M&A Activity: 2010 and the Road Ahead

Today's powerhouse companies rely on mergers & acquisitions for acquiring talent and accelerating expansion into new markets.

U.S. M&A activity in 2010 shows definite signs of improvement—though it is still not up to 2006 levels. There are also some positive indicators for 2011.

Beyond the Arc clients are typically involved in mergers and acquisitions, so we follow this kind of activity closely here and in major markets abroad.

Here we share observations from the recent California Israel Chamber of Commerce forum in Mountain View, California: "*Tech M&A Drivers in 2010 and What to Expect for 2011*."

Panelists included:

- Mike Brown, Corporate Development, Facebook®
- Tanya Capuano, Director of Strategy and Corporate Development, Intuit®
- Shekar Ayyar, VP, Strategy and Corporate Development, VMware®
- Mark Burnhill, Principal, Platinum Equity, LLC
- Clemens Buss, Managing Director, Lazard
- David Healy, Co-Chair M&A Group, Fenwick & West

Cautious Optimism, but Optimism Nonetheless

Gil Livnah of Livnah Associates moderated the panel. While providing an overview of the market in 2010, he noted that there were many positive indicators of improved conditions, including:

- Initial jobless claims
- Customer confidence
- Stock indices
- GDP growth
- M&A activity
- The IPO market

Buying Growth

Gil also observed that cash-rich, large-cap companies have seen a rapid decline in growth over the past 20 years—and that they are using their financial resources to buy it. Much of this money is overseas, and the tax implications for offshore deals are favorable. Among the companies involved: Microsoft® and Cisco® with $40B each, Google® with $33B, and Oracle® with $25B.

Speed and Talent: The Panel Weighs In

Shekar Ayyar noted that VMware primarily seeks acquisitions in order to accelerate expansion into adjacent markets. Currently, VMware is focusing on applications that run on virtual servers and acquiring the companies that produce them. His advice? If you want to be acquired, think about where a potential buyer will be two to three years down the road and move briskly in that direction.

According to Mike Brown, Facebook's push is to bring in talent, period—"great people with great ideas." With its brand, business model, and channels firmly in place, the company has very little interest in anything else an acquired company can bring to the table. Further—and probably like other companies—Facebook is focused on three areas where M&A can add value:

- User growth – The growth of mobile apps is the next engine to drive increased numbers of users. Facebook is particularly interested in applications that can run on basic phones without data plans.
- User engagement – Facebook has recently bought a company that will improve its photo-sharing capability. Facebook is also investing in integrating location information into its apps.
- Monetization – Facebook wants to increase advertising revenue and the use of Facebook credits. The company also wants to expand beyond the games market.

Facebook is a powerhouse—having already locked in 10 acquisitions in 2010. Its M&A toolkit includes offering sellers a choice of cash or stock and making strategic use of agreements that incentivize employees to stay.

What the Bankers and Lawyers See

Bankers and lawyers are seeing increased activity in Internet, e-commerce, games, and mobile company acquisitions. Software, life sciences, and clean tech, on the other hand, are distinctly flat. Many VCs are running out of patience with these sectors.

These panelists offered up the following prescriptions for M&A success:

- Avoid earn-outs – They look good on the surface but can be tough to implement. Earn-outs also open the door to litigation. If you think your company is capable of 10-fold revenue growth but your purchaser disagrees and diverts resources elsewhere, you can have some unpleasant surprises. In this scenario, the lawyers may be the biggest winners.
- Don't overplay your hand – Deals can fall through because a company is overvalued by its founders. The situation gets more complicated if sellers don't take action until they're out of cash.

- Act fast – Speed matters. As a deal drags on and new buyers come courting, sellers can get cold feet. Lawsuits, negative press, or other events can also get an acquisition off-track. And stock-based offers always take more time than expected.

Making M&A Work

These days, mergers and acquisitions make a tremendous amount of economic sense for participants on both sides of the table. Clearly, the nature of the initial offer and any counter-offers is critical. So are competent legal, financial, and executive teams and their ability to carry negotiations forward. And, as this post bears out, understanding the environment in which you are operating is indispensable.

Let's talk...

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