PErspective in TECHNOLOGY – SOFTWARE

A FEATURE EXAMINING THE ROLE OF PRIVATE EQUITY IN THE TECHNOLOGY INDUSTRY.

Software M&A activity—and deal-making in general—was robust in 2015, with PitchBook reporting 2,375 software mergers globally through the end of November.

Only a fraction of these deals (187) were backed by private equity, reflective of a downturn in PE deal activity across the board. High valuations—driven by low interest rates, the stock market's long bull run, increased competition from cash-rich corporates and a strong private fundraising market—coupled with a regulatory crackdown on leveraged lending, left many PE firms sitting on significant amounts of dry powder.

PE deal-making may be down, but deal sizes are trending upwards. According to Dealogic, PE deal numbers in general are at a six-year low (1,527 so far in 2015 compared with 1,742 in 2014), but values are at an eight-year high ($230.7 billion up from $223.4 billion in 2014). Since PE firms are paying top multiples, they want to invest in firms with reliable revenue streams in attractive growth sectors that are more recession-proof, *Forbes* reports.

That has many eyes turned toward the software sector, and cloud technology in particular. PE investors are drawn by the non-cyclical nature of the industry, its potential for large returns, and the ever-increasing popularity of the cloud software delivery model. Gartner projects that global spending on enterprise application software will grow from $149.9 billion in 2015 to $201 billion by 2019, with much of the focus centered on updating or replacing older business applications with cloud-based software. Chicago and San Francisco-based PE firm Thoma Bravo has backed more than 25 companies that use cloud technology, *The Middle Market* reports.

PE-backed technology megadeals helped drive software deal values upward this year, including Carlyle Group's $8 billion acquisition of Symantec's Veritas unit, Permira Funds' $5.3 billion joint purchase of Informatica and Vista Equity Partners' buyout of Solera Holdings in a deal valued at $6.5 billion including debt. Larger PE firms are generally dominating such deals, thanks to their ability to raise the necessary funds, *Institutional Investor* reports.

Software companies have largely been able to generate higher multiples than they would in the public markets by tapping venture capital, corporate and mutual fund investors, so IPOs stalled this year. There were 57 software IPOs worldwide through 2015, of which 18 were PE-backed, according to Pitchbook data.

Will the public markets regain popularity in 2016? Technology news site *Mashable* predicts that many of Silicon Valley's so-called unicorns (private companies valued at over $1 billion) may be "taken down a notch" in the coming months as their valuations come under increased scrutiny from the SEC and mutual fund investors. More realistic valuations could activate PE deals, but a potential interest rate hike will make leveraged acquisitions more expensive for all buyers.

PErspective in software is a feature examining the role of private equity in the software sector.

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