AP CAPITAL RESEARCH

M&A Deal of The Week

SYNOPSYS X ANSYS

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Executive Summary

M&A DEAL OF THE WEEK

Deal Summary

- On the 16th January 2024, chip design software maker Synopsys (NASDAQ - SNPS) stated that it would be entering into a definitive agreement to acquire software company Ansys (NASDAQ - ANSS) for $35 billion, or $390.19 per share with a deal structure of 50:50 stock and cash. Investors are set to receive $197 in cash and 0.3450 of Synopsys common stock.
- This deal represents a premium of 29% when compared to Ansys' last close on the 21st December 2023, before news of a potential deal leaked, leading to an 18% rise in share price.
- This is the biggest deal in the technology industry since semiconductor giant Broadcom acquired Cloud Computing software maker VMware on November 23 for $69 billion.
- This acquisition is expected to solidify Synopsys' position in the Software and Tech Services industry, which could lead to potential regulatory scrutiny because the market is heavily concentrated.
- This acquisition is expected to expand Synopsys' Total Accessible Market (TAM) by 1.5x to $28 billion, equalling an 11% CAGR [from FY23-28].
- This deal is predicted to be accretive to Synopsys Non-GAAP EPS and is estimated to be closed in the first half of 2025.

Deal Advisors

Synopsys:
Financial Advisor: Evercore

Ansys:
Financial Advisor: Qatalyst Partners

Key Figures

- Offer Premium: 29% [$390.19/share]
- Synopsys Market Cap: $82.2 billion
- Synopsys P/E: 69.7
- Estimated Synergies
  - Revenue: $400 million
  - Cost: $400 million

- Ansys Market Cap: $28.9 Billion
- Ansys P/E: 60.51
- Ansys EV/EBITDA: 42.1x
- Ansys EV - $29.7 billion

Company Information

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Synopsys - NASDAQ: SNPS

- First founded in 1986, Synopsys is a technology company that focuses on designing electronic systems used to build and analyse semiconductor chips, known as Electronic Design Automation (EDA). They also offer other software products and services; however, EDA accounts for 65% of their revenue.
- Headquartered in Sunnyvale, California, Synopsys has many subsidiaries globally and operates in Europe and Asia. However, it is mainly focused on North America, where 47% of its revenue comes from.
- Regarding financials, 2023 (FY ending November) resulted in a revenue of $5.84 billion, which is up 15% from the previous year due to an increase in revenues across all geographic regions, with a net income of $1.22 billion, leaving a net profit margin of 20.8%. Their R&D spend in 2023 was $1.95 billion (33% of total revenue), up 11.6% from 2022's total R&D expense.
- Synopsys' Q3 23 results generated $1.59 billion in revenue, up approximately 25% YoY, resulting in an EPS of $2.26 and a P/E of 66.9.
- Since the deal is predicted to be accretive, Synopsys EPS is expected to grow once the deal has closed.

Ansys - NASDAQ: ANSS

- Founded in 1970, Ansys offers an engineering simulation software service that gives customers an understanding of how their product/service will work in real-time. They also offer maintenance/servicing as well as IT solutions. They have operations globally, focusing on the US and EMEA, which account for 73% of revenue and are a main driver of earnings.
- Regarding financials, 2023(FY ended December) earned a revenue of $2.16 billion, up 6.5% from 2022 and led to a net income of $483.6 million and a net profit margin of 22%.
- Ansys' Q3 23 results generated $458 million in revenue, down 3% from 2022. Operating profit margin also fell significantly from 26% in Q3 2022 to 15% in the third quarter of 2023. This was due to a deferred revenue and backlog of $1,203 million during September 2023. Ansys' final results yielded an EPS of $0.64, leading to a P/E of 59.9x, which puts Ansys below the peer average of 76.6x.

Deal Rationale

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Synergetic benefits and consolidating industry

- **Synergetic benefit** - EDA paired with engineering simulation software provides customers with a more comprehensive, robust and system-focused approach to improving their business. This is expected to lead to revenue synergies of approximately $400 million.
- **Consolidating Market Share in the Business Software Industry** - This deal is expected to increase Synopsys' Total Addressable Market by 1.5x to approximately $28 billion and create roughly $400 million run-rate cost synergies. Furthermore, this acquisition is expected to increase non-GAAP operating profit margins by 1.25% and increase unlevered free cash flow margins by 0.75%, which will help any potential liquidity issues.
- **Semiconductor chip demand** - Synopsys can capitalise on the increased demand for semiconductor chips due to the market shift toward AI. The effects of the heightened demand from the AI trend are evident from their 15% YoY revenue increase and 25% third-quarter revenue growth. Acquiring Ansys will enable Synopsys to continue to expand its growth in the EDA and SaaS industry.

Risks

- **Regulatory Uncertainty** - Given that Synopsys holds 32% of the EDA market, the acquisition with Ansys may raise regulatory concerns over potential antitrust issues, according to the Federal Trade Commission. If the acquisition is blocked by regulators or the deal falls through, Synopsys will have to pay Ansys a termination fee of $1.5 billion.
- **Synopsys' Financial Leverage Elevated by Acquisition -** Both companies have sound financial health. Synopsys currently has a D/E of 0.3%, which will increase to around 19% after acquiring $16 billion in debt financing to fund a portion of the cash transaction of this acquisition, assuming its market cap remains steady. The remainder of this transaction is financed by equity, exchanging 0.345 shares per Ansys share. Synopsys has a good track record of managing debt and liquidity. Ansys currently has a D/E ratio of 15.1%.

Industry Analysis

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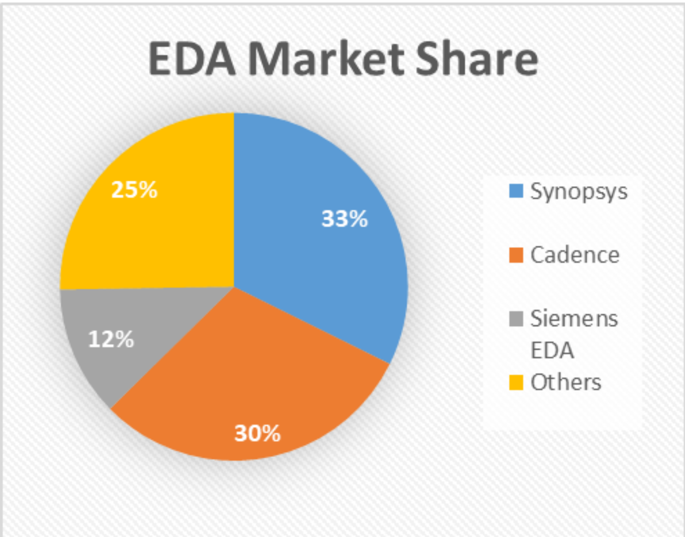
The Electronic Design Automation (EDA) Market

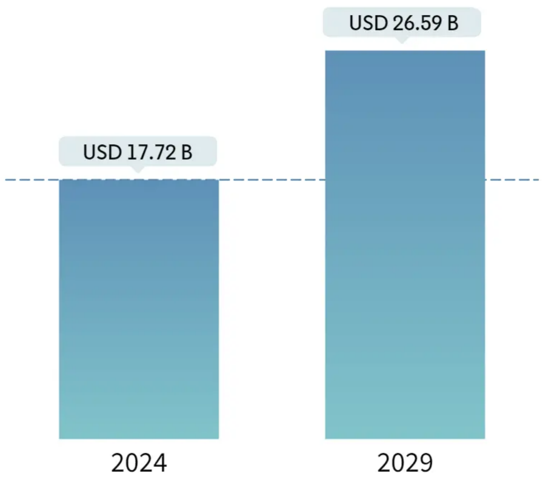
- The Electronic Design Automation Industry is rapidly growing, with a compound annual growth rate (CAGR) of 8.46% predicted from 2022 until the end of 2029 (Mordor Intelligence)
- Over the coming years, the EDA market is expected to benefit from the increased demand for AI and the production of semiconductor products, adding to predicted revenue growth.
- As of August 2022, The EDA industry has a Herfindahl-Hirschman Index of 2718, signifying the industry is highly concentrated.



Global Electronic Design Automation Tools (EDA) Market

Market Size in USD Billion

CAGR 8.46%



Source : Mordor Intelligence

Threat

- A potential threat is big tech companies' in-house design and production of semiconductor chips. This would be bad for the EDA industry as it would lead to significant falls in revenue, as 70% of revenue stems from demand for semiconductor production.
- Synopsys would be more resistant to this, assuming that the Ansys acquisition goes through, as they can offer a premium EDA service that outcompetes other firms due to the complimentary services both the companies combined offer. This is because EDA, paired with engineering simulation software, allows for a more accurate and effective design and implementation of new and innovative technologies.

Final Thoughts

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Synopsys' acquisition of Ansys is a good acquisition because it allows them to capitalise on the AI boom and add complimentary services to their portfolio, further solidifying their market position and expanding their Total Addressable Market.

Regarding valuation, Ansys is currently overvalued by 35%, and a premium of 29% means Synopsys are significantly overpaying for this deal. Still, this is often the case with most tech deals as the acquirer pays for the company, the long-term growth prospects and the synergies they expect to extract.

As mentioned earlier, the only potential issue with this acquisition is the potential antitrust concerns. The Software and Tech Services market is considered highly concentrated based on the HHI of 2718. Synopsys currently holds a 32% market share in the industry, so the FTC will scrutinise any additions to the industry due to the highly concentrated market.

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