Technology Capital Confidence Barometer

Digital disruption spurs M&A, blurs industries
Key global M&A findings for all sectors

- 59% of companies expect to actively pursue acquisitions in the next 12 months
- 48% of companies intend to pursue acquisitions outside their own sector
- 26% of companies have increased their intention to acquire in the Eurozone
- 24% increase in appetite for upper-middle-market deals
- 55% of companies currently have three or more deals in their pipelines
Companies embrace sustainable M&A as deal markets generate renewed growth

The 13th edition of our Global Capital Confidence Barometer (CCB) finds companies pursuing deals at a rate not seen this decade. As 2015 global M&A value approaches record highs, executives’ long-term growth considerations outweigh short-term concerns about market volatility.

With deal intentions at a six-year peak, executives’ economic optimism is steadfast, and companies are pursuing bolder, more innovative growth strategies.

In 2015, we have seen continued volatility in commodities and currencies, intense swings in equity markets and decelerating growth in several key emerging economies. Despite these challenges, companies remain confident about dealmaking in the current macroeconomic environment.

Almost half of companies are now looking at acquisitions beyond their traditional industry boundaries, fueled by innovative disruption and changing customer preferences. Cross-border as well as cross-sector deals will also be a big part of the M&A story. The majority of potential acquirers are looking beyond their own national borders – with intentions around deals in the Eurozone strengthening.

With all signs in the deal market pointing upward, some analysts raise the prospect of a market overheating. However, executives are proceeding judiciously as they look to M&A for growth. They are conducting more thorough due diligence, including new levels of cyber risk scrutiny. And they are prepared to walk away from transactions that do not meet their strategic goals.

In short, M&A is back for all industries now as an essential mechanism for generating long-term value. With global macroeconomic growth tempered and their industries perpetually challenged, executives are searching for more than organic growth. In government and global leadership circles, “sustainability” has long been a buzzword for big-picture thinking about the interdependence of nations and resources to support development worldwide. In their way, executives are pursuing their own form of corporate sustainability, reimagining their businesses to both safeguard the last decade’s cost-reduction rigor and build the next decade’s platform for growth.

Pip McCrostie
Global Vice Chair
Transaction Advisory Services
Key technology sector findings

- 35% now cite R&D and product introductions as their primary focus for organic growth
  - See page 7

- 37% say digital disruption is driving their acquisition strategy
  - See page 8

- 34% of companies intend to pursue acquisitions outside their own sector
  - See page 9

- 45% of companies expect to actively pursue acquisitions in the next 12 months
  - See page 11

- 96% see the size of their deal pipeline as stable or growing
  - See page 13
Digital disruption spurs M&A, blurs industries

As the overall M&A market hits its stride, the technology sector has continued to shatter M&A records from one quarter to the next. The tech space saw more than 1,000 deals in the third quarter of this year, the seventh quarter in a row that activity has reached a sector high since the dotcom bubble. At such heights, questions naturally arise. When do we reach the top? What will be the “new normal?” Suffice it to say that this CCB shows fundamental drivers at work, pointing emphatically to more dealmaking ahead. And deal-driver No. 1 is digital disruption.

While digital disruption is not a new story, we have clearly entered a new chapter in its impact on M&A. It is one in which the customer is becoming a more digitally empowered protagonist. And changing customer behavior is driving technology company acquisitions of non-technology companies — and vice versa.

For tech companies, buying outside of the sector is a means to move from “stack to solution,” offering customers end-to-end answers to business challenges, rather than any discrete technology or even technology stack. For non-tech companies, tech M&A can provide a shortcut to delivering the now-requisite anytime/anywhere offerings to their markets.

The greater the number of these transactions, the greater the blurring between and among industries, which ultimately becomes the new normal.

But here is another question that was bound to emerge: is the M&A market overheated? While there are indications of this in the following pages — particularly in statistics on stiff buyer competition and widening deal valuation gaps — technology executives say they have walked away from contemplated deals rather than overpay.

Another question, amid so much M&A activity: how are these deals working out, post-merger? In this report, we reflect on integration through a digital lens. Executives are finding that technologies such as cloud computing can accelerate the integration timeline. However, buying outside of one’s sector can also bring steeper integration challenges — digital and otherwise.

Ultimately, the most fundamental question is this: what should be your strategy for innovation, growth and profitability as M&A redefines the industry around you? For most of the executives responding to our survey, the answer lies in balancing growth and integral efficiency, while building an innovation platform by any means necessary. For those technology executives we surveyed, those means are more acquisitions, more R&D and more talent.

Jeff Liu
Global Technology Industry Leader
Transaction Advisory Services
EY
Confidence in an improving global economy has surged in the past year.

80% of executives are positive in their economic outlook.
Macroeconomic sentiment runs positive

Over one in three technology executives (39%) see the global economy strongly improving today and a similar number (41%) see it improving modestly. Their macroeconomic sentiment has swung significantly from last year, when stability (44%) was the rising indicator. Given economic growth (albeit modest) in the US\(^1\) and EU\(^2\) this year, executives have become less sensitive to daily speculation around such issues as an emerging market slowdown or the potential timing of a US interest rate hike.

75% of tech executives bullish on corporate earnings

All leading financial indicators hover around 90%, in terms of executives seeing either improvement or stability in corporate earnings (75% improvement, 17% stability), short-term market conditions (74%, 16%), equity valuations (56%, 34%) and credit availability (78%, 16%). That said, the ranks of the pessimistic have also increased somewhat in this CCB; only 2% of tech executives predicted earnings declines a year ago, and now 8% do. For most companies, 2015 earnings have, in fact, exceeded analysts’ expectations. And credit is expected to remain readily available in the US (notwithstanding a potential interest rate hike), in the EU and Japan (due to quantitative easing programs), and in Mainland China (due to policy shifts).

Political instability, currency and commodity volatility are key economic risks

No single outstanding issue is tainting executives’ overall macro view. Ongoing geopolitical tension continues to rank as technology executives’ overarching concern, cited by nearly one in three executives (32%). Currency and commodity shifts are a more immediate concern (24%), although tempered from six months ago (34%). For companies reporting in US dollars, currency shifts may directly affect near-term earnings, potentially leading to negative investor impressions. However, a silver lining could be the swing seen in this CCB toward investing in emerging markets, where the strong dollar has helped make asset prices more attractive. Nearly half of all technology respondents (48%) plan to allocate more than 10% of their acquisition capital to emerging markets; six months ago, only 24% said they would do so. Overall, increased volatility in commodities and currencies is commanding more attention in the boardroom, where 45% of respondents said it is rising on the agenda.

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Executives line up acquisitions, R&D and talent for future growth.

60% of available capital will be allocated to growth strategies.
Companies seek efficiencies in M&A integrations

Efficiency (52%) trumps growth (32%) as tech executives’ overriding strategic imperative in this Barometer, and it has all year. While this may seem counterintuitive as M&As surge, companies must balance both. Integrating acquisitions requires deliberate focus on cost reduction and operational efficiency. Executives have learned from past upturns that timely integration of new assets is essential for value creation. At the board level, however, cost concerns have recently focused more on the commodity and currency volatility cited (45%, see page 5) than on reducing costs and improving margins (16%).

Innovation is chosen path to organic growth

For organic growth, tech executives are much more focused today on R&D and new products (35%), generally emphasizing innovation over more conventional growth strategies. What is more, one in four executives from across all sectors say they are focused on exploiting technology to develop new markets and products. In fact, this number is virtually the same (and up significantly from last year) for both tech and global (all industries) companies, demonstrating the growing embrace of digital business models by all industries. Throughout this CCB, digital innovation recurs as a driver – whether of organic or inorganic growth.

Tech companies look to grow workforce

Bullish on both the global economy and their own corporate earnings, more than half of technology executives (56%) say they are growing their workforces. While there has been some fluctuation over the past year between the number seeking to create jobs and those looking to stay the same size, the overall trend is upward. Some 14% say acquiring talent is a driver of their planned M&A.
For many tech and non-tech companies, digital disruption drives M&A

Q: Which of the following will affect your core business and your acquisition strategy most in the next 12 months?

```
Digital future  22%  37%
Entrepreneurship rising  14%  23%
Global marketplace  23%  34%
Health reimagined  11%  11%
Resourceful planet  7%  7%
Urban world  3%  8%
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“Digital future” is the term we use to describe how technology is disrupting all areas of enterprise, driving myriad opportunities and challenges. It is also what technology respondents to our survey identified as their most important driver of acquisitions (37%). What is more, it nearly tied for top driver among respondents from across all sectors (23%, or a single point behind globalization), underscoring the rise of digital business models in every industry. In fact, three times as many tech executives singled out digital disruption as an acquisition driver in this CCB, compared with six months ago, and almost twice as many respondents from across all industries did so, too. The results: EY’s most recent Global technology M&A report recorded a 52% increase from 2Q15 to 3Q15 in technology company acquisitions by non-tech buyers, with an aggregate value of US$16.6 billion.

Digitally enabled companies of all stripes are positioned to globalize much more rapidly. In describing their core business strategies, 34% of tech executives (and a similar number of non-tech executives) give highest importance to serving the global marketplace.

Divestitures rise on boardroom agendas

Digital dynamics are also reflected in changing boardroom agendas. Elsewhere in this report (see page 5), we have addressed boards’ short-term preoccupation with increased volatility in commodities and currencies. At the same time, however, spin-offs, initial public offerings and other portfolio strategies are moving higher on their agenda. One in four technology respondents called out this trend. Tech company divestitures, including spin-offs, actually accounted for about a third (32%) of 3Q15 aggregate technology deal value, according to our Global technology M&A report. Many tech companies have what we call “hidden gems” among their operations — business units or offerings benefiting from digital transformation but obscured by a larger whole. In this CCB, we see their boards engaged in finding these hidden gems and unlocking their potential value.

Q: Which of the following has been elevated on your boardroom agenda in the past six months?

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Shareholder activism, including returning cash to shareholders  1%
Cybersecurity  3%
Acquisitions  3%
Reducing costs/improving margins  7%
Regulatory and competition/antitrust oversight  16%
Portfolio analysis, including strategic divestment (spin-off/IPO)  25%
Increased volatility in commodities and currencies  45%
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Entrepreneurship rising, Global marketplace, Resourceful planet, Urban world and Health reimagined are tied at 7%.

Entrepreneurship rising, Global marketplace, Resourceful planet, Urban world and Health reimagined are tied at 7%.
Customer behavior drives disruption

Customers’ changing behavior and the imperative to map product innovation to their increasingly digital preferences are clearly at work in this CCB, amid the convergence of mobile, social, cloud and big data technologies. Taken together, changing customer behaviors and product innovation account for more than a third (34%) of the disruption that tech respondents see to their core business in the next 12 months.

**Q:** From where do you see the most disruption to your core business in the next 12 months?

- Increased globalization: 21%
- Industry regulation: 19%
- Product innovation: 17%
- Changing customer behavior and expectations: 17%
- Advances in technology and digitalization: 14%
- Sector convergence/increase competition from companies in other sectors: 12%

Technology companies are buying non-tech companies – and vice versa

New customer behaviors are cited above all others (46%) in driving technology companies to buy non-tech companies, and new product innovation ranks second (21%). More than one-third (34%) of technology executives are planning acquisitions outside their own sector. In many cases, we see a “stack to solution” trend. That is, business customers are developing a more solution-oriented philosophy, in which they may no longer care about whether they’re buying software, storage or security, and companies must respond by selling total solutions. M&A is often the easiest path to that objective.

Similarly, 29% of companies from across all sectors are responding to new customer behaviors by making acquisitions, and 15% have new product innovation at the heart of their M&A strategies. In many cases, they are buying technology companies. Non-tech companies’ US$16.6 billion in tech company acquisitions in 3Q15 included deals for the internet of things, online payment, mobility, security and digital advertising and marketing, according to our Global technology M&A report.

**Q:** Are you planning an acquisition in a sector other than your own?

- Planning an acquisition outside of my own sector: 34%
- Not planning an acquisition outside of my own sector: 66%

**Q:** What is the main strategic driver for pursuing an acquisition outside your own sector?

- Changes in customer behavior: 46%
- New product innovation: 21%
- Access to new materials or production technologies: 11%
- Technology and digitization: 11%
- Reacting to competition: 11%
M&A outlook

Tech sector continues to build on record-breaking M&A.

45% of companies intend to pursue acquisitions in the next 12 months
More tech deals being pursued

Not only did 3Q15 set a seventh consecutive post-dotcom-bubble record for technology deal volume (1,069 deals), but in this CCB, technology respondents say they plan to keep the M&A momentum going. Forty-five percent plan to actively pursue acquisitions in the coming year. While that number may be down from six months ago, it remains above the past three October reports (44% in 2014, 33% in 2013 and 20% in 2012). And with a single US$67 billion tech deal already announced in 4Q15, aggregate deal value has already hit another quarterly record.

Outlook on quality and quantity of opportunities remain high

Tech executives see considerable quality (75%) and quantity (80%) of acquisition opportunities in the market – more than in the past two CCBs. As a group, they are also more likely to close acquisitions in the coming year (62%). However, countertrends described below and later in this report include buyer competition and widening valuation gaps.

Competitors vie for deals

About three out of four technology respondents (72%) say they have walked away from contemplated deals in the past 12 months. For many (38%), buyer competition was the cause, and others (19%) blamed wide valuation gaps between their expectations and the seller’s. With total global M&A exceeding US$1 trillion in value in 3Q15 alone (the third highest value on record), some question whether the market is becoming overheated. However, technology executives in this CCB have shown they are prepared to withdraw from a deal rather than overpay for assets.
Tech executives say M&A market has room to grow

The vast majority of technology executives (80%) predict the global M&A market will thrive in the next 12 months. Our current survey shows this positive deal-market sentiment accelerating, with a particular shift in the past 12 months from those expecting stability to those anticipating greater activity.

The real action is in midsize deals, though megadeals remain prominent

The majority of planned technology investments are forecast to be in the lower-middle market. However, the trend since 2014 has been toward more upper-middle-market deals (between US$250 million and US$1 billion), which now make up more than a quarter of planned M&As.

Deals valued at more than US$1 billion dominate current M&A headlines. But while these megadeals are a vital component of total M&A transacted value, they make up a small proportion of the total volume of planned deals. Executives do expect more of these megadeals over the next 12 months, even as only a small percentage of companies plan to pursue them.
In the technology M&A market, nearly all respondents still see their deal pipeline sizes either as stable (47%) or growing (49%). Pipelines are much more likely now to hold two or more deals — with a significant shift higher over the past six months — while the number of companies pursuing only a single deal has plummeted.

### How many deals do you currently have in your pipeline?

<table>
<thead>
<tr>
<th>Number of Deals</th>
<th>Oct 14</th>
<th>Apr 15</th>
<th>Oct 15</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>3%</td>
<td>5%</td>
<td>4%</td>
</tr>
<tr>
<td>2</td>
<td>8%</td>
<td>9%</td>
<td>21%</td>
</tr>
<tr>
<td>3</td>
<td>13%</td>
<td>12%</td>
<td>23%</td>
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<tr>
<td>4</td>
<td>4%</td>
<td>4%</td>
<td>4%</td>
</tr>
<tr>
<td>&gt;=5</td>
<td>19%</td>
<td>9%</td>
<td>43%</td>
</tr>
</tbody>
</table>

### How do you expect your deal pipeline to change over the next 12 months?

<table>
<thead>
<tr>
<th>Change in pipeline size</th>
<th>Oct 14</th>
<th>Apr 15</th>
<th>Oct 15</th>
</tr>
</thead>
<tbody>
<tr>
<td>Increase</td>
<td>49%</td>
<td>32%</td>
<td>69%</td>
</tr>
<tr>
<td>No change</td>
<td>47%</td>
<td>18%</td>
<td>28%</td>
</tr>
<tr>
<td>Decrease</td>
<td>4%</td>
<td>50%</td>
<td>3%</td>
</tr>
</tbody>
</table>

Companies are more likely to pursue and complete multiple deals in a year.
Technology valuation gaps a growing concern

A year ago, when asked how buyers’ expectations compared with sellers’ view of deal valuations in the market, 60% of executives cited a gap of under 10%. Six months ago, 34% said the valuation gap was that small. And in this CCB, only 26% say so. Most respondents see a sizable gap. What is more, there is a sharp increase in the number of executives who expect that gap to grow in the coming year (51% in October 2015 vs. 22% in April 2015).

Global macro trends affect asset values

One area that may have a deeper impact on valuations is the timing and pace of rate normalization by the US Federal Reserve, which will directly impact the cost of capital. Even here, executives believe rate increases will be gradual, data-dependent and reflective of global economic conditions. Valuations also differ widely by geography and sector, differences that may spur share-based deals and bring new opportunities to the table.

Executives see beyond near-term volatility

Technology executives appear to be maintaining a confident attitude toward asset valuations. Most see the recent correction in global stocks as temporary, and they expect asset prices to recover and grow. Nearly half (46%) expect an increase in the pricing of tech assets – well above the 17% expressing this view only six months ago.
Companies are increasingly buying assets outside of their core business, and these may be difficult to fit into their current operations. Integrating a new acquisition into optimized structures to realize cost synergies is a delicate exercise. Poor integration execution and failure to achieve synergies together account for 46% of the missed expectations identified by technology buyers. Poor operating cost assumptions also rank highly (21%).

**Digital technology aids due diligence and integration**

More than ever, digital technology influences what companies acquire, how they integrate and how they monitor and measure success. Digital due diligence, for example, is conducted by more than one in three companies (36%), including social media and big data analytics. And post-merger, digital technology (such as cloud computing) can accelerate the integration timeline and therefore the ROI of the acquired business.

Still, as companies increasingly acquire digital assets with different cultural and operational models, integration can also be challenging. The need to retain acquired talent and expertise is paramount. Integration considerations have long needed to be part of the front-end deal strategy — now more than ever in an increasingly digital world.

**Deals subjected to cyber-risk scrutiny**

More than 90% of technology executives view cybersecurity as a significant risk, either medium or high, to their deal process. A majority of companies perform cybersecurity due diligence as a standard procedure. Areas of focus include their acquisition targets’ IT systems, interfaces with third-party systems, joint ventures and supply chain interfaces.
Fundamental global changes reshaping corporate strategies

**Q:** What percentage of available capital will you allocate to each of the following?

- Organic growth (e.g., investing in products, talent retention, R&D)
- Inorganic growth (e.g., acquisitions, alliances and joint ventures)
- Improve balance sheet by reducing debt
- Returning cash to shareholders

Companies are considering a full range of opportunities for allocating available capital

The effective allocation of capital is a senior management team’s most fundamental responsibility. In a time of modest global economic growth, executives are taking extra care to balance their allocations to support long-term strategic goals. A typical capital allocation strategy also strikes a balance between long-range planning and shorter-term imperatives.

In the years immediately after the global financial crisis, many companies pursued share buybacks and other short-term measures, in many cases under pressure from large or institutional investors. While these maneuvers satisfied various constituencies at a time of market challenge, executives were reminded of a perennial truth: a focus on short-term tactics can be at odds with building long-term value.

Balance and frequency are keys to successful allocation

In this Barometer, we find executives have moved beyond the financial-crisis mindset and are employing a full range of available allocation tools. They are balancing financial prudence (reducing debt), rewarding existing shareholders (returning cash) and growing the business for the long term (organic and inorganic growth).

Research consistently shows that companies with the most active capital allocation processes will outperform and ultimately achieve higher returns than those with more passive or infrequent allocation approaches. In the new-normal environment of tempered global growth, continual reassessment of where to deploy and recycle capital is how companies sustain their growth trajectory and maximize value.

Companies with the most active capital allocation processes are consistently shown to outperform those with more passive or infrequent allocation approaches.
Many companies looking farther afield for deals

Amid globalization, executives consider all locations for acquisitions

Over the past six months, technology executives’ attention has shifted farther outside their domestic market or immediate region (up to 53% in October 2015, from 30% in April 2015).

Emerging markets elicit new attention

The majority of allocation for global investment remains focused on developed markets. However, we still see a distinct increase in appetite for higher-risk global investment. Emerging markets are attracting a larger share of acquisition capital, with 47% of tech respondents now devoting 10%-50% of their acquisition funds.

Recent currency swings and lower equity valuations in emerging markets have raised concerns. However, from a valuation perspective, these changes have also made emerging market assets more attractive.
Top five investment destinations

Stronger growth in the US and the UK, and the attractiveness of high-quality assets in Germany, are making these countries popular investment destinations. Mainland China and India also remain attractive destinations for investors, notwithstanding recent concerns about the wider Asia-Pacific region’s economic growth and stability.

1. US
2. UK
3. India
4. Germany
5. Mainland China

EU investment appetite increases

More than a third of technology executives have increased plans to acquire assets in the Eurozone. This is in part due to companies “catching up” on planned acquisitions in the region following a period of instability — and in part due to attractive pricing amid currency fluctuations. The ongoing program of quantitative easing by the European Central Bank may also help improve dealmaking in the Eurozone.

While it may be the world’s largest single market, the Eurozone’s wide range of economic conditions and business environments means investors are picking and choosing where to invest.

Q: Has your intention to acquire assets in the Eurozone altered due to recent political events and changes in monetary and economic policy?

- Increased: 37%
- Stayed the same: 47%
- Decreased: 4%
- Not relevant/no plans to invest in Eurozone: 12%
Technology continues on blockbuster pace

3Q15 digital disruption keeps dealmaking strong

If anyone still needs convincing about the underlying strength of global technology M&A, look no further — in 3Q15, the NASDAQ Composite Index dropped 7%, but global tech M&A volume increased 5% to 1,069 deals — dotcom bubble territory. In the eight years EY has produced its Global technology M&A reports, it’s only the fourth quarterly period in which tech M&A volume and the NASDAQ did not move together.

Although 3Q15 aggregate deal value declined, expect dealmaking strength to continue. Deal drivers are still accelerating because tech-enabled digital transformations disrupting multiple industries are only just getting underway.

Highlights from our 3Q15 report:

• Aggregate value of US$65.4 billion fell 49% from 2Q15’s post-dotcom-bubble record, but it still ranked as the ninth-highest quarterly total since 1996*

• Quarterly volume of 1,069 deals set a seventh consecutive post-dotcom-bubble record

• Thirteen deals above US$1 billion with an aggregate value of US$41.8 billion

• Growth in deals targeting big data analytics, the internet of things and payment and financial services technologies made the biggest contributions to 3Q15 value.

4Q15 promises more of the same

• October at a glance M&A report analysis indicates that value soars and volume also rises:
  • At US$126.7 billion, October 2015 aggregate value more than doubled the previous post-dotcom-bubble record monthly high
  • Volume for the month (364 announced deals) is the second highest volume month of the year
  • As of 9 November 2015, YTD aggregate deal value of US$413.5 billion surpassed the height of the dotcom era for full-year 2000 of US$412.4 billion

EY’s 3Q15 Global technology M&A update and October 2015 at a glance reports are available at ey.com/technology.

*The earliest year for which we have data.
Note: all deals are announced deals and value is aggregate value.
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 53 countries; more than 50% were CEOs, CFOs and other C-level executives. In this survey, we had 161 respondents from technology companies of which 49% were CEOs, CFOs and other C-level executives.

- Technology companies’ annual global revenues ranged from: less than US$500m (37%); US$500m-US$1b (20%); US$1b-US$3b (16%); US$3b-US$5b (9%) and more than US$5b (18%).

- Global company ownership was as follows: publicly listed (67%), privately owned (31%), family-owned (1%) and government/state-owned (1%).
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