manatt

SHAPING THE FUTURE

Trends in Digital Media and Frontier Technologies M&A

Table of Contents

Methodology

In Q3 2016, Mergermarket surveyed 100 senior global executives to understand their strategies and views regarding M&A in the digital media and frontier technology sectors. For the purposes of this report, frontier technologies include but are not limited to augmented/mixed/virtual reality, artificial intelligence, live streaming, wearable technology, eSports and Internet of Things. Respondents were split geographically across the U.S. (50%), Western Europe and Scandinavia (25%), and Greater China (25%). Respondents were also divided among corporates (50%) and dealmakers (50%); the latter included private equity partners, venture capital investors and investment bankers.

Foreword

People consume entertainment on an unprecedented level today. They watch TV shows on their commute, listen to podcasts at the gym and play augmented reality games at cafes. As demand for content and digital recreation continues to climb, media and technology companies are increasingly using M&A as a key part of their growth strategy—whether to expand their content offerings, acquire new distribution platforms or be first to market with an emerging technology.

Old definitions of media, entertainment and technology are being erased as sectors converge. Apple, once known purely as a device maker, has a powerful content distribution system now via Apple Music and Apple TV. Facebook, previously thought of strictly as a social network, is redefining its value proposition with its strength as a content engagement platform, as evidenced by its success with video content and its ecosystem of services and products, including WhatsApp, Instagram and Oculus. Comcast, formerly a cable company, now owns TV networks, a film studio, digital-first studios and even game developers. Firms that do not expand into synergistic new segments often end up being purchased themselves—otherwise, they will become irrelevant.

At the same time, acquisitive strategies do have their pitfalls. For example, there have been reports of integration issues at Dailymotion since its takeover by Vivendi. Even with smaller deals, acquirers run risks such as overestimating the value of a technology or mismanaging integration. As cross-border deals become more common, companies must make sure that their mutual integration goals are aligned and executed.

To analyze and better understand media and technology companies' attitudes toward M&A, Manatt Digital, a division of Manatt, Phelps & Phillips, LLP, conducted a survey of senior executives from around the globe, together with financial intelligence firm Mergermarket. Respondents revealed that content is indeed king, even as monetization of that content remains vital as well; emerging technologies such as virtual reality and augmented reality are still just that—emerging; a premium is put on strategic technology and first-to-market status; and overall, acquirers from different regions still share the same priorities: to enter new market segments and acquire strategic technology and patents.

Executive Summary

The core focus for companies' acquisition strategies is on relatively traditional business areas, including digital media services, content creation and video distribution.

However, frontier technologies are attracting significant attention as well. More than a third of respondents are targeting companies in the Internet of Things, wearable tech, artificial intelligence, AR/VR and drone technology segments.

Scandinavian countries represent the top cross-border priority for almost one in two respondents to the survey, making the region the leading target for buyers—perhaps reflecting the reputation of countries such as Sweden and Denmark for innovation. Despite Brexit, the U.K. was the second-most popular target region.

Acquirers from the U.S., Europe and China mostly share the same priorities in dealmaking. Nonetheless, certain distinctions do exist. For instance, Chinese respondents expressed relatively more interest in digital publishing and gaming, while U.S. and European respondents are more keen on advertising and marketing tech.

M&A in technology and media can be high-risk, given the uncertainties of translating market potential into tangible results, particularly given the limited track record of many companies. Almost one in two respondents see wrongly evaluating a technology's importance or potential as the biggest risk in an M&A deal in these sectors. More than a third fear misjudging a target's growth potential, a similar concern.

Companies rely heavily on advisors and other third parties to conduct due diligence, reflecting the difficulties of accurately assessing digital media and technology companies. The majority of respondents emphasize the importance of thorough diligence, even if this extends the deal timeline, over the need to conclude a deal quickly.

While more than a third of respondents said potential problems such as cultural clashes concerned them when conducting M&A, very few cited integration as a priority in due diligence. This mismatch indicates that acquirers may underestimate the importance of planning for post-merger integration when doing a deal.

Data Overview

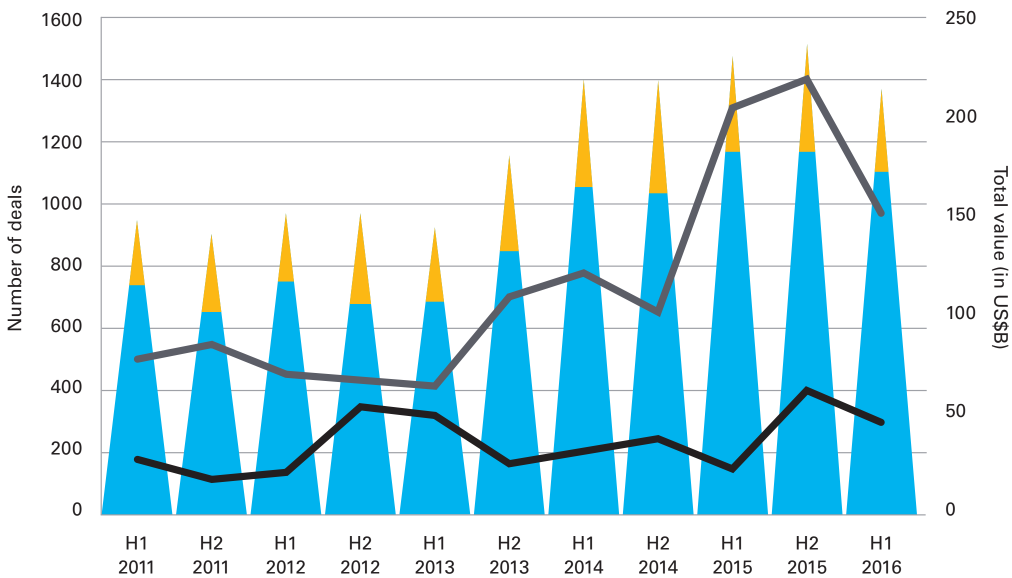
The media and technology sectors have undergone an M&A boom in recent years, with dealmaking in the industries outstripping even the rapid pace seen in other sectors. Across media and technology combined, the number of deals jumped from 1,860 in 2011 to 2,980 in 2015, according to Mergermarket data. In cash terms, the increase was even more dramatic, with deal values rising from US$206B to US$508B during that period.

As Figure 1 shows, M&A volumes slowed during the first half of 2016, with 1,377 deals worth US$196B across the two sectors. However, while this suggests M&A for the year ahead will come in behind 2014 and 2015, dealmaking remains on target to outstrip 2013. The M&A boom of the past two years may be slowing, but big deals are still getting over the line.

Indeed, this year has already seen China's Dalian Wanda buy production company Legendary Entertainment for over US$3.5B in January, while Verizon acquired Yahoo for US$5B in July. And in the networking and social media space, Microsoft agreed to pay US$26.2B for the social network LinkedIn.

Figure 1: Technology and media M&A leaps forward

Technology + Media M&A, 2011-2016



	H1 2011	H2 2011	H1 2012	H2 2012	H1 2013	H2 2013	H1 2014	H2 2014	H1 2015	H2 2015	H1 2016
Number of media deals	198	277	223	266	249	313	333	345	307	330	269
Number of technology deals	762	673	749	708	703	857	1075	1055	1175	1172	1108
Value of technology deals	77.5	84	68.8	68	64.3	107.3	121.9	103.2	204.7	219.3	151.3
Value of media deals	28.5	15.8	18.7	54.3	48.3	27.1	35.7	41	22.6	61.7	45.2

Chapter 1: The Digital Frontier

Media and technology companies are focused both on the quality and quantity of their content, and on how to distribute—and therefore monetize—what they have created. These twin-track priorities are reflected in the most popular sub-sectors of the industry for dealmaking. As Figure 2 shows, three of the top five priorities for M&A cited by respondents to this survey—digital media services, digital content creation, and digital publishers—are content-driven activities, while the other two—advertising/marketing technology and digital video distribution—are distribution-focused.

This is not to say that emerging technologies are not of interest to dealmakers. As the chart shows, there is significant attention being paid to a very broad range of developing trends, from the Internet of Things to wearable technologies, and from artificial intelligence to augmented or virtual reality.

Collectively, these emerging segments are set to account for a large chunk of M&A in technology and media; more than half the respondents in this research (52%) cited emerging technologies, in aggregate, as one of three most attractive areas of the industry for a deal. "We want to invest in companies that will help us improve our business," says the chief strategy officer of a Chinese company. "We are looking to develop further, diversify our revenues, improve our security and exploit new opportunities."

M&A is clearly an important strategic tool for many participants in the media and technology sectors: As Figure 4 shows, more than half the respondents (51%) are looking for deals in order to enter new market segments, while almost as many (47%) cite

Emerging technologies: One of the most attractive segments in the industry for a deal.

On which areas of the digital media and frontier technology sectors will you focus most of your M&A targeting?

52%

Emerging technologies (including IoT, live streaming, wearable technology, artificial intelligence, augmented reality/virtual reality/mixed reality, eSports, and drone technology)

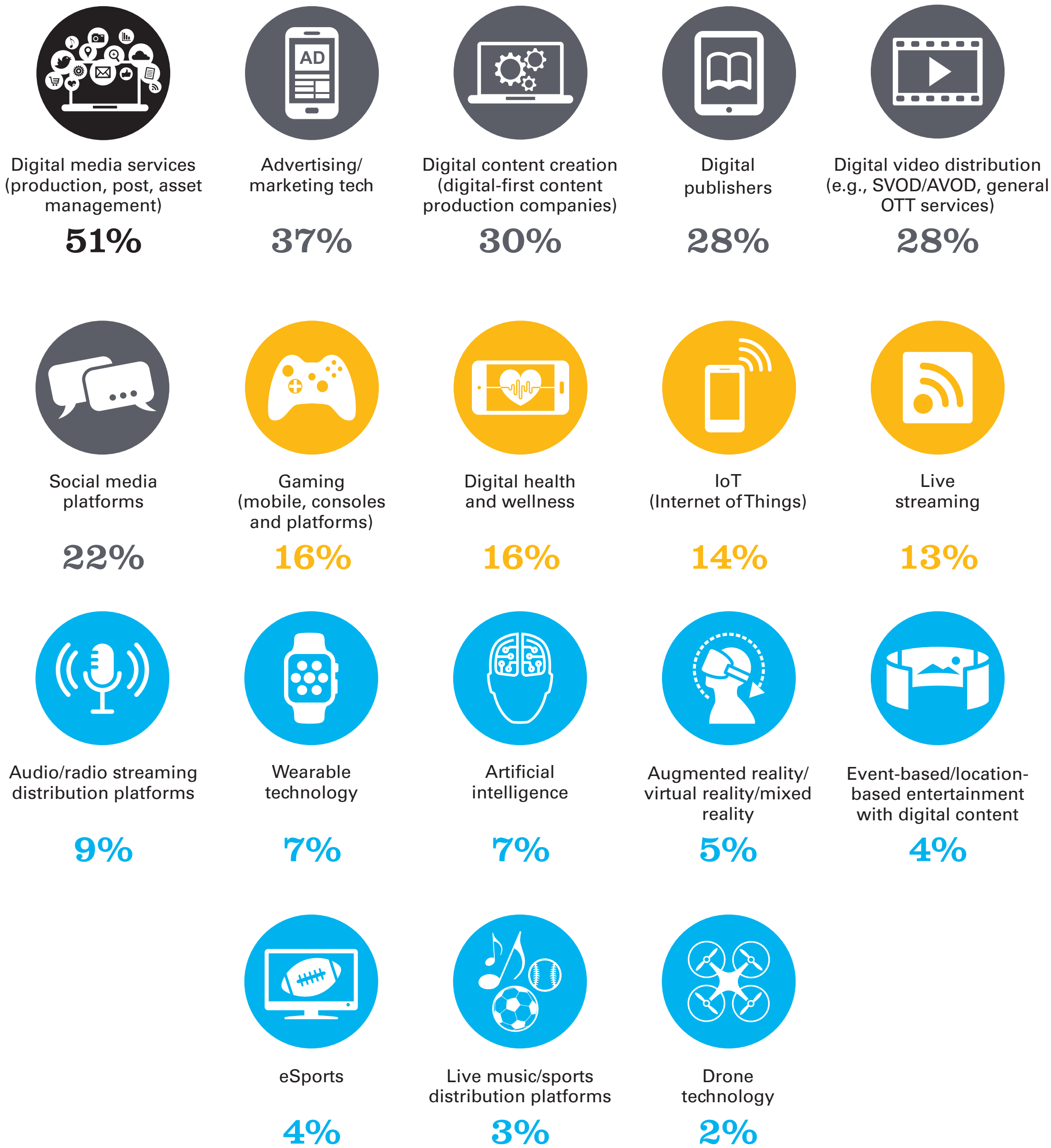
their desire to acquire strategic technology and patents. Often, deals are viewed as a way to get an edge on competitors—more than a quarter of respondents (28%) are interested in M&A that would enable them to be first into an emerging market or segment.

One good example of a deal where several of these motivations were drivers is Samsung Electronics' US$250M purchase last year of LoopPay. The deal gave Samsung a strong platform in the electronic payments market, with LoopPay's contactless technology, and a portfolio of intellectual property. Or look at Hitachi Data Systems' US$600M deal to buy Pentaho, a transaction that has put the multinational company at the forefront of big data, set to be a crucial market over the next decade.

Other important deal drivers include the desire to utilize available cash or cheap funding—reflecting the low interest rate environment that dominates much of the global economy—and the need to diversify revenue sources, which is important in industries where the pace of change is often relentless.

Figure 2: Where dealmakers are planning to target M&A

On which areas of the digital media and frontier technology sectors will you focus most of your M&A targeting in the next 12 months?



Regional breakdown

Gaming + publishing hot in China

In large part, respondents from different global regions share similar strategies when it comes to sub-sector targets. However, several noteworthy distinctions can be seen. Chinese acquirers, for instance, expressed less interest in advertising/marketing tech (20%) and digital content creation (16%), and relatively more focus on digital publishing (36%), gaming (24%), and live streaming (20%).

"We want to improve our gaming services and take advantage of the growth in this sector," said the CFO of a major Chinese media firm. "We also plan on investing to improve our security and make our overall platform perform better, as well as to reduce risks of piracy."

Figure 3: **On which areas of the digital media and frontier technology sectors will you focus most of your M&A targeting in the next 12 months?**

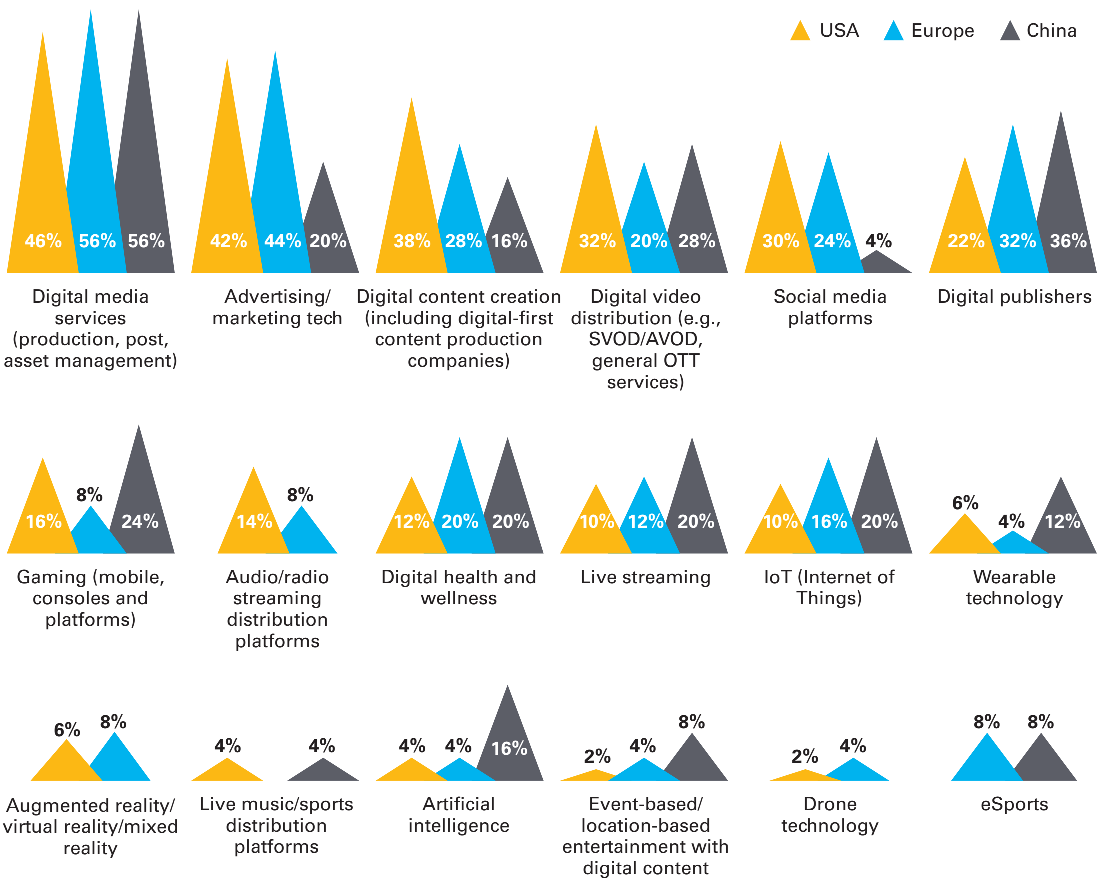


Figure 4: Why dealmakers are seeking M&A

What are your primary motivations for seeking M&A deals in the digital media and frontier technology sectors?

Entering new market segments	51%
Acquiring strategic technology and patents	47%
Seeking first-to-market status in an emerging segment	28%
Utilizing available cash, stock or cheap credit	20%
Positioning for market leadership	20%
Diversifying revenue sources	19%
Increasing monetization capabilities	17%
Acquiring content distribution platforms	16%
Acquiring data (analytical, business or consumer)	14%
Acquiring audience and market reach	14%
Entering new geographies	12%
Sending a signal to the market (e.g., regarding strategic positioning)	11%
Acquiring content pipeline	11%
Improving mobile functionality	6%
Competition migration	5%
Positioning for an IPO	4%
Vertical integration	2%
Seeking inorganic revenue growth	1%
Obtaining human capital	1%

Nevertheless, the consistent theme among respondents is a desire to be "first in the game"—to have first-mover or market leadership advantage in a particular segment or market. The chief strategy officer of a U.S. organization explains: "The market is changing and there is a need to invest in new segments in order to help us diversify – we need to increase market share and penetrate deeper across the market."

That is understandable given the rewards that have accrued to first-movers in many areas of technology and digital media in the past. However, it is also something of a risky strategy, with trailblazers in these industries regularly coming unstuck. In short, many M&A deals represent a gamble that may not pay off. There are plenty of examples of both. Facebook's US$2B bet on virtual reality device-maker Oculus Rift in 2014 has shown promise—since then, Oculus has driven the growth of an entirely new ecosystem of VR investors, creators, and consumers. Another lauded deal is Amazon's US$970M acquisition of eSports platform Twitch, which had an estimated 100 million unique monthly users in 2015.[1] By contrast, Yahoo paid US$1.1B for Tumblr, but this year had to write down US$482M of its value; it has consistently struggled to work out how to monetize the company.

[1] http://www.cnbc.com/2016/05/13/amazons-twitch-streamers-can-make-big-bucks.html

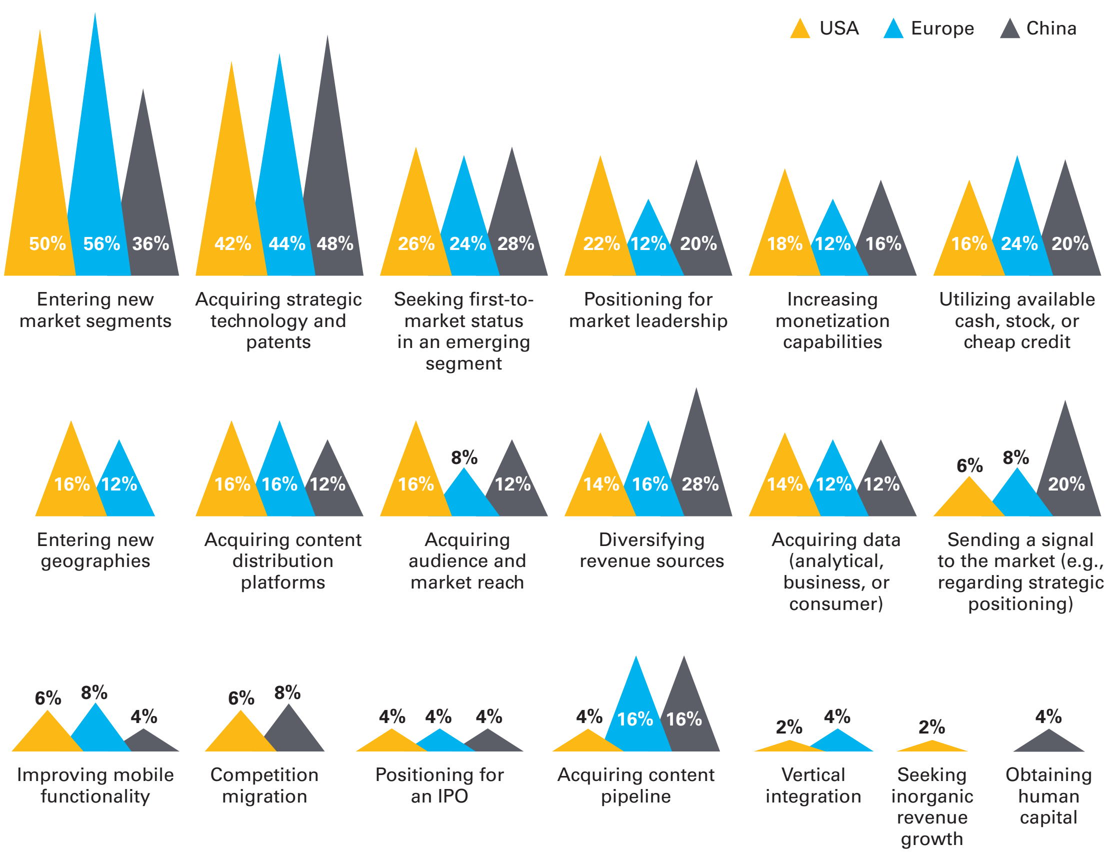
Regional breakdown

US + European acquirers seek new markets

US and European acquirers tend to be most interested in entering new market segments, with 50% of US respondents citing this as vital and 56% of European respondents saying the same. Chinese buyers, on the other hand, are more interested in acquiring strategic technology and patents (48%), as well as diversifying revenue sources (28%) and sending a signal to the market (20%).

"Investing in this sector is profitable—it is a very fast-emerging sector, and investing in startups helps us acquire new technologies and patents," said a managing partner of a German venture fund. "It also enables us to expand into new markets and market segments that are growing quickly."

Figure 5: **What are your primary motivations for seeking M&A deals in the digital media and frontier technology sectors?**



Such possibilities are reflected in the risks that dealmakers in technology and digital media perceive as most serious when considering M&A. As Figure 6 shows, almost half the respondents (45%) cite the fear of getting it wrong when they're assessing the importance or potential of a particular technology. Similarly, more than a third (37%) fear they may misjudge the growth prospects of a target company. More than a fifth (22%) point to the dangers of investing in a dynamic and developing marketplace.

These fears underline the challenge posed to businesses conducting M&A in digital media and technology, for they must also contend with more traditional deal risks. More than a third (35%) point to difficulties around legal or regulatory issues, for example, while 29% fear they may not come to grips with the details of target companies' markets.

The risk of a cultural mismatch is also a major concern, cited by 34% of respondents. This may be a particular fear for larger companies making smaller acquisitions, where the possibility of a clash between a major corporate organization and a more entrepreneurial startup business is very real.

Valuations are also a concern for a significant number (21%) of respondents; given the boom of the past few years, the fear of overpaying is likely to be well founded.

Often, many of these risks are over-linked. "Wrongly evaluating a company's potential can be really detrimental to our business and is expensive because these organizations are highly valued and there are many competitors looking to invest," says the director of strategy at a U.K. business. "Plus regulation, especially in the European Union, has been making our lives tougher."

Case study

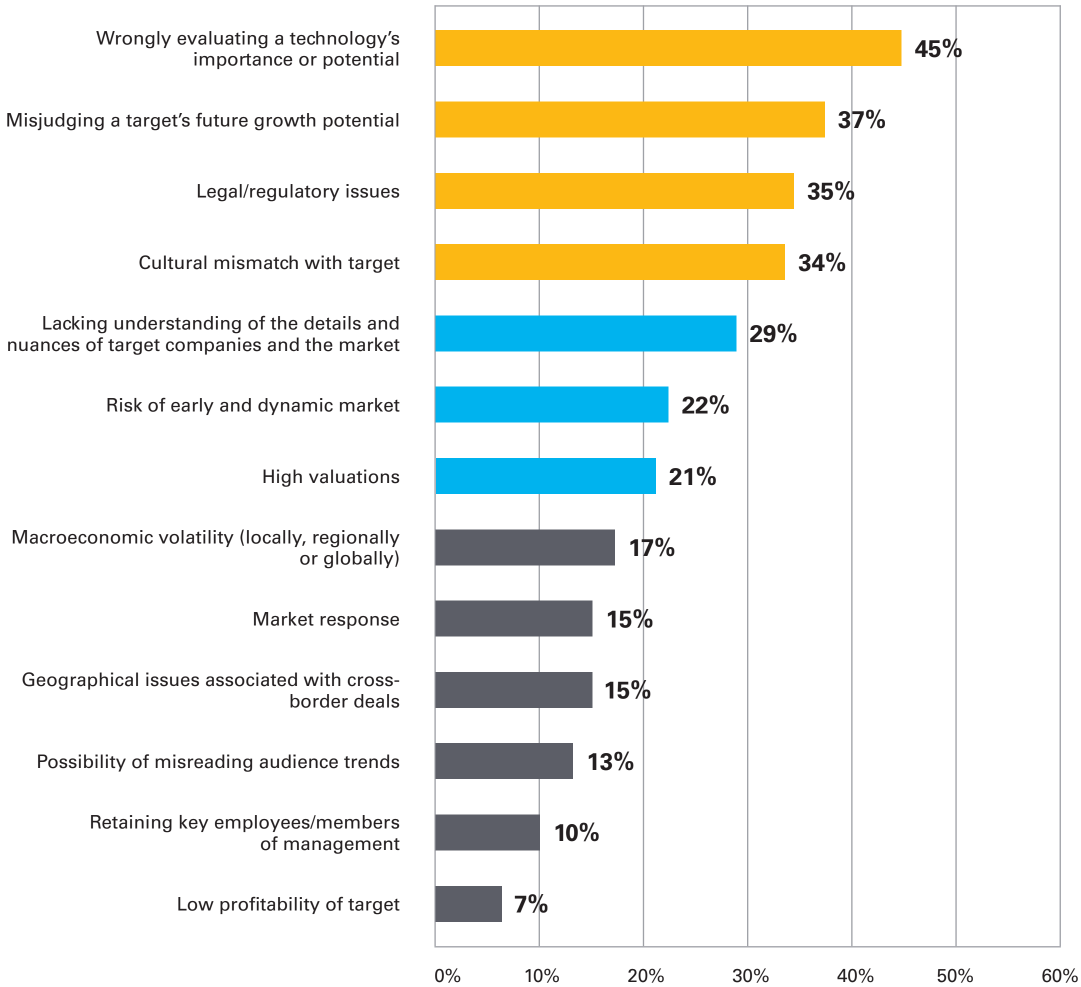
Creating a game-changing digital strategy

In high-stakes situations, it is necessary for a company to ensure that it is putting its best foot forward both in performance and in strategy. This is especially the case when a company is looking to attract a sizeable investor and position itself to be acquired. So, when a highly regarded production studio sat down at the table with a large media conglomerate to discuss the opportunity for investment, they were surprised to learn that their proposed valuation was significantly lower than expected. When they asked why, they were told their future growth plan was missing a digital strategy. After receiving this feedback, the company engaged Manatt Digital to develop a digital strategy and plan to enhance their overall enterprise value.

Our team rolled up our sleeves and in four weeks, developed and recommended an authentic digital strategy and roadmap toward monetization of digital-first content, as well as strategic messaging and positioning. We provided our guidance and recommendations, as well as content for the investor pitch deck that helped our client articulate their digital approach to strategic partners and the marketplace. As of September 2016, our client had implemented our recommendations and was closing on an offer that far exceeded their initial valuation.

Figure 6: The risks of M&A in digital media and technology

What are the biggest risks/challenges when considering M&A deals in the digital media and frontier technology sectors?



M&A hunting grounds

Where are dealmakers looking for M&A targets and what type of company are they most interested in finding? In geographical terms, as Figure 8 shows, while almost every business is eager to pursue deal opportunities in their own markets, the appetite for cross-border M&A has slowed somewhat, and particularly so for global deals.

That may reflect a variety of factors, including the relatively fragmented nature of digital media and technology, the current volatile macroeconomic and geopolitical climate, and the elevated risk of cross-border deals, given the already considerable challenges to M&A.

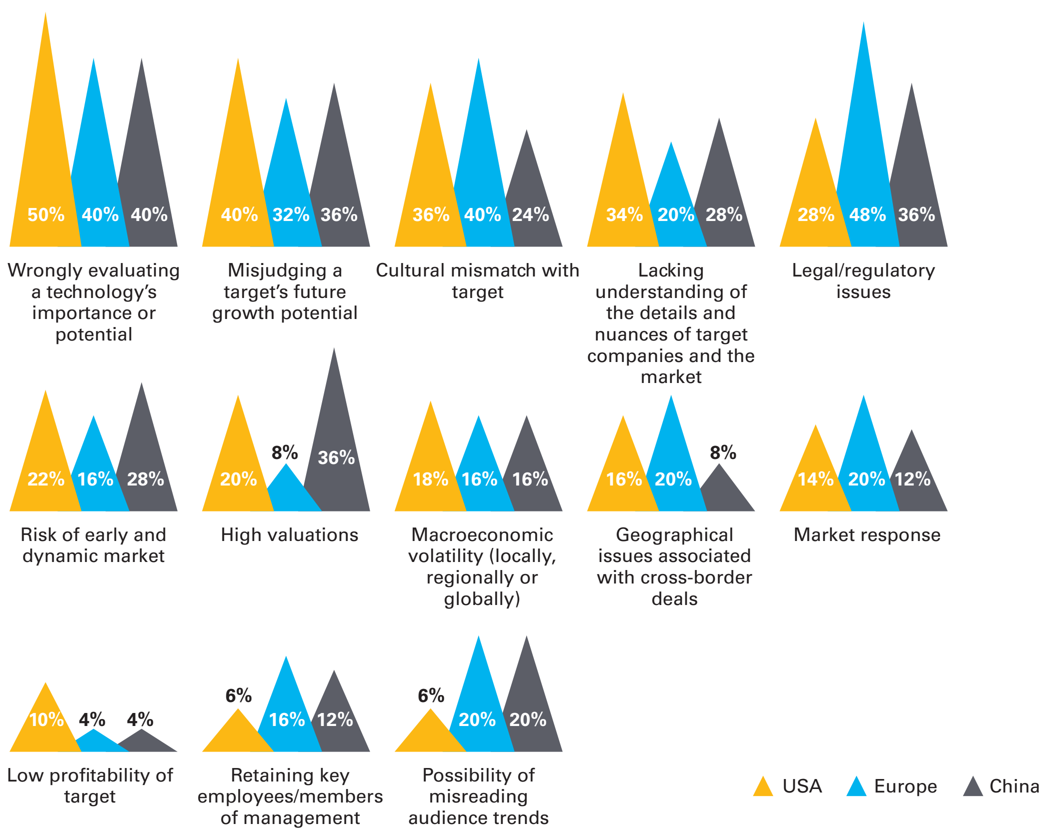
Regional breakdown

European firms wary of regulation

For European buyers, the biggest challenge in media and technology deals is legal and regulatory issues (48%). Indeed, European Union regulators have shown themselves to be some of the toughest in the world when it comes to companies in these sectors, bringing landmark cases against the likes of Google and Apple in recent years.

Chinese purchasers are also concerned with regulatory problems (36%) as well as high valuations (36%). "When investing in the US, Japan and Korea, rules and regulations change quickly and this makes it difficult for us to carry out investments," said a managing director at a Hong Kong-based private equity firm. "Many times companies in this sector are also highly priced, and this can make it risky and expensive to make acquisitions."

Figure 7: **What are the biggest risks/challenges when considering M&A deals in the digital media and frontier technology sectors?**



44% of respondents who target frontier tech acquisitions are concerned about legal issues when doing M&A deals. For comparison, just 31% of respondents with a digital media focus cite legal problems as a serious risk. One partner at a venture capital fund with a diverse range of technology investments explained that regulatory issues can be especially thorny in cross-border deals. "When you're working in a foreign jurisdiction, there are always differences in the regulatory environments," the VC partner said. "These can be time-consuming to fully understand and to cope with."

Another respondent, a partner at a Hong Kong-based private equity firm, said that it had become "difficult to invest in new regions" due to stringent legal requirements, as well as regulators that "scrutinize investments very closely."

Sub-sector M&A spotlight

Digital media

The digital media world has seen an abundance of intriguing deals so far in 2016, across various segments and valuation levels. Overall, there were 269 media deals of over US$5M in value in the first half of 2016, worth a total of US$45.2B, according to Mergermarket data.

One of the central trends in dealmaking has been the transformation of traditional media companies toward building and growing out their digital assets. For instance, in early September, newspaper giant Gannett announced an investment in social media company Digg, reported to be in the seven figures. At the same time, native digital companies are attracting increasing amounts of funding. For example, Defy Media, holder of web franchises such as Smosh and Screen Junkies, attracted US$70M in series B funding earlier this year.

One other interesting trend has been U.S.-U.K. cross-border deals. In September 2016 alone, there were three such deals—despite the uncertainty bred by Brexit—including U.K.-based Informa Group's US$1.5B purchase of U.S. communications company Penton Media.

Frontier technologies

Digital segments that sprang up just a few years ago, such as artificial intelligence and virtual and augmented reality, are quickly becoming highly sought-after. One of the most popular of all has been virtual and augmented reality. According to data from CB Insights, venture funding to the segment had already surpassed the 2015 total by 85% in July 2016. This was led by Magic Leap's US$793M series C fundraising in February.

It's not just venture capital investing in these categories either. Software maker Salesforce.com has purchased three artificial intelligence firms in just the past two years: deep learning companies MetaMind and PredictionIO, as well as smart calendar producer Tempo AI, all for undisclosed sums.

Sub-sector M&A spotlight continued

Digital health + wellness

The healthcare industry continues to see a boom in activity due to demographic trends, and digital health is receiving increasing infusions of investment dollars. In Q1 2016, venture funding to the segment rose 13% to a total of US$981.3M, according to Rock Health. Significant recent deals have included a US$175M series C round for oncology software maker Flatiron; a US$95M growth equity raising by information provider Healthline; and One Medical Group's US$20M acquisition of nutrition app maker Rise Labs.

The number of sub-segments within digital health is growing as well. In addition to traditional spheres such as big data and wearables, artificial intelligence tools are beginning to be given serious attention. More than 50 AI-focused medical startups have raised their first equity round since the start of 2015 alone, according to CB Insights.

Gaming + eSports

The gaming sector has seen a major influx of funding, as new mobile franchises emerge and segments such as eSports gain in popularity. Tencent Holdings made an ambitious bet in June 2016 with its US$8.6B purchase of Finland's Supercell Oy, maker of Clash of Clans. Another recent deal saw Microsoft's Xbox unit acquire Beam, a live-streaming eSports service, for an undisclosed sum in August 2016.

Chinese companies have shown especially strong interest in gaming targets, even when the acquirers are not in the gaming business at all. Take the case of Leyou Technologies, a Hong Kong-listed company that has a large number of chicken farming assets in China. Recently, it also began buying firms such as Splash Damage, a British video game developer, for which it paid US$150M.

As for size, many participants in M&A in digital media and technology appear to be agnostic – Figure 10 reveals that almost two-thirds of respondents (61%) do not target deals of a particular size. In other words, they are focused on the nature of the opportunity rather than its scale.

Among the 39% of dealmakers that do prefer to target a certain deal value, the focus is largely on small- to medium-size companies, Figure 9 suggests, though not necessarily the very smallest companies of all. "We prefer to invest in companies that have been around for a while," says the managing director of a U.S. private equity firm. "We want to see how well they have been able to perform and what that might mean for our investment."

In many ways, this is understandable—the smaller the business, very often the larger the risk. Given many respondents' fears of getting the deal wrong, a strategy of avoiding the minnows of the sector makes sense. On the other hand, the risk is that

Figure 8: Domestic M&A suits more dealmakers

In terms of geography, how would you categorize your most frequent transactions in the digital media and frontier technology space?

99%

Domestic

63%

Regional (target based on same continent)

42%

Global (target based on different continent)

Figure 9: Dealmakers seek small to medium-size targets

If yes, which range(s) of deal value do you typically target?

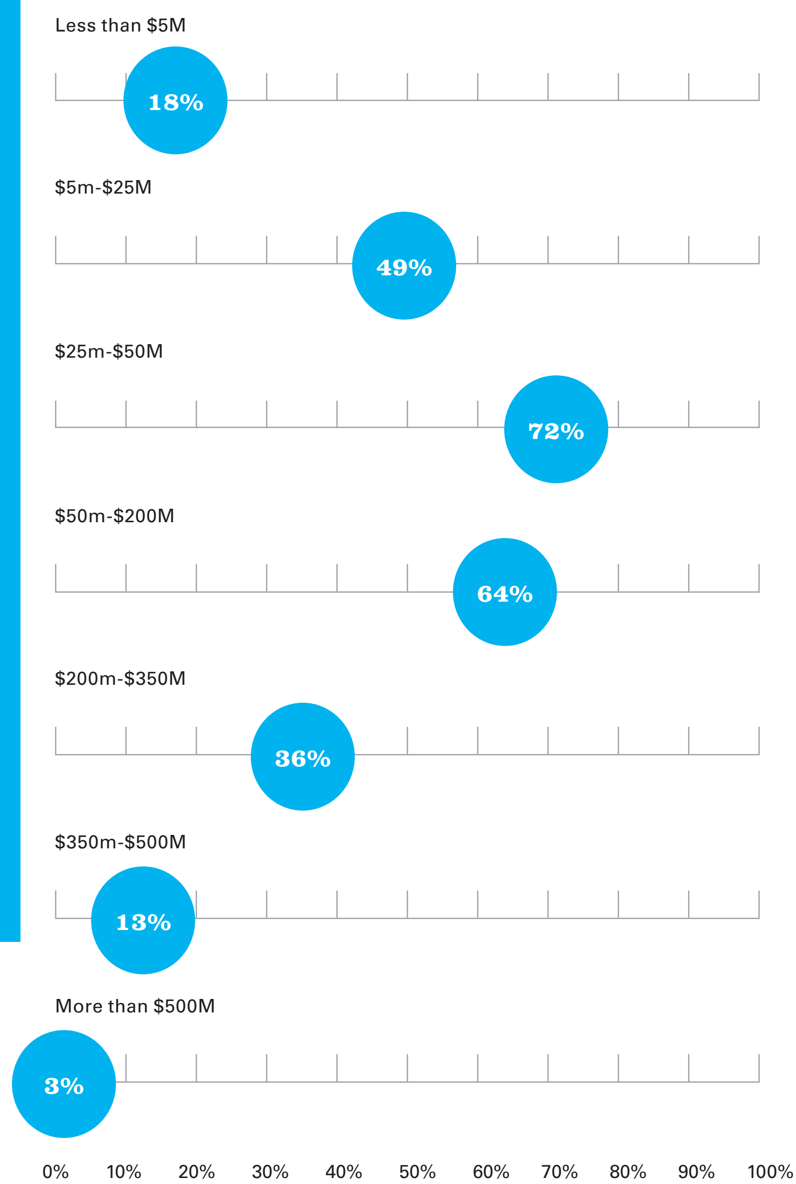


Figure 10: Does size matter?

When considering potential digital media and frontier technology acquisitions, is there a specific deal value that you target?

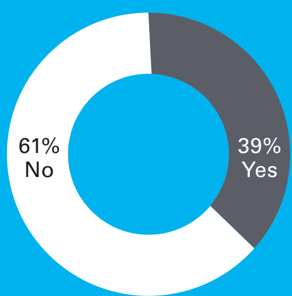
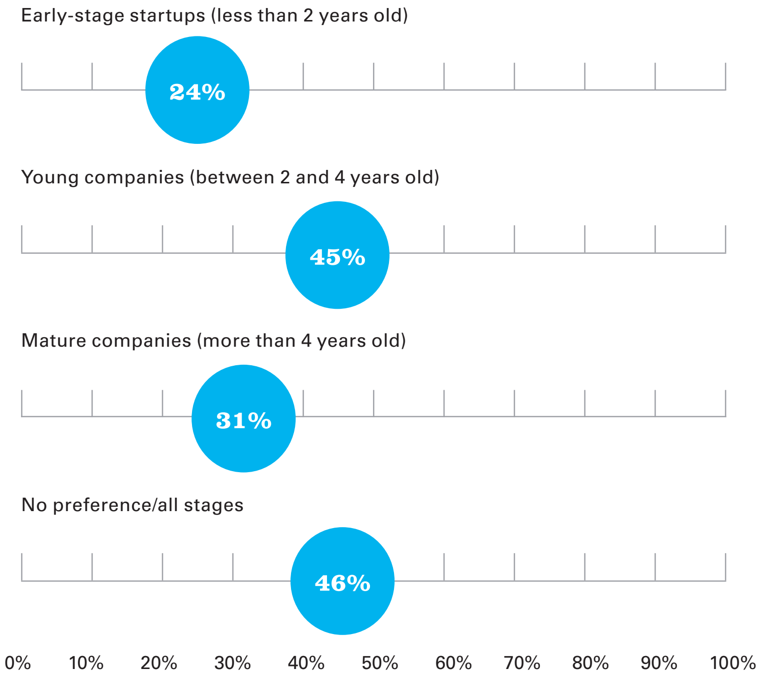


Figure 11: Startups less popular

At which development stage(s) are the digital media and frontier technology companies that you typically target?



by waiting for a company to scale up before considering an acquisition—to prove it is less of a risky bet, in other words—dealmakers will see one of their rivals move in more quickly. Valuations for larger businesses with more established track records are also likely to be more heady.

Figure 11 charts respondents' views of high-risk deals in a slightly different way but with similar results. Of the roughly one in two respondents (54%) that tend to look for businesses at a particular development stage, less than a quarter (24%) are targeting early-stage startups. Close to half (45%) prefer established startups aged between two and four years, while almost a third (31%) want even more mature businesses.

This is a difficult trade-off for dealmakers to get right. Startup businesses are dogged by high failure rates, particularly in industries such as digital media and technology, where it is notoriously difficult to assess market trends or to separate the winning technologies of the future from the also-rans. Yet some dealmakers may take the view that they only need one or more of these very early-stage investments to provide a mega payday in order to more than compensate for potential losses on other deals. "It is the startups that have the technologies with potential to really disrupt the market," argues the chief financial officer of a U.S. business.

Regional breakdown

Scandinavia heads the list of favored destinations

While many dealmakers in the digital media and technology sectors are reluctant to pursue international transactions, those that are considering cross-border M&A are eschewing the more obvious markets of the US and India in favor of other destinations. Most strikingly, as Figure 12 shows, Scandinavia is a target for 49% of respondents considering an overseas deal.

This may reflect the advanced adoption of certain technologies in the region. For example, Sweden and Denmark now lead the world in terms of moving toward a cashless society.[2] The region has also seen the emergence of startup businesses that have gone on to become global champions—Nokia, Ericsson, Spotify and Skype are just some of the examples; the hunt for their successors may be one reason why Scandinavia is a favored destination.

Last year, for example, saw China's Tencent pay US$8.9B for Finland's Supercell, maker of the popular Clash of Clans game. In the same sector, the U.S. gaming company Activision Blizzard picked up Sweden's King.com—best known as the maker of Candy Crush—for US$5.9B. Some deals in Scandinavia were smaller—for example, Germany's Nemetschek paid US$49M for software sector peer Solibri of Finland, while Gravity4 of the U.S. acquired Conyak of Denmark for US$29M in an internet market and advertising tie-up.

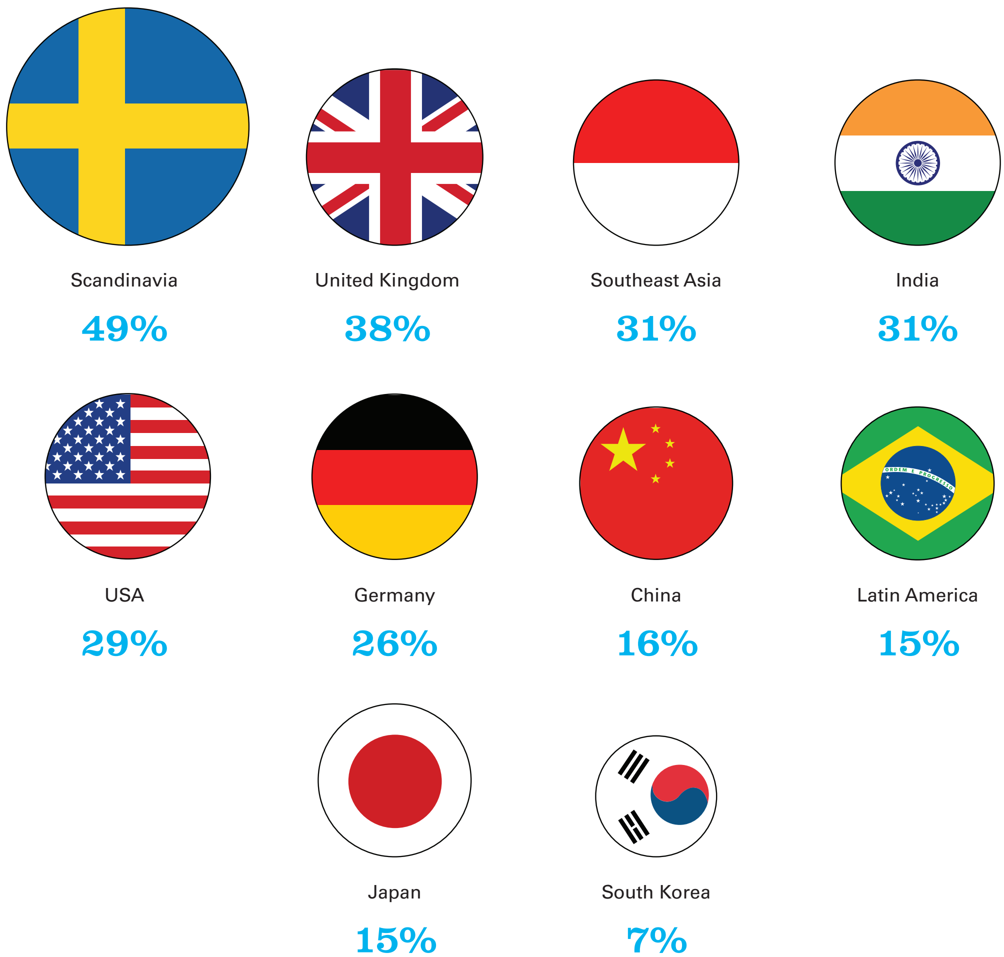
As for the U.K., the fact that the country is the second most popular destination cited by respondents will reassure those who feared the Brexit decision, in which the U.K. voted to leave the European Union, would deter overseas investors. The U.K.'s burgeoning financial technology sector—the world's most important by some measures[3]—is one obvious attraction. The purchase of London-based payments technology specialist VocaLink by MasterCard, a US$871M deal, is just the latest transaction in the U.K. fintech sector.

Meanwhile, in the U.S., which is home to the world's largest digital media and technology industries, the comparative lack of appetite for M&A among international investors may be explained partly by the high valuations on which U.S. businesses in these sectors now trade[4] after a sustained period of dealmaking. The high level of competition from domestic investors is also likely to be a significant factor.

[2] http://www.cityam.com/242726/the-war-on-cash-is-raging-should-we-welcome-of-fear-the-death-of-hard-money-
[3] https://www.gov.uk/government/news/fintech-week-2016-report-finds-britain-to-be-the-worlds-leading-fintech-centre
[4] http://www.wsj.com/articles/linkedin-and-the-tech-valuation-boom-1465858665

Figure 12: Focus of digital media and frontier technology M&A targeting

If you do cross-border deals, in which regions/countries do you expect to focus most of your digital media and frontier technology M&A targeting in the next 12 months?



Chapter 2: Ready, Aim, Acquire

Most dealmakers draw on a broad range of resources throughout the process of setting M&A strategy and targeting, and due diligence, both internally and externally. This is especially crucial in digital media and technology—fast-moving industries where competition for transactions is tough and risk levels are elevated. "M&A requires the involvement of a wide group," argues the managing director of a Hong Kong-based investment bank. "You need specialized people for particular tasks and no single team can handle all the responsibilities."

As Figure 14 reveals, that spread comes into play right from the beginning, as M&A targets are sought. Nine in ten respondents in this research use an internal M&A team to identify potential targets, but dealmakers draw on other resources too. Almost two-thirds (64%) employ legal advisors at this early stage, more than half (53%) use strategic consultants and more than a third (39%) work with investment bankers or other financial advisors. It is also interesting to note the use of technology, with 36% of dealmakers relying on online research tools (such as Mergermarket).

Nevertheless, there are omissions here too. Most obviously, slightly less than three-quarters of respondents (74%) say their senior management is engaged in M&A strategy and targeting. It may be that only certain members of the leadership team are embedded in the strategy unit, but those outside of the tent will need to provide their input at the earliest possible stage.

Figure 13 shows that, for half the respondents in this research, a roughly equal balance of internal and external advisors drive the strategy and targeting process, with very few companies—just 11%—more dependent on outside advisors.

Figure 13: Internal or external strategists?

Who do you rely on more in the strategy/targeting process – internal team members or outside advisors?

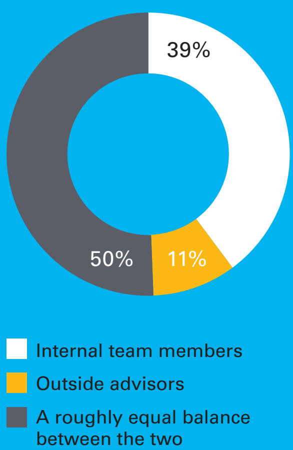


Figure 14: Where M&A strategy/targeting is conducted

When conducting strategy/targeting for digital media and frontier technology acquisitions, which types of resources do you typically use?

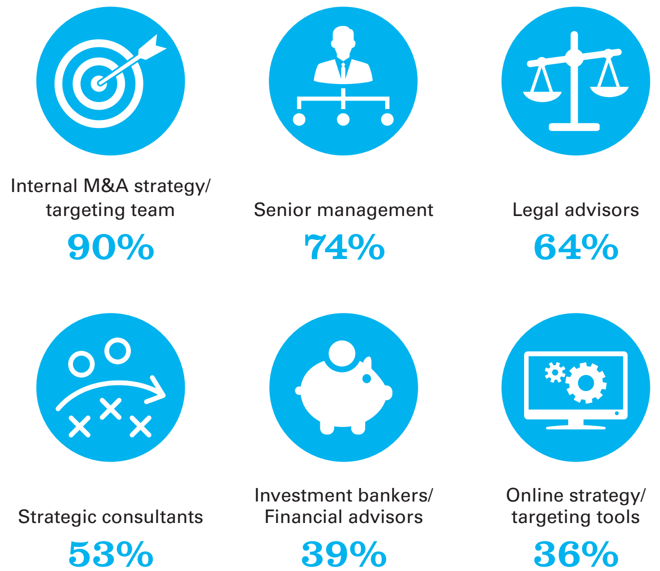
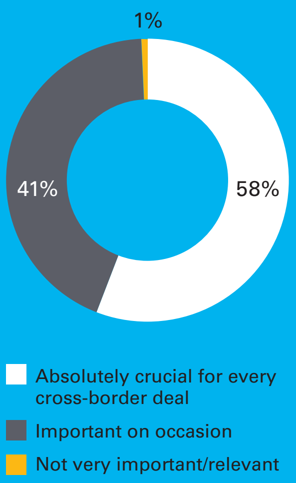


Figure 15: The need for regional resources

How important is it that the strategy/targeting process for cross-border deals include regional and/or global resources (i.e., company employees or advisors in the country/region being targeted)?



However, Figure 15 flags another potential flaw in the targeting process of some dealmakers: While more than half those dealmakers that conduct cross-border deals (58%) regard the services of local specialists in targeted markets as essential, a significant number (42%) don't think this is crucial for every deal.

That may leave dealmakers open to unnecessary risk, given the difficulties of cross-border M&A in the digital media and telecoms sectors—from legal and regulatory issues to the potential for cultural mismatches. It also contrasts with the position on due diligence, where 81% of dealmakers regard having country or regional specialists as crucial for every cross-border deal (see Figure 18).

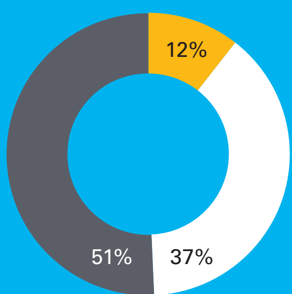
Once dealmakers do get to the due diligence stage, they show the same determination to draw on a wide range of resources to ensure they make the right judgments. As Figure 17 shows, more than nine in ten respondents (93%) employ third-party due diligence firms when conducting due diligence—likely to be higher in digital media and technology acquisitions than in other industries, given the detailed and specialist work required to get this right—while almost as many (90%) rely on their own internal teams.

"It is difficult for any single team to get the best results," insists the head of M&A at a Norwegian business. "We prefer to involve experts from every relevant field. As a result, the work gets done more quickly and the quality of the inputs is higher."

Again, however, it is surprising that the number of dealmakers engaging their senior management teams in due diligence efforts is more limited, at 70%, particularly if diligence extends to considering issues such as strategic fit and cultural alignment. Many businesses do rely heavily on their legal advisors, with 70% looking to these consultants to provide detailed diligence work.

Figure 16: Internal or external diligence?

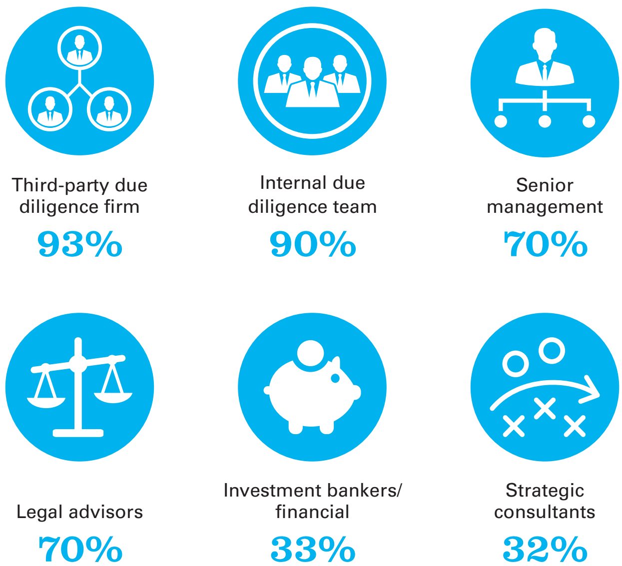
Who do you rely on more in the due diligence process—internal team members or outside advisors?



- Internal team members
- Outside advisors
- A roughly equal balance between the two

Figure 17: Due diligence is a team endeavor

When conducting due diligence for digital media and frontier technology acquisitions, which types of resources do you typically use?

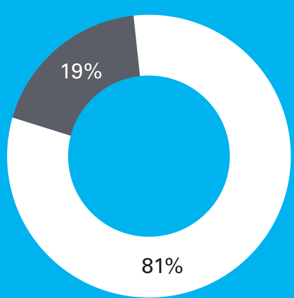


It is also striking that dealmakers are significantly more likely to rely on outside advisors for due diligence than for targeting and strategy. As Figure 16 shows, while half the respondents (51%) to this research say they depend on a roughly equal balance between internal and external advisors, more than a third (37%) rely most on external consultants—more than three times as many who said the same for targeting and strategy.

The specialist nature of the due diligence process—and the traps businesses can fall into by missing something important—is crucial here. And where deals have an international dimension, this becomes more important still; the vast majority of dealmakers depend on local experts to help with due diligence during a cross-border transaction (see Figure 18).

Figure 18: The need for regional resources

How important is it that the due diligence for cross-border deals include regional and/or global resources (i.e., company employees or advisors in the country/region being targeted)?



It is clear that the due diligence process is not straightforward when it comes to digital media and frontier technology transactions. Figure 21 and Figure 22 reveal that the three aspects of the process respondents consider most crucial for deal success are also the three most challenging tasks to get right.

The list of challenges is led by the difficulty of valuing a target's real assets, cited by three-quarters of respondents (75%). In businesses where subjective judgments such as the value of data and proprietary tools may be required, this is indeed a difficult task. This is one reason why so many companies depend on external advisors to help them with the due diligence process.

Related to that is the question of intellectual property, another crucial consideration in many technology and media deals—and cited as a due diligence priority by more than a fifth (22%) of respondents. The fact that only 16% see it as a challenge may suggest an element of complacency.

It is also striking that, while more than a third of respondents (36%) see it as vital to assess the value of the target's existing and potential markets, an even greater number (39%) regard this as one of the toughest challenges. The figures underline why so many participants in the digital media and technology M&A space see the potential for misjudging the potential of a company or market as such a big risk, as we saw in Chapter 1.

This is not to downplay other substantial due diligence challenges where dealmakers may require expert assistance. Significant numbers of respondents point to challenges, such as the need to evaluate financial health, the difficulty of identifying underlying red flags, and the integration planning process.

Regional Breakdown

Chinese acquirers practice self-reliance

One of the starkest differences found between Chinese and Western acquirers in our survey appeared in answers to questions regarding the use of internal team members vs. outside advisors in due diligence, as well as targeting and integration. While just 4% of U.S. and European respondents said they rely most on their internal teams during due diligence, 38% of Chinese respondents said they do. In addition, while over 80% of U.S. and European participants said global resources are crucial for every cross-border deal, just 52% of Chinese participants said they agreed. This was led by Magic Leap's US$793M series C fundraising in February.

Figure 19: **U.S. vs. Europe vs. China: Who do you rely on more in the due diligence process—internal team members or outside advisors?**

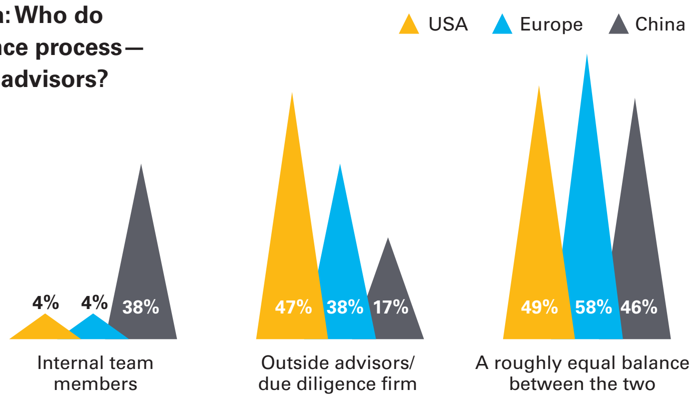


Figure 20: **U.S. vs. Europe vs. China: How important is it that the due diligence for cross-border deals include regional and/or global resources (i.e., company employees or advisors in the country/ region being targeted)?**

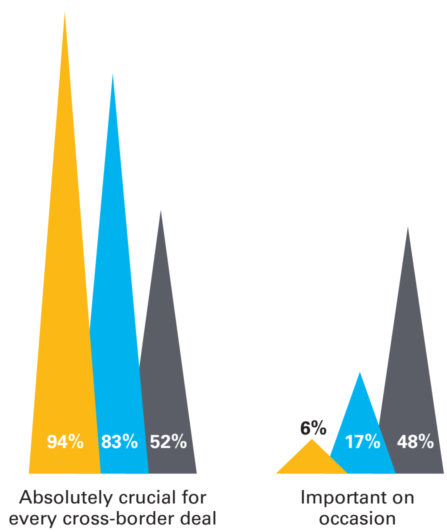


Figure 21: Due diligence imperatives revealed

When conducting due diligence on a potential digital media or frontier technology acquisition, which aspects of the process do you think are most vital?

Valuing a target's real assets, including data, technology and hard assets	60%
Identifying legal/regulatory issues	41%
Assessing the value of existing and target audiences/consumers	36%
Identifying underlying red flags	28%
Evaluating financial health and forecasts	28%
Valuing a target's intellectual property + proprietary technology	22%
Evaluating the competitive landscape	21%
Identifying potential synergies	18%
Evaluating human capital and interdependencies	12%
Evaluating IT + cybersecurity infrastructure	12%
Vetting senior management's knowledge/expertise	11%
Planning for potential integration issues	9%
Vetting non-senior employees' knowledge/expertise	2%

Figure 22: The difficulties of getting due diligence right

When conducting due diligence on a potential digital media or frontier technology acquisition, which aspects of the process do you think are most challenging?

Valuing a target's real assets, including data, technology and hard assets	75%
Identifying legal/regulatory issues	45%
Assessing the value of existing and target audiences/consumers	39%
Evaluating financial health and forecasts	34%
Identifying underlying red flags	28%
Evaluating the competitive landscape	22%
Valuing a target's intellectual property + proprietary technology	16%
Planning for potential integration issues	12%
Identifying potential synergies	10%
Evaluating human capital and interdependencies	8%
Vetting senior management's knowledge/expertise	6%
Evaluating IT + cybersecurity infrastructure	3%

Finally, it is worth pointing out that, while 80% of respondents are prepared to take their time over due diligence—and to extend their timelines if necessary to complete the vetting process—20% are focused on finishing the process quickly. While beating the competition and securing synergies are understandable drivers of the desire for speedy diligence, it is important dealmakers do not expose themselves to unnecessary risk.

"The prime reason to conduct due diligence is to obtain all relevant information of value, so we do not hurry," says the senior vice president of a U.S. business. "We expand the diligence timeline according to need, because finishing in urgency, curbing the time you have available, only causes losses."

Case Study

Helping create a "great buyer"

Rapid speed through inorganic growth was the mandate for a global media company. Based on prior difficult integrations and in preparation for the execution of this strategy, our client asked Manatt Digital to position them to be a world-class buyer.

The goal was to make each acquisition effective and efficient from start to finish, creating the need for a standard approach for due diligence, transaction and integration across processes, systems, organizational and operational planning and legal procedures. By drawing on Manatt Digital's full-service capabilities and breadth of experience, our client asked Manatt Digital to create a deal-flow process. We leveraged best practices while providing a custom solution tailored to meet the company's objective. With a target under LOI, we initiated the due diligence process, evaluating all aspects of the company, including operations, sales, finance, product, data, systems and human capital. We made immediate recommendations and identified risks that were critical to the overall transaction.

The strategy was smart. We helped make our client more efficient in their acquisition practices, nimble enough to quickly respond and move on to new target opportunities without timing or process constraints, and able to not deflate the excitement and critically important "spirit" from a deal. This approach is instrumental in effectively optimizing the investments and helping our client reach their growth potential.

Chapter 3: The Challenges of Integration

Once dealmakers get an M&A transaction over the line, their focus must turn to integration, and in the rapidly evolving digital media and frontier technology sectors, where the market landscape may have changed significantly since the deal was first proposed, this can be particularly challenging.

Time is of the essence, warns the chief strategy officer of a U.S. company. "The post-merger integration process is a time-consuming task, but it has to be completed within the right time frame to ensure synergies and value are not lost," the executive warns. "We have to finish the process quickly to secure the financial advantages and avoid operational disruption."

The integration process is likely to depend on a number of key stakeholders. As Figure 24 shows, more than nine in 10 respondents (93%) operate with an internal integration team, but most also rely on external resources – 86% employ legal advisors, while a striking 56% utilize strategic consultants to help with integration.

Figure 23: Internal vs. external advisors?

Who do you rely on more in the integration process—internal team members or outside advisors?

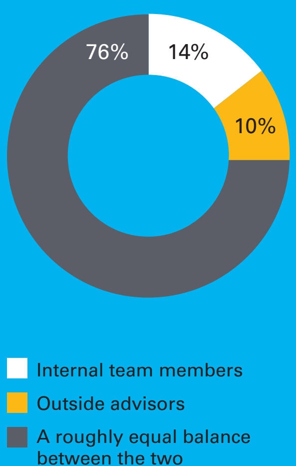


Figure 24: Integration resources required

When conducting post-merger integration for digital media and frontier technology acquisitions, which types of resources do you typically use?

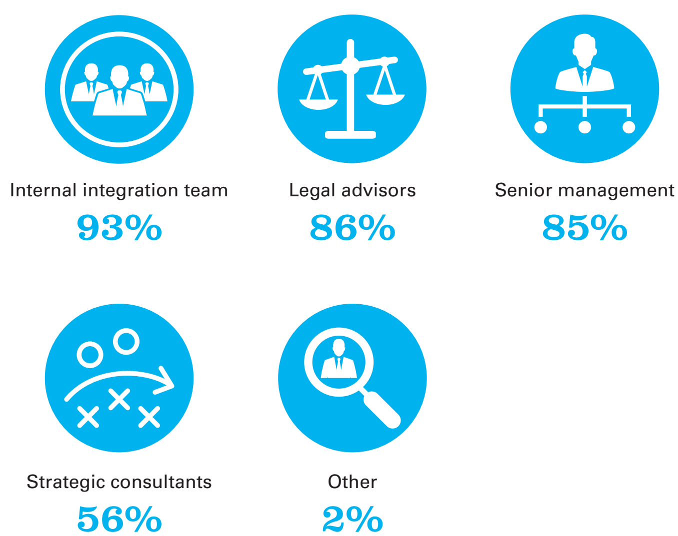
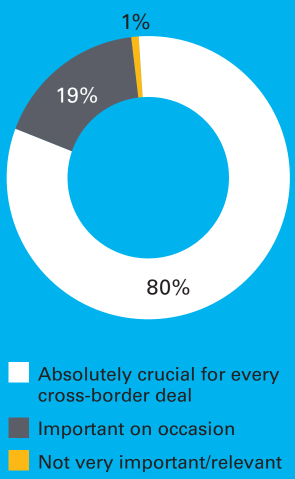


Figure 25: Local support with integration

How important is it that the integration process for cross-border deals include regional and/or global resources (i.e., company employees or advisors in the country/region being targeted?)



Three-quarters of the respondents to this research depend roughly equally on internal and external advisors to help them with integration (see Figure 23), while the majority engaged in cross-border deals, some 80%, say they regard it as vital to have local specialists involved in this process (see Figure 25). By contrast, the remaining 20% may find they run into trouble during the integration process if local expertise is not available to support integration of what may be very different types of organizations.

This lack of local knowledge comes into stark reality when we see that cultural fit is very often the most significant challenge during integration – and the most vital task. Figure 26 shows that 39% of respondents to this research see integrating work cultures as the most vital aspect of the integration process, more than any other single priority; but this is far from easy, with more than half the respondents (51%) citing it as the most difficult thing to get right following a deal.

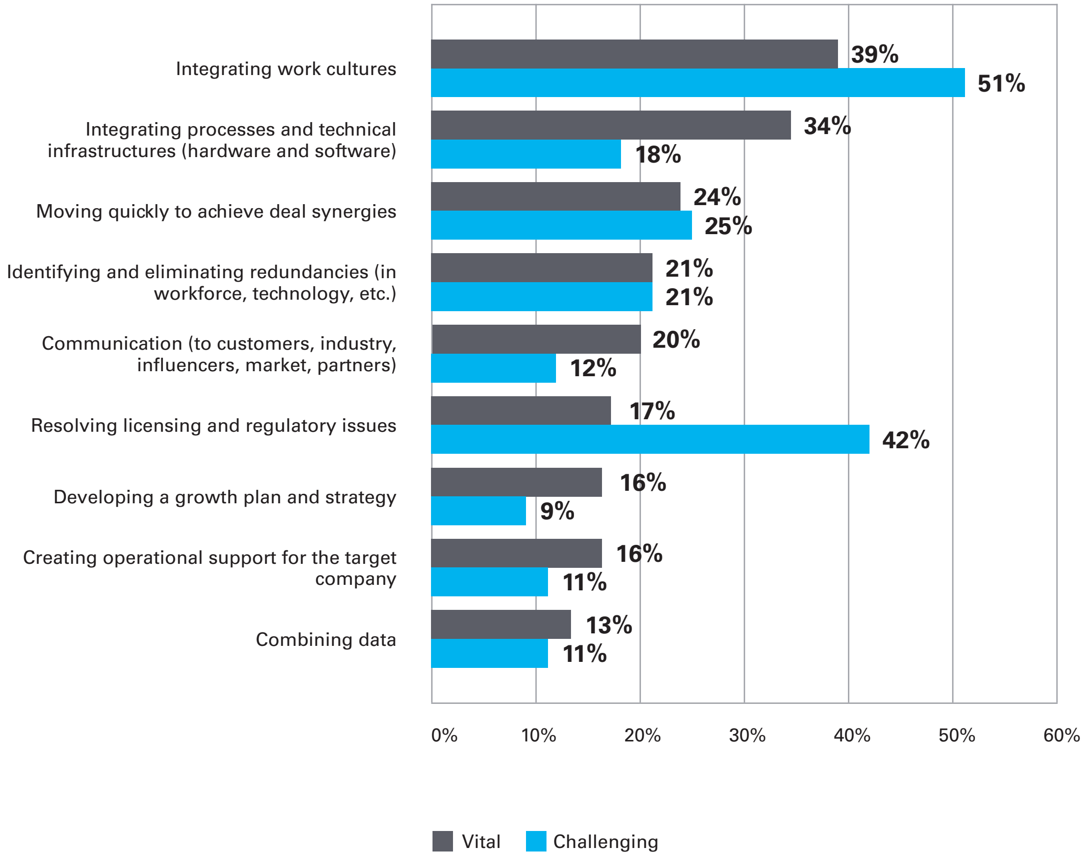
Still, the prize is worthwhile, says the executive director of M&A at a German business. "Combining two different work cultures is challenging but essential," the director says. "When two firms put their differences aside and work on the same strategies, that is when the deal turns out to be most successful."

It's in this area that external advisors, with experience of working with different types of organizations in different locations—but also with expertise on cultural alignment—may be able to add significant value. It is also important, however, for dealmakers and their senior leadership to consider cultural issues before completion: For example, in some circumstances, it may be appropriate for an acquirer to take a hands-off approach following a deal, while in other cases the need for integration and alignment may be more pressing, particularly if the transaction is partly predicated on operating strategies.

Not that other integration challenges can be ignored. Licensing and regulatory issues will need to be addressed quickly—cited as potentially problematic by 42% of respondents—while physical integration of assets, people and processes will be important but challenging too. One in five dealmakers (20%) points to the importance of communication—it is crucial that customers, suppliers, partners and other stakeholders are kept informed about how the organization is changing.

Figure 26: The most pressing integration issues and integration challenges

When it comes to integrating a digital media or frontier technology acquisition, which aspects of the integration process do you think are most vital and most challenging?



Regional breakdown

Integration differences

When it comes to post-merger integration, certain regional distinctions can be seen, especially with regard to European and Chinese acquirers. For European respondents, integrating work cultures is seen as highly important (52%), while the combining of technical aspects of the businesses is given less emphasis (16%). By contrast, Chinese respondents focus most on the technical side (48%) and are relatively less concerned about culture (32%). Also noteworthy is the priority of many Chinese companies to move quickly to achieve deal synergies (28%).

“The work culture of every firm is unique, and this applies to their working processes as well,” said the director of M&A at a British communications firm. “It is very important during any integration to combine the work cultures to maintain the smooth working of operations.”

Figure 27: **When it comes to integrating a digital media or frontier technology acquisition, which aspects of the integration process do you think are most vital?**

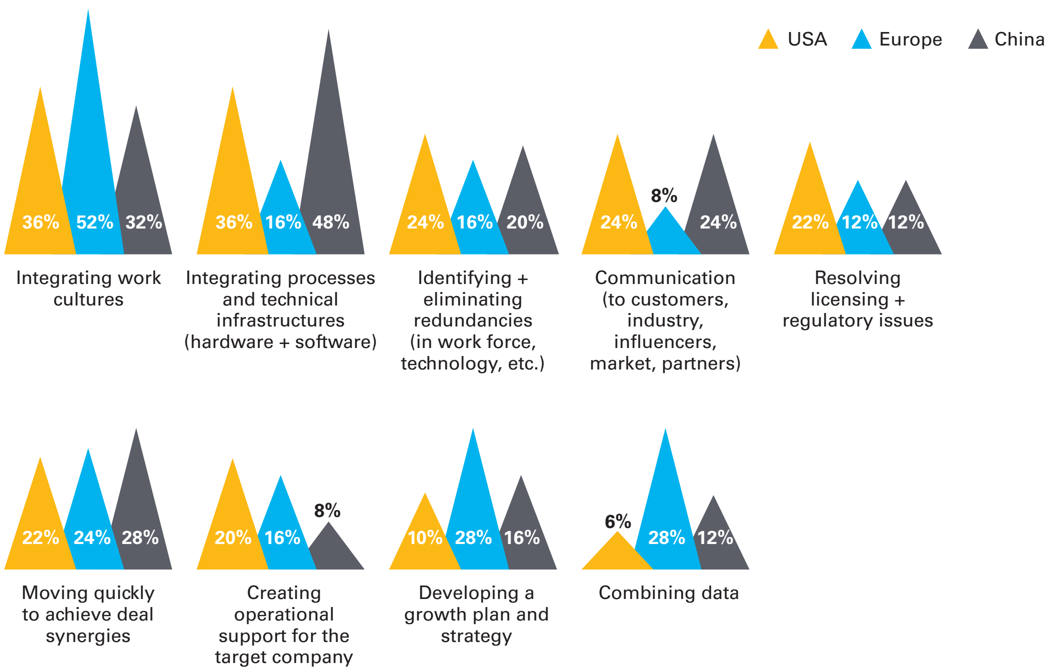


Figure 28: More haste, less speed?

When it comes to completing the post-merger integration process, which is your typical priority?

36%

Finishing the process quickly, to ensure minimal disruption to operations and begin taking advantage of synergies

64%

Expanding the integration process as needed, to avoid making costly errors

The best integration exercises start well before the deal is completed, with clearly defined targets for progress planned out for the weeks and months following the transaction. Indeed, this work should be undertaken as part of the due diligence process.

Nevertheless, integration sometimes takes longer than expected, and dealmakers may need to be flexible. In fact, as Figure 28 reveals, almost two-thirds of respondents (64%) say they are prepared to extend the integration process if required, in order to avoid costly mistakes.

The remaining third (36%), for whom the priority is speed and minimal disruption, may need to think again—while the need to begin capturing synergies may be paramount, a failure to properly integrate may threaten the long-term value created by the deal. As the chief technology officer of a U.S. company puts it: “Our focus is on a very thorough integration process, and if that means risking some of the synergies because you’ve extended the timeline, the danger of a problem such as a data loss is much bigger.”

Conclusion

In the fast-moving digital media and frontier technology sectors, where incumbents are under constant pressure from evolving technologies and emerging competitors, M&A often represents the best way to capture or retain market leadership.

Nevertheless, the dealmakers surveyed in this report are acutely aware of the risks they face. One danger is being late to an opportunity or emerging growth area. Speed to market has become one of the biggest indicators and measures of success in this market. Another danger is completing a deal with the wrong company. There is a tightrope to walk between success and failure, but those who have taken the time to structure a thoughtful strategy in advance will have the best chance to thrive.

Alongside this danger sits execution risk—the danger that dealmakers will make the wrong strategic decisions for their businesses, or that due diligence or integration failures will jeopardize the potential value of a transaction. While this risk exists with any type of M&A, the rapid pace of change in the media and technology sectors often forces dealmakers to act at speed, leaving them more vulnerable to such setbacks.

The message of this research is that, while the technology and media sectors offer exciting M&A opportunities—and dealmaking will often be essential as businesses seek to monetize their existing assets or to retain market leadership—those dealmakers that fail to pay attention risk being left behind. They should therefore be mindful of a number of key lessons:

Competition on the rise.

Dealmakers looking for value-adding transactions in the months and years ahead should be prepared for competition. We anticipate increased deal activity in the emerging digital technology sectors such as digital media services, IoT, AR/VR and artificial intelligence. Scandinavia and the U.K. both appear poised for cross-border M&A attention in the near future. It will be interesting to see how Chinese interest in the digital publishing and gaming sectors as well as U.S. and European focus on the advertising and marketing tech sectors play out in the market.

Look to the future.

While the majority of respondents were focusing on those segments that make sense at present, such as digital media services and advertising and marketing tools, far fewer were concentrating on aspects such as AI, gaming, augmented reality and drone technology. The pace of technology is relentless—companies need to have an eye on the future and to build this into their acquisition strategy.

The human factor.

M&A is about more than just buying emerging technology, picking up patents and moving into new segments—it's about people. Therefore, it's surprising that "obtaining human capital" is the primary motivation for only 1% of dealmakers in our survey. This is particularly worrying when 34% of respondents feel that cultural mismatches with targets are the biggest challenges when considering M&A deals in the sector. Dealmakers need to pay close attention to both management and key employees of the target—otherwise, they may find that their sparkling new acquisition could quickly lose its shine.

Risk vs. reward.

Given the current macroeconomic and geopolitical volatility, it is understandable that companies are doing fewer truly global deals (only 42% according to our survey) and that even fewer are willing to target early-stage startups (those less than two years old). However, with strong due diligence and local experts on the ground, it could be worthwhile taking a calculated risk on a young startup in a location slightly farther from home. After all, it only takes one Snapchat or Uber to truly disrupt the industry and bring real rewards.

Think global.

A significant 42% of respondents do not think that local specialists are vital when targeting deals. This could be an unnecessary risk. Forgoing local knowledge for cross-border M&A deals at the targeting stage could lead buyers into a minefield of regulatory and cultural issues. Thankfully, when it comes to due diligence, 81% believe local specialists are vital for all deals—perhaps the 19% that see them as important only on occasion should take note.

Successful integration is successful M&A.

Getting a deal across the line will claim the headlines, but successful integration is the only true measure of long-term M&A success. And more often than not, this success comes down to the "human question." Over half of respondents found integrating work cultures to be the most significant challenge in the process. This is especially true in deals between agile startups and larger, established corporations. The challenge comes when the executives working on the M&A transaction are often not the same executives responsible for the integration and execution. Executives should develop an integration strategy and roadmap throughout the stages of due diligence. The successful execution of the plan after the transaction is critical to optimizing the investments and growth potential in the deal.

manatt

Albany
Chicago
Los Angeles
New York
Orange County
Palo Alto
Sacramento
San Francisco
Washington, D.C.

MERGER**MARKET**