INSIGHTS FROM THE BDO TECHNOLOGY PRACTICE

TECH M&A: CREATING VALUE IN AN UNCERTAIN MARKET

After years of rising valuations and fast-paced growth – including a record-breaking year for M&A in 2021 – the technology sector is slowing down, with big tech stocks losing a combined market value of more than $3.3 trillion through June.

Tech companies that made acquisitions in the past few years must now contend with market fundamentals that look markedly different from when they first developed their value-creation plans. As CFOs pivot their corporate strategies in advance of a potential recession, they will also need to pivot their approach to deal integration and value creation.

WHERE WE ARE NOW

BDO's recent insight, **How Interest Rates, Inflation, and Geopolitical Uncertainty Influence TMT M&A Valuations**, highlights the confluence of factors that have led to the current market conditions.

Inflation is a chief concern, with rates in the U.S. currently four times higher than Federal Reserve targets and the U.K. seeing a 40-year high in June. This has triggered a worldwide response, with the U.S. raising interest rates in March (0.25%), May (0.5%), June (0.75%) and July (0.75%).

The European Central Bank also raised interest rates in July by 0.5%. Conditions are further exacerbated by supply chain delays, geopolitical conflict and challenges with talent retention and recruitment. These factors drive more costly financing, lower return on investment and more difficult asset divestment and return generation.

All of this raises the question: how can tech companies that thrived in the previous deal landscape successfully navigate current market conditions and maintain value in their acquisitions?

SHORT-TERM STRATEGY

For tech companies that made transformational deals before the current market slowdown, it may feel like options are limited. Although deal value cannot change, there are other ways to lower costs and recover value without liquidating the deal altogether.

Now is the time to rethink the original value creation strategy for deals made in 2021. Rather than trying to predict the future of an uncertain market with a 12- or 24-month value creation plan, consider a six-month plan that matches current market conditions and focuses on near-term forecasting. Revisit the value creation plan frequently to ensure continued alignment with market conditions – but avoid changing course too quickly, which can waste both time and money.

Companies considering deals at this time should take current market volatility into account when developing value creation plans. In this economy, the value creation plan should be developed based on a valuation 10 to 20 percent lower than the purchase price. In some instances, it may impact the decision to move forward with an acquisition at all.

The BDO M&A POWERED Platform™ helps companies maximize the success of their deals with a thoughtful and insightful approach to value creation. Learn more.

ALIGN STAFFING WITH CURRENT NEEDS

According to **BDO's 2022 Technology CFO Outlook Survey**, the top three workforce challenges that CFOs anticipated in 2022 were: attracting new talent (47%), retaining key talent (46%) and a shortage of skilled workers (39%).

These challenges, exacerbated by the Great Resignation, have led to an ongoing bidding war for talent and forced companies to prioritize investment in recruitment and retention – until now. Current market conditions are changing this prioritization by shining a light on staffing needs and showing that many companies over-hired in 2021.

Now is the time for companies to analyze staff utilization and determine if hiring still makes sense, or if they need to course-correct. Staffing is a fixed cost – and a high one at that – and reductions to headcount will bring this cost down. Determining where to reduce headcount is an opportunity to shift resources to the business activities that provide the most value.

Many tech companies are making headlines right now for reducing headcount, but this is just one potential solution of many. Rather than cutting staff, tech companies may consider pivoting to an alternative staffing model, such as **outsourcing or co-sourcing**, which provides flexibility to scale up or down as needed.

STRATEGIC ASSESSMENT IN A SLOWDOWN PERIOD

The acquisition process is slowing down — literally — as potential buyers take more time and greater care in their decision-making. This minimizes the urgent pressure buyers were previously facing over concerns that an asset would be snatched up by a competitor. By slowing down, buyers can conduct more comprehensive due diligence and create more thorough plans for post-close value creation.

In addition to taking a more detailed approach to new deals, tech companies should use this slowdown to revisit how recent acquisitions were integrated. They cannot afford to let proper integration fall to the wayside for the sake of moving rapidly, which risks leaving value on the table.

Instead, lean into the pause and use it as an opportunity to fix integration inefficiencies with previously acquired assets that may not have previously been a priority. Use data to evaluate the asset, compare existing processes and find areas to make improvements. These improvements are a step toward maintaining and/or recovering value.

SHIFTING APPROACHES TO VALUE CREATION

The headwinds causing market uncertainty make it difficult to predict what M&A will look like 12 months from now. This does not mean the window for M&A is closed, rather, it signals a shift in how tech companies should approach new deals and reconsider their existing value creation strategies.

Creating value in the current market will require a steady hand for short-term planning and the flexibility to adjust those plans as the market changes. Companies should use the slowdown period to assess where they can find or create value, be it through recalibrating headcount, exploring flexible staffing models, more efficient integration with recent acquisitions.

Download BDO's e-book, **Maximizing Returns: Unlocking Value throughout the Private Equity Lifecycle**, for an overview of how due diligence has changed in recent years and how buyers and sellers can meet these new expectations.

CONTACT BDO to learn how your company can navigate these impacts and identify operational value.

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