



Q3 2019 TECHNOLOGY SPOTLIGHT

M&A trends and private
equity deal activity





"Speed is the name of the game for both buyers and sellers in the current climate. Given geopolitical shakiness as well as broader concerns around any potential slowdown, buyers are prioritizing companies with metrics that exhibit resilience to any major impacts."

David Van Wert, partner with transaction advisory services at RSM US LLP

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The information technology mergers and acquisitions cycle has remained dynamic for years. The four-year stretch from 2015 to 2018 saw near or above 4,000 transactions close in the sector each year across Europe and North America, while aggregate deal values soared to record highs—2016 alone reached a staggering \$672.2 billion. However, as deal sizes stay at prolonged highs against a backdrop of increasing geopolitical and economic tension, a downturn in volume over the past few quarters is suggestive of growing caution.

"High multiples' persistence, combined with more aggressive acquisitive behavior and general preparation for any economic softening, point to the end of a cycle," says David Van Wert, partner with transaction advisory services at RSM US LLP (RSM). "Many signs indicate that the cycle is in a late stage where buyers are getting more aggressive to get deals done, with no sign of a conservatism that usually emerges when a market correction takes place."

With that said, the timing of such a market downturn is still unknown, so private equity (PE) investors and corporate buyers are still willing to pay top dollar for well-positioned IT assets. Not only does the massive hoard of PE dry powder continue to help bolster tech buyout activity, but the ongoing proliferation of software into multiple industries and consolidation among the earliest waves of software-as-a-service companies have aided the level of deal flow as well. Thus, all signs point toward the M&A cycle overall across IT moderating. The next phases of significant technological advancement and adoption are already slowly revving up (e.g., 5G across wireless). "The technology industry tends to be more resistant to political volatility and downward trends than other industries," says Alex Weiss, partner with transaction advisory services at RSM. "Systems and software tend to be critical to operations, making them more elastic."

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As noted in a [recent RSM Industry Outlook](#), broadcast television networks have actually outperformed the S&P 500 since the beginning of 2019, even as their advertising revenues have understandably waned due to the impact of on-demand streaming. That outperformance is primarily driven by so-called retransmission fees—the fees paid by cable, satellite and streaming platforms to retransmit local TV broadcast signals—and not by a spike in political campaign advertising dollars or the advent of sports seasons' viewership. However, as those retransmission fees continue to grow, they help encourage significant M&A across local TV broadcasters.

This theme of consolidation is hardly novel to the broader IT space, as it has been a key proponent of M&A across the cycle in its later stages. Many headlines have dwelt on fintech consolidation over the past two years given megamergers such as that of First Data and Fiserv for \$22 billion in the summer of 2019. It's also worth noting the significant amalgamation among cloud services, for example, the absorption of Hortonworks by Cloudera for \$5.2 billion in January 2019. As both fintech and cloud services continue to progress through their maturing M&A cycle, new specialties will gain attention. One prime contender is cybersecurity. "Cybersecurity is obviously paramount for the entire IT industry," says Weiss. "While we've seen a shift in market appetite for pre-close cybersecurity due diligence, it's not yet at levels we'd recommend given the low cost of procedures relative to the potential negative consequences of ignoring the issues." However, it is likely buyers will start investing more heavily in cybersecurity measures—including through acquisitions—as the cost of data breaches continues to rise for companies small to large. A few prominent transactions signal the potential emergence of such cybersecurity consolidation in 2019 to date, including Cylance's \$1.4 billion purchase by BlackBerry in February 2019.

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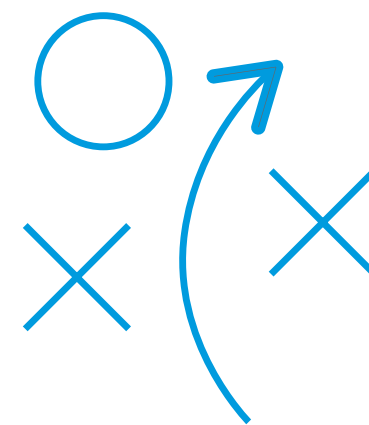
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It is reasonable to expect continued caution from deal-makers given signs indicating the M&A cycle is in its last stages. "There's a clear divide between buyers in this exorbitantly priced marketplace," says Weiss. "For PE, at the extremes, some take an aggressive approach and continue to be platform acquisitive, while others sit on the sidelines entirely. The majority is somewhere in between, spending increasing time executing on a rollup strategy where lower multiples and synergies yield value." However, given the level of dry powder that PE has on hand, plus newer entrants flocking to the space, the IT M&A cycle still has plenty of supporting factors to keep deal values and volumes healthy.



As for the broader strategic M&A cycle, much of it will still be driven by consolidation and pursuit of inorganic, top-line growth in segments such as cybersecurity. "Historically, cybersecurity was viewed as a cost center—for example, as a way to spend money without getting anything in return," Van Wert explains. "But now, given the risks of not ensuring your enterprises are secure, the potential costs dwarf actual cybersecurity spending." Those are the same characteristics that will help identify IT segments where future consolidation and investment could occur, as even against an uncertain economic and political backdrop, deal-makers will still invest in technologies and arenas that are perceived as imperative or generating growth.

Our new [Insights for Technology Companies](#) newsletter will keep you up to speed on the M&A cycle and other trends. In addition, RSM's latest e-book, [Scaling up: Successfully growing your technology company](#), offers insights related to preparing your business for future growth.

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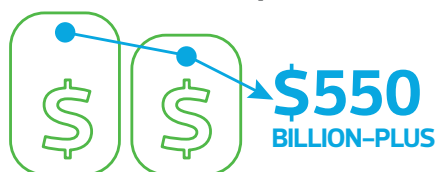
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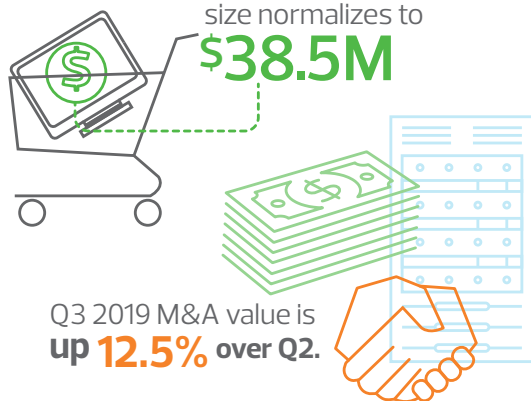
M&A PROCEEDING AT SLOWER PACE

Despite a slowdown in volume, 2019 is on pace for **\$550 billion-plus** in deal value.



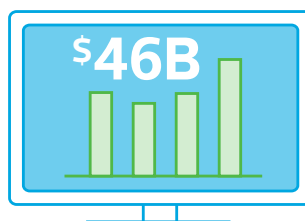
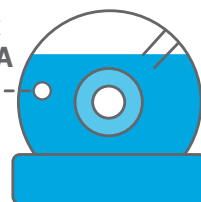
After a record high of **\$49 million** earlier this year, median transaction size normalizes to

\$38.5M



SOFTWARE'S PROLIFERATION INTO OTHER NICHES (E.G., MANUFACTURING 4.0)

Software holds steady at close to **70% of all IT M&A volume** in Q3.



IT services has strongest quarter in a long time, at nearly **\$46 billion**.

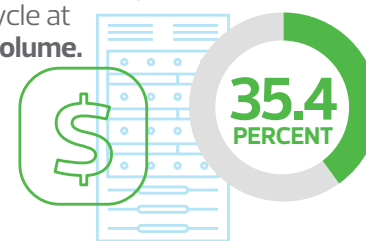
\$84.9M



Software still bidding up prices to hit **\$84.9 billion** in Q3 deal value.

PE CONTINUES PLUNGE INTO TECH

PE activity remains key component for M&A cycle at **35.4% of volume**.



Add-ons surge to a new high, signifying the degree of PE building out in tech.



Tech divisions of publicly traded companies still remain a hot space for PE funds, **buying 18** through Q3.

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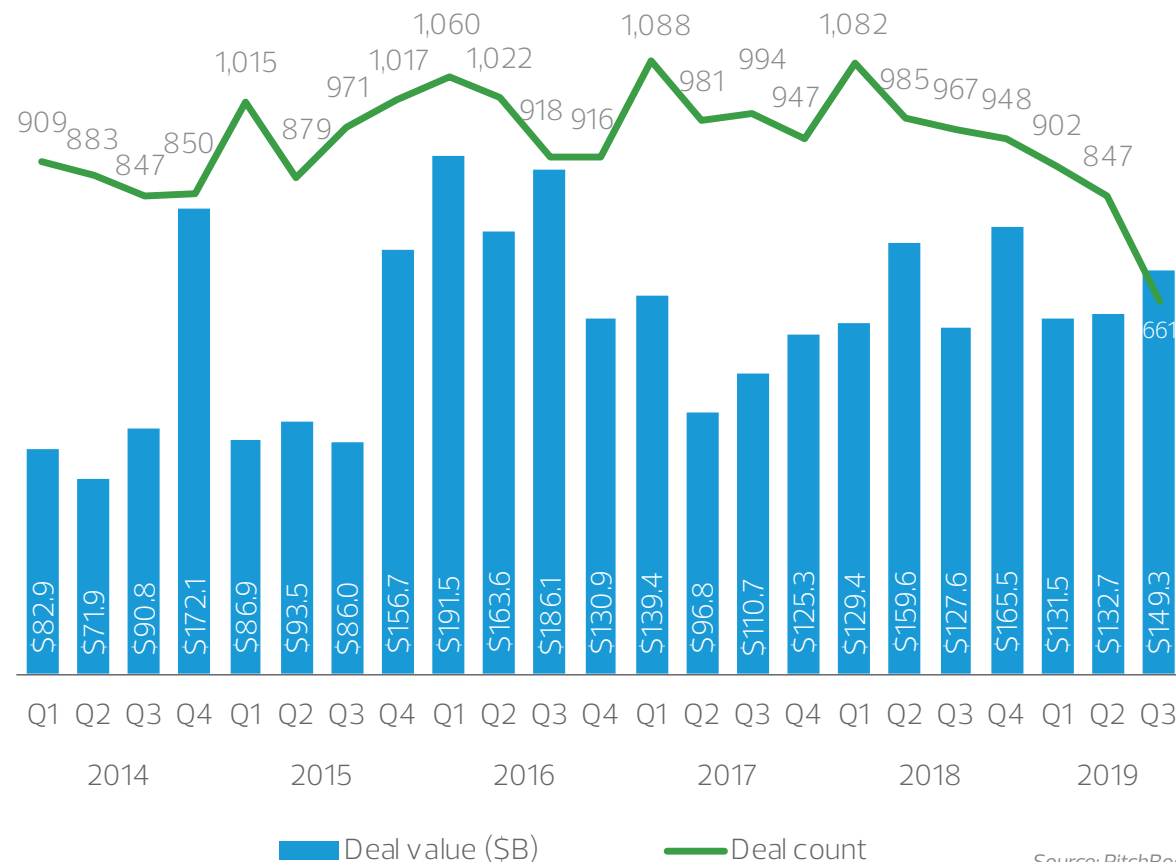
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THE M&A CYCLE EVENS OUT

Any megadeals closing in the final quarter of the year could result in 2019 being another historic year for the IT M&A cycle overall; even at the end of the third quarter, no less than \$413.4 billion closed across over 2,400 transactions. While that count is far below the prior four years' annual tallies, deal value still remained robust. "There are still plenty of deals getting done," says Van Wert. "Regardless of which segment of the market you are looking at, multiples are still high."

High valuations undoubtedly affect volume, especially in a cautious climate, which could help explain diminishing count numbers. With that said, before a definitive verdict emerges on whether the M&A cycle is significantly slowing, we will have to wait until year-end figures are available.

IT M&A ACTIVITY



Source: PitchBook

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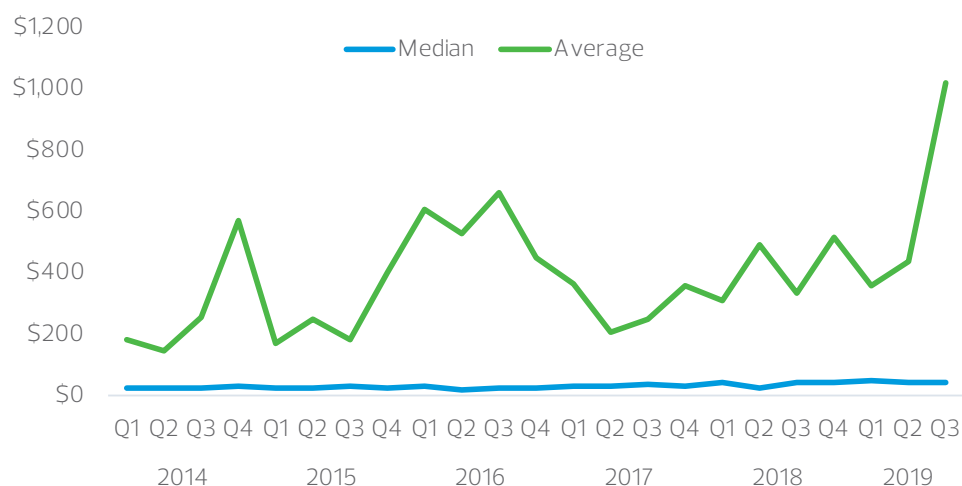
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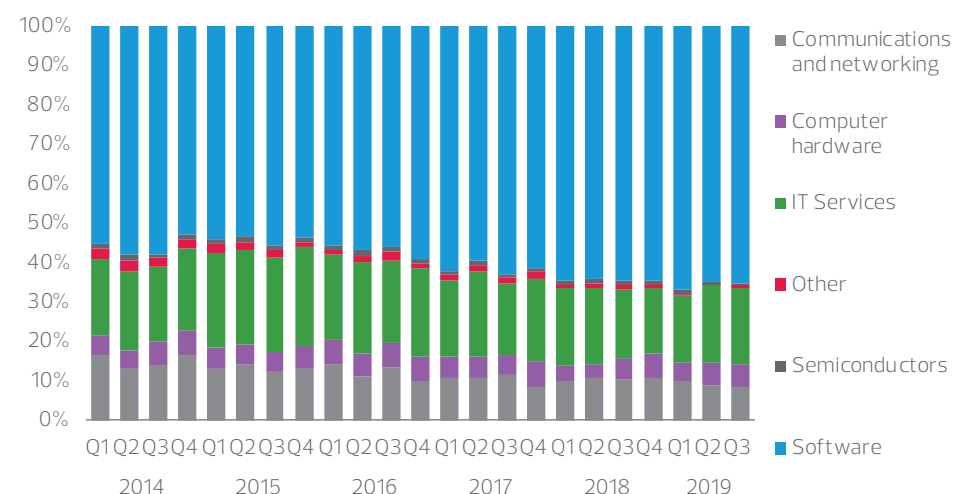
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MEDIAN & AVERAGE IT M&A SIZE (\$M)



Source: PitchBook

IT M&A (#) BY SUBSECTOR



Source: PitchBook

HIGHER PRICES SET FOR SHORT TERM

The median transaction size for the third quarter of 2019 indicates that prices are staying historically high. Intriguingly, the average transaction size also exceeded a mammoth \$1 billion. When the mean and median both stay high, it signals not only a marketwide inflation but also a willingness to pay up in certain instances for the right business, especially in the still-popular SaaS and occasionally services segments, or some combination thereof. "For market-leading, recession-proof businesses that exhibit higher retention of customers and higher recurring revenues, firms—both PE and corporates—are willing to pay very high multiples," says Van Wert. "I would predict that short-term multiples will remain high."

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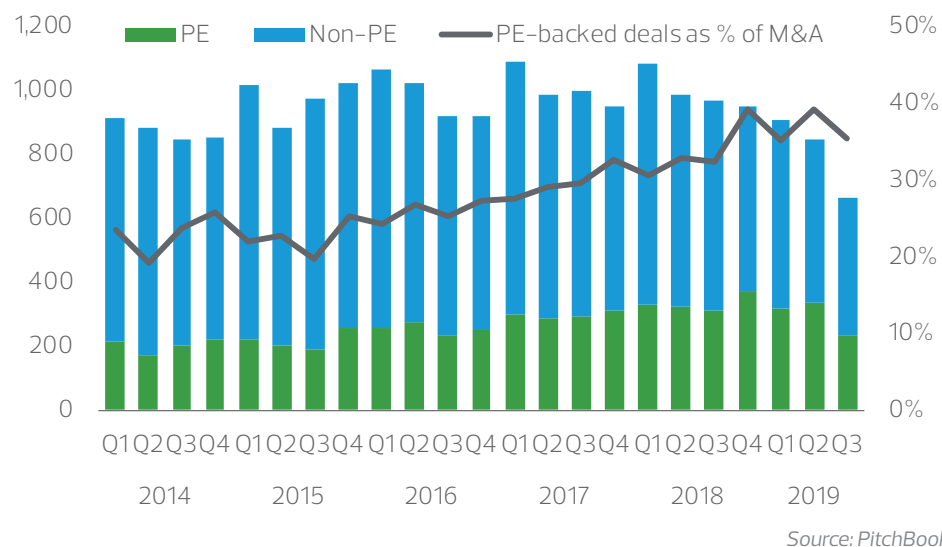
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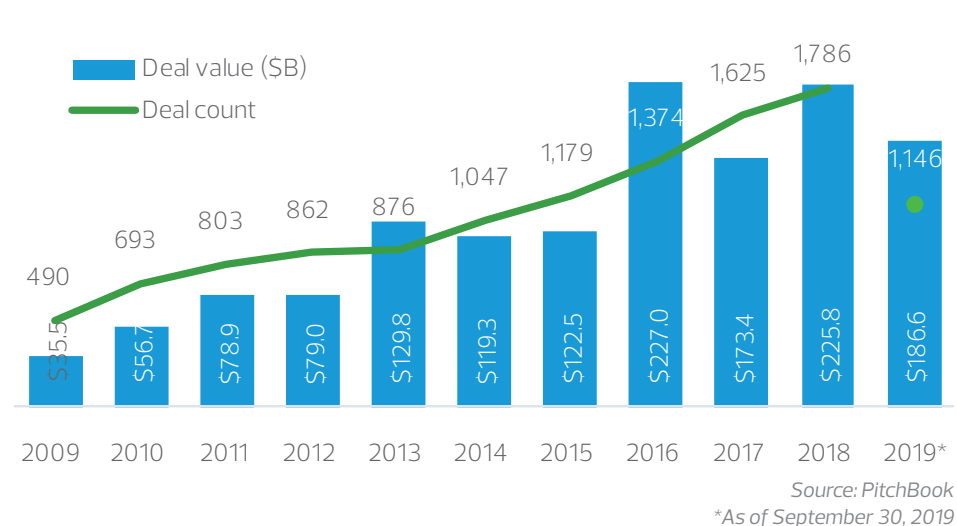
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PE DEALS (#) AS % OF OVERALL IT M&A



PE IT DEAL ACTIVITY



PE STAYS DIALED IN

PE activity continues to bolster the overall M&A cycle, despite what will likely prove to be a momentary downturn in volume and deal value for PE in the third quarter. Investment theses continue to evolve as more PE buyers pile into the sector; for example, 18 take-privates have already closed in 2019 to date, matching 2018's entire tally and returning to more robust levels. Especially as the first movers in IT-focused PE—Thoma Bravo, Silver Lake, Vista Equity Partners—continue to refine their approaches and continue to raise significant sums of capital, positive pressures to underpin the PE cycle will persist, and imitators will flock in.

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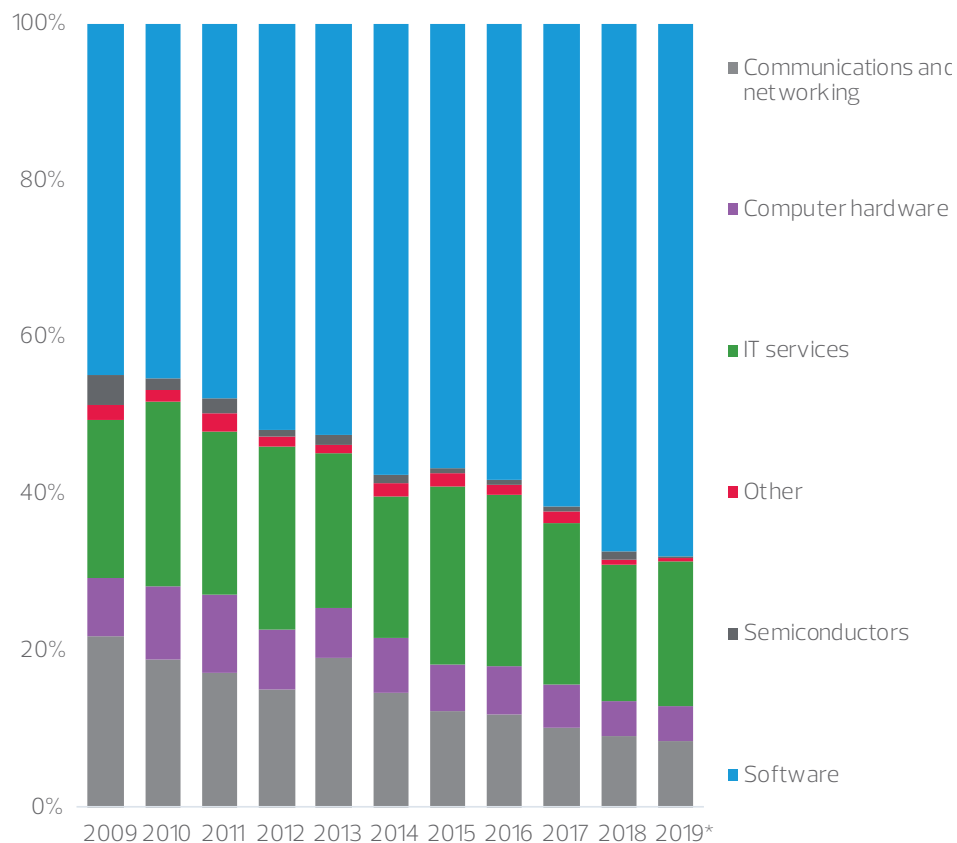
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PE IT DEALS (#) BY SECTOR

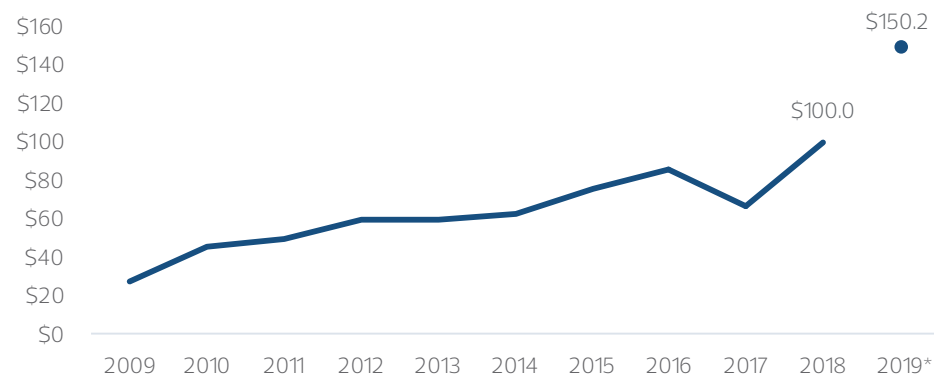


Source: PitchBook
*As of September 30, 2019

ROBUST THROUGH FIRST HALF

The median PE deal size in IT still stands at a record. "Lenders are more aggressive in the market," says Van Wert. "They are working with buyers to form creative packages when reviewing the quality of EBITDA and the actual recurrence of revenue." Creativity isn't necessarily problematic, but discipline must remain critical, especially given broader concerns around potential economic slowdowns.

MEDIAN PE IT DEAL SIZE (\$M)



Source: PitchBook
*As of September 30, 2019

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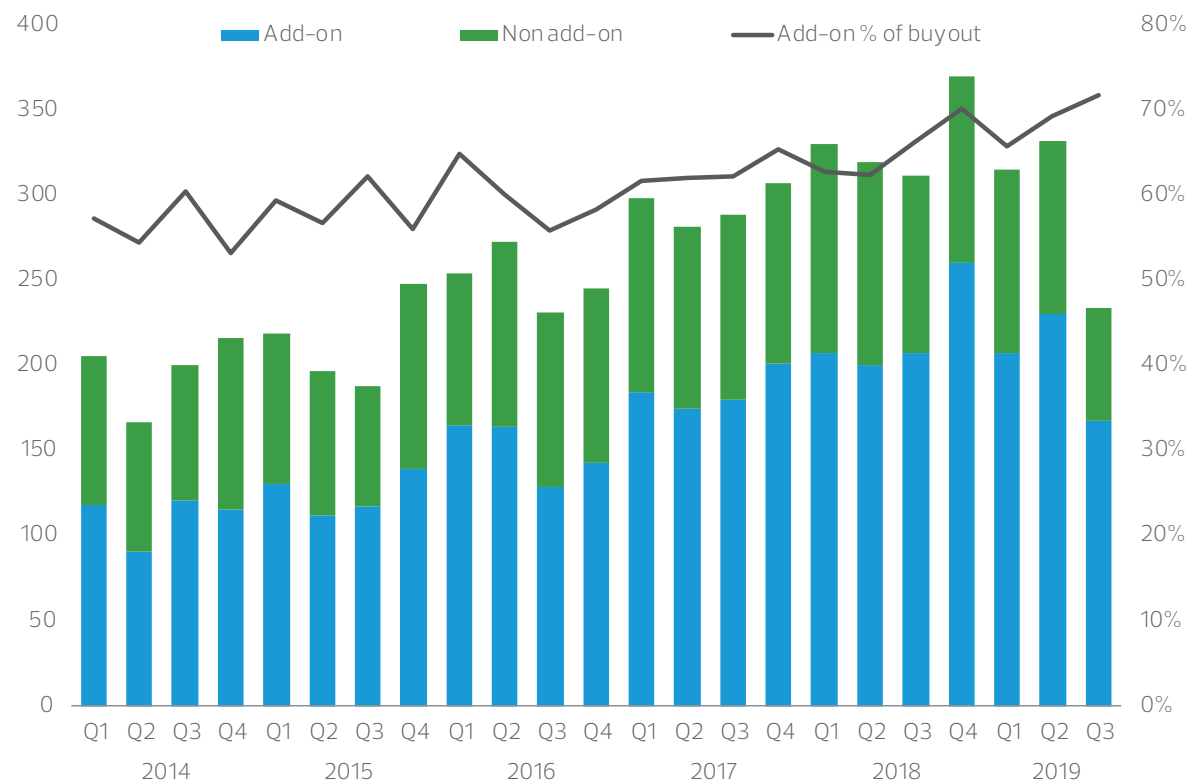
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A RECORD FOR ADDING ON

"You could make a case that multiples for add-ons nowadays can range even higher, even in the middle market," says Van Wert. "That is because buyers are able to factor in synergies, cost savings and accretive top-line factors into their valuation models, anticipating building out a platform." Not only does that support high median PE deal size, but it also speaks to the sheer level of appetite for IT companies exhibited by PE buyers as they seek to deploy whatever strategies possible to gain exposure, including an intense focus on building out platforms. "For the most part, add-ons are either purely a market share capture or a somewhat complementary and superior product suite acquisition," says Van Wert.

ADD-ONS (#) AS % OF PE IT BUYOUTS



Source: PitchBook

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THE VALUE OF RSM'S MIDDLE-MARKET LEADERSHIP

Focusing on the middle market, RSM US provides integrated transaction advisory, tax, assurance and consulting services. Our work with 2,700 technology, media and telecommunication (TMT) companies gives us a deep understanding of the key trends impacting the industry. In addition, we have performed due diligence on nearly 2,600 deals in the past five years, 450 of which were TMT transactions. This in-depth knowledge provides our private equity and strategic buyer clients with industry-specific due diligence considerations.

METHODOLOGY

M&A is defined as the substantive transfer of control or ownership. The data in this report tracks only completed control transactions. Announced, rumored or canceled deals are not included. Eligible transaction types include but are not limited to control acquisitions, leveraged buyouts (including asset acquisitions), add-on deals, corporate divestitures and reverse mergers. Volume will lag between quarters and will likely be revised upward once more data is collected, often resulting in more robust figures as the result of an ongoing research process to retroactively track down deals. All companies in underlying datasets that are acquired are headquartered in either Europe or North America.

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