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Market Intelligence

Tech M&A Outlook 2022: Another year for the ages?

Analysts - Brenon Daly

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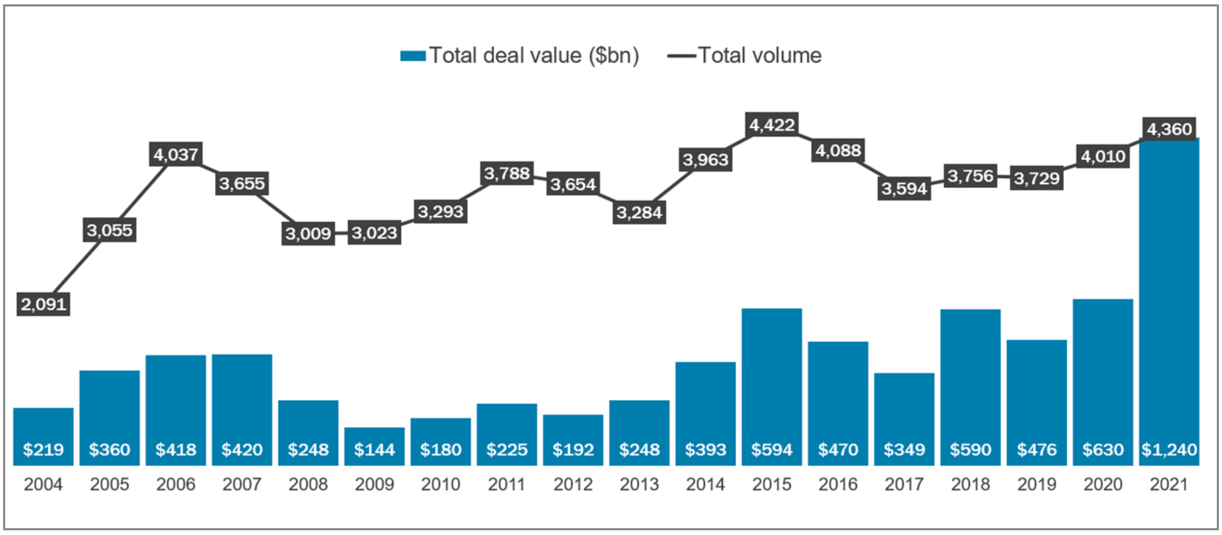
Introduction

Buoyed by record spending by every type of shopper, the value of tech deals announced last year topped the $1-trillion-dollar threshold for the first time in history, according to 451 Research's M&A KnowledgeBase. Hitting that previously unimaginable level – with spending measured out to 13 digits, an order of magnitude above the measly hundreds of billions of dollars – required acquirers to look through the (still-lingering) pandemic and pay valuations in 2021 that were more than twice as rich as any year in the M&A KnowledgeBase. They stepped up and did just that.

Recent Annual Tech M&A Activity

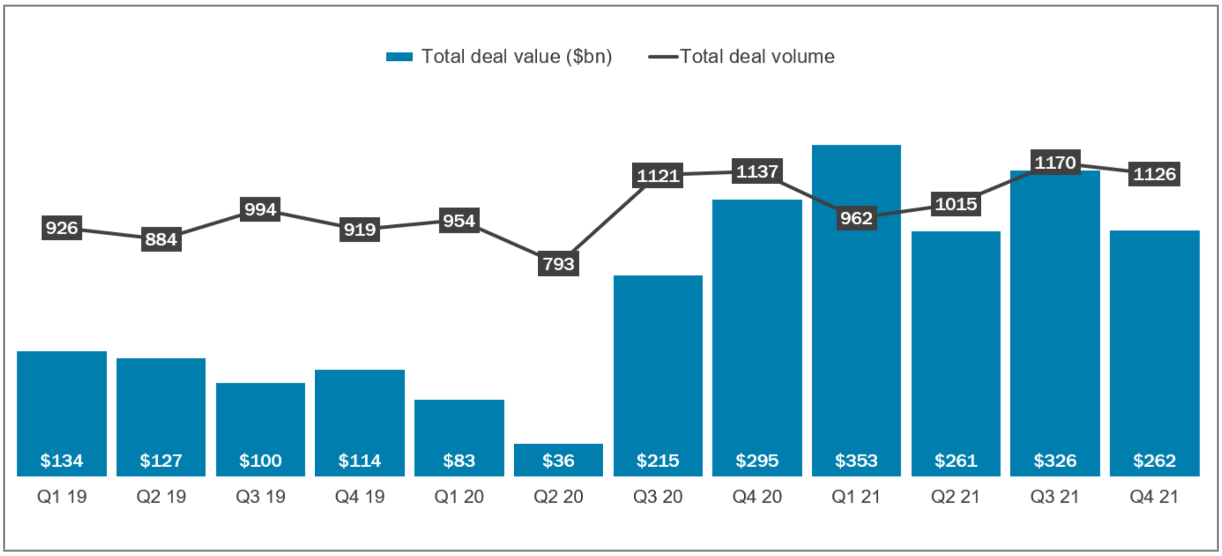


Source: 451 Research's M&A KnowledgeBase

Increasingly confident vendors of all stripes, cash-rich buyout firms and even unproven-but-popular special purpose acquisition companies (SPACs) all came together to push the total value of 2021's tech transactions to $1.2 trillion. Our data shows that topped the total from the two previous years *combined*. In last year's record-shattering shopping spree, everyone was bidding high and bidding often.

- **Strategic acquirers:** Public and private companies spent one-quarter more on tech deals in 2021 than any other year, including almost as many billion-dollar purchases as they printed, collectively, in 2019 and 2020. (To be clear, that tally excludes any transactions by SPACs.) Last year's record spending by this group featured the largest-ever acquisitions by tech industry mainstays such as Oracle, Intuit and Square.
- **Private equity:** More funds with more money meant a record number of deals at record prices for PE firms. Collectively, buyout shops and their portfolio companies announced almost 1,500 purchases, an unprecedented 34% of all tech transactions, according to the M&A KnowledgeBase. Spending soared along with that, with the value of deals announced by PE firms in 2021 doubling the average of the past half-decade.
- **SPACs:** Despite falling in and out of favor in recent decades (as well as last year), SPACs emerged as a more viable exit option in 2021. Combining elements of both an IPO and M&A, blank-check companies found an unprecedented number of takers on both sides of the previously lightly used process. In terms of tech acquisitions, or 'de-SPAC' transactions, the M&A KnowledgeBase shows that more than 180 tech vendors announced reverse mergers last year, which is four times as many companies as the previous record year.

Recent Quarterly Tech M&A Activity



Source: 451 Research's M&A KnowledgeBase

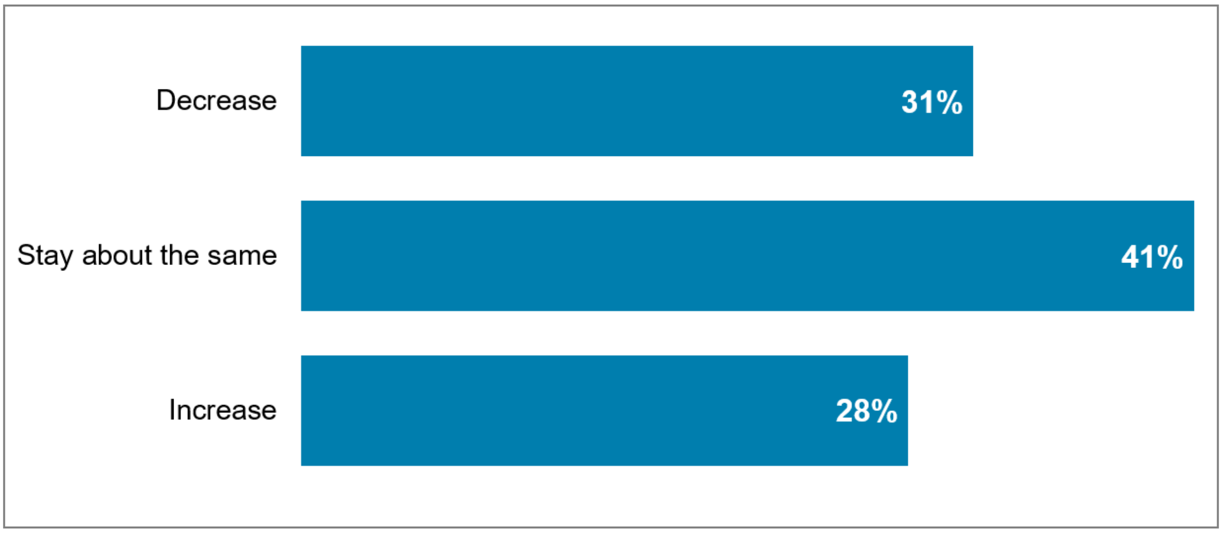
Not only was last year's activity consistent across all buying groups, it was also consistent throughout the year. The robust spending was sustained, without the peak-and-valley pattern typically seen in M&A markets. Our data indicates that the aggregate value of tech deals topped $250bn in every single quarter of 2021. (There was a time – not too long ago – when a quarter-trillion dollars of M&A spending would have been a pretty big full-year total.)

All six of the largest spending quarters in the 20-year history of the M&A KnowledgeBase have come since mid-2020, when the world started its fitful recovery from the initial COVID-19 outbreak.

Where do we go from here?

Most of the trends that drove last year's record-smashing performance appear likely to continue in 2022. In a late-December survey by 451 Research of some of the tech industry's busiest buyers and their silver-tongued advisers, two-thirds of respondents forecast that this year would either match or even top the frenzied rate from 2021. This year is shaping up – once again – to be one for the ages.

Forecast Change in Tech M&A in 2022 vs. 2021



Source: 451 Research Tech M&A Outlook Survey, December 2021

In our just-concluded 451 Research Tech M&A Outlook Survey, a plurality of respondents (41%) predicted that 2021's historic acquisition pace would continue in 2022, with the remaining M&A professionals roughly split on their outlook for the coming year. They were ever-so-slightly more likely to project a downtick in acquisitions (31%) in 2022 than a further increase (28%) from last year's blowout.

That narrowly negative view goes against the typical optimistic responses we have received in more than a decade of surveying tech M&A professionals. It isn't uncommon for twice (or even three times) as many of survey respondents to forecast an acceleration rather than a slowdown in the coming year.

Of course, none of those previous forecasts were coming after a year like we just had. And it's worth noting that the outlook for 2022 goes against the typical pattern. Historically, activity recedes after a surge. According to the M&A KnowledgeBase, the value of deals in the years immediately following previous records in 2007 and 2015 dropped 39% and 20%, respectively.

Reversion to the mean can be a powerful force in markets. However, even that isn't enough to curtail tech's urge to merge in the coming year.

Pernicious prices

Despite the prevailing bullish forecast from acquirers and advisers in our survey, the tech market – along with the broader economy – faces a number of challenges in 2022 that weren't necessarily part of last year's planning. That's having all sorts of knock-on impacts, including ones that could slow tech buyers in the coming year. As an example, consider the all-pervading and highly pernicious specter of inflation.

Throughout much of last year, economists traced rising prices primarily back to pent-up demand because of coronavirus, which locked out many shoppers along with idling manufacturers and snarling supply chains around the world. But as the pandemic continued to drag on, prices for virtually all goods and services ticked up almost uninterruptedly throughout 2021.

Inflation in the US finished last year at its highest level in nearly 40 years, while the rate hit a 30-year-high in the UK. (Those are key geographies for the tech M&A market, since the US and UK are home to more tech acquirers than any other countries. Our data shows that US- and UK-based buyers collectively account for about 70% of tech transactions announced around the world each year.)

That dramatic run-up in prices, which erodes purchasing power, poses a threat to both tech M&A and the broader economy. Paying more and getting less isn't a particularly favorable economic exchange, whether you're buying a software vendor or a sofa. A pair of 451 Research surveys of two very different groups reflect that same concern.

- In the 451 Research Tech M&A Outlook Survey, dealmakers overwhelmingly selected inflation as the chief worry from a list of four possible macroeconomic disruptions to their business.
- Our Voice of the Customer survey last summer similarly showed that consumers identified inflation as the single-biggest threat to their personal finances.

After some delay, those concerns have registered at the previously dovish US Federal Reserve, which has telegraphed three interest rate increases in 2022 to help cool off red-hot prices in the world's largest economy. Assuming the Fed goes ahead with the planned hikes, higher rates are all but certain to make it more expensive to pay for deals.

Obviously, the current dirt-cheap debt will get pricier. Consider how that has already hit the mortgage market, which typically takes its cues from the 10-year US Treasury note. Mortgage rates in early 2022 hit their highest levels since the pandemic started in March 2020.

More expensive mortgages don't mean no one will buy a house, any more than they mean debt-reliant acquirers will step completely out of the market. They just mean paying for deals, which are already priced at historic highs, will get a little pricier and the threshold for returns will get a little higher. (*See our section below for more on current market valuations*.)

A rotation or a rout?

Ripples from higher rates won't just be limited to the lending market, however. Equity could also fall out of favor as an M&A currency if it continues to get devalued as investors shed their risky tech holdings, which have put up big returns during the pandemic, and move into more rate-sensitive stocks and bonds. Wall Street has already started that rotation.

The multibillion-dollar swing out of tech last year doesn't necessarily show up in most stock indexes, at least not at first glance. Whatever particular market measuring stick for tech you consider, the gain is all but certain to top the 26% return in 2021 posted by the benchmark S&P 500 Index. But a closer look shows those were top-heavy gains. Tech's big names powered the performance, while a surprising number of companies lagged.

As one indication of this uneven distribution, consider this: Despite US equity markets surging to record highs in 2021, the Screener tool on S&P Capital IQ Pro indicates an unexpectedly high number of tech names deeply in the red: 309 tech/media/telecom (TMT) vendors on US exchanges saw their share prices drop at least 20% last year. That's exactly the same number of TMT vendors that saw their shares tick at least 20% higher in the historically bullish year.

Tech's underperformance has become more universal this year. In the first three weeks of 2022, most of the tech-specific indexes tracked by S&P Global Market Intelligence posted at least mid-single-digit percentage declines. Many of tech's household names have shed 10% or even 20% of their value in what has turned into a tech rout to start the year.

Most-Significant Tech Deal of the Year

2021	Two-way tie: Oracle-Cerner; Microsoft-Nuance
2020	Salesforce.com-Slack
2019	Salesforce.com-Tableau
2018	IBM-Red Hat
2017	Three-way tie: Intel-Mobileye; Cisco-AppDynamics; Broadcom-Qualcomm
2016	Microsoft-LinkedIn
2015	Dell-EMC
2014	Facebook-WhatsApp
2013	IBM-SoftLayer
2012	VMware-Nicira
2011	Google-Motorola Mobility

Source: 451 Research's Tech Corporate Development Outlook Survey (2011-19); 451 Research Flash Survey: Coronavirus Impact of Tech Banking (2020); 451 Tech M&A Outlook Survey (2021)

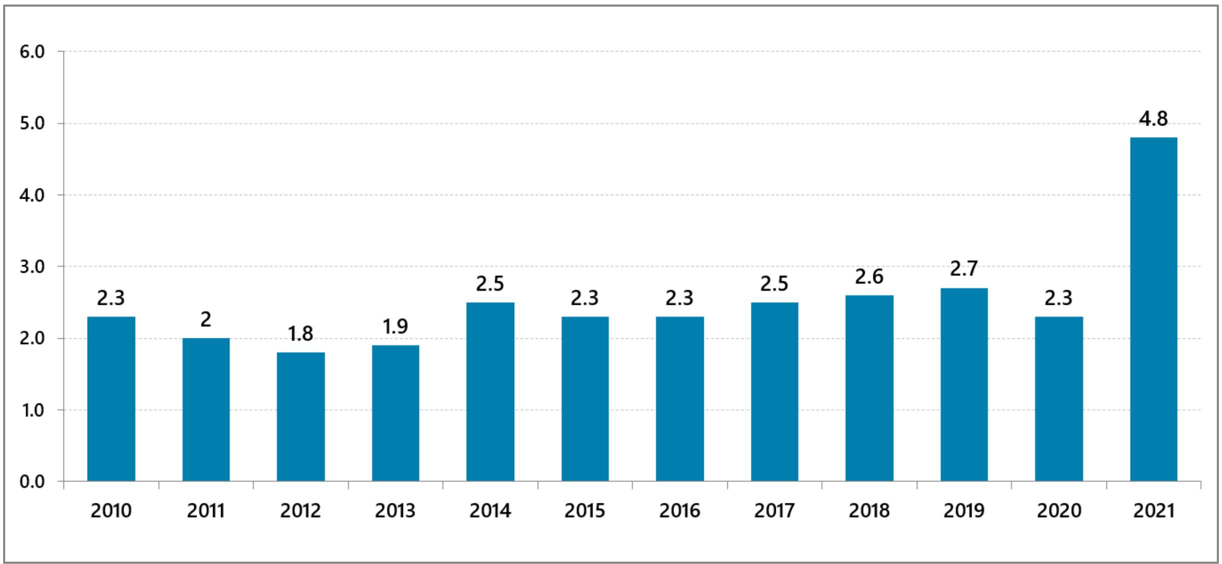
In addition to undermining the confidence at many tech acquirers, a slumping stock price can also take away some of their currency. Target companies don't want to 'catch a falling knife,' as the Wall Street cliché would have it.

Declining tech stocks are more of a concern for the tech M&A market right now than at any time since the Great Recession. The M&A KnowledgeBase shows that a decade-high 299 buyers covered at least some of the cost of their tech spending in 2021 with their own equity. In last year's bull market, there were about 60% more 'paper' deals than the average over the previous half-decade.

Up, up and away

While economists and investors are worried about the implications of inflation, tech acquirers have already mostly priced it in. Valuations in the tech M&A market in 2021 soared to their highest-ever level, nearly twice the average over the past decade, according to the M&A KnowledgeBase. Excluding SPAC transactions, buyers paid an unprecedented 4.8x trailing sales in tech deals last year.

Average Price/Sales Multiple for Tech M&A, Excluding SPACs

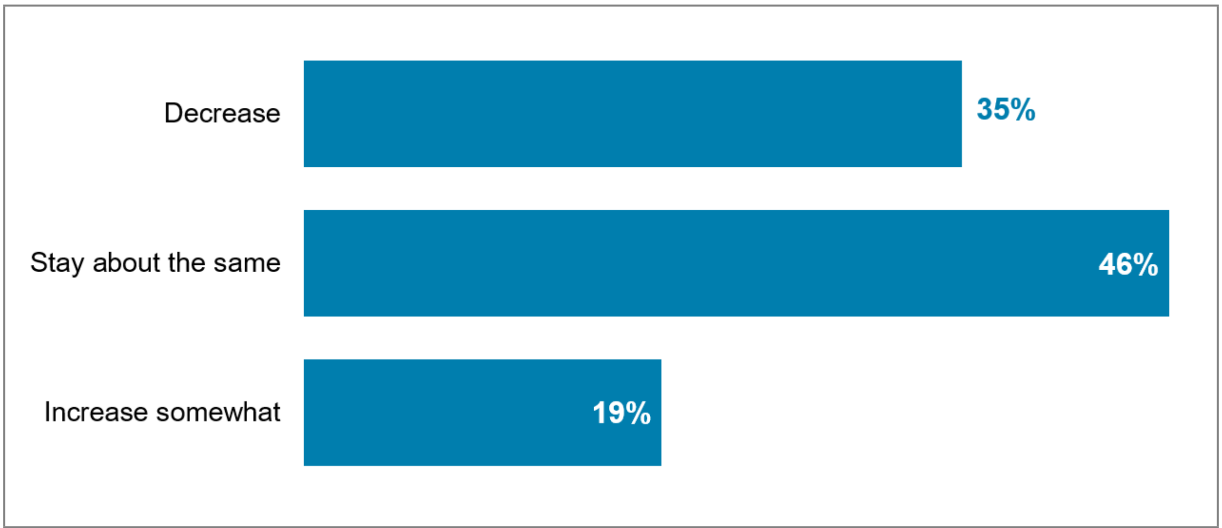


Source: 451 Research's M&A KnowledgeBase

Historically rich prices extended to every corner of the tech M&A market. According to the M&A KnowledgeBase, there were virtually no bargains to be found in 2021, no matter where shoppers looked.

- Free-spending SPACs shattered all conventional metrics, awarding billion-dollar-plus valuations to tech providers that, in some cases, were still several quarters (or even several years) away from any meaningful revenue. Those speculative deals drove the overall de-SPAC multiple (based on all-in equity valuation) to a stratospheric 16x sales, or more than three times richer than the overall market.
- Financial acquirers paid higher overall valuations (6x trailing sales) than their strategic counterparts in 2021. Thoma Bravo bid double-digit multiples in the take-privates of both Proofpoint and Medallia, while Clearlake Capital paid its top LBO valuation in our records for Cornerstone OnDemand.
- European buyers reversed years of bargain shopping, paying an average of 4x sales – two turns higher than ever before. PE firm Permira valued Mimecast, which is similarly headquartered in London, at 10x sales. (Although that initial bid may not be enough to get the deal done.) In early January, Dublin-based Aptiv also paid 10x for Wind River Systems.
- Dealmakers in high-flying tech sectors had little choice but to pay ever-increasing prices. Last year's infosec purchases, for instance, went off at 10x revenue – roughly 50% higher than the previous record in that sector. The platinum valuations extended out to even old-line consolidations, such as NortonLifeLock paying 9x sales for fellow infosec veteran Avast Software.
- Startups from across the broader tech landscape sold for richer prices than they ever have in history. On average, venture-backed startups garnered 6.5x trailing sales in non-SPAC exits announced in 2021. That's roughly 50% richer than their average multiple over the previous 20 years.

Forecast Change in Private Company M&A Valuations, 2022 vs. 2021



Source: 451 Research Tech M&A Outlook Survey, December 2021

As to where these historically elevated multiples will head this year, buyers are bracing for more inflation. Consider the M&A valuation projection for privately held startups – which serves as the quintessential tech transaction – given in the 451 Research Tech M&A Outlook Survey. Roughly two-thirds of respondents anticipated that the current record high private company M&A valuations would either hold steady (46%) or even increase (19%) in 2022. Just one-third (35%) forecast that they would be getting bargains in 2022.

That said, the winter chill that has hit tech names on Wall Street may yet impact the tech M&A market, as has often been the case since both markets run on confidence. Acquirers seeing double-digit percentage declines in the value of their own company are almost certainly going to be less likely to pay top-dollar M&A multiples. They may wait for discounts. And since, historically, private-market valuations lag the more-visible, more-liquid public markets, startup multiples may well head lower if the bear market on Wall Street grinds on throughout 2022.

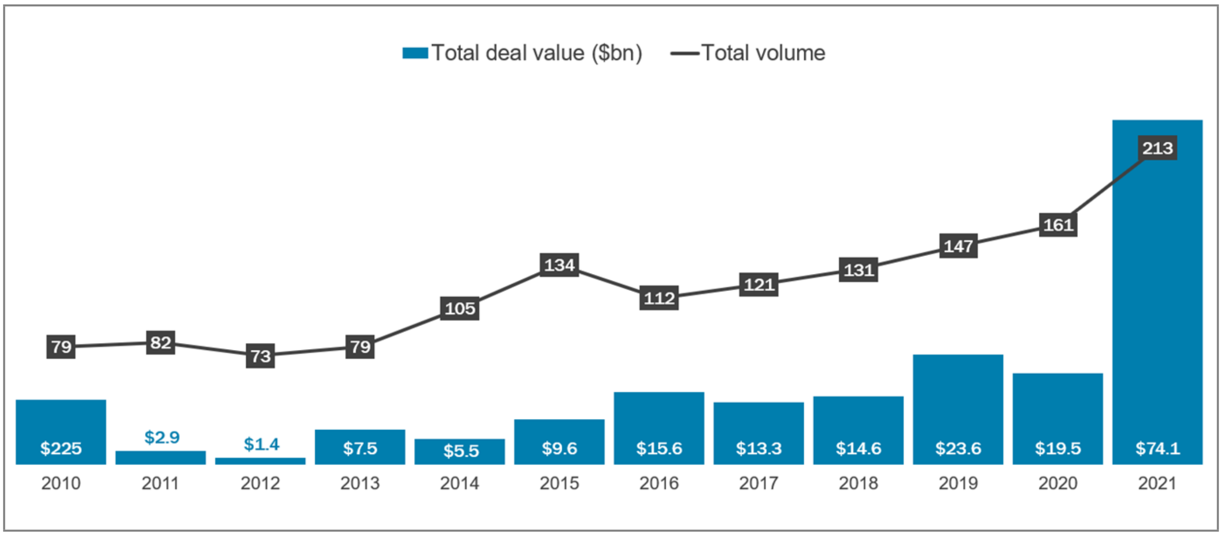
Sector outlook: Information security and software

Looking out over the balance of 2022, there's a lot stacked against dealmakers, who are facing exceptionally rich tech M&A valuations just as the tech industry slows in its post-pandemic resurgence. (Not to mention they are having to struggle against the gravitational pull of precedent. Boom years, like we saw in the record-shattering 2021, are almost invariably followed by significantly quieter periods.)

Regardless, there are IT sectors where deals are likely to continue flowing as the industry continues to adapt to the once-in-a-generation changes brought about by the COVID-19 outbreak and accompanying economic disruption. 'Digital transformation,' which got accelerated during the pandemic, will redirect billions of dollars of acquisition spending in coming years. That will primarily show up in two broad areas of technology: How companies are doing their work and how they are securing it.

Already, M&A activity in both infosec and application software has spiked to its highest-ever level in the M&A KnowledgeBase. And last year's record performance may be just the beginning. Respondents to the 451 Research Tech Outlook Survey forecast that the two sectors of infosec and application software would see the biggest increase in acquisition spending in the coming year among the half-dozen IT markets we listed. More than three-quarters forecast an uptick in deal value in the two markets, compared with just a single-digit percentage expecting a decline. In the final section of this report, we look at the broad trends that are likely to shape M&A in these two markets in the year ahead.

Infosec M&A Activity, Since 2010

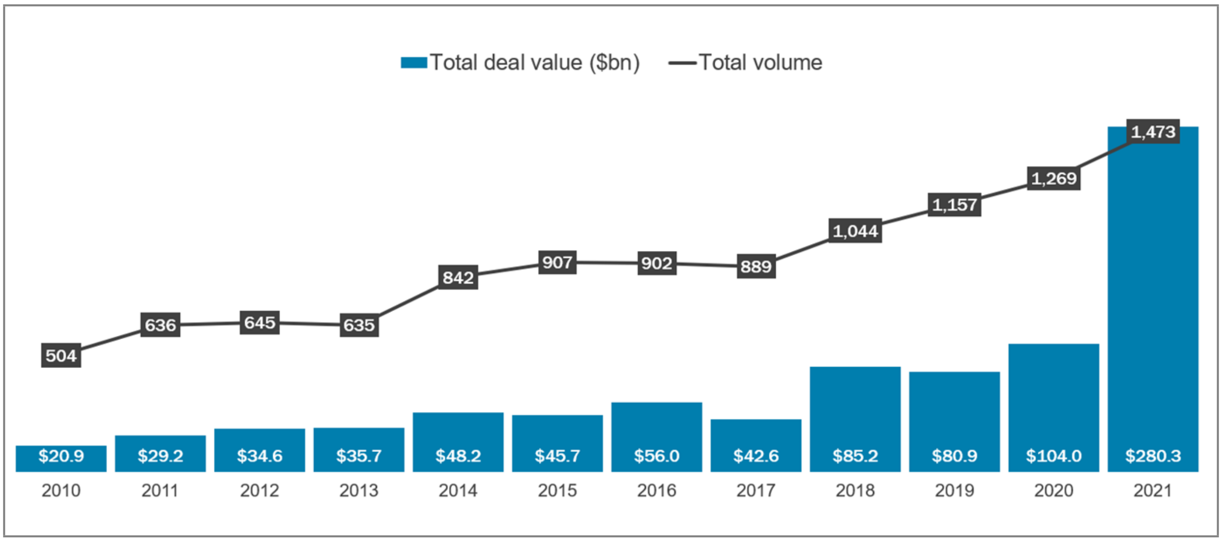


Source: 451 Research's M&A KnowledgeBase

- **Information Security:** In last year's unprecedented shopping spree, overall tech M&A spending 'only' matched the two previous years, while the value of infosec deals in 2021 eclipsed the total from the previous four years *combined*. Volume also hit an all-time high amid a disconcerting spate of high-profile cyberattacks and the general expansion of work well outside the traditionally defined (and defended) corporate perimeter.

Likely drivers for infosec purchases in the coming year include the continued expansion of 'detection and response' offerings (the first mention in the M&A KnowledgeBase of the term XDR, or extended detection and response, came in May 2020 – the tally for XDR is now up to 28 deal records). Additionally, identity and access technology has assumed new significance in the overall IT stack since it serves as a 'front door' to all manner of cloud-based offerings.

Application Software M&A Activity, Since 2010



Source: 451 Research's M&A KnowledgeBase

- **Application software:** Underscoring the broad – and expanding – importance of software in this newly digital world, all three quarters featuring the highest M&A spending on application software in the M&A KnowledgeBase came in 2021. Deal volume also surged to an all-time high, paced by an astronomical increase in machine learning (ML) deals. We tallied 620 ML transactions last year, nearly quadruple the number from just three years ago.

The two industries that saw some of the biggest acquisitions last year also saw some of the biggest disruption during the pandemic, with the changes continuing into this year. Healthcare got overwhelmed by the global outbreak, which helped accelerate providers away from paper-based records and bricks-and-mortar service locations. Oracle and Microsoft both bought their way into that massive change, spending a collective $50bn on healthcare tech deals last year.

With closed stores and wary shoppers during the pandemic, retail also moved online. That multibillion shift in shopping sparked a vast wave of transformative transactions covering virtually every aspect of the sales process – from how potential customers are initially reached (Intuit spending $12bn for Mailchimp) to how they pay (multibillion 'buy now, pay later' purchases by both PayPal and Square), to what they thought of the experience (Thoma Bravo's $6.4bn take-private of Medallia).