

Technology

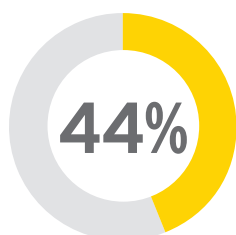
Capital Confidence Barometer

**Rising M&A tide lifts
middle-market dealmaking**



Building a better
working world

Technology Capital Confidence Barometer | October 2014



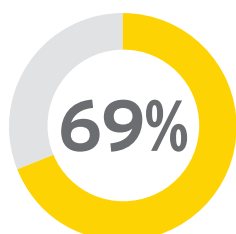
The ranks of technology companies expecting to do deals in the next 12 months keep growing – up by a third in six months

► See page 11



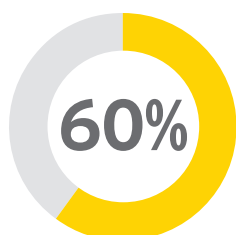
The vast majority seek deals below US\$1b, with M&A momentum growing in middle-market and smaller acquisitions

► See page 12



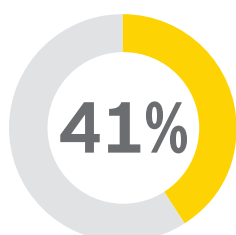
Pipelines are already full of deals, but over two-thirds expect to explore even more acquisitions in the coming year

► See page 13



Most see only small valuation gaps between buyers and sellers – and expect them to stay that way in the near term

► See page 14



With favorable credit markets and robust balance sheets, executives are ready to increase leverage to achieve growth

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“The momentum in middle-market and smaller acquisitions is filling technology deal pipelines with strategic options for innovation, operational efficiency, market expansion and access to talent.”



A note from Jeff Liu, Global Technology Industry Transaction Advisory Services Leader, EY

Dealmaking commands center stage in our latest Technology *Capital Confidence Barometer*, as it has done in the sector itself. Even with a near-record 2,500 deals in the first three quarters of 2014, the economic, financial and mechanical underpinnings for technology M&A all point to continued dealmaking, according to the executives we surveyed. And despite headline-grabbing megadeals, the momentum is particularly strong for middle-market and smaller deals.

The numbers are striking. With so many deals done – and pipelines already filled with more potential deals – 69% of technology executives still expect to keep adding to their pipelines in the coming year. Forty-four percent expect to do deals in the same time frame. Modest valuation gaps are paving the way for productive negotiations, according to 60% of respondents. Favorable credit markets are increasingly seen providing the means.

Digital transformation is driving dealmaking in this sector as companies seek to accelerate their adaptation to the technology megatrends of smart mobility, cloud computing, social networking and big data analytics. Growth is paramount in the competitive technology arena, but companies are balancing growth and efficiency, as they integrate new assets, face increasingly activist shareholders and apply lessons learned in the global financial crisis. Ultimately, buyers are looking for the best strategic fit, and such thorough examination, in turn, brings even more deals into the pipeline.

Unless derailed by geopolitical stress or the kind of stock market turmoil that surfaced in October, technology M&A appears on track for a blockbuster year.



A note from Pip McCrostie, EY Global Vice Chair, Transaction Advisory Services

Our 11th *Capital Confidence Barometer* predicts healthy growth for M&A globally, which should take the market back to levels last seen before the financial crisis.

Acquisitive appetite has increased and deal fundamentals – credit, cash and prices – are strong, as is confidence in economic stability. The biggest indicator of this positive sentiment is deal pipeline, which has increased by a remarkable 30% since April. In addition, two-thirds of executives expect M&A pipelines to expand further over the next year – more than double the number expecting expansion six months ago.

As we predicted in our previous *Barometer*, 2014 has seen a big increase in multibillion-dollar deals. Now, increasing competition at the top end and a renewed focus on growing core businesses will fuel more middle-market deals.

The majority of acquisitive companies are now focusing on M&A to strengthen their core business, with an eye to boosting market share, managing costs and improving margin growth.

Megadeals are set to continue. However, the next chapter of the M&A story should be middle-market deals fueling an M&A rebound globally.

Macroeconomic environment

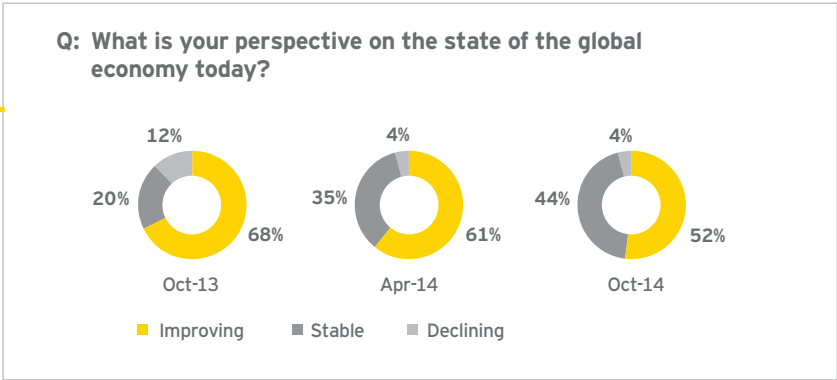


Confidence in financial indicators surpasses global economic sentiment.

Technology executives' confidence in corporate earnings has nearly doubled in the last 12 months, alongside increasingly positive views of credit and stock markets, while their economic outlook has moderated.

Executives increasingly see the global economy stabilizing

Amid an uneven global recovery, very few technology executives expect economic decline. Over half still see the economy improving, though such expectations have fallen over the past year. The rising sentiment is one of stability, a condition that allows companies to plan freely for growth and M&A.

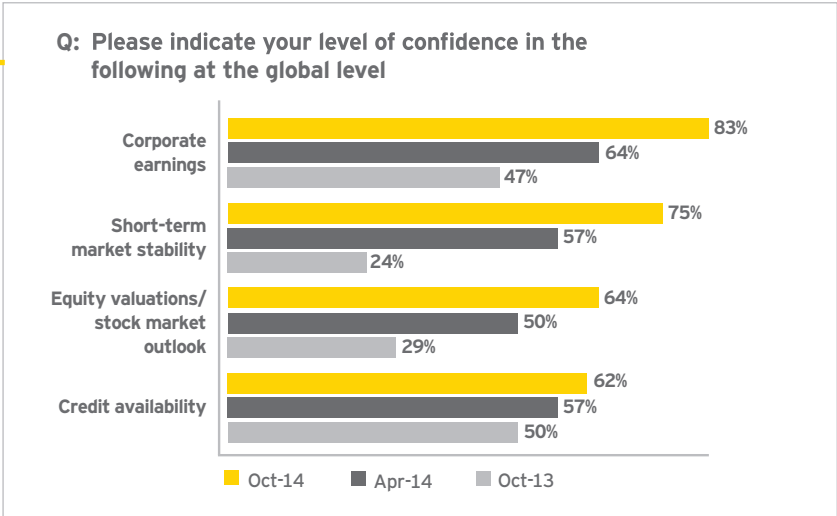


Confidence surges in corporate earnings

More than four out of five technology executives have a confident outlook on corporate earnings – a surge in the confidence level seen 12 months ago.

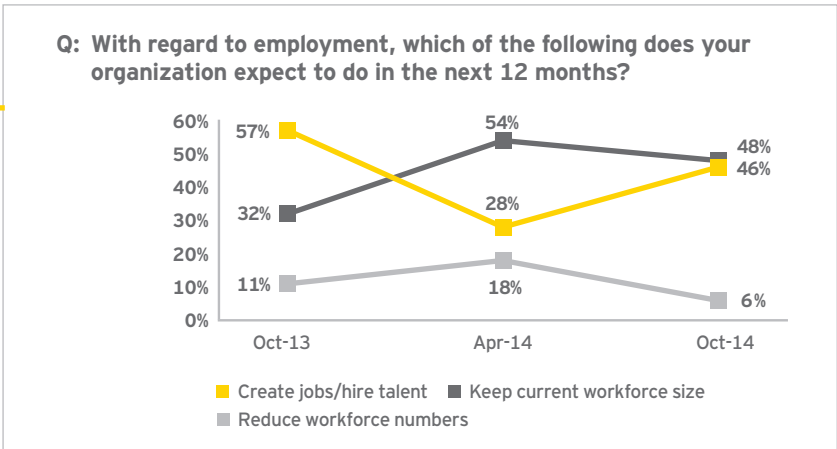
Corporate earnings across sectors – and particularly in the US – came in remarkably strong in the first half of 2014. Seventy percent of the S&P 500 beat estimates, though results in the UK and Eurozone were mixed.

Technology sector confidence is also significantly higher in the credit and stock markets – all healthy indicators for dealmaking.



Strong financial indicators enabling strategic hiring

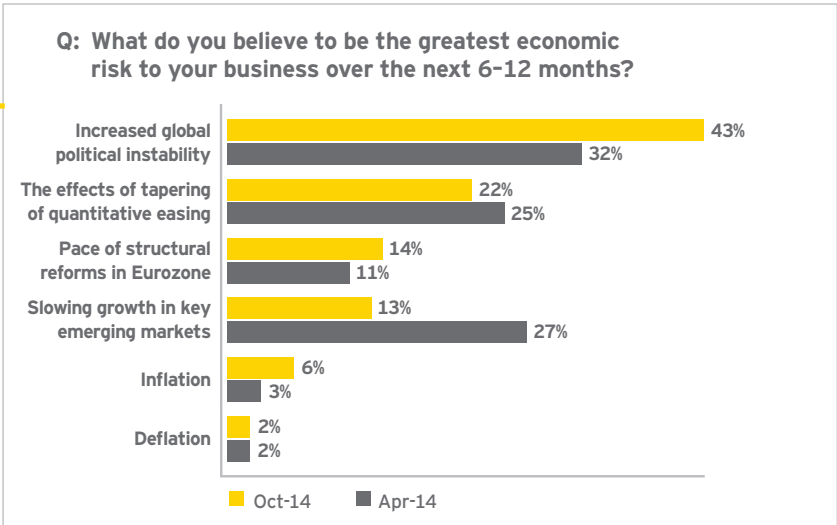
Despite recent news of layoffs at leading technology sector companies, only 6% of respondents expect to reduce workforce numbers in the next 12 months. Hiring intentions are actually growing amid strong market indicators, as technology companies rebalance skills for their top priority: digital transformation (see page 6).



Companies factor in mounting geopolitical risks

Technology respondents increasingly see geopolitical instability as a potential threat to business, amid crises and conflicts in Africa, the Middle East and Ukraine. In contrast, concerns about slow growth in key emerging markets have fallen.

While such issues tend to temper M&A activity, executives have become more accustomed to factoring related risks into their growth plans.



Corporate strategy



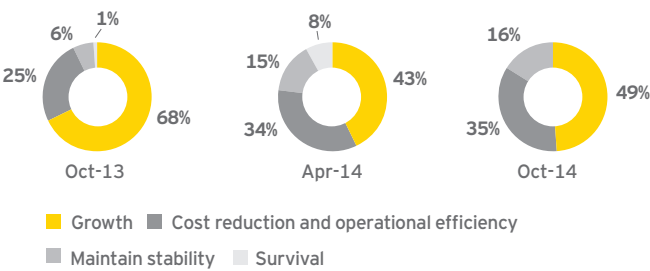
Digital transformation has driven technology M&A to near-record levels in 2014, with executives now seeking the right balance between growth and efficiency.

While the quest for growth remains paramount, cost reduction and operational efficiency are commanding an increasing share of technology executives' strategy.

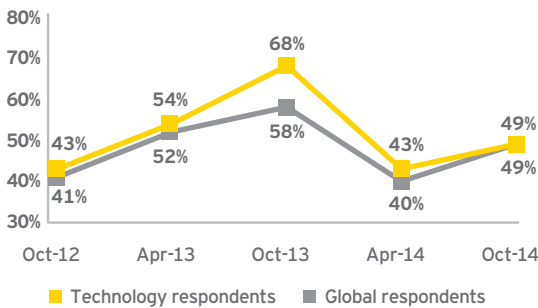
Companies continue to seek growth – and to assimilate growth

Technology executives continue to give their highest priority to growth – with more than 2,500 acquisitions already recorded by EY’s *Global technology M&A update* in the first three quarters of 2014. Still, the focus is shifting, with a 40% increase in emphasis on cost reduction and operational efficiency in the past year. Companies are looking to integrate new assets efficiently. Executives are also mindful of lessons learned during the global financial crisis, as they continue to drive both inorganic and organic growth.

Q: Which statement best describes your organization’s focus over the next 12 months?



% focused on growth

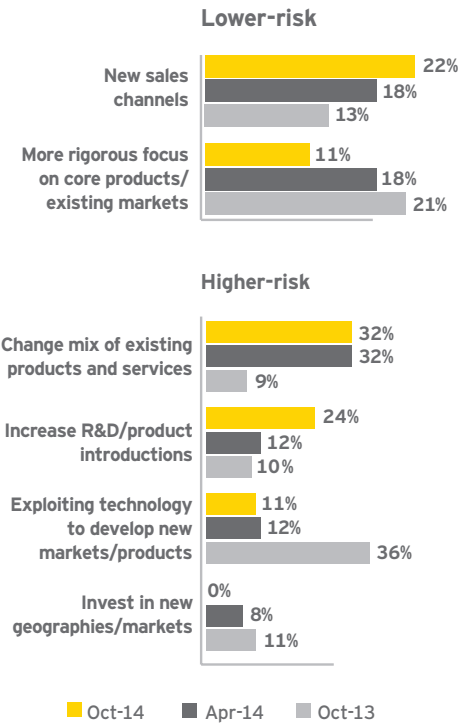


Organic growth plans reflect dynamics of digital transformation

Technology executives’ top two priorities for organic growth – changing the mix of existing products/ services and increasing R&D – demonstrate how companies in this industry are plotting higher-risk strategies to accelerate adaptation to the technological megatrends of mobile, social, cloud and big data analytics. Our survey shows a threefold increase from a year ago in the number of companies changing their product mix.

Risk tolerance appears to be decreasing in other areas, however, with executives favoring the development of new sales channels over investing in new geographies in this *Capital Confidence Barometer*.

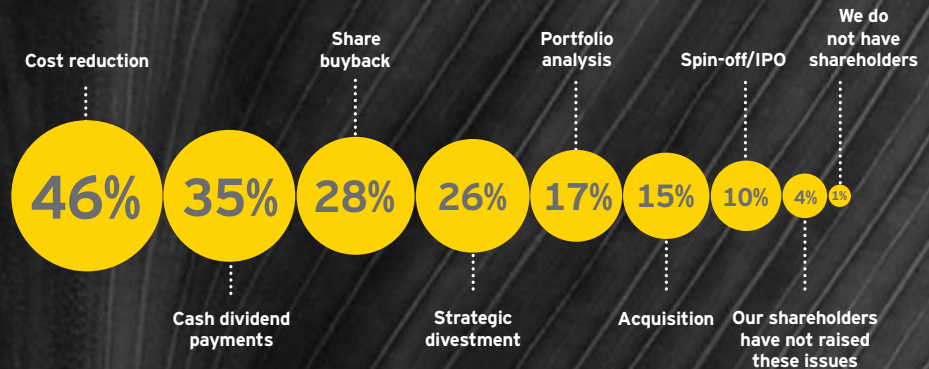
Q: What is the primary focus of your company’s organic growth over the next 12 months?



Activist shareholders influence boardroom agenda

The C-suite agenda – organic and inorganic growth priorities – is increasingly swayed by the rising influence of shareholder activism.

Q: Which of the following has been elevated on your boardroom agenda as a result of shareholder activism? Select up to two.



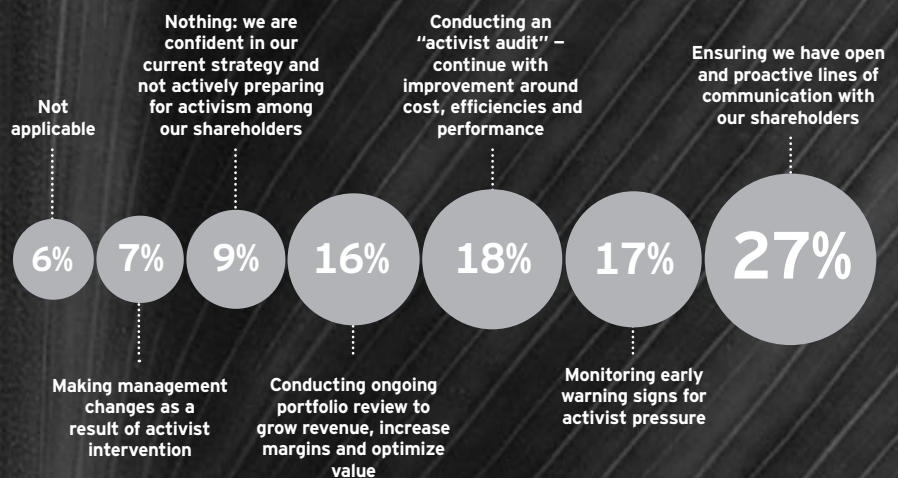
Oct-14

High-profile examples of activist intervention in the US have influenced companies in other markets. Activist cases are building as the global economy enters a new phase of low but stable growth.

Cost management, returning cash and portfolio analysis are key areas of focus, spurring technology companies in their attempts to balance growth and efficiency. Activist pressures for strategic divestments are also contributing to technology deal flow.

In response, companies are stepping up their efforts to manage shareholder activism, enhancing communication with stakeholders, monitoring signs of activist pressure and performing ongoing portfolio reviews. Pre-emptive “activist audits” are now de rigueur at some companies.

Q: How are you preparing to manage any shareholder activism?

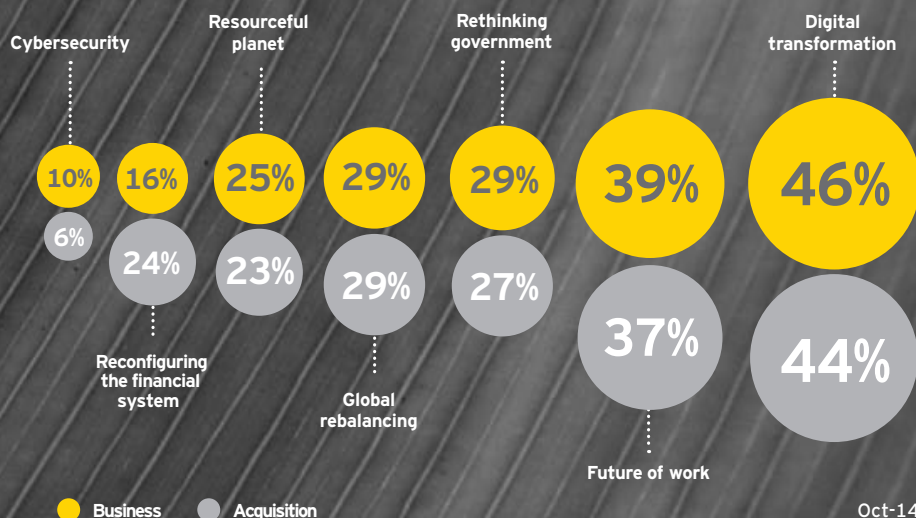


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Digital transformation drives business and acquisition strategies

Digital transformation tops technology executives' list of global megatrends driving business and acquisition strategies, and its influence is cited across other industries as well. The momentum of mobile, social, cloud and big data technologies is spurring accelerated adaptation throughout the business world.

Q: Which of the following will impact a) your core business and b) your acquisition strategy most in the next 12 months? Select up to two.



Specifically, nearly half of technology respondents (46%) cite digital transformation as impacting business strategy, as do a third of the cross-industry respondents to our *Capital Confidence Barometer* survey. In the technology sector, the results are evident in survey findings that emphasize R&D and changing product mixes over core products. Acquisition strategies show similar levels of influence both in the technology sector (44%) and across sectors (37%).

"Future of work" issues also command the technology sector's attention, as their strategies increasingly accommodate the move to a more flexible workforce. Driven by the shifting expectations and needs of both employers and employees, the traditional talent contract is being rewritten. An increasing number of mobile, part-time and self-employed workers are changing the nature of work and the workplace. In the technology sector, where competition for talent often drives dealmaking, "future of work" trends also provide opportunities for collaboration and productivity.

Among other top influences, global rebalancing is altering cross-border business models and dealmaking strategies. Trends include a growing focus on developed markets and increasing overseas investment by Chinese and Japanese companies.

Also given significant strategic weight by technology sector executives is the global effort to rethink government. From building social safety nets in key emerging markets to reducing deficits and debt in developed countries, governments are trying to meet enormous challenges without dampening economic expansion. These changes have far-reaching implications for business, creating an urgent need to stay agile, keep up with policy changes and ensure compliance and collaboration with public sector agencies.

Global megatrends

M&A outlook



This year's flood tide of technology M&A is not expected to abate any time soon, given the confluence of positive asset valuations, favorable credit markets, competitive pressures and other drivers. The deal current is changing, however, with a growing emphasis on acquisitions that are middle-market and smaller.

The spate of megadeals in 2014 is producing a ripple effect in the M&A market. It is increasing buyers' confidence and triggering transaction activity further down the deal chain.

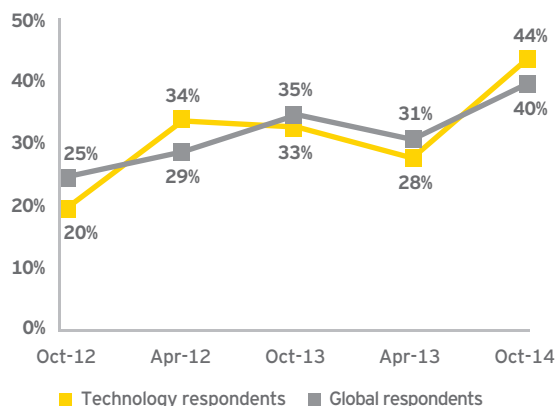
Technology deals keep coming

Appetite to acquire remains strong – at 2,500 deals and counting

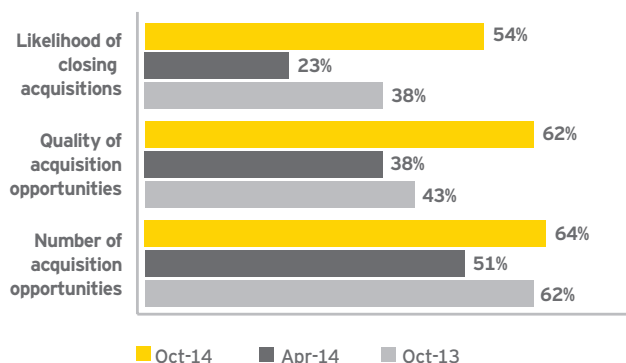
Forty-four percent of technology executives expect their own companies to pursue acquisitions in the next 12 months – even after a near-record 2,553 technology sector deals have already been done in the first three quarters of 2014. Nearly two-thirds say both quality and quantity of acquisition opportunities remain strong.

Dealmaking challenges still persist: just over half of executives are confident about the likelihood of closing acquisitions. This may be because of increasing rigor in the search for strategically aligned assets, more thorough due diligence or greater competition.

Q: Do you expect your company to pursue acquisitions in the next 12 months?



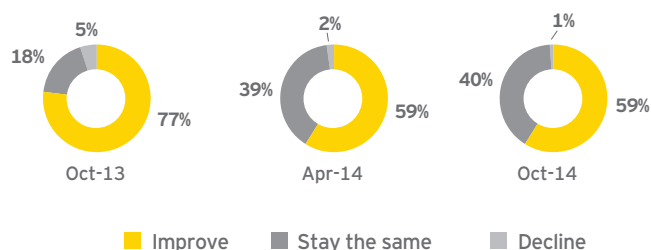
Q: Please indicate your level of confidence in the following at the global level:



Executives see technology M&A streak continuing in the near term

Unless derailed by geopolitical stress or the market turmoil that arose in early October, technology M&A appears on track for a blockbuster year. Ninety-nine percent of technology respondents expect dealmaking either to continue at the same level or to grow over the next 12 months. However, breaking down those numbers may reflect on the volume of deals; there has been an 18-point drop in the growth projection since the October 2013 *Barometer*.

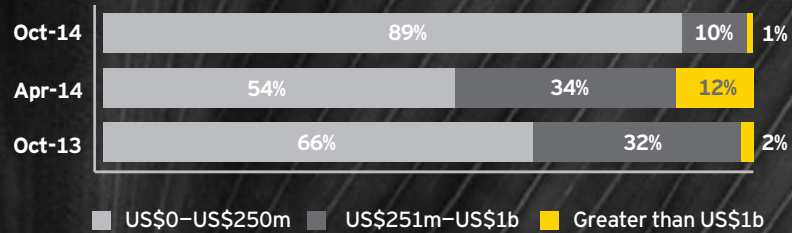
Q: What is your expectation for the global M&A market in the next 12 months?



Momentum moves down the deal chain

Focus shifts to middle-market and smaller deals

Q: What is the maximum single deal value expected over the next 12 months?



Multibillion-dollar deals will continue to grab the headlines; however, the next chapter of the M&A story should be about momentum in middle-market and smaller deals.

Year to date, in fact, the number of deals above US\$1 billion is 29% ahead of 2013, while deals below US\$1 billion are 54% ahead, according to EY's *Global technology M&A update*. Looking ahead, 99% of technology respondents to this *Capital Confidence Barometer* project deal values below US\$1 billion, with a major shift to deals valued at US\$250 million and under.

Across all industries, our analysis of year-on-year changes in deal volumes also shows that previous upturns have been led by megadeals and upper-middle-market deals, followed by an upswing in the lower middle market.

Big or small, transformative deals are being made alongside "utility" deals addressing a wide range of drivers – from gaining access to intellectual property to reducing costs and growing market share (see page 15).

Our analysis shows the technology sector making more deals than any other sector in the 12 months ended August 2014.

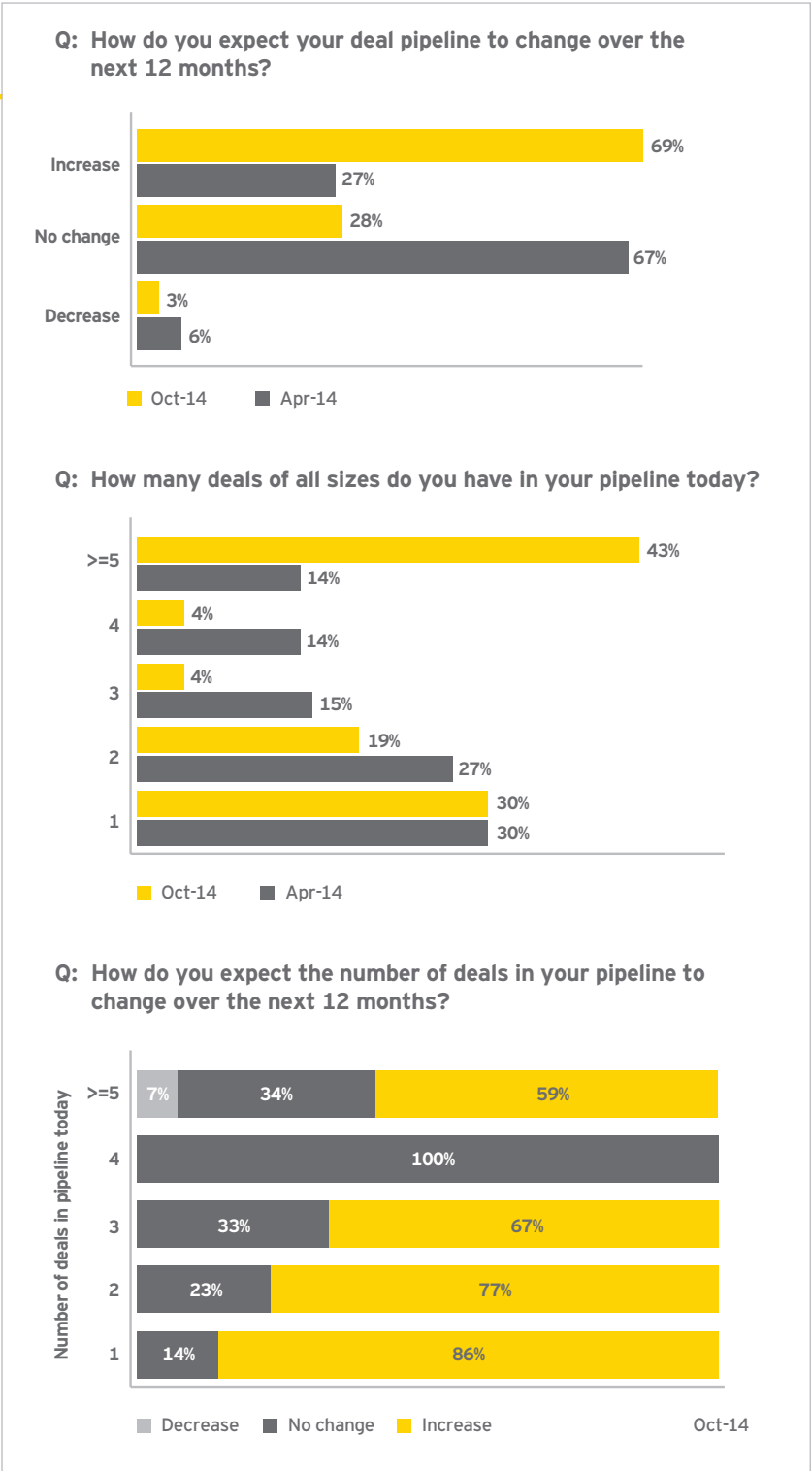
Pipelines full of deals – and growing

Strategic deal intentions swell pipelines

Nearly 7 out of 10 technology executives expect their deal pipelines to grow in the next year, with more than 4 out of 10 reporting that their pipelines already include 5 deals or more. Notably, these statistics are also up sharply over a year ago.

An analysis of the correlation between current pipelines and “expectation to increase” shows that companies with the smallest pipelines express the most desire to expand in the next 12 months. Companies with larger pipelines are overwhelmingly in favor of maintaining or even increasing theirs as well. In aggregate, our 163 technology respondents report an almost fourfold increase in the size of their pipelines.

Renewed discipline in dealmaking is compelling companies to thoroughly examine more investment opportunities to find the best strategic fit. This move toward larger pipelines also reinforces the trend toward middle-market and smaller deals.



Narrow valuation gaps open door to deals

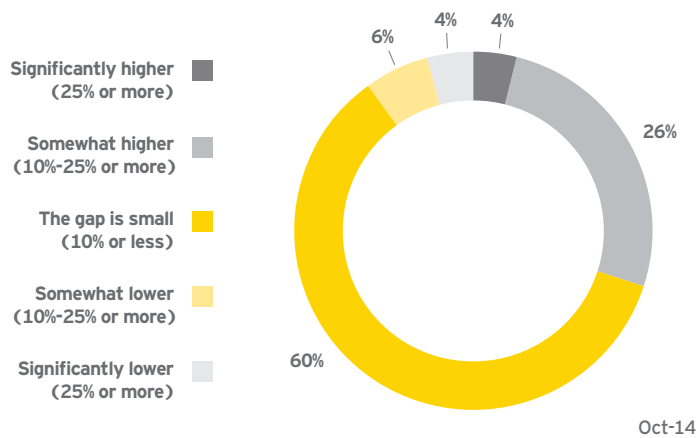
Most see gaps between buyers and sellers below 10%

The number of technology executives seeing only a small discrepancy between buyers' and sellers' expectations on asset valuations has almost tripled in the past year. Sixty percent now see valuation gaps at or below 10%.

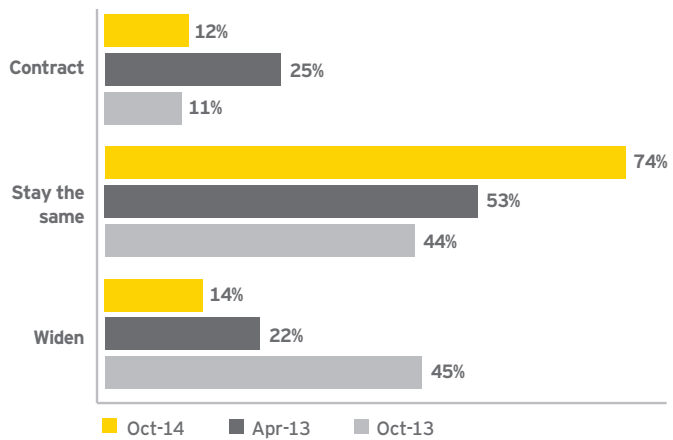
What is more, 74% expect little change. Last year's technology sector concerns about widening gaps have fallen away, from 45% of respondents to 14%.

As buyers become more confident in newly acquired assets' long-term value, and sellers no longer hold out for higher prices in the future, negotiations become more productive – especially in the lower middle market, where valuation gaps are most easily bridged.

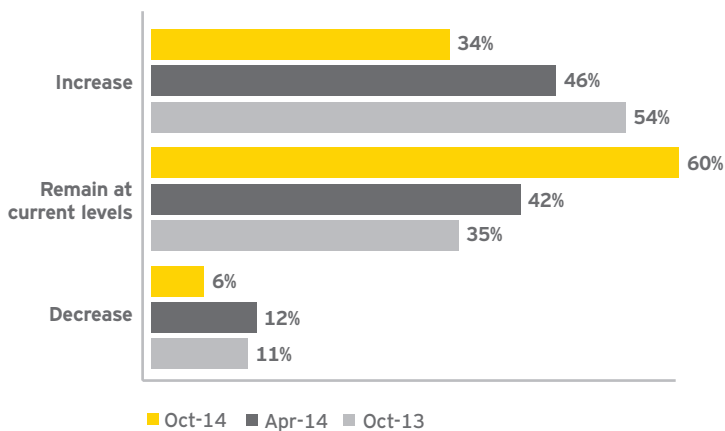
Q: How do you think that buyers' expectations currently compare to sellers' (valuation gap)?



Q: Do you expect the valuation gap between buyers and sellers in the next 12 months to:



Q: What do you expect the price/valuation of assets to do over the next 12 months?



Deals strengthen and transform technology companies

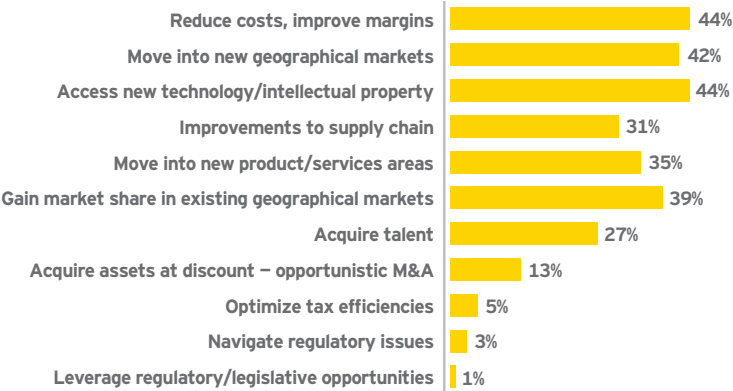
Executives seek to innovate and grow market share while mindful of margins

Technology respondents to this *Capital Confidence Barometer* are just as likely to buy a company for its intellectual property as for its potential to deliver cost efficiencies. M&A is also seen as a tool to grow market share – both in existing geographical markets and new ones.

While most acquisition strategies look to strengthen and expand out from the company’s core, technology executives are more likely to do disruptive deals than their counterparts in other industries. In some cases, this will translate into the acquisition of innovative middle-market assets that shift the scope of their business. Technology companies are also more likely to do transformative deals – high-value acquisitions that significantly change the size of the acquirer. Forty-two percent are considering such transactions.

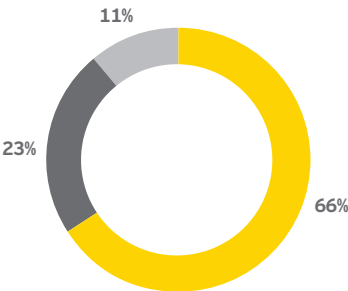
The impetus for disruptive and transformative M&A comes as technology companies accelerate their adaptation to the disruptive megatrends of mobile, social, cloud and big data analytics. This drive is fundamental, with more than half of respondents saying that they are increasing focus on transformative innovation to remain competitive. Technology companies can no longer afford to make only incremental or marginal improvements to products and services.

Q: What are the main drivers impacting your M&A strategy over the next 12 months? Select up to three.



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Q: Are your M&A deals planned in or outside of your core sector?



We are looking to acquire competitors/similar companies in our core sector

We are looking both inside and outside of our core sector

We are looking outside of our core sector

Q: Your planned M&A activity will mostly be:



Bolt-on (complement current business model)

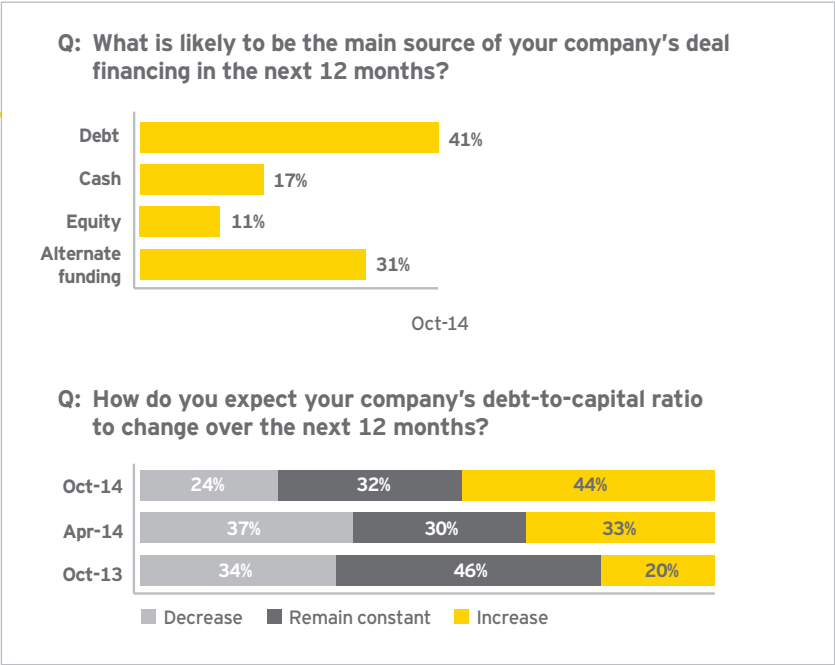
Transformative (high-value acquisition which significantly changes the size of acquirer)

Oct-14

Debt to fund dealmaking

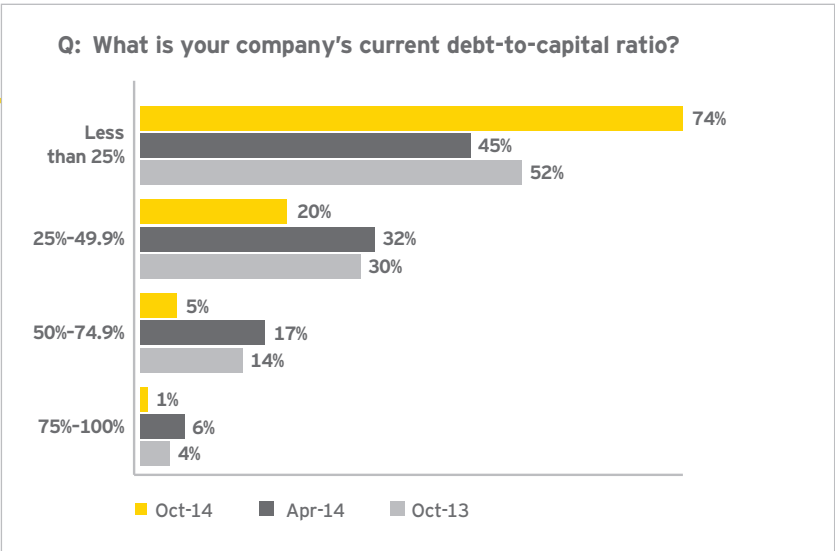
Technology companies ready to increase leverage to achieve growth

Favorable credit markets and robust balance sheets put technology executives in a position to fund deals with debt financing. The *Capital Confidence Barometer* has recorded a steadily increasing sentiment for doing so. Forty-one percent of technology sector respondents now see debt as their primary source of deal financing for the next 12 months, up from 27% in April 2013. Their plans to increase debt-to-capital ratios have more than doubled in the past year, to 44%.

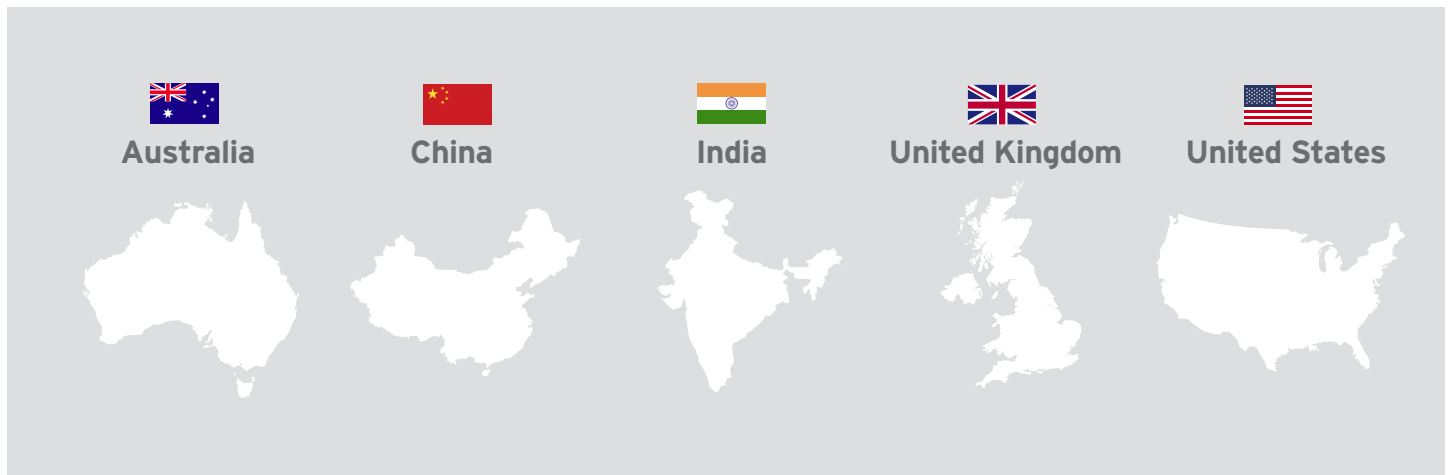


Strong balance sheets leave room for debt

Leverage has declined since the global financial crisis and technology companies' financials are in an especially strong position, with a clear majority reporting healthy balance sheets. Nearly three-fourths of technology respondents report a debt-to-capital ratio of less than 25%, up from about half the previous year. This deleveraging trend could reverse as executives ramp up for more deals before interest rates eventually increase.



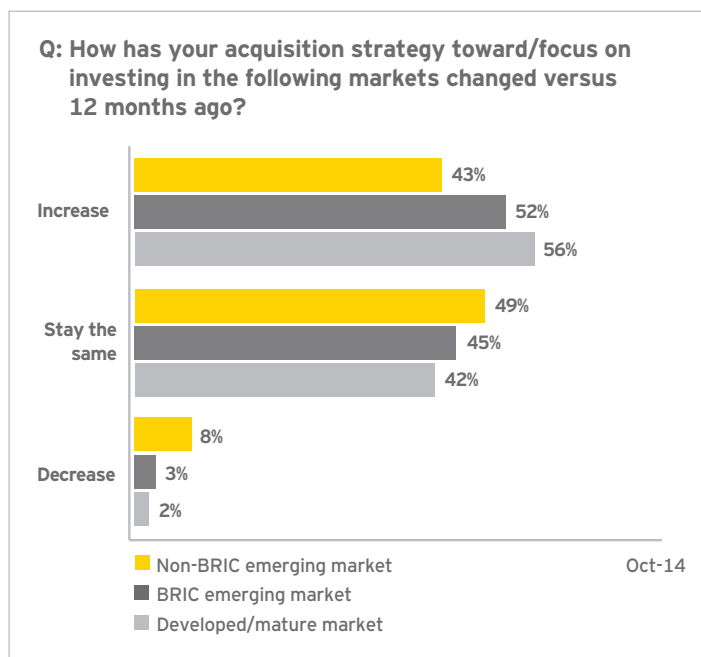
Top five investment destinations



Developed markets show growing appeal

Developed markets have increased in appeal to technology executives in this *Capital Confidence Barometer*, as economies such as the US and Australia have delivered stronger growth than some of their global peers.

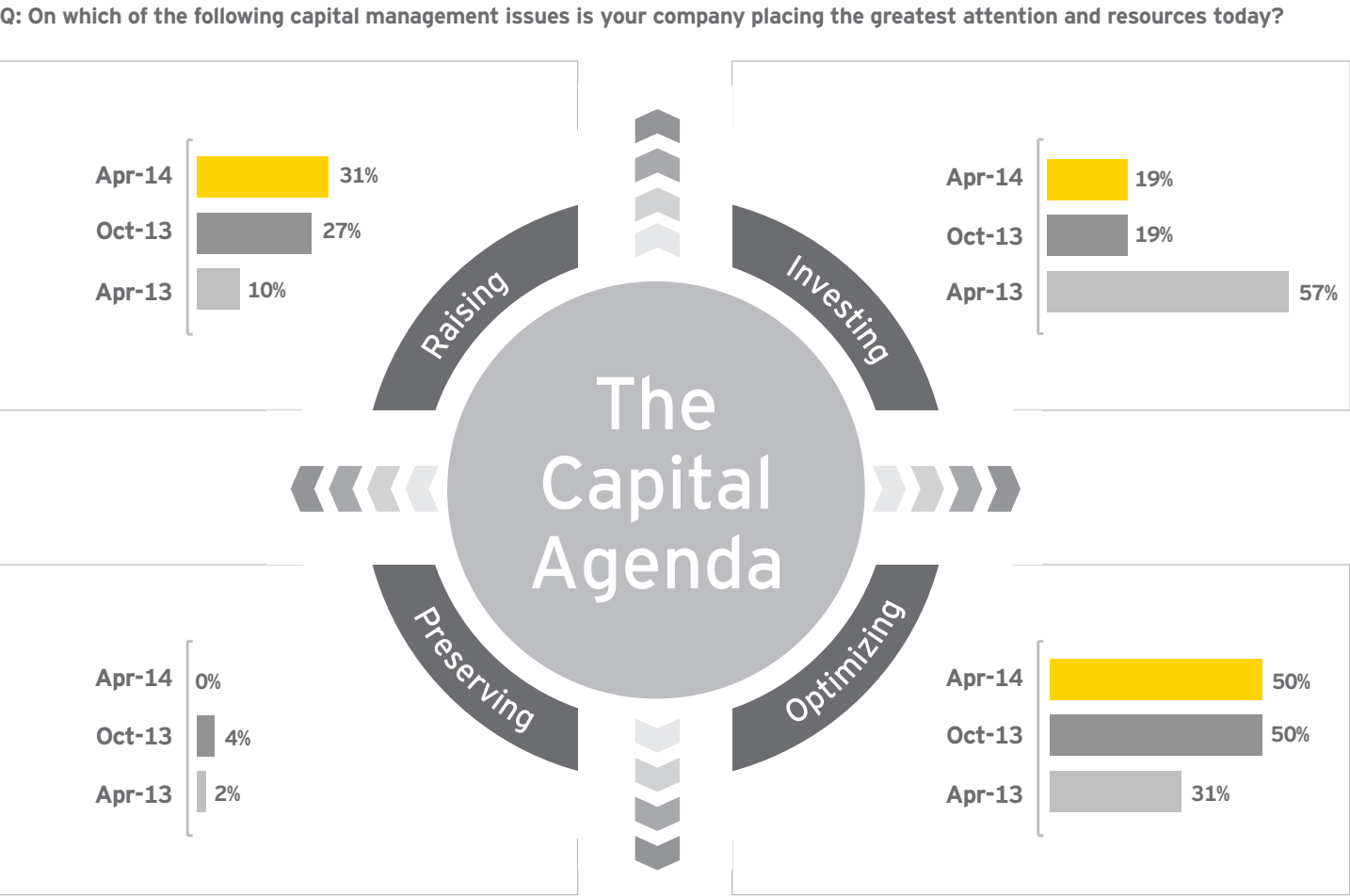
While technology respondents indicate they are considering all geographical groupings for potential investment, over half are more focused on investing in developed markets today, compared with only over a third in April 2014. Interest continues to increase in BRIC emerging markets (up from 47% in April) and has only slightly diminished in non-BRIC emerging markets (down from 46% in April).



As for top destinations, technology executives cite the following:

- ▶ **Australia** is a growing focus of technology sector expansion. Relative global economic strength and the election of a business-friendly government at the end of 2013 provide context for the burgeoning interest.
- ▶ **China** remains attractive due to its continuing strong and stable levels of economic growth. With economic rebalancing a stated policy of the Chinese Government, further investment opportunities should arise for inbound investors.
- ▶ **India** is a technology center whose deal market is expected to improve. Investor sentiment has recently seen a significant recovery. In addition, the new Government's pro-business stance should foster a more benign investment landscape for inbound investment.
- ▶ The **UK** has long been a favored destination for foreign firms wanting to access the wider EU market. With strong domestic growth forecast through 2014-15 and a focus on reducing red tape, the UK should be able to continue this trend.
- ▶ The **US** M&A market is attractive to foreign investors, thanks to improving economic fundamentals and strong corporate earnings. In this positive transaction environment – and with an interest rate rise not expected before early 2015 – we expect high levels of deal activity to sustain over the coming months.

Raising and optimizing capital to increase strategic agility



Rising activist activity drives technology company focus on optimizing capital. Technology executives are balancing efficiency and investment in the future as they use strategic M&A to transform their businesses.

About this survey

The *Global Capital Confidence Barometer* gauges corporate confidence in the economic outlook and identifies boardroom trends and practices in the way companies manage their Capital Agendas – EY's framework for strategically managing capital.

It is a regular survey of senior executives from large companies around the world, conducted by the Economist Intelligence Unit (EIU). Our panel comprises select global EY clients and contacts and regular EIU contributors.

- ▶ In August and September, we surveyed a panel of more than 1,600 executives in 62 countries; more than half were CEOs, CFOs and other C-level executives.
- ▶ Respondents represented 18 sectors, including financial services, consumer products and retail, technology, life sciences, automotive and transportation, oil and gas, power and utilities, mining and metals, diversified industrial products and construction.
- ▶ Global companies' annual global revenues ranged from less than US\$500m to greater than US\$5b: <US\$500m (18%), US\$500m–US\$999.9m (24%), US\$1b–US\$4.9b (31%) and >US\$5b (27%).
- ▶ More than 800 companies would have qualified for the Fortune 1000 based on revenue.
- ▶ Global company ownership was publicly listed (64%), privately owned (22%), PE/portfolio-owned (9%), family-owned (3%) and government/state-owned (2%).

Technology company respondent profile:

- ▶ There were 163 executives from technology companies.
- ▶ Technology companies' annual global revenues ranged from less than US\$500m to greater than US\$5b: <US\$500m (36%), US\$500m–US\$999.9m (26%), US\$1b–US\$4.9b (21%); and >US\$5b (17%).
- ▶ Global technology company ownership was publicly listed (68%), privately owned (22%), PE/portfolio-owned (9%), family-owned (1%) and government/state-owned (0%).

**For a conversation about your capital strategy,
please contact us.**

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How you manage your capital agenda today will define your competitive position tomorrow. We work with clients to create social and economic value by helping them make better, more informed decisions about strategically managing capital and transactions in fast-changing markets. Whether you're preserving, optimizing, raising or investing capital, EY's Transaction Advisory Services combine a unique set of skills, insight and experience to deliver focused advice. We help you drive competitive advantage and increased returns through improved decisions across all aspects of your capital agenda.

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