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TECHNOLOGY M&A

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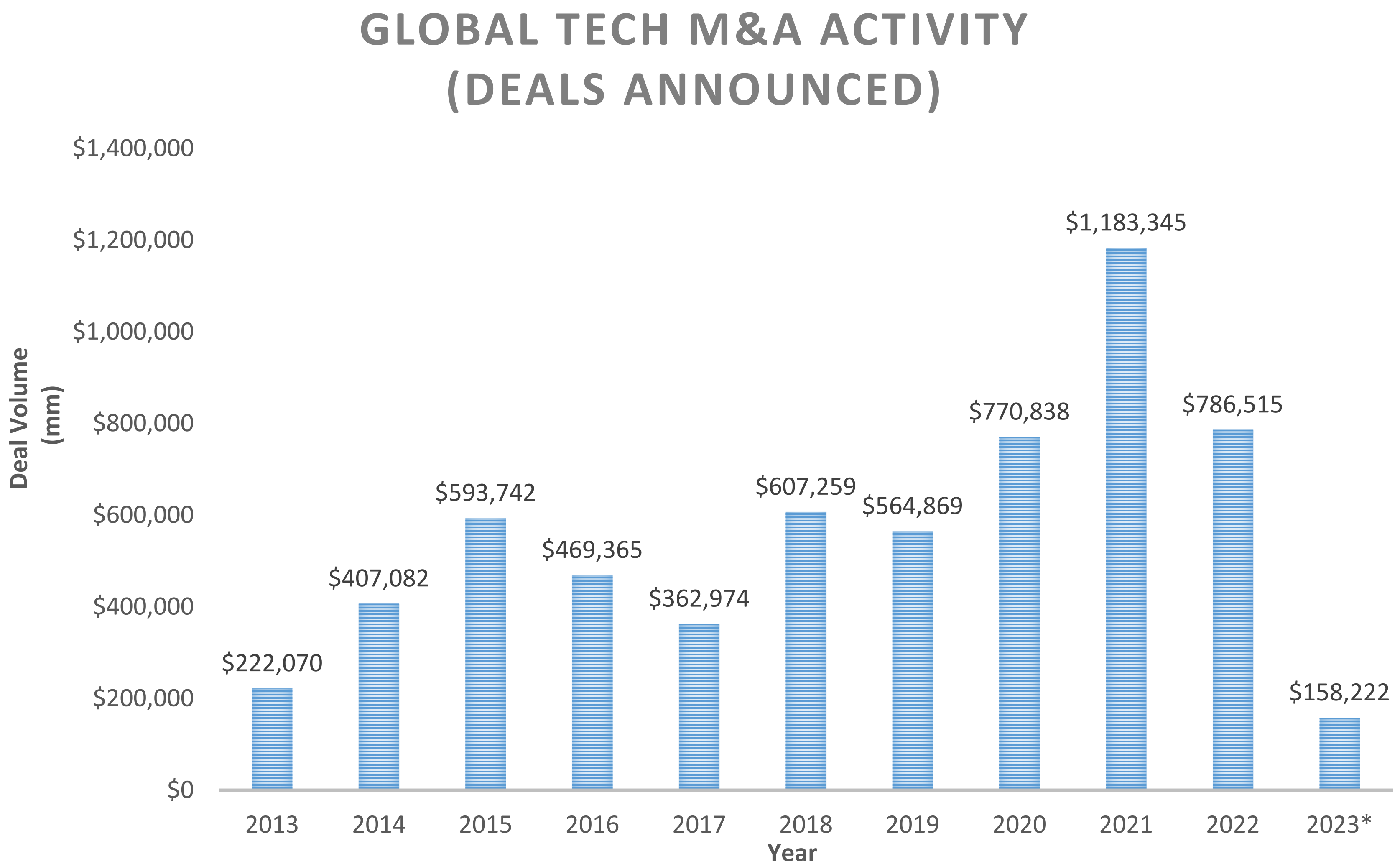
Discussion Topics

- Tech M&A trends
- The state of tech M&A
- Hot topic 1: down rounds
- Hot topic 2: foreign investments in the tech sector
- Hot topic 3: killer acquisition in the tech sector
- Hot topic 4: data issues
- Hot topic 5: due diligence
- Where does tech M&A go from here?

TECH M&A TRENDS

- **The tech industry has been the most active sector for transactions over the past years.**
  - Majority of M&A deals in the tech sector, accounting for approximately one-quarter of both deal volume and value (globally: 10 937 transactions valued at $1.125 billion in 2022, source PwC).
  - The multiples in the tech sector have risen from approximately 13 to 14 times the EBITDA in 2018-2019 to 16 to 18 times in 2020 and 2021.
  - Low interest rates have driven investments.
  - France: 1st among EU tech ecosystems for startup investment in Q2 2022 with 3.2 billion euros.
  - India: in 2021, IT/ ITES sector contributed 20% of the total deal value and 16% of the total deal volume in India. In 2022, IT/ ITES sector remained second most active sector and contributed 21% of the total deal value in India.
  - Israel: Tech sector contributes 16% of GDP, 45% of GDP growth, 55% of exports, and 34% of employee income tax.
- **Nevertheless, new context since mid 2022 hard to swallow for tech sector.**
  - High interest rates: capital more expensive.
  - Global macro environment.
  - Fewer unicorns created in 2022 than in the 2021 boom (1st: US, 2nd: China, 3rd: India).
- **Consequences: drop in valuation but opportunities for M&A.**
  - Slower buyout activity.
  - Drop in valuation of the tech companies (Average 70% decline in valuations from November 2021 to October 2022).
  - Companies rethinking their strategy for more profitable models.
  - Opportunities for traditional M&A and consolidation between scale ups.



Source: *Refinitiv*

*Up to 31 May, 2023

HOT TOPIC 1: DOWN ROUNDS

Given decreasing values, increase of “down rounds” (*i.e.* when a financing round is done at a value that is less than the previous round)

- Concern about lack of liquidity: the founders of tech companies raise at significantly lower valuations (reduction of valuation multiples by 50% - 70%).
  - Number of VCs deals and the total VCs investment in Europe fell for the fourth straight quarter, dropping from $15.7 billion in Q4’22 to $9.8 billion in Q1’23 (KPMG estimate).
  - Stripe, an Irish-American financial services company, conducted a new financing round in March 2023 that valued the company at $50 billion, down by almost half from its $95 billion valuation in 2021.
  - Klarna, a Swedish fintech company, drummed up $800 million in July 2022 at a valuation of $6.7 billion – a drop from 2021’s valuation of $46 billion.
- Consequences of a down round
  - Image. Talent retention (impact on employees’ incentives).
  - Dilution of shareholders (potentially unequal if existing investors have anti-dilution protection).
  - Questions the business model and future opportunities for raising funds.
- Possible reactions to decreasing values
  - Wait it out: restructuration or recourse to bridge-financing.
  - If publicly listed: consider take-private with group of shareholders who believe in future and can finance the business plan.
  - If not:
    - Bite the bullet and do the down round.
    - Try to renegotiate terms and buy out disillusioned shareholders (depends on leverage).

HOT TOPIC 2: FOREIGN INVESTMENTS IN THE TECH SECTOR

Continued trend of increased monitoring and control of foreign investment in the tech sector limiting the ability of multinationals from acquiring tech companies (prolonged acquisition processes and potential rejections).

- **In France,** research and development activities relating to critical technologies (*i.e., cybersecurity, AI, robotics, additive manufacturing, semiconductors, quantum technologies, energy storage, biotechnologies*) in certain business sectors are considered sensitive and subject to the French foreign investment regime (*i.e., authorization to be obtained from the Treasury Department of the French Ministry of Economy and Finances*).
- **In the EU,** non-EU foreign direct investments likely to affect the security or public order of more than one Member State (i.*e., which may have an effect in particular on critical technologies, including artificial intelligence, robotics, semiconductors, cybersecurity*) is subject to the EU-wide cooperation mechanism (*i.e., the Commission may raise concerns which would be taken into account in the context of the foreign investment authorization process to be obtained in the relevant Member State*).
- **In South Africa**, exchange controls place restrictions on the export of intellectual property.
- **In Israel,** sensitive foreign investments are subject to review; military cyber and other tech exports are subject to approval; and contemplated "judicial reform" negatively affects tech sector foreign investments.

HOT TOPIC 3: KILLER ACQUISITION IN THE TECH SECTOR

Acquisition of a firm that plays or may develop into playing a significant competitive role on the market despite generating little or no turnover at the moment of the acquisition, with a view to potentially shutting it down.

In the EU

- New thresholds in terms of value of the transaction (Germany and Austria) – ex: Apple/Shazam caught by the new Austrian threshold.
- Review of a merger upon the request of the merger control authority of a Member State even if its own jurisdictional thresholds are not reached (Article 22 of EUMR) – ex: Illumina/Grail.
- Possible recourse to abuse of dominant position theory in relation to killer acquisitions, even where merger control clearance is not required.

In India

- Indian anti-trust regulator (CCI) has sought to bring in its notification ambit low value global deals if target business has substantial business operations in India. Also proposing to link penalty to global turnover. Amendments yet to be made effective.

HOT TOPIC 4: DATA ISSUES CONTINUE TO BE RELEVANT

Data is a key asset in M&A deals with several implications, in particular with respect to anti competitive practices and data privacy rules.

- **Competition concerns:** European regulators closely watch transactions on data-intensive markets.
  - Acquisition of Fitbit by Google (*2020*): the EU Commission based its assessment on the parties being able to lawfully combine their databases (a*pproval of the deal due to Google's commitments*).
  - Acquisition of Kustomer by Meta (*2022*): investigation by the EU Commission given the significant amount of data that would be available to Facebook for personalization of the ads it displays (*approval of the deal due to Meta's commitments*).
- **Data privacy concerns**:
  - Importance of the due diligence of the IT security systems and data protection laws compliance of the target. (*UK data protection authority fined Marriot* ***£18.4 million*** *following the hacking of Starwood, a company acquired by Marriot, noting the lack of DD – 2020*).
  - Use of the data acquired post acquisition: sharing of data with acquirer can be restricted due to privacy rules. (*Irish data protection authority fined WhatsApp* ***€225 million*** *for unlawful sharing of personal data with Facebook companies – 2021).*
  - Transfer of personal data of the target outside its country/region of origin post acquisition:
    - Strict rules on data transfers outside the European Union (*Schrems cases - Irish data protection authority fined Meta* ***€1.2 billion*** *for unlawful transfers of personal data outside the European Union – 2023*).
    - Data localization regulations in some countries (India, Russia).

HOT TOPIC 5: DUE DILIGENCE

Due to the legal risks associated with tech companies, due diligence is crucial and requires more resources and time.

- Increasing number of regulations applying to tech companies requiring extensive compliance audits.
- Reviewing companies' legal and regulatory compliance takes longer and requires specific IP, data, financial and regulatory expertise.
- Reciprocal due diligence.
  - India: Press note 3 including security clearance for directors.
- Changes in tech due diligence and RWI in Israeli tech transactions.

WHERE DOES TECH M&A GO FROM HERE?

- **Continued Regulatory Vigilance?**
- **Increased Geopolitical Tension?**
- **Continued Nationalistic Tendencies?**
- **Restrictions on Capital and Labor Flows?**