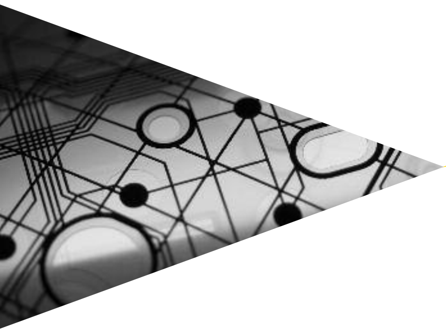
Top of Mind

Issues facing
technology companies



Megatrends, "hidden gems" and activist investors drive divestiture activity

Technology company divestitures increased in every quarter of 2013, demonstrating that more technology companies are focusing on portfolio management. Evidence from EY's own research, news headlines and the deals themselves suggest that the rising divestiture trend is being driven by technology megatrends (mobile, social, cloud, big data analytics and accelerated adaptation), shareholder activism and the discovery of "hidden gems" within companies.

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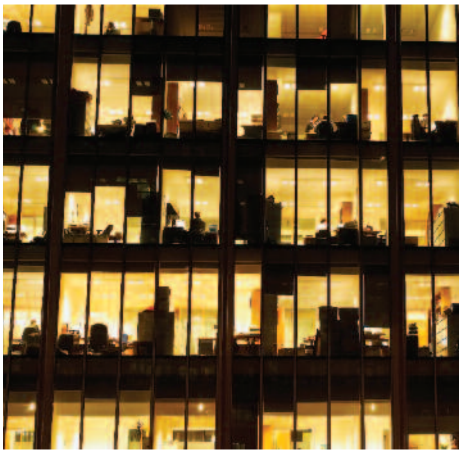

In addition, there is the need for speed. The acceleration of technology innovation makes products and business models obsolete faster than before, so leading technology companies are assessing their portfolios more often – and taking action more quickly. It's more important than ever before for technology companies to continuously re-evaluate their core business strategy, obtain better information for divestiture decision-making – and take action.

"It's getting increasingly important for technology companies to look ahead five years or more, analyze how smart mobility, the cloud and big data, for example, will affect their business, and continually re-assess their portfolios in that light," says Jim Reinhart, Managing Director, US Technology Lead Advisory, M&A, for Ernst & Young Capital Advisors LLC. "What has become clearer in the last year or so is that if companies hesitate to do this themselves, activist investors will step in and do it for them."

Notable divestitures

There were nearly 60 divestitures in our Q413 dataset. While most were small or had non-disclosed values, some were big-ticket: for example, Samsung's $3.4 billion sale of its interest in LCD glass maker Samsung Corning Precision Materials, or Deutsche Telekom's $2 billion sale of e-commerce business Scout24 to PE firm Hellman & Friedman.

Far smaller, but interesting in light of the rapid evolution of 3D printing, was 3D Systems, Inc.'s $33 million purchase of a Xerox Corporation engineering and chemistry group that provides solid inks and related materials research. Among deals that were small or had undisclosed values, Panasonic Corporation sold semiconductor manufacturing plants, NXP Semiconductors Inc. sold vehicle telematics technology, and Mindspeed Technologies, Inc. sold its 3G and 4G small-cell wireless technology to Intel. And we saw a $260 million divestiture that was unusual in that it was between rivals: LivingSocial Inc.'s divestiture of its Korean daily deal subsidiary Ticket Monster Inc. to Groupon, Inc.

Hidden gems of 2013

Reinhart notes that one company's non-core asset often can be more strategically valuable to another company. For example, 1 of the top 10 deals of Q413 – NCR's $1.7 billion acquisition of Digital Insight from PE firm Thoma Bravo – was of a company divested in the previous quarter. Thoma Bravo acquired the target in Q313 for $1 billion from Intuit, Inc. (where it was known as Intuit Financial Services).

This suggests companies might get better valuations for potential divestitures than they expect, depending on the situation. This is an important consideration in light of the finding that 38% of technology respondents to EY's 2014 Global Corporate Divestment Study identified valuations as their biggest divestiture challenge.[1]

Some 2013 deals with hidden gem potential included: Cisco Systems' sale of its home networking business, including the Linksys brand, to Belkin International Inc. and Microsoft's sale to Facebook of its Atlas online advertising platform,[2] which can show how online ads may have influenced online purchases not made directly through the ad. And already in January 2014, IBM has announced the divestiture of its low-end server division and Google has divested its Motorola handset business, both to Lenovo Group Ltd.[3,4]

"The hidden gem idea is not about divesting poor assets, but rather about making a star of an underutilized asset," says Jeff Liu, Senior Managing Director and Leader US Technology M&A Advisory, Ernst & Young Capital Advisors LLC. The search for hidden gems may be the reason why nearly half the technology respondents to our divestiture study chose big data analytics as the key trend motivating them to consider divestitures. "Most technology companies, particularly those in the services subsector, have large amounts of big data. That information may have far more value than before, once monetized through the lens of emerging big data analytics tools," Liu explains.

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Activist influence on the rise

Activist shareholders have become increasingly active in the technology industry. During 2013 and early 2014, activists have taken positions and advocated for strategic change at companies including: Dell, eBay, Juniper Networks, Inc., Netflix, Inc. and Sony Corporation. Activist influence is not limited to divestitures of course; for example, activists played a role in the deals to take Dell and BMC Software private.[5,6]

When appropriate, however, divestitures are a quick route to unlocking hidden shareholder value because they generate cash from the sale — and can often lead to improved share price. For example, activists have recently encouraged eBay to spin off PayPal[7] and Sony to separate its consumer electronics and entertainment businesses.[8] In this context, our Global Corporate Divestment Study had an interesting finding: among respondents from all industries, 80% of those who based strategic divestment decisions on a regular portfolio review experienced a higher valuation multiple following their last divestment.

Three leading practices for high-performing divestments

The divestment study found three leading practices that differentiated those companies whose divestments achieved a high sales price and also had a very positive impact on the remaining company valuation multiple. These are:

- Know your core business
- Get better information with which to make decisions
- Take action

While these three practices may sound fundamental, the first two, at least, have become increasingly challenging as the pace of technology change accelerates. A surprisingly low 12% of companies in the survey follow all three leading practices.

Know your core

In the current rapidly evolving environment, knowing your core business requires reviewing your core strategy more often than historically necessary. It means continually analyzing core competencies, differentiators and industry trends to understand your areas of growth and decline. Involving senior leadership early in the review process is important for two reasons: senior executives tend to be more objective than business unit leaders, and when senior leaders help shape the portfolio review the results are more likely to be seriously considered.

Make better-informed decisions

To make better decisions, companies in the divestment survey improved the resources they drew upon for portfolio reviews and the quality of the data under consideration. Fifty-two percent of technology respondents said a dedicated team makes the portfolio review more effective. Most successful teams are led by an executive with the authority to make decisions and recruit the appropriate professionals with diverse skill sets.

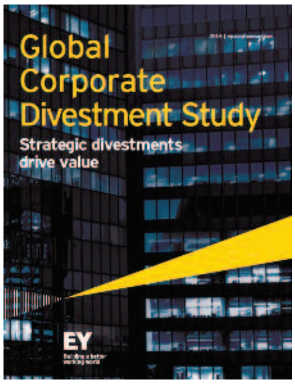
Analyzing the right metrics is also key. The research suggests focusing on return on invested capital (ROIC), which takes into account return on assets and present value; sales and EBITDA growth (are sales growing faster or slower than competitors? Is EBITDA margin acceptable compared with other parts of the business and/or the market?); and economic value-add, which helps you understand if a unit strategically enhances other parts of the business.

Take action

Finally, companies can't derive value from their portfolio reviews if they are unwilling to take action on the resulting recommendations. We're always surprised by how many companies get this far and then fail to act — or act too slowly, which in the current environment is nearly as problematic.

We recommend reviewing your portfolio at least twice per year, and using strategic analyses to determine if you are the best owner of a particular business unit. And be prepared to divest when indicated.

EY's *Global Corporate Divestment Study: Strategic divestments drive value* can be accessed via ey.com/transactions.



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Source notes:

1. *Global Corporate Divestment Study,* EY, © 2014 EYGM Ltd.
2. "Facebook Buys Microsoft's Atlas Digital-Ad Service," Dow Jones Top News & Commentary, 28 February 2013, via Factiva, © 2013 Dow Jones & Company, Inc.
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