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Bill's article last month, concerning the permanent injunction issued against Microsoft for violating the software patent of i4i and the merits of software patents in general, was recently picked up for re-publication in *Lexology*, a publication of the Association of Corporate Counsel.



There's more news about Microsoft this month. See "Good News for Microsoft" below.

## In this Issue of *The Venema Report*:

**Glimmers of Hope for M&A?**

**-- and --**

**Good News for Microsoft**

## Glimmers of Hope for M&A?

Regular readers of this newsletter know that it is often devoted to topics concerning M&A, because that is the core of Bill's law practice. Unfortunately, during the last year the news has been dismal. The credit crisis and the global recession that followed caused most sellers to hunker down and wait for better days. On the buy side, most potential buyers have wanted to avoid grabbing a falling knife and have chosen to wait until they are sure it's on the floor.

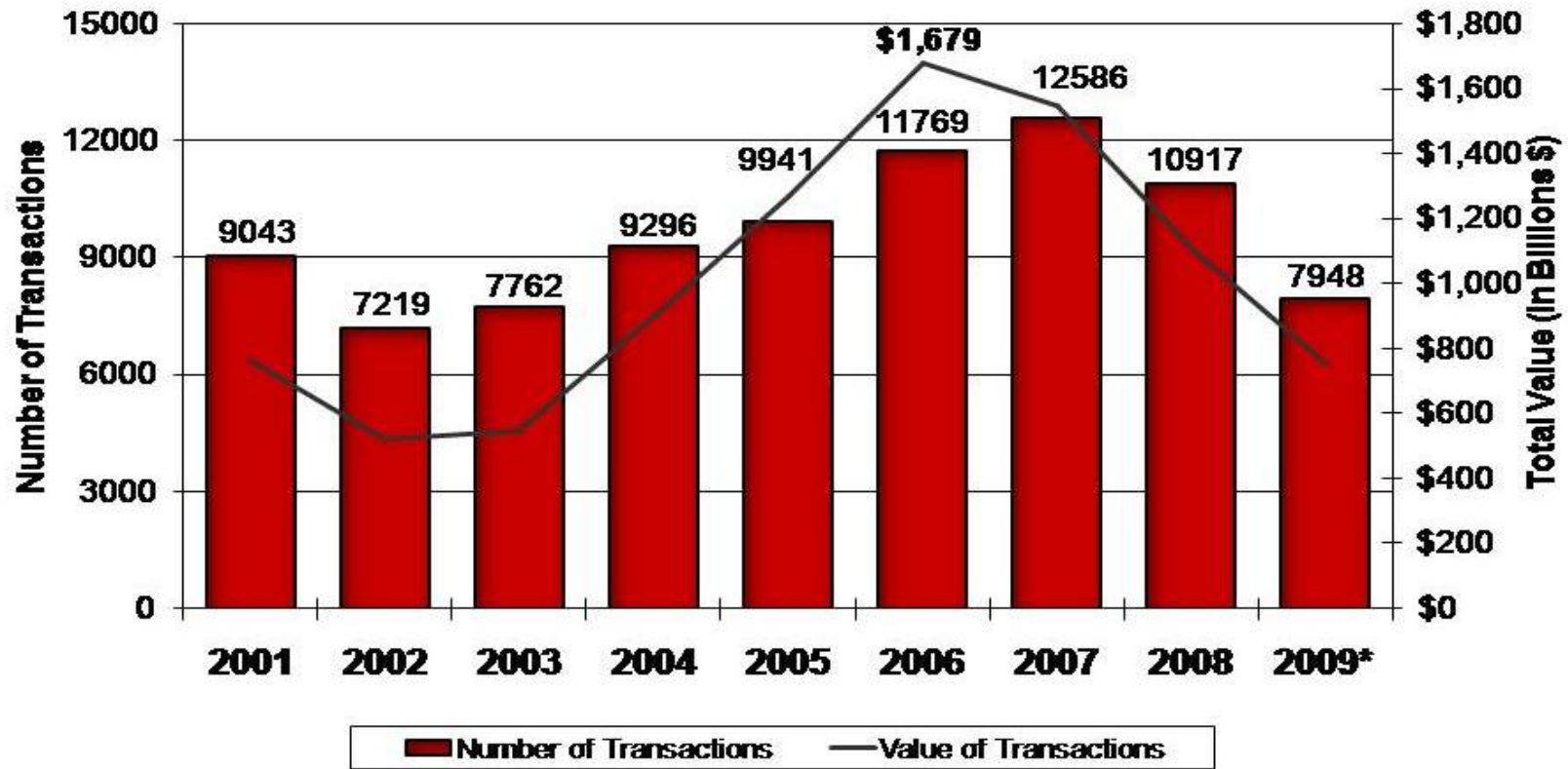
### The Current Market by the Numbers

The number of M&A transactions has fallen dramatically since 2007, and valuations have fallen as well. During the second quarter of 2009, M&A activity across all industry sectors was uninspiring. Fewer buyers focused on smaller transactions, so that both the number of transactions and the value of transactions dropped from the second quarter of 2008.

	Q2 2008	Q1 2009	Q2 2009
<b>Number of Transactions</b>	2575	1827	2012
<b>Value of Transactions</b>	\$281 billion	\$277 billion	\$104 billion

Note that while deal volume in the second quarter rose over the volume of deals in the first quarter, deal values fell significantly from both the prior quarter and from second quarter of 2008. In other words, although the number of deals increased 10% from the first quarter to the second, the **value of the deals declined 62%**.

Although there were some large transactions in the first quarter of 2009 that affected the numbers, it is clear that valuation multiples for U.S. M&A transactions have declined dramatically. Compared to the results of the recent past, the trend looks bleak, as shown in the following chart.



Source: Capital IQ  
 \*2009 is annualized.

For deals announced in the first six months of 2009, the median ratio of enterprise value to trailing twelve months EBITDA was lower than the last six months of 2008 and all of 2007. See the chart below.

	2007	2008	H2 2008	H1 2009
EV / TTM EBITDA	10.7	9.3	8.5	7.1

The decline in EBITDA multiples is not across every industry sector. Some sectors are faring better than others, particularly

those with stable cash flows and good growth prospects. For example, healthcare and technology have fared better than deals involving consumer-related companies or industrials. The chart below sets forth the multiples for various sectors for the first half of 2009.

	<b>Healthcare</b>	<b>Technology</b>	<b>Consumer</b>	<b>Industrials</b>
<b>EV / TTM EBITDA</b>	9.0	8.2	6.3	6.8

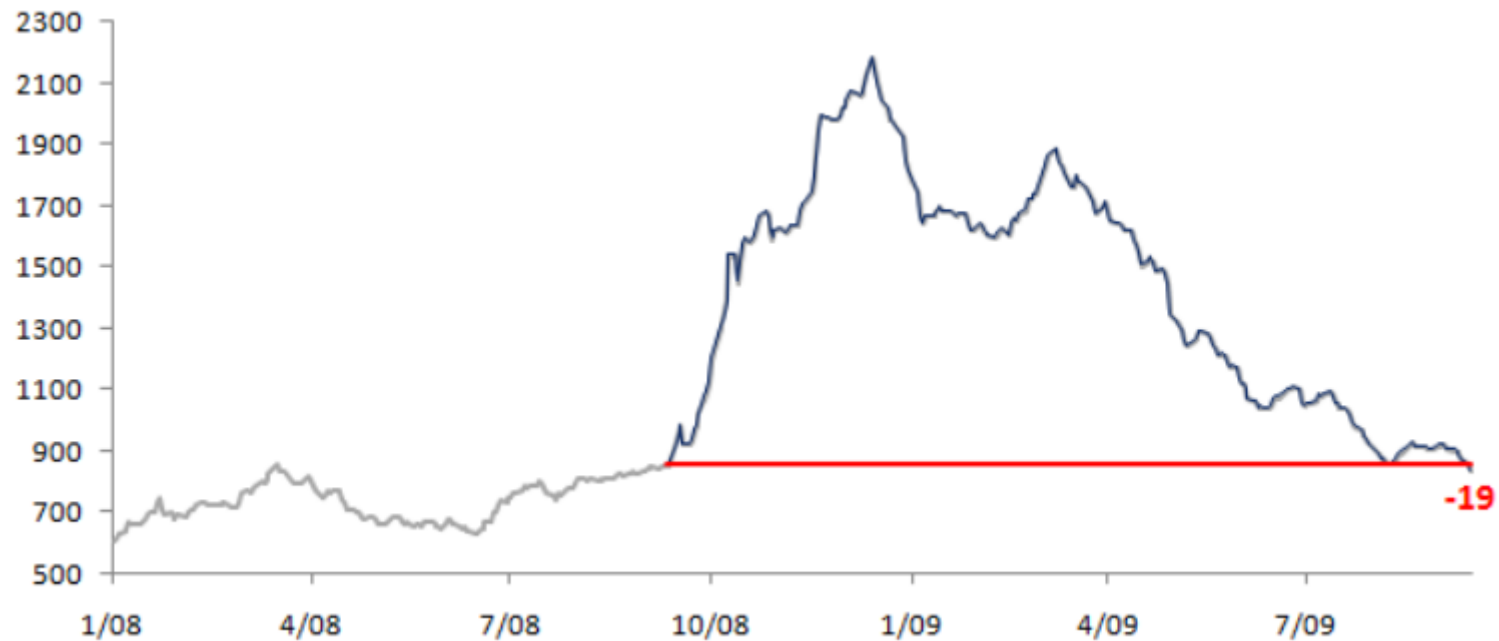
## **Glimmers of Hope?**

As bleak as things seem, there are reasons to hope.

As shown on the chart below, the **yield on junk bonds recently dropped 19 basis points**, to a level that is 835 basis points more than comparable Treasuries. (As a point of reference, note that the spread was 854 on September 12, 2008, which was the Friday before the Lehman's bankruptcy.)

This drop is good news, because the spread between junk bond interest rates and comparable Treasuries is a good barometer for predicting a rebound in M&A market activity. If the spread is higher than the historical average of 590 basis points, banks consider the risk of lending to be above average and, therefore, charge higher interest rates, which makes it difficult to finance M&A transactions.

When the spread between junk bonds and comparable Treasuries is below the historical average, banks consider the climate for lending to be good. Consequently, they charge lower interest rates, which makes it easier to finance deals. Although a spread of 835 basis points is still above the average of 590 basis points, it is a vast improvement over the spreads of the past year, when the spread hit 2,180 basis points.



This drop also helps to explain why, according to Thomson Reuters LPC, **total debt issuances** for working capital, M&A, and other purposes **increased by 74.4%** in the second quarter of 2009, compared to the first quarter of 2009.

The second reason to hope that M&A market activity might be coming back is **the rally in the equity markets**. The improvement in equity valuations will also improve M&A valuations, even among private companies, because public company comparables are a key factor in determining their values. Improving valuations will comfort business owners who stubbornly cling to the valuations of the heady days of 2006.

Although the economy continues to send mixed signals, a third reason for hope is the **renewal of optimism among business people**. On September 1, Tatum, LLC, published its monthly Survey of Business Conditions, which is based on the views of executives and consulting professionals across the country concerning current business and economic conditions. The report revealed that the business index moved up to 4.2 from 2.9 and that the three-month moving average rose for the eighth consecutive month, thereby indicating that those surveyed believe a business recovery is underway.

Finally, there is a virtual arsenal of cash on the balance sheets of corporate America. The credit crisis and economic slowdown caused them to hoard their cash. S&P analyst Howard Silverblatt estimates that the amount of **corporate cash available is around \$700 billion**, not counting the financial, utilities, and transportation sectors, which carry large cash balances as a normal part of doing business.

In addition, private equity funds are estimated to be sitting on \$1.02 trillion of cash, according to Preqin, a London-based research service. Almost half of that amount—around \$472 billion—is held by buyout funds.

That amount of uninvested capital won't sit idle for long, especially when it's earning a mere 1% in a bank account.

It's too early to tell whether the dark days are truly over. Nevertheless, there are reasons to hope. If the credit and equity markets continue to improve, and business optimism holds up, then we could be in store for a true rally of M&A activity.

## Good News for Microsoft

### First Bit of Good News

Last month we reported on a lawsuit, in which U.S. District Court in the Eastern District of Texas, issued a permanent injunction that barred Microsoft from selling recent versions of its Word software, because the software violates a patent for processing XML, a markup language that allows users to customize the underlying format of text documents. In addition to the injunction, the court awarded the patent holder damages of approximately \$290 million.

On September 3, 2009, the U.S. Court of Appeals for the Federal Circuit granted Microsoft a stay of the injunction, noting simply, “[T]he court determines based upon the motion papers submitted that Microsoft has met its burden to obtain a stay of the injunction.”

In its appeal [see a copy [here](#)] Microsoft argued that the District Court judge was incompetent as a “gatekeeper” and failed to strike the “delicate balance” needed in patent law disputes, noting specifically:

That balance can be lost if the district court does not protect the process, and patent litigation then becomes a tax on innovation rather than its guardian.

Microsoft argued that the court erred in several respects, including its construction of the patent claim, failure to set aside the jury verdict on the grounds of obviousness, rejection of Microsoft's argument that the patent holder had sold a product that embodied the invention prior to filing the patent, and failure to properly monitor the damages award.

Oral arguments are scheduled for September 23. This case bears watching, especially concerning how the court views Microsoft's argument on obviousness. As a longtime advocate of software patents, it is ironic that Microsoft is now making an argument that many contend cuts to the heart of why most software patents should be disregarded.

### Other Good News: In the *Lucent* Case Court Overturns Damages

Microsoft received more good news recently. Last April, after more than six years of litigation, a software developer was awarded \$358 million in damages against Microsoft for patent infringement. That award was the fifth-largest patent jury award in U.S. history.

Microsoft appealed, and on September 11, the U.S. Court of Appeals for the Federal Circuit, though it upheld the jury verdict that Microsoft's calendar date-picker tool infringed the patent held by Alcatel-Lucent, also **found that the damages award of \$358 million was unjustified** based on the evidence, ruling:

Having examined the relevant Georgia-Pacific factors, we are left with the unmistakable conclusion that the jury's damages award is not supported by substantial evidence, but is based mainly on speculation or guesswork. . . . The jury's award of a lump-sum payment of about \$358 million does not rest on substantial evidence and is likewise against the clear weight of the evidence.

The court remanded the case to the District Court for another trial on damages. The case is *Lucent Technologies Inc. et al. v. Gateway Inc. et al.*, case numbers 08-1485, 08-1487 and 08-1495, in the U.S. Court of Appeals for the Federal Circuit.

## Mission Statement:

Our masthead proclaims our mission:

**“Empowering today’s entrepreneurs for tomorrow”**

That phrase affects everything we do. We want to be a resource for entrepreneurs. The Venema Report Web site contains a wealth of useful information for entrepreneurs. Although Bill's book, which is featured on the Web site, is concerned with selling a software company, the Web site and all of The Venema Report are committed to assisting entrepreneurs of all sorts with a variety of issues and concerns. We believe that success will come to those who do their homework. **Therefore, if there are topics that you would like to see us address in this newsletter or on the Web site, please let us know: [bill@TheVenemaReport.com](mailto:bill@TheVenemaReport.com).**

*The Venema Report* is published to provide useful information to entrepreneurs and those who assist them. Although legal topics are addressed, nothing in this letter shall be deemed to constitute legal advice. If you would rather not receive this newsletter, simply reply and type "remove" in the subject line.