February, the level of antitrust merger enforcement in 2019 increased from the prior year and was similar to the levels that occurred during the administration of Barack Obama between 2011–2014. State agencies have also become less deferential to their federal counterparts and stepped up their efforts to challenge deals independently.

Federal, state and foreign antitrust agencies, such as the European Commission, have become increasingly interested in assessing whether some technology companies have become too large and powerful due to inadequate antitrust enforcement. In response to the growing impact of digital and technology markets on many sectors of the economy, the Federal Trade Commission recently established a Technology Enforcement Division to investigate potential anti-competitive mergers and conduct in these areas, particularly online advertising, social networking, mobile operating systems and apps, and digital platform businesses.

Officials at U.S. and international agencies have publicly noted that they intend to be increasingly vigilant in order to prevent large technology firms from thwarting nascent and potential threats through acquisitions and will bring challenges to consummated transactions if necessary to remedy any harm to consumers.

Likewise, antitrust agencies are increasingly evaluating whether and how the control of data by merging parties is being used to create or enhance entry barriers or otherwise harm consumer choice, innovation and other nonprice aspects of competition, including the level of privacy protection offered to consumers.

Foreign regulators also remain active; deals that must be notified in China continue to face lengthy review periods and remedy requirements that may vary from other jurisdictions.

Finally, recent litigation over pending or failed deals has also shown the need for parties to carefully consider how they allocate antitrust risk in their agreements and document the steps expected to be taken in the face of lengthy regulatory reviews.

Conclusion

At the end of the year, we will likely see that tech M&A in 2019 declined overall from 2018, but it will still be a strong performance — as 451 Research noted, the year has gone from “exceptional” to “merely above average.” Deal makers will need to contend with economic and regulatory uncertainty and other market factors, but with available cash and potential leverage, and companies’ continued need for growth, they have the resources and motivation to do deals in 2020.

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[1] The full results of our survey can be found here: https://www.mofo.com/resources/news/191104-deal-activity-forecasts-are-cooling.html.