2011 M&A Trends

BY DAVID HEALY

JUNE 30, 2011

Deal volume has picked up substantially in 2010 relative to 2009 and remains robust in 2011

- F&W deals: 62 in 2009 ($32B), 112 in 2010 ($10.5B+) and 49 in 2011 YTD ($5.5B+)
- Global tech deal activity increased significantly from Q1 2009 to Q3 2010 (Thomson Financial)
- Deal activity (in terms of aggregate transaction value across all industries) was up substantially from Q2 2009 through 2010 (Lazard)
- Global M&A volume (deals over $100M) rose 26% in 2010 (Bloomberg)
- Tech deal dollar volume in 2H 2010 was twice what it was in 1H 2010 (Goldman)
- Current environment indicates cyclical upswing in 2011 for M&A activity (Lazard)
- However, large scale transactions are still well below historical levels (Centerview)

Tech M&A Breakdown

- Over half of F&W M&A deals in 2010 were in Internet e-commerce, software and entertainment/media/games, with the balance in life sciences, communications, semiconductor/EDA, business services and clean tech
- The TMT segment accounted for about 17% of global M&A deals above $100M announced in 2010 YTD (Thomson One Banker as of 11/30/2010), and technology, telecom and media account for 15%, and life sciences accounted for 12%, of U.S. deals through Q3 2010 (Mergermarket M&A Round-up), so there is a robust non-tech M&A environment as well (e.g., 30% of deals were in energy/mining/utilities through Q3)

Key Drivers of M&A Activity in 2010

- Strategic buyers are trying to more effectively strategically position themselves, especially since it is now more clear that they will face competition not just from within their markets but also from adjacent markets (e.g., Microsoft from Google, Google from Facebook, Intel from Qualcom, and IBM from Oracle/Sun), so they need to bulk up on strategic assets and fill out product lines
  - Increasing vertical integration in the IT space (networking, storage, cloud computing, data center and virtualization)
  - IT customer demand for "one stop shopping"
  - Rapidly evolving market segments (mobile, security, social media, gaming)
    - Many talent/IP deals: Facebook, Twitter; Google; Juniper/Smobile; Salesforce/Jigsaw
  - Looking for new markets and scale in existing markets
  - Oracle's announced intention to buy chip companies to own more of IP in chips
  - IBM has said it will spend $20 billion on acquisitions through 2015
  - These factors leading to more contested bids (EMC/Data Domain; HP/3Par)
- Strategic buyers seeking growth that is unavailable organically (e.g., some tech segments maturing—Microsoft, Oracle and Dell CAGR went from above 28% range in 95-2000 to 10% range in 2000-2009; IBM has 1% CAGR (CapitalIQ)
  - Large amount of cash ($1.85tn (up 29% over early 2009 levels) per Centerview) on strategic buyer balance sheets (e.g., $24B at Oracle), with low rate of interest (under 1% in some cases) earned on that cash, and activists demanding that cash not used for organic growth/M&A be returned to stockholders
- Debt financing costs falling significantly, so debt is available to fund acquisitions by strategics
- PE buyer volume way down relative to 2007 highs (only 55 completed US PE deals, totaling $61bn, during first nine months of 2010, vs 171 deals in first nine months of 2007, totaling $309bn)(Lazard), but PE funds have almost $500B in committed funds (representing almost $2tn in possible transaction value with leverage) (and must do deals or refund cash to investors)(Lazard)

- 2010 sponsor transactions include SonicWall by Thoma Bravo (which F&W handled and was recognized as Technology Deal of the Year at the Americas M&A Atlas awards)
- Leveraged M&A activity has increased as a result of declining interest rates and increased high yield issuance ($85.2bn through Q3 in 201 vs. $17.2bn in same period in 2009, per Centerview)
  - › PE funds are comfortable using more leverage (5-6X EBIDA) than comparable public strategic buyer might use, so PE buyers may be able to outbid strategics that have substantial operating synergies
  - › PE funds trying to provide deal certainty to targets are willing to use a higher equity contribution (53% in recent 3G Capital/Burger King deal) and to offer a reverse break up fee
- Macro environment stabilizing, partial recovery in valuations and reduced volatility so easier to assess “true market value” and overcome differing views on fair valuation
  - › However, tech valuations (e.g., as measured by rolling NTM PE ratio or rolling LTM EV/EBITDA ratio) are still well below pre-crisis levels so valuations can look “cheap” from a multiples perspective--that is, for example, while a buyer may be paying a 75% premium to the current trading price, that might only represent 19X earnings, but many deals in that market segment 3 years ago were in the range of 30X earnings
  - › Premiums are back up to historic averages
  - › 71% of 2010 deals involve cash, the highest % in recent years, due to continued concern about volatility and associated difficulty in pricing/valuation (Lazard)
- IPO window began to open in 2010 and is opening further in 2011, but IPO alternative is still often viewed as a higher risk alternative to M&A (and must show revenue growth and increasing profitability (or clear path to profitability) to go public), so “dual track” exit approach is often not credible and M&A is by far the more typical liquidity event
- Increase in cross-border deals (37% 2009 YTD/2010 YTD increase in cross border deals as a % of all deals)
  - › e.g., F&W represented Diamond Foods in its acquisition of Kettle Foods (which won the “Cross Border Deal of the Year” award at the M&A Atlas awards)
  - › Foreign companies with strong balance sheets are increasingly active in US
    - ▫ Baidu and Ten Cent ($40B market caps) making acquisitions in gaming
    - ▫ DST making investments in social media companies to provide liquidity
    - ▫ Advantest (Japan) $724M bid for Verigy
  - › US buyers can buy offshore assets using offshore cash that is otherwise trapped or subject to tax upon repatriation
- Eroding appetite of VCs/PE funds to support huge long term spend for uncertain exit outcomes (cleantech/life sciences) likely to result in eventual consolidation
- Hot private companies using private currency/RSUs for M&A
  - › but are achieving valuations that make them hard to afford as targets (Groupon)
- Unsolicited activity on rise in 2010 after a slowdown in 2009 in part due to continued stock market weakness (Lazard)
  - › Activist investor pressure makes it harder to “just say no” to unsolicited bids
- Continuing federal deficit presents long term challenges, while changing political landscape adds to uncertainty (e.g., for financial institutions and clean tech companies)
- Life sciences M&A focusing on revenue generating companies (Novartis/Alcon) and less on biotech deals (projected to be off 18% from 2009) (and private biotech deals above $50M are down from 13 deals in 2009 to 5 deals in 2010 YTD) (Lazard)

David W. Healy (dhealy@fenwick.com) is the Co-Chair of the Mergers and Acquisitions group and a Partner in the Corporate Group at Fenwick & West LLP. Mr. Healy’s practice focuses on start-ups, mergers and acquisitions and strategic partnering.