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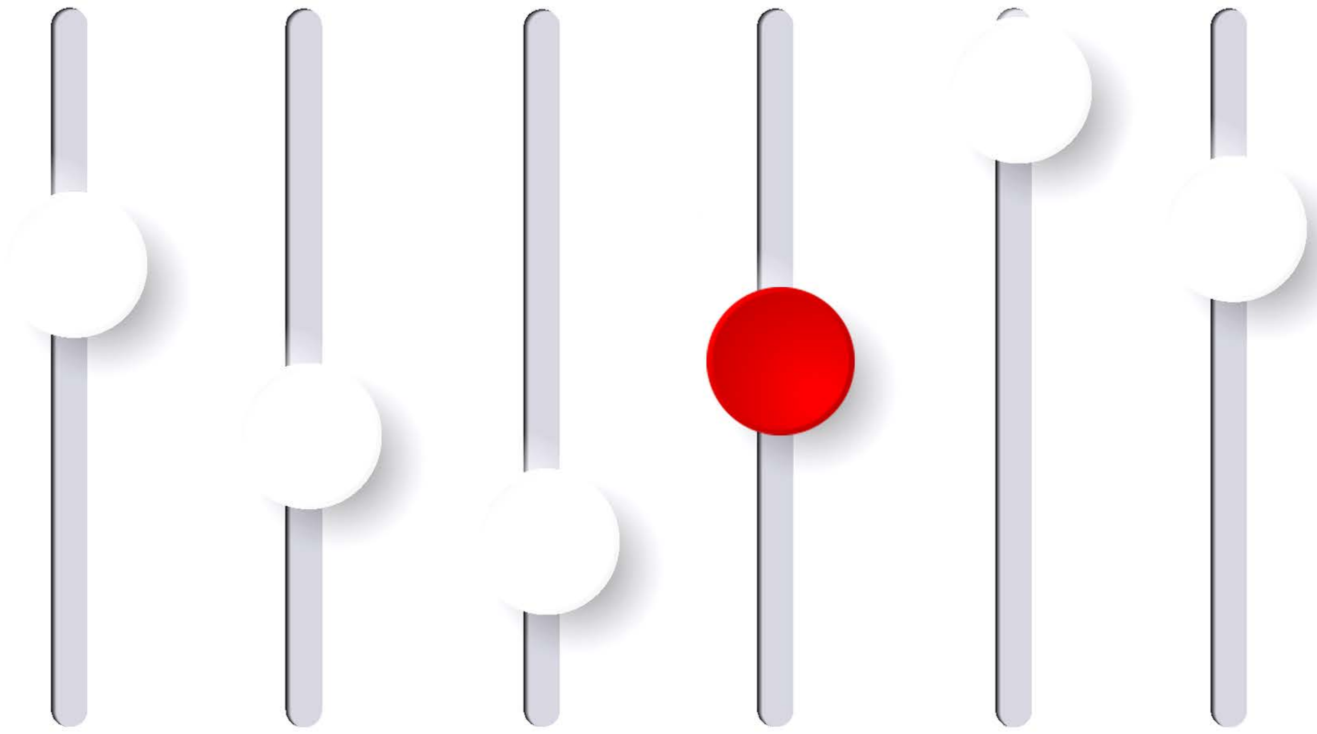
PITCH PERFECT

RETUNING SOFTWARE M&A



ACHIEVE COMPETITIVE AGILITY

With buyers from both inside and outside the industry, the software M&A market is intense. Last year broke records, both in number of transactions and total deal value (see Figure 1).

These software deals are a different kind of M&A. Planning timelines are short. Post-deal integration is tricky. Competitors launch countermeasures the moment deals are announced. With the landscape shifting so fast, how can boards and management successfully plan for and execute these deals?

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The software market is colossal. Including applications and infrastructure, it remains the highest growth component of global IT spend (see Figure 2). It is also unique. There are only a few truly global enterprise software companies with revenues exceeding US$1 billion.[1]

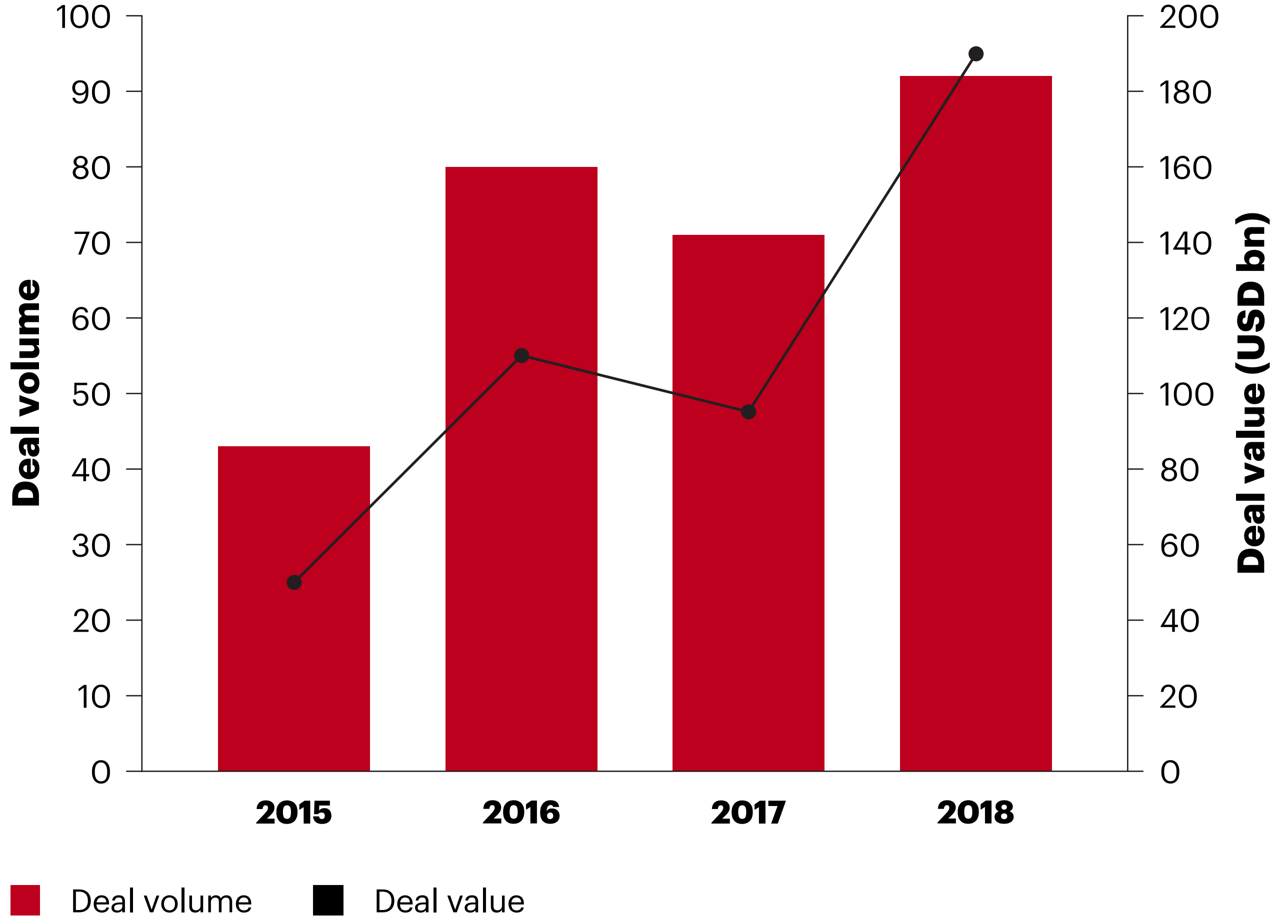
Smaller companies are jockeying for position in the race for growth, reach and talent. Many of these companies will not survive on their own and make attractive targets for buyers, both from inside and outside the industry.

The buyer can be a large software enterprise that needs to stay on the leading edge. But it can also be a large company from a different industry looking to expand its capabilities in technologies such as business intelligence (BI), artificial intelligence (AI) and data analytics. Instead of developing such skills internally, the company may prefer buying one or several smaller software companies to develop these critical capabilities faster.

Of all recent software deals with deal value above US$250 million, 62 percent of buyers were from outside the sector.[2] But executives who think they can use their existing M&A practices when buying a software company may find they are off-key.

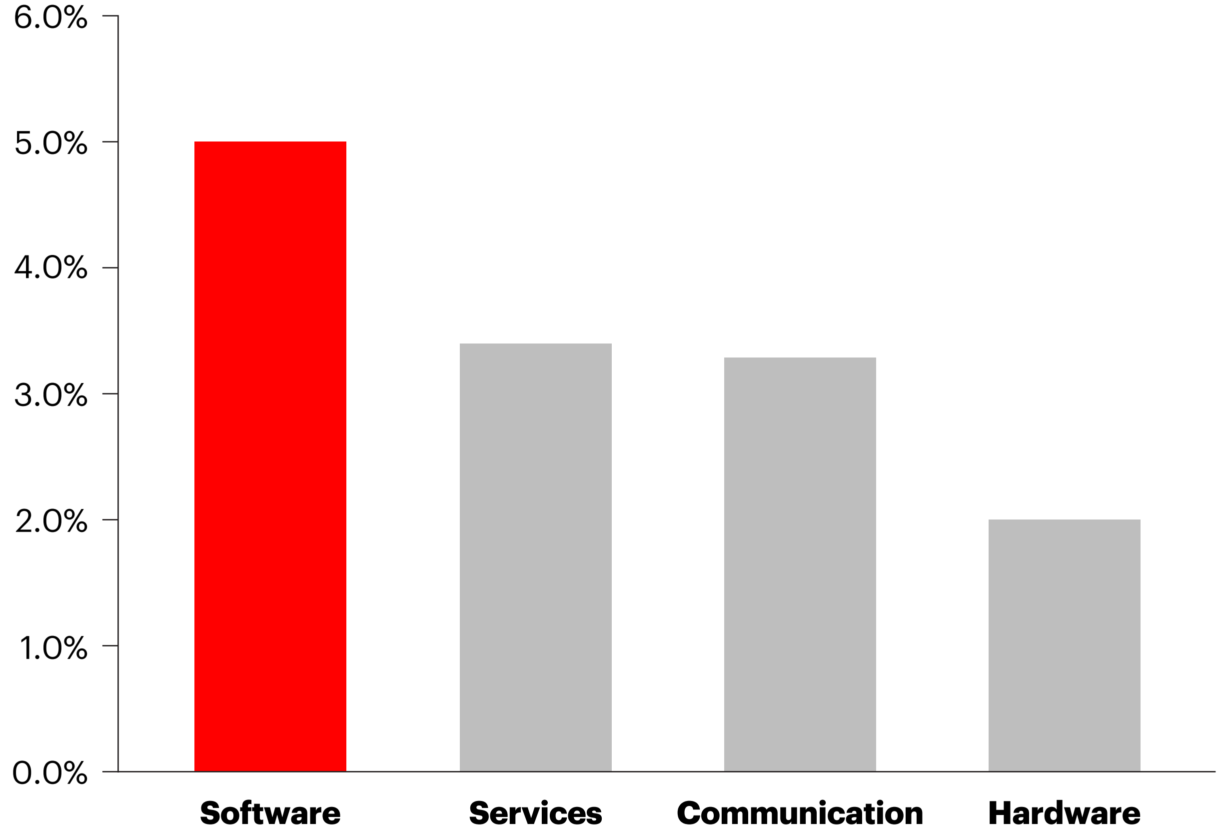
62% of all recent software deals exceeding US$250 million involve a buyer from outside the sector.

Figure 1: 2018 was a record year for software M&A, both in volume and value.



Source: S&P Capital IQ, 2019. All deals exceeding US$250 million.

Figure 2: Of all IT sectors, software spend continues to show the highest projected growth.



Source: Morgan Stanley Research, AlphaWise CIO 1Q19 Survey, 2019.

TOSS YOUR EXISTING M&A PLAYBOOK

Typical M&A playbooks are generic, cross-industry, process and methodology-based and built for larger, regulated deals. For software deals—fast-paced, complex and transformational in nature—the standard playbook won't work.

Key milestones are changing in real time and deals are closing at speed. Our analysis of all deals since 2015 revealed, on average, software deals closed in 76 days from announcement while, on average, non-software deals closed in 114 days post-announcement.[3] Furthermore, shareholders, customers and employees all expect more to be done in a short time period post deal announcement. To keep pace, M&A playbooks must be customized and flexible, with timelines measured in days and weeks rather than months.

For buyers outside of the industry, software deals should be considered a form of a "digital deal", in which the acquiring company pursues technologies or capabilities it does not possess. These deals require a new, customized approach, however our research indicates less than half of executives (49 percent) use a different playbook for digital deals.[4]

A customized approach for the talent portion of the playbook is especially crucial. As soon as a deal is announced, competitors may reach out to poach your top talent. Despite staggering deal values, the underlying employee base of the target is relatively small. Compare the recent Salesforce/Tableau deal valued at US$17 billion with 4,000 target employees or the Cloudera/Hortonworks merger (US$5.2 billion and 1,500 employees), with the US$996 million office retail company Staples paid to acquire Essendant, a company of 6,400 employees.[5, 6, 7]

Successful deals hinge upon software workforces. Engineering and product employees, in particular, need to understand the vision of the deal and their place within the new organization. These employees are most likely to get poached and churn, so get them excited about what the future looks like in the new organization.

These factors render existing M&A playbooks ineffective and obsolete for software deals. Transaction leaders need to adopt a different approach to integration primarily focusing on revenue synergies, product and new operating model capabilities ahead of corporate functional integration and cost synergies.

Software deals on average close a third faster than non-software deals.

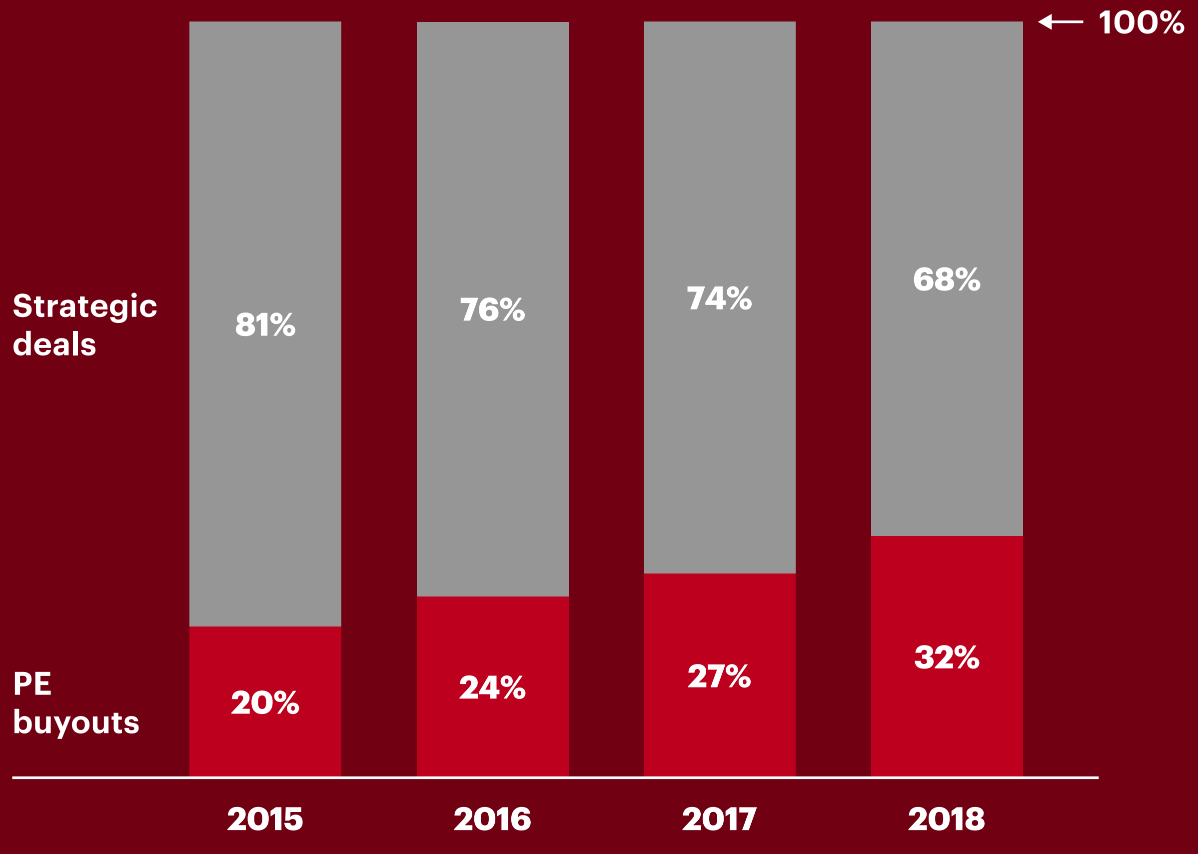
NEW BUYERS, NEW APPROACHES

The majority of today's software buyers come from outside the industry.

It could be an automotive manufacturer looking to boost its driverless vehicle capabilities, or an industrial products conglomerate looking to buy a data analytics and machine learning company. But it can also be a private equity firm looking to grow its software portfolio. Nearly a third of US software deals are now private equity buyouts (see Figure 3). The biggest announced deal in 2019 to date is when private equity firm Hellman & Friedman agreed to buy Ultimate Software for US$11 billion, at a 19 percent premium to its market value before the offer.[8]

No matter the type, all buyers need to have a clear vision of the deal rationale, key timelines and an optimized plan to fit the target software company into their existing business or portfolio.

Figure 3. Financial buyers are increasingly investing in software businesses.



Source: MergerMarket, 2018.

THE RACE FOR COMPETITIVENESS BEGINS AT ANNOUNCEMENT

Software-related components are becoming increasingly important to achieving corporate priorities. These priorities can include advancing along the journey to cloud and Internet of Things (IoT), and transforming the underlying cloud platforms, data, apps and more.

By 2020, 90 percent of enterprises will use multiple cloud services and platforms.[9] Transformation is such a critical deal priority that nearly half (45 percent) of software deals in the last five years are "transformational" in nature, citing IoT, cloud and automation as key deal drivers.[10]

The search for the right software building blocks will continue to influence software M&A. Nearly half of executives we surveyed (42 percent) say the need for next-gen technology is a typical trigger of M&A events and 42 percent say expansion to another industry is a typical trigger.[11] These transformational growth and expansion efforts are part of what makes software deals so exciting.

Ironically, software deals close so fast that executives are inclined to put off transformational initiatives just to get the deal done. For example, some major software deals we have observed have not included journey-to-cloud planning, which can prevent a fast track to competitive transformation.

Software M&A plans need to include the basics as well as outline the transformation needed to realize value and capture the hearts and minds of investors and key talent. Executives and integration leaders need to find the right balance of speed and thoughtful decision making about products, talent and other key variables.

45% of recent software deals are transformational in nature.

WATCH YOUR BACK

Competitors are lurking in the shadows, waiting to pounce while you get organized. This group of unicorns, cloud majors, private equity firms and feisty startups is seeking to disrupt the software landscape.

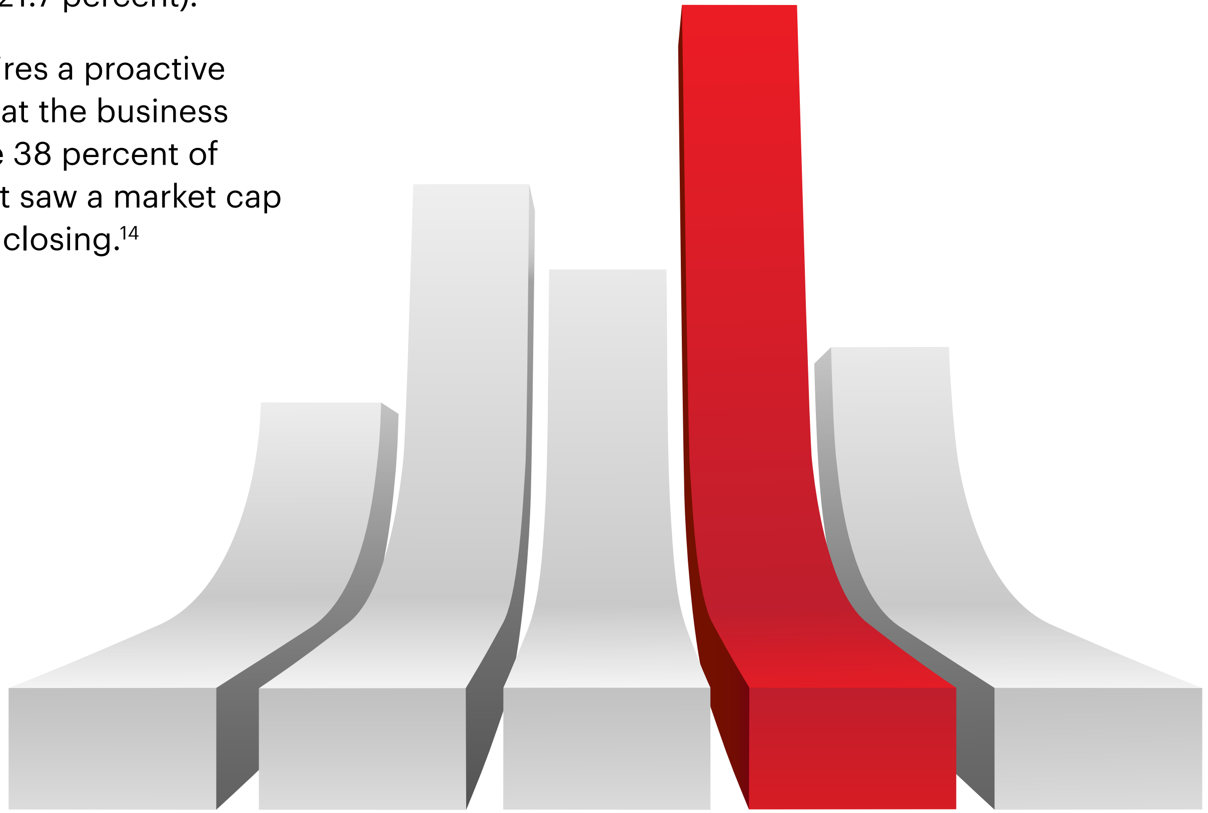
Many are well-funded. The median amount raised per company rose from US$64 million in 2012 to US$239 million in 2018. In 2018, 286 of the top private software companies raised US$30.5 billion.[12]

Software company acquirers must go up against these behemoths as they are looking to develop industry-relevant products and services anchored on megatrends like BI, automation, cloud, IoT, AI, machine learning and 5G.

They must also try to protect talent, who will jump ship quickly if they don't believe in the future. Recent surveys indicate software companies face higher employee turnover than any other industry with the highest attrition rates at the most vital, in-demand roles including user experience designers (23.3 percent), data analysts (21.7 percent) and embedded software engineers (21.7 percent).[13]

A successful software deal requires a proactive plan—pre-announcement—so that the business won't suffer the same fate as the 38 percent of software company acquirers that saw a market cap drop within the first year of deal closing.[14]

Software companies face the highest attrition rates of any industry.



SEAL THE DEAL WITH A NEW PLAYBOOK

Software deals are unlike any other. And different types of buyers will focus on different actions depending on their objectives.

Boards, financial sponsors and management teams should all aim to prioritize growth-related factors such as revenue synergies, product development, customer retention and talent selection over other cost-focused factors.

All buyers must tackle software acquisitions differently, both in the pre-deal and post-deal phases of the transaction lifecycle.

Forward-thinking leaders will customize their M&A playbooks to address key software-specific risk factors such as:

The right valuation. Factor the target's annual recurring revenues as well as potential revenue and cost synergies. Identify both risks to existing revenue streams and big rocks that could prevent you from achieving synergies early.

Cultural alignment. Cultural aspects are especially important for buyers outside of the software industry, who may have a larger gap to close.

Stability of key talent groups. These groups include engineering, product and sales. Focus on early retention plans to keep these vital players in house.

Product/platform transformations. To maximize deal value, leading buyers start defining their product strategy and developing the underlying product roadmap the moment the deal is announced.

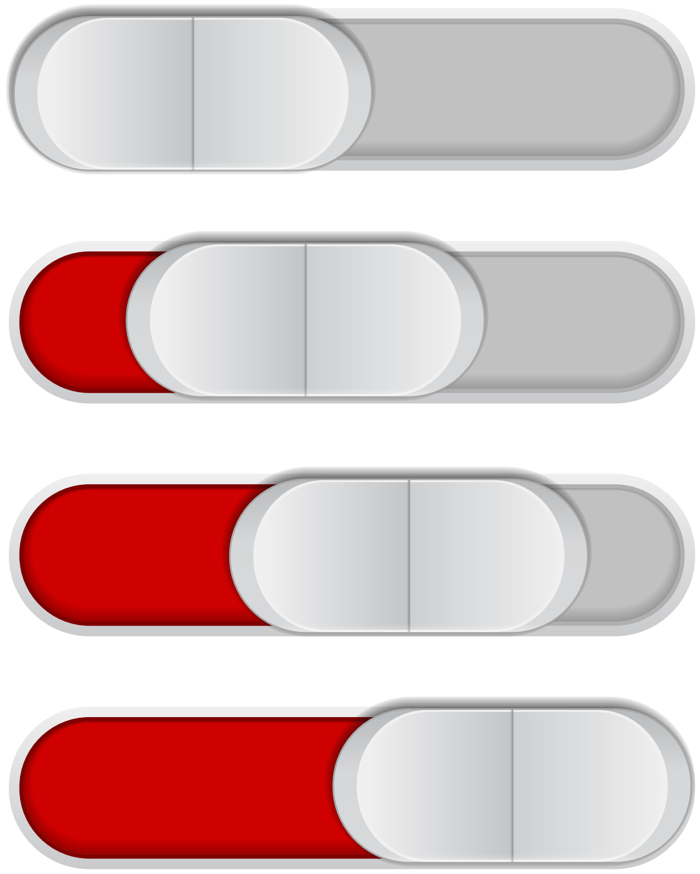
Anticipated actions by competitors. In this extremely competitive market, buyers need to protect their base business and critical employee groups from their competition, addressing integration and transformation efforts simultaneously.

Winning leadership teams will play an active role in software M&A, setting aggressive timelines with the intent to achieve more. Consider assigning board members to oversee specific areas of the deal according to their areas of expertise, such as cultural integration, sales, product and engineering. Furthermore, forward-thinking leaders will push customer-facing deal teams to explain how they are planning for competitive response. Finally, boards must work to align with the leadership teams in order to deliver maximum deal value.

> **Buyers must tackle software acquisitions differently, both pre-deal and post-deal.**

The software M&A market will only continue to heat up. Bring your M&A approaches in sync, from the earliest phases of due diligence all the way to closing and the first 100 days post-closing. It's the only way to get the software deal done right.

Reach out to our authors to explore how to retune M&A for your software transactions.



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Accenture Strategy combines deep industry expertise, advanced analytics capabilities and human-led design methodologies that enable clients to act with speed and confidence. By identifying clear, actionable paths to accelerate competitive agility, Accenture Strategy helps leaders in the C-suite envision and execute strategies that drive growth in the face of digital transformation. For more information, follow **@AccentureStrat** or visit **www.accenture.com/strategy**.

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