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# Board Focus on M&A

*A Closer Look at Technology, Media, Telecom  
Trends for 2008*

# Convergence, Changing Technology Drive TMT Deals

*Product innovation, convergence, and cost control are among the many factors driving activity in the TMT sector, where volume is expected to pick up in the latter part of 2008.*

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### **What is your overall outlook as far as the M&A environment in the technology, media, and telecommunication sectors for 2008?**

**Mike Huffman:** I think 2008 will be a healthy year for M&A in the technology, media, and telecom sectors. While we won't necessarily hit any all-time highs, I do believe it will be a robust market, with various factors such as convergence continuing to fuel this trend. The blockbuster private equity deals that fueled much of the activity in the first half of 2007 pretty well vanished in the latter part of the year and will continue to stay very slow for the first half of 2008. But at some point, whether it's in the second half of the year, or a bit after, activity will pick up.

**Janine Brown:** As Mike noted, in the last six months of 2007, activity was certainly down. Heading into 2008, the questions become, "What does technology and advertising spending look like? Will there be a downturn and, if so, how will that affect M&A activity?" Like Mike, I think M&A activity in 2008 will continue to be robust, but I would be a little surprised if it exceeds 2007's activity. A couple of blockbuster deals could certainly pull it over the line. It may be, however, that we see an increase in smaller deals. So the volume may increase over 2007, but I question whether aggregate value will end up exceeding the 2007 level.

**Asher Cohen:** My take on 2008, and I always like to look back first, begins with its relationship to 2007, which was definitely a very active year. I can speak more to telecom than the technology and media sectors, but in looking at the telecom side, it is worth noting that despite the amount of activity, there was a decline in the number of sizable transactions in 2007 versus 2006. Now, as to whether or not we're going to see any activity in telecom M&A in the year ahead, I'm sure we will. In just looking at deal flow so far in 2008, I don't see a big change in the drivers pushing board members and management on either the strategic or the financial side. They're still driven to do transactions, although there are more underlying fundamentals that will affect deal activity. If we look at wireless, we have seen a lot of consolidation since 2006, so just by the nature of how many players are left and how many potential transactions are out there, deal volume is expected to be down. Overall, telecom is an interesting sector and one that is very sensitive to changes in technology. There are still lots of reasons, both on the strategic and financial side, to do transactions.

Another way to slice it is in terms of high-leverage deals versus medium-to low-leverage deals. It's pretty obvious that the higher-leverage deals will be very challenging to come up with in 2008. Deals that need to be closed and obviously need to be priced in terms of the debt size are still out there, and you can see this just by the spread encompassing these deals, from Clear Channel to BCE. The market is not confident that these deals are going to get done. So overall, my take is that the telecom sector will still be active, but I don't see it as active as 2007.

### **Could you discuss some of the strategies driving deals in the TMT sector?**

**Huffman:** As mentioned previously, I think a major driver is convergence. Convergence is a topic we've talked about in the industry for years as a future vision, but I believe it is now becoming a reality. A classic example is the iPhone's phenomenal success. If you look at that one little device, does it fall within technology or telecom? With all that content, one could certainly argue that it falls within

media. One could even argue that it falls within consumer business. So all of these different, and what were at one point disparate industries are converging. This is true across the spectrum. In almost all the companies out there, there is some form of convergence, and the adaptability and acceptance of the markets is accelerating this movement. There are many TMT companies that have stayed in one particular sector that now realize they have to participate in a much broader industry segment, but they don't have all the necessary technology, products, distribution networks, or content to do so. This has resulted in them looking at M&A to attain these.

**Brown:** There are potential divestitures in the media space, especially, that are essentially spinoffs or breakups of media conglomerates. There's a likelihood these will impact the overall market, and strategically, there's certainly concern about the value of the independent parts of these larger entities. I think the globalization strategy is a question for both domestic players looking abroad and global players in terms of what they might be looking for in the United States. Back to Mike's point, with regard to convergence, it seems that within mobile broadband, e-commerce and location-based services are likely to be drivers. And then overall, there is the question of enhancing technology efficiencies, and perhaps we've already seen those strategies at play in terms of some of the acquisitions that have been announced in 2008.

**Cohen:** The way I look at it is twofold: strategic transactions and financial transactions. From the strategic standpoint, our experience is that the deals are mostly driven by scale, particularly in telecom. There are obviously many upfront, fixed costs for most of the strategic-based operators and service providers. As companies grow, a larger portion of incremental revenues flow to the bottom line, so scale is key. Between 2001 and 2004 in the telecom arena, everyone was occupied fixing their balance sheets. Since then, they've refocused on fixing their business plans, and there were lots of shifts in terms of business plans and which customers that operation should target. This is what we've seen driving some of the deals we've witnessed already. In terms of standalone, if you're not one of the market leaders, it's really difficult to stay on the same track, which has been causing most of these midsize to smaller operators either to buy and grow with acquisitions, or if they are not able to buy, to go out and try to sell themselves. That's what we've seen with many of our clients. They tried to do more acquisitions, and at some point they determined that it might be better to turn around and sell.

**Huffman:** To tag along with what both Janine and Asher have said, what is happening is an overall consolidation within many of these segments. Now, there's product innovation, evolving markets, and the convergence I

mentioned, but there's also the cost-control factor. Many of these industries, even tech, are now considered mature industries, so to be more efficient and remain cost-effective, they are, in some cases, looking to combine with other companies. Another factor driving a reasonable amount of activity in 2008 is the weakness of the U.S. dollar compared to other major currencies. I wouldn't be surprised if foreign companies start looking at some U.S. assets as reasonably inexpensive, just based on exchange rates.

### **What are some of the more noteworthy deals that occurred in the sector last year?**

**Huffman:** In the first two-thirds of 2007, there were a large number of significant take-private equity transactions, such as First Data, Avaya, Alliance Data, Alltel, BCE, and Clear Channel, just to name a few. Now, some have closed and some are pending. As Asher mentioned, if you take a look at the spreads between the offer prices and the current market prices, many investors are betting that some of these deals won't actually close. So again, while there were a number of large transactions in 2007, the volume of large private equity deals really set the tone in early 2007. While I believe the take-private activity will be slow in the first part of 2008, there are a lot of fundamentals relative to TMT companies that make these industries appealing to financial buyers. So when the debt markets settle out, I think the private equity investors will jump back into these industries.

**Brown:** Just in terms of deals, while Mike mentioned a number of private equity deals, on the strategic side there was Microsoft/aQuantive, Oracle/Hyperion, Cisco/WebEx, IBM/Cognos, and there were telecom deals, such as AT&T/Dobson, Deutsche Telekom/SunComWireless, and the Nokia/Navteq deal. This goes back to the earlier question of the strategies driving some of these deals, as well as to the issue of convergence, especially when looking at Microsoft's acquisition of aQuantive. Essentially you're looking at technology converging with ad networks and ad agencies. When one looks at some of the acquisitions that have already been announced this year, it appears we'll continue to see strategic buyers taking the lead, at least in the early part of 2008.

**Cohen:** As far as 2007, private equity was obviously the noteworthy player. The various pending transactions that are still out there such as Clear Channel, BCE, and Alltel are very significant. Telecom was something that private equity always shied away from, given the higher level of capex and the less leveragable types of assets. So I would say the noteworthy theme in terms of telecom deals for 2007 was really not specific transactions, but the emergence of private equity deals in telecom.



**M&A activity in the online media sector increased last year nearly 70% over 2006, driven by both B2B and consumer media transactions. Is this a trend that will continue in 2008?**

**Huffman:** Online media will perhaps be the hottest sector once again in 2008. The foundation is related to convergence, but what is interesting is how quickly this space is evolving. If you think about the devices, content, and mobility that existed just two or three years ago, and compare that to what exists today, it's wildly different, and it will be wildly different again in two or three years. It's no longer only the innovators who are using the Internet to buy things or to look at advertising. It's widespread and fully accepted. There's been a significant decline in traditional advertising and corresponding increases in online advertising as well as overall activity. All of that will continue to drive technology companies, including traditional ones like Microsoft, to be active in this space. Then there are companies such as Google that were born, bred, and thrive in this space and will continue to consolidate and add assets. And there are companies such as eBay that may acquire or divest some of their businesses, and Yahoo, which has been struggling and could very well do a blockbuster deal, either as an acquirer or perhaps even as a target. I think this space is ripe for continued M&A activity. *(Editor's Note: Microsoft's bid for Yahoo occurred weeks after this interview.)*

**Brown:** I agree with Mike. We're going to see an increase in online media deals for all the reasons he mentioned, whether it's due to convergence or globalization, which also drives some of the activity in this area. In my mind at least, there is a bit of a wild card related to a slowdown in advertising spending. Even if that's the case, the shift from traditional media to online media is so strong, and if one thinks about the strategic buyers and players in this space, it would seem to nonetheless drive considerable M&A activity over the course of 2008.

**Cohen:** I don't have a lot to add, but I do have a couple of points to make. One is regarding social networks. In terms of Facebook, MySpace, and Classmates, we will continue to

see deal activity. These obviously represent significant growth within this sector. Another development involves Netflix going into online downloads of movies. That will drive some activity in terms of the underlying technology and related companies, such as the studios.

**Moving over to focus on the software industry, early this year Oracle announced its intent to acquire BEA Systems for \$8.5 billion and Sun Microsystems announced it was going to acquire open-source database vendor MySQL for \$1 billion. Do you see deals like this continuing in the software sector?**

**Huffman:** I think they are a continuation of a trend. Those are two great examples. Oracle acquiring BEA is an example of consolidation in the ERP [enterprise resource planning] space. Companies want to get broader and deeper and have more of a presence and control. The Sun Microsystems transaction is just another example of the innovation we see in technology where a younger, much smaller company develops appealing products, and larger companies want to take advantage of that. So from both a consolidation and innovation standpoint, I think we'll continue to see software companies doing a lot of transactions.

**Brown:** One interesting thing to note about the Oracle/BEA deal is that had it taken place in 2007, it would have been one of the largest software deals. Some of the smaller companies may continue to feel pressure, depending on whether or not we really see a significant downturn in 2008, so some of the larger strategic players may really have an opportunity there. In looking at Sun Microsystems' acquisition of MySQL, it follows a pattern with JBoss being acquired by Red Hat in 2006, and then Yahoo acquiring Zimbra and Citrix Systems acquiring XenSource in 2007. These all harken to the theme of convergence and to the notion of why I think there is continued heightened activity in online media. Ultimately, it goes back to mobile broadband and the Web, in general.

**In closing, is the fear of recession having any impact, negative or positive, on the sector?**

**Huffman:** I believe that if we do have a recession it's not going to have much of an impact on M&A activity in the TMT space for a couple of reasons. Many transactions will be driven by bellwether companies—the IBMs, Oracles, Ciscos, and Googles of the world. These are companies with a lot of cash and stability, and they're going to be doing deals in the coming years. They might actually view a slight downturn as an opportunity and take advantage of some of the dislocation and uncertainty and be even more aggressive. The flip side is there could be a bit of uncertainty as companies evaluate timing, and they may think that if they hold off for three or four months, they can get better pricing. I don't believe a small downturn will deter the big guys because they have a vision of where they need to be in a couple of years, and they'll go for it unless a larger shock to the system happens.

**Brown:** I agree, and wonder whether a slowdown could actually drive more M&A activity as a growth strategy if organic growth slows, particularly since so many strategic players have been the ones making acquisitions in the TMT space. For the financial players, the credit crunch is not necessarily what's driving acquisition activity within the space. If a U.S. recession materializes, as we discussed earlier, it may actually encourage overseas buyers to make a play.

**Cohen:** In summary, I will reiterate what I said before. Deal volume will decline, but I don't think that's going to be due to a recession. I think that will be driven more by the credit environment and by virtue of having a smaller number of players in the sector. Those will be the main drivers for 2008. I don't see a recession as a factor in terms of how management or boards will make decisions related to deal activity. Although some of the general market is starting to flatten or even decline, select segments in the telecom arena have been experiencing stronger growth over the last few months.

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