

Cross-border tech M&A in a disrupted world

Despite an uncertain economic and political outlook, tech companies are still doing cross-border deals, and activity in 2018 has been remarkably strong





Methodology

In H2 2018, White & Case, in partnership with Mergermarket, surveyed 150 senior-level executives from technology sector companies that have completed at least one cross-border transaction in the past 24 months and have an annual minimum turnover of US\$100 million. The aim of the survey was to analyze dealmaker sentiment including the strategic drivers of cross-border deals over the next 12 to 24 months, and to identify challenges and issues facing dealmakers. Job titles included CEO, CFO, Head of Strategy and Head of M&A.

Regional breakdown

North America	60
EMEA	60
Asia-Pacific	30

Tech executives are optimistic but practical about cross-border M&A

Our survey of 150 senior executives in the technology sector indicates that the majority of respondents expect to do more cross-border M&A in the next two years, despite global economic and political uncertainty. But executives are willing to leave the negotiating table if economic conditions change

By Carola Glasauer, Dani Guo, Tobias Heinrich, Farhad Jalinous and Daniel Turgel

Cross-border dealmaking across the tech sector remained buoyant in 2018. In the first three quarters of the year, deal value rose to US\$89.4 billion, up 1.5 percent on the same period in 2017. With volume dropping by 11 percent, this suggests that valuations were up considerably. This is largely in line with overall trends for global M&A in a year that could rank as one of the best on record.

However, with economic and geopolitical headwinds, the outlook for the future is decidedly uncertain. Mindful of that, we conducted a survey of 150 tech executives around the world to gauge their expectations for cross-border dealmaking over the next two years—and to gain a better understanding of the challenges they face when doing cross-border deals.



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Cross-border technology M&A 2013 – 2018 YTD



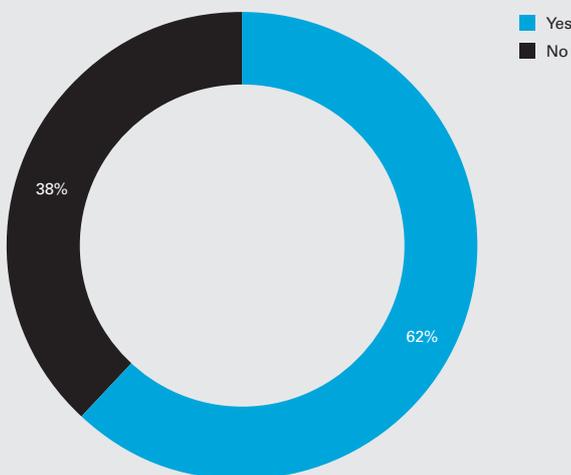
Their expectations are high. The majority of respondents, 62 percent, said that they expect to do additional cross-border technology acquisitions over the next two years. This figure speaks both to the optimism that executives have about the future, as well as the importance of cross-border M&A for companies in the technology space.

But their optimism comes with an apparent caveat. Almost half of respondents, 44 percent, indicated that they had walked away from potential cross-border deals in the past. And 57 percent of this group (more than one-third of respondents overall) said that they had walked away from deals due to changes in the macroeconomic environment.

This is a significant figure, given that there seems to be a growing consensus that the macroeconomic environment could be transformed over the next two years. In April, the International Monetary Fund (IMF) estimated that global GDP would grow at 3.9 percent in both 2018 and 2019 but that the global economy will slow down in 2020. The IMF affirmed this view in October, but it added that economic expansion had become less balanced around the world, peaking in some major economies, and that downside risks had increased, including the threat posed by possible trade wars.



Do you plan to seek additional cross-border acquisitions over the next 12 to 24 months?



62%

Percentage of respondents who say that they expect to seek additional cross-border technology acquisitions over the next two years

Indeed, 47 percent of respondents point to trade wars and rising protectionism as the most significant geopolitical factor affecting acquisition strategies over the next 12 months. And 70 percent of those who said they had walked away from deals said that political interference was an important factor in the decision.

Our report highlights these and other important trends affecting cross-border M&A in the tech sector, as well as examining the opportunities and challenges that dealmakers face when pursuing deals across borders.

Tech deals defy changing times

The appetite for cross-border M&A shows no signs of abating. Despite rising valuations, growing regulatory scrutiny, interest rate hikes and the

specter of protectionism, 62 percent of respondents are planning a cross-border technology acquisition in the next two years.

A drive to survive

These cross-border tech deals are being driven by strategic rather than tactical imperatives. For many acquirers, getting the right deal is a means of survival in the face of accelerating technological disruption.

Our survey findings bear this out. Factors that normally motivate acquirers—such as affordable valuations, supply chain improvements, cost reductions and low labor costs—barely move

the needle. Instead, acquirers are overwhelmingly focused on the strategic imperatives of building scale and acquiring IP.

The fundamental nature of the forces driving deals suggests that the momentum will continue. A significant percentage of cross-border tech deals are clearly non-discretionary, as companies struggle to remain relevant in the face of accelerating digital disruption. For example, carmakers—and others—are racing to develop new technology in connection with autonomous driving and electric vehicles. And in sub-sectors such as luxury goods, accelerated dealmaking is being



69%

Percentage of respondents who say growing their customer base is one of the top two strategic drivers of any future deals

spurred on by businesses anxious to grab customers before Amazon and Alibaba get to them.

Our research highlights two main drivers for cross-border tech acquisitions. The first is the race to grow the customer base and increase scale, mentioned by 69 percent of respondents. To this end, acquirers are expanding into new geographies, extending product ranges or offering existing products on new platforms.

The second motivation is the need to build depth by acquiring IP. Forty-six percent of respondents said getting new IP to strengthen their position in current areas of business was important. IP-driven acquisitions can deepen existing capabilities and enable growth in adjacent markets.

Meanwhile, the ongoing struggle to remain relevant in a fast-changing world revealed 22 percent who said that the ability to expand into new areas of business was an important factor driving their acquisition strategies.

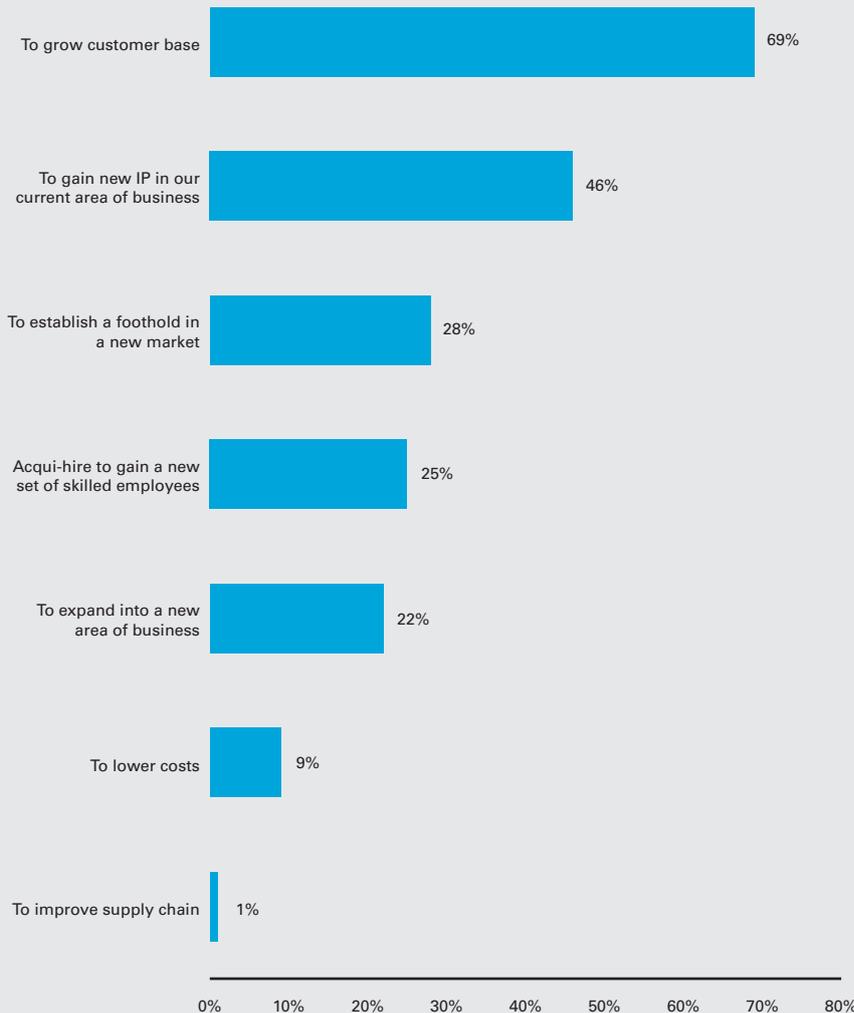
New tech horizons

When it comes to choosing whether to acquire a tech target in another country, there are two standout attractions, according to respondents. Seventy-one percent cite the existence of an attractive market for a company’s products, and 57 percent cite a strong pool of tech targets in that country. Meanwhile, almost 32 percent cite favorable demographics.

Only 11 percent point to affordable valuations and a mere 6 percent cite low labor costs as important factors. This provides further confirmation that tech acquirers are motivated by strategic factors in the current environment.

India heads the list of most attractive countries, with 20 percent of respondents picking it as the top spot for a technology acquisition over the next 12 to 24 months. Rapid growth is a key attraction. Indian e-commerce is expected to reach US\$200 billion by 2026, up from US\$38.5 billion in 2017, according to the Brand Equity Foundation. And within the next six years, India will overtake China to become the world’s most populous

What are likely to be the main strategic drivers of any deals? (Select top two)



nation, according to the UN.

Germany takes second place, chosen by 16 percent of respondents—well ahead of the US, the UK and Canada. Executives point to Germany's deep pool of tech targets as a motivating factor. Indeed, the World Economic Forum's Global Competitiveness Report recently found Germany to be the world's most innovative nation and the highest-placed European economy for competitiveness.

The UK is attractive to companies that want to grow their customer or IP base or develop new business models. However, a disorderly Brexit could have negative consequences for tech investment and erode the country's current position as a strategic European foothold. The fact that India and Germany rank much higher than the UK as attractive locations suggests that Brexit concerns may already be having an effect.

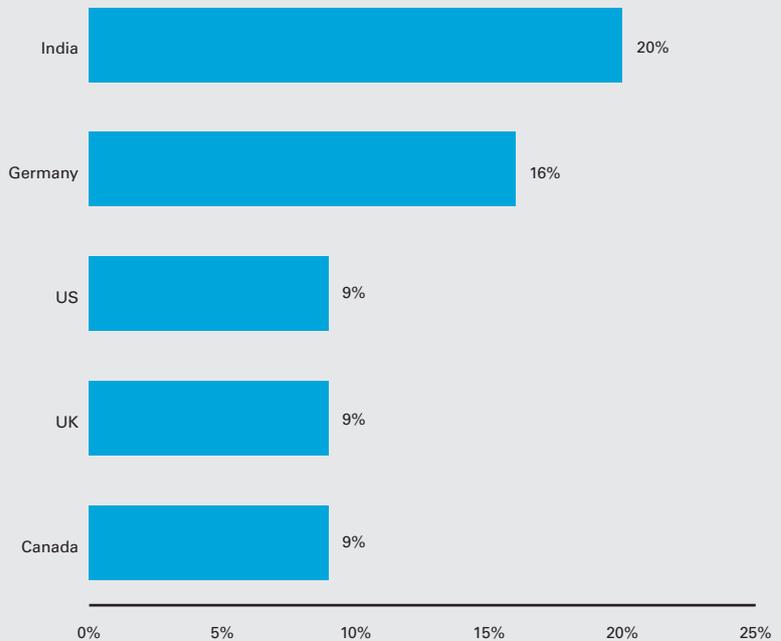
Other growth markets include Israel, which is a hotbed for tech innovation. Recent deal figures show that corporations and private equity firms are increasingly homing in on the country.

Meanwhile, the Nordics—birthplace of Spotify and Skype—also offer enormous opportunities. Tech-related dealmaking in the region outstripped both France and Germany in both volume and value in the five years up to and including 2018.

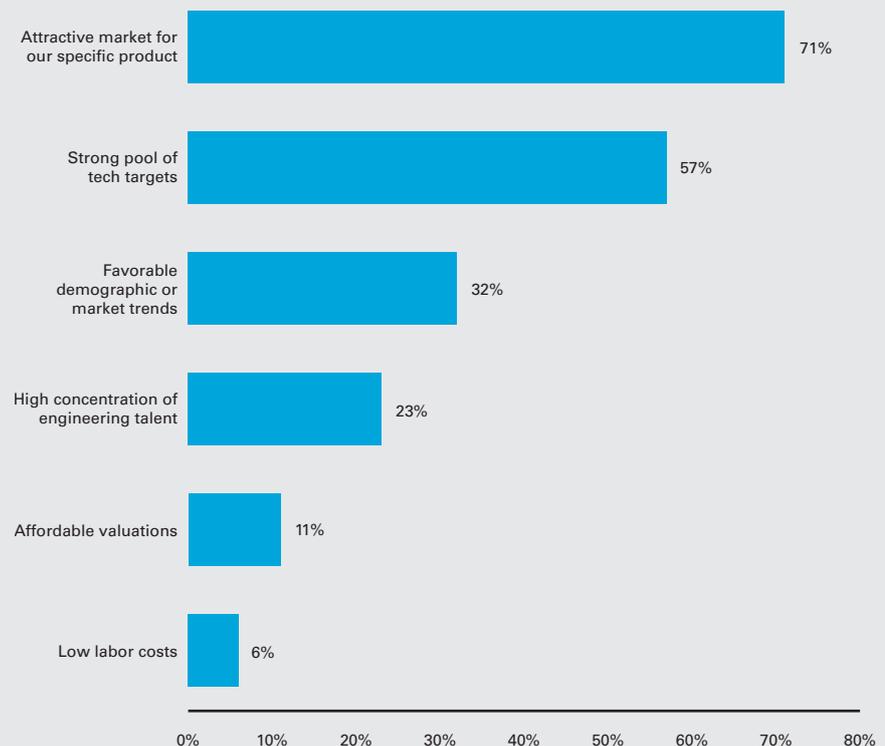


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Which country will be most attractive to your company for technology acquisitions over the next 12 to 24 months? (Top choices shown)



What makes this country attractive? (Select top-two most important)





Aqui-hires, blockchain and data

The war for talent rages on. A quarter of respondents say that adding highly valued talent by means of an acquisition (an “acqui-hire”) is a primary strategic driver for cross-border acquisitions. “Skilled employees are hard to get and retaining them is even more of an issue,” says the director of a US-based cloud computing company. “The best way to build talent is to acquire it.” Outside of these survey responses, it is difficult to track the extent to which acqui-hires are being used—public companies may elect not to disclose acqui-hires if they are not material in size, and private companies are not subject to obligations to report acquisitions.

Blockchain is on everyone’s mind. An increasing number of companies appear to have accepted that blockchain will be a game changer and are working to incorporate blockchain technology into their businesses. For example, in sectors as diverse as banking, diamond mining, fresh produce and real estate, companies are looking to distributed ledger technology as a way to drive business transformation.

Data drives deals. Large proprietary sets of data (for example, generated by users of an online product) can be a primary driver of value for a technology company. Using this data helps companies more effectively tailor products and services in ways that others are unable to match. And artificial intelligence is increasingly viewed as a vital method for unlocking value from data.



47%

Percentage of respondents who point to trade wars and rising protectionism as one of the most significant geopolitical factors affecting acquisition strategies over the next 12 months

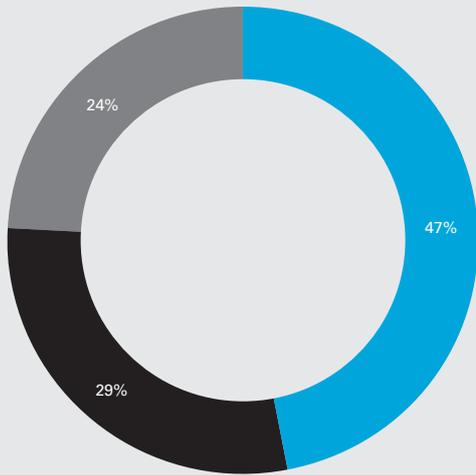
Challenges remain: Geopolitics and regulations can be decisive

Despite the opportunities available in the market, the changing face of global politics is exerting an increasing influence over deals. Almost half of respondents (47 percent) point to trade wars and rising protectionism as one of the most significant geopolitical factors affecting acquisition strategies over the next 12 months. This is followed by US tensions with traditional allies (29 percent).

Meanwhile, nearly a quarter (24 percent) point to Brexit as an important factor. A CFO of a France-based cloud computing company says: “Brexit has affected our European M&A plans. Unless the environment becomes clear, we are not quite sure of finalizing any acquisition in Europe. We are instead looking for acquisitions in other regions where the growth and opportunities are better.”

In addition, executives are feeling increasingly challenged by the regulatory environment in

Which of the following geopolitical issues will affect your acquisition strategy most over the next 12 months?



■ Trade wars and rising protectionism
■ US tensions with traditional allies
■ Brexit

cross-border deals. Thirty-nine percent say that they were unsuccessful in this area and that there is significant room for improvement.

Too many rules spoil the deal?

When we examine the deal process itself, a majority of respondents noted that their biggest mistake was failing to study local market regulations sufficiently in advance. "There were an awful lot of procedures to follow," says one technology executive. "The biggest problem was identifying those procedures: foreign regulatory approval; reform commission; antitrust administration; national security authority; and many more. You need experienced advisers, otherwise it takes a very long time to get clearance."

Asked to name the top-two legal and regulatory challenges faced during acquisitions, respondents selected antitrust (61 percent), taxes (55 percent) and national security reviews (27 percent).

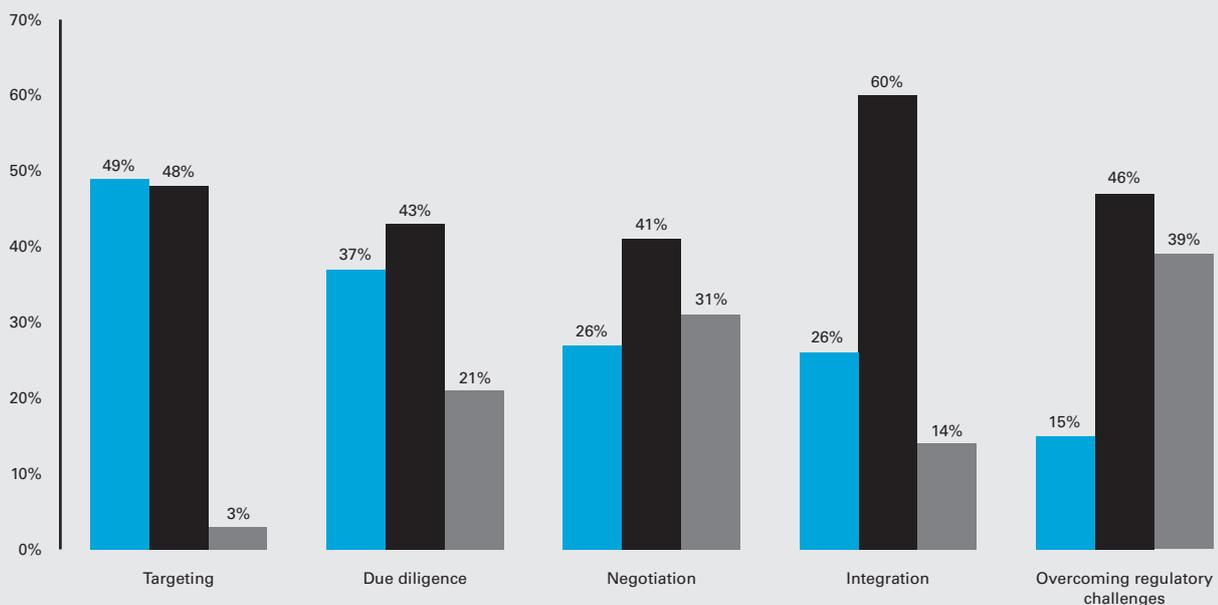
And antitrust rules are tightening around the world. "With Trump as president and strict policies to

restrict foreign companies, antitrust is now the most challenging regulatory hurdle," says the finance director of a UK-based cybersecurity company.

Governments are also taking stronger approaches to reviewing deals for national security threats, particularly when they involve technology. The Committee on Foreign Investment in the United States (CFIUS), which scrutinizes foreign investments in the US, recently had its remit expanded. In August, the government introduced the Foreign Investment Risk Review Modernization Act (FIRRMA), which is widely seen as intended to curb Chinese influence. Among other things, FIRRMA extends the power of CFIUS to scrutinize deals involving sensitive personal data and critical technology.

"The USA is going overboard with its national security concerns," says the SVP of an India-based telecommunications company. "I fail to understand why they interpret every deal as a threat to their security. Even with those which have

How would you rate the success of your most important deal of the last 24 months in the area of targeting?



■ Very successful
■ Generally successful (some room for improvement)
■ Not very successful (significant room for improvement)

nothing to do with national security, they keep delaying approval.”

The UK has also tightened merger scrutiny, giving the government greater powers to review cross-border tech deals. Meanwhile, momentum for stronger investment controls is building in Europe, both at the EU level and for individual states. Germany, for example, recently vetoed a high-tech manufacturing takeover.

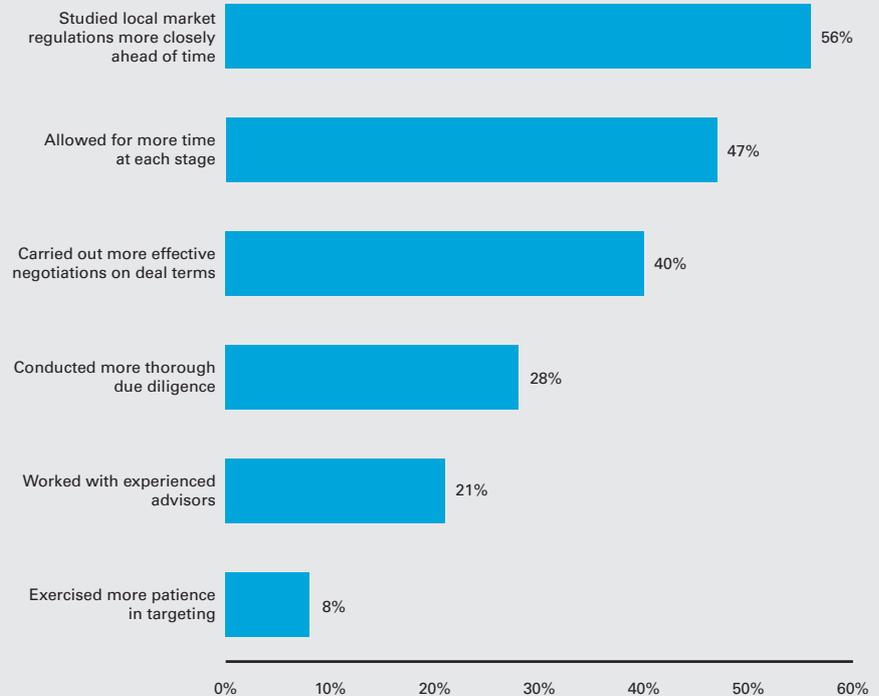
While tougher rules on inbound investment in the West are primarily meant to rein in growing Chinese influence, they raise the regulatory bar for any cross-border acquirer of sensitive tech assets. Even foreign-to-foreign acquisitions can fall afoul of cross-border rules in third-party jurisdictions if the target has end-customers or relevant activities in that country.

“Since the change of leadership in the USA, we have seen a lot of policy changes creating an uncertain business environment. Making an acquisition in such an environment is a challenge we don’t want to face at present,” said the SVP of an India-based telecommunications firm.

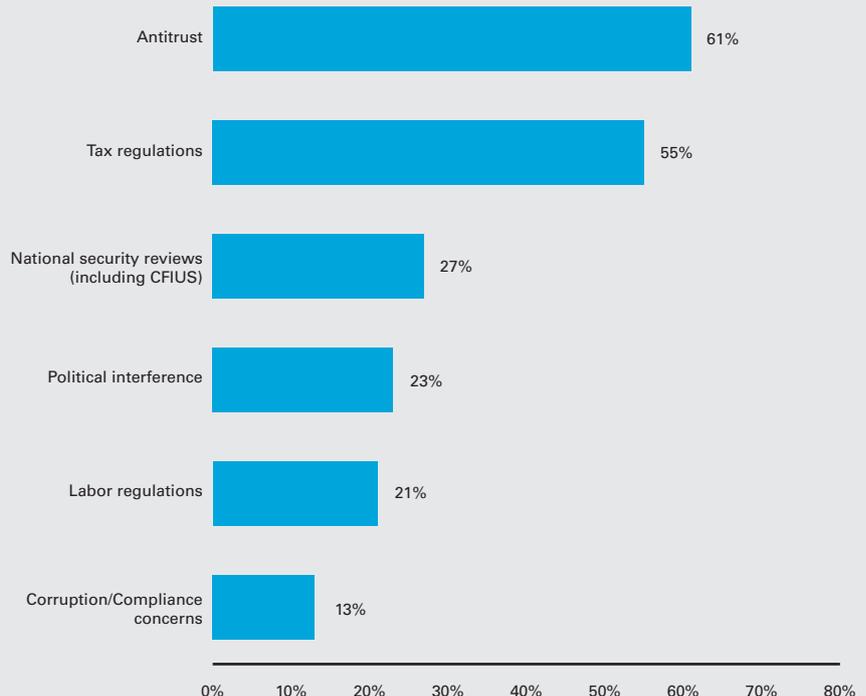


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What is the most important step you wish you had taken in the deal process? (Select top two)



What were the biggest legal or regulatory challenges you faced as you pursued this deal? (Select top two)





Due diligence in the deal

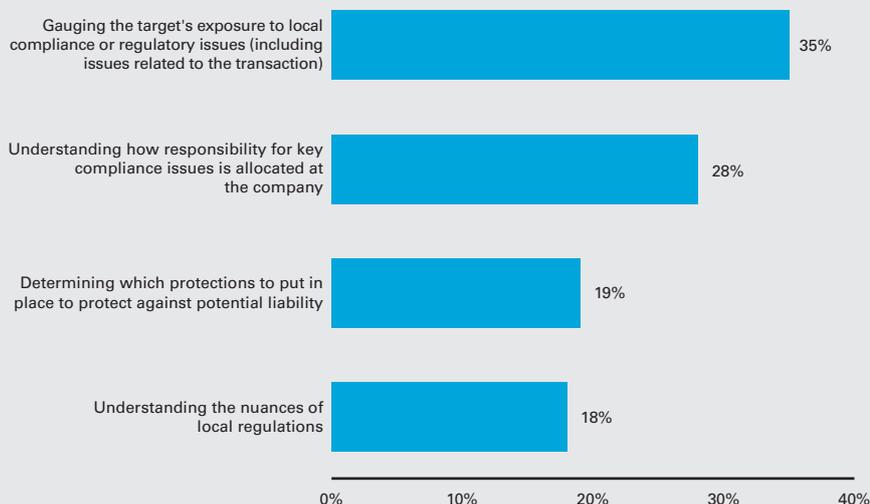
When it came to due diligence on regulatory and compliance matters, 35 percent of respondents said gauging the target's exposure is the greatest challenge, and 28 percent cited understanding how responsibility for compliance issues is allocated within the company is the most difficult.

These responses highlight the ongoing need for acquirers to engage competent regulatory counsel in the target jurisdiction early in the process. In particular, a tech target may be subject to privacy, national security or import/export regulations that warrant in-depth review.

Culture is a perennial challenge

In addition to regulatory matters, our survey examined due diligence challenges across the deal process. In terms of cultural due diligence,

What was the biggest challenge you faced in the area of regulatory + compliance due diligence?





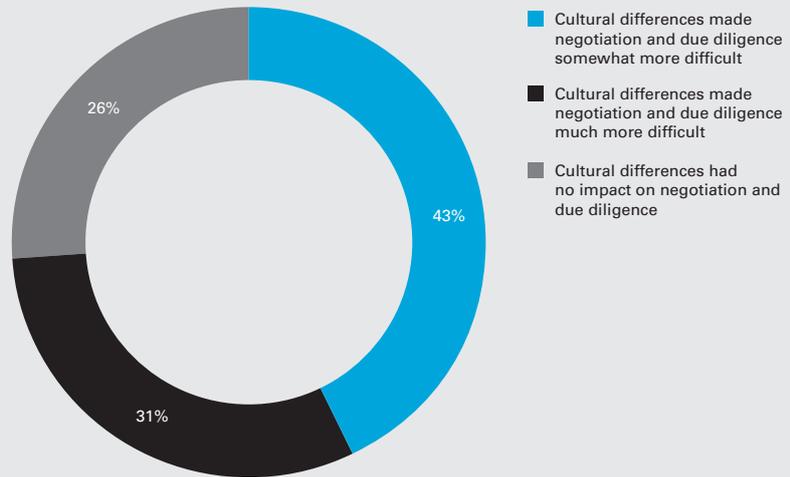
evaluating the fit between the target and the acquirer’s culture was the biggest issue, according to 39 percent of respondents.

Overall, 74 percent say cultural differences made negotiations and due diligence more difficult, to some degree. “The market has evolved and information is easily available now compared to ten years ago, but at the same time complexities have also increased,” says the SVP of an India-based telecommunications firm. “Our due diligence was not sufficient. Cultural aspects were something we misjudged completely—there was far more difference than we anticipated.”

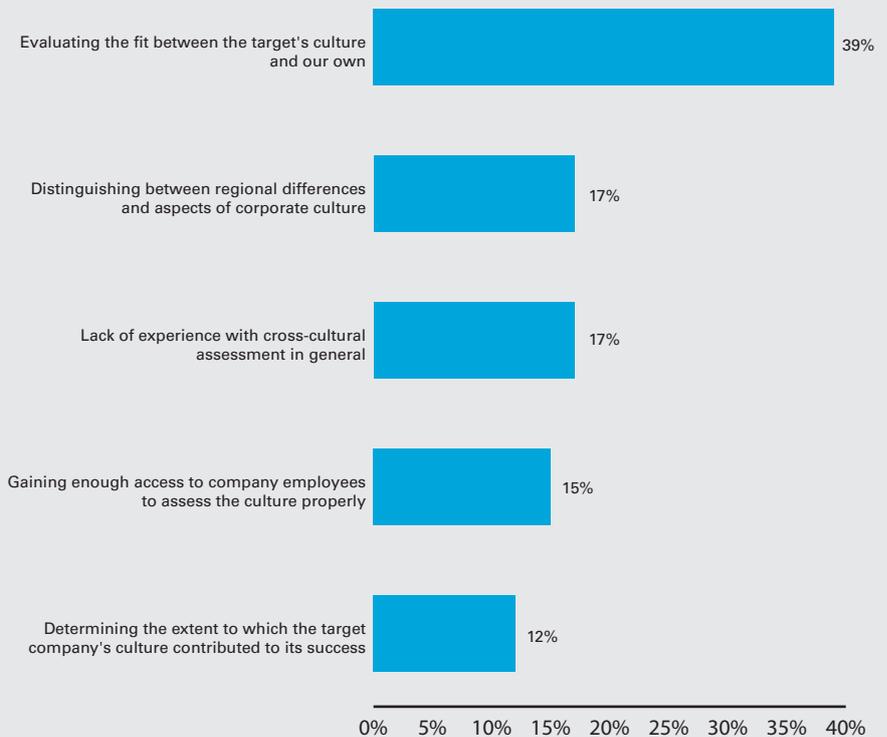
Lack of info scuppers tech due diligence

Insufficient information about the target company’s assets is seen as the biggest challenge in doing tech and IP due diligence.

To what extent did cultural differences make negotiation and due diligence for the deal more difficult?



What was the biggest challenge you faced in the area of cultural due diligence?



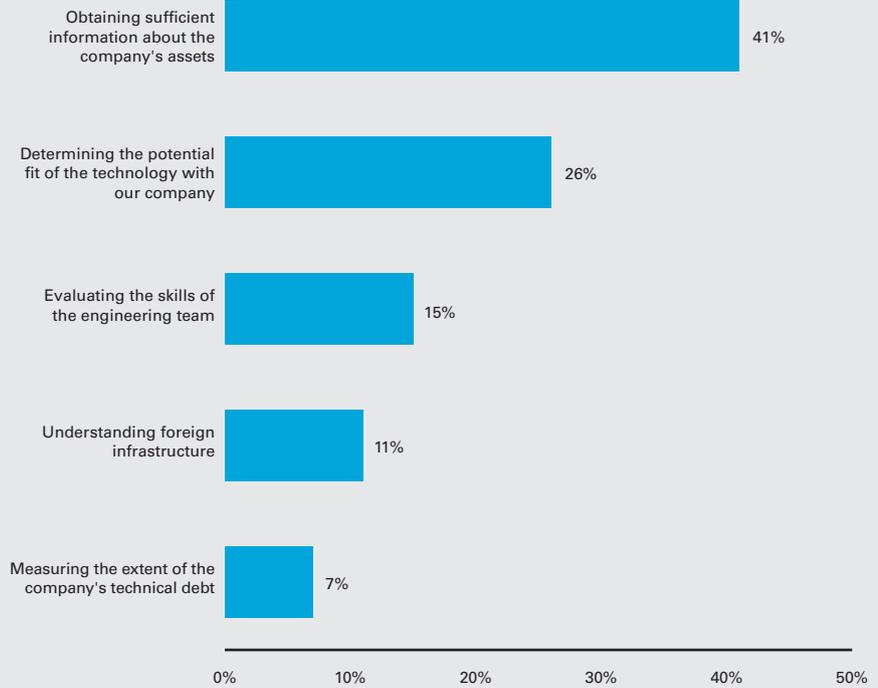
Due to the importance of trade secrets and other proprietary or information to their businesses, technology targets may prefer to limit the amount of information disclosed to a bidder until a firm offer is on the table. A bidder will have similar but opposite concerns. In a cross-border deal, this dynamic can be exacerbated by unfamiliarity with the target's or acquirer's jurisdiction and differing practices regarding the depth and pace of due diligence.

No shame in walking away

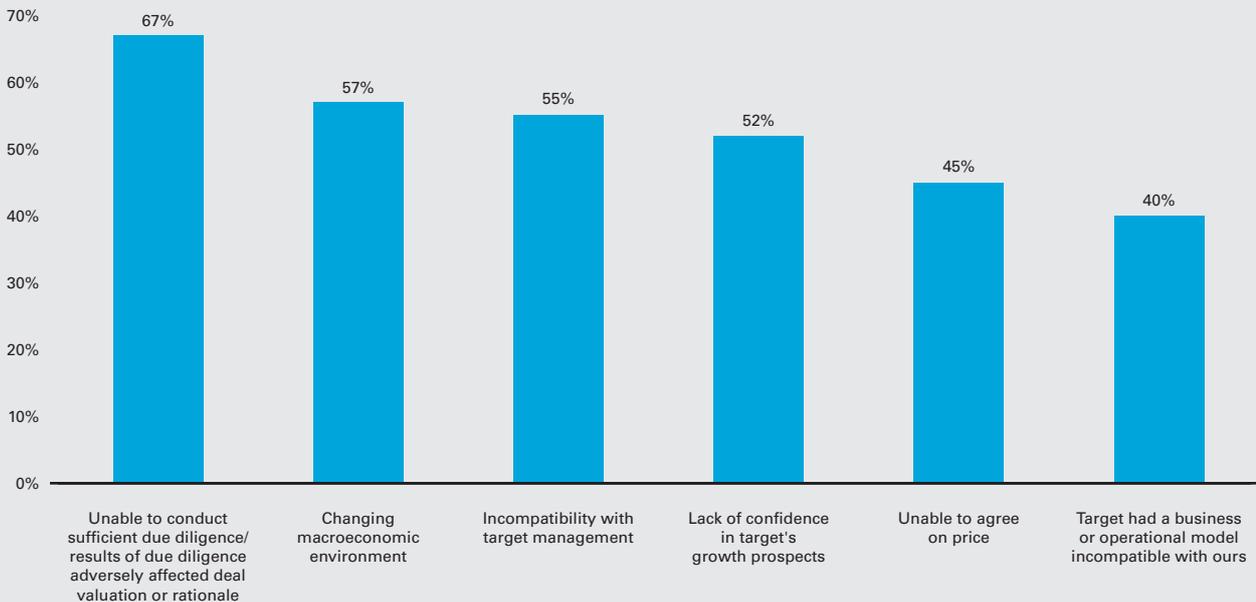
And when buyers feel unable to conduct enough due diligence, our survey finds that many (44 percent) buyers are unafraid to walk away. The top reason buyers walk away from deals, cited by 67 percent of respondents, is the inability to conduct sufficient due diligence or that the results of the due diligence adversely affect deal valuation or rationale.

But macro-factors can also throw a wrench into the works: 57 percent of respondents said they had walked away from a deal because of the changing macroeconomic environment.

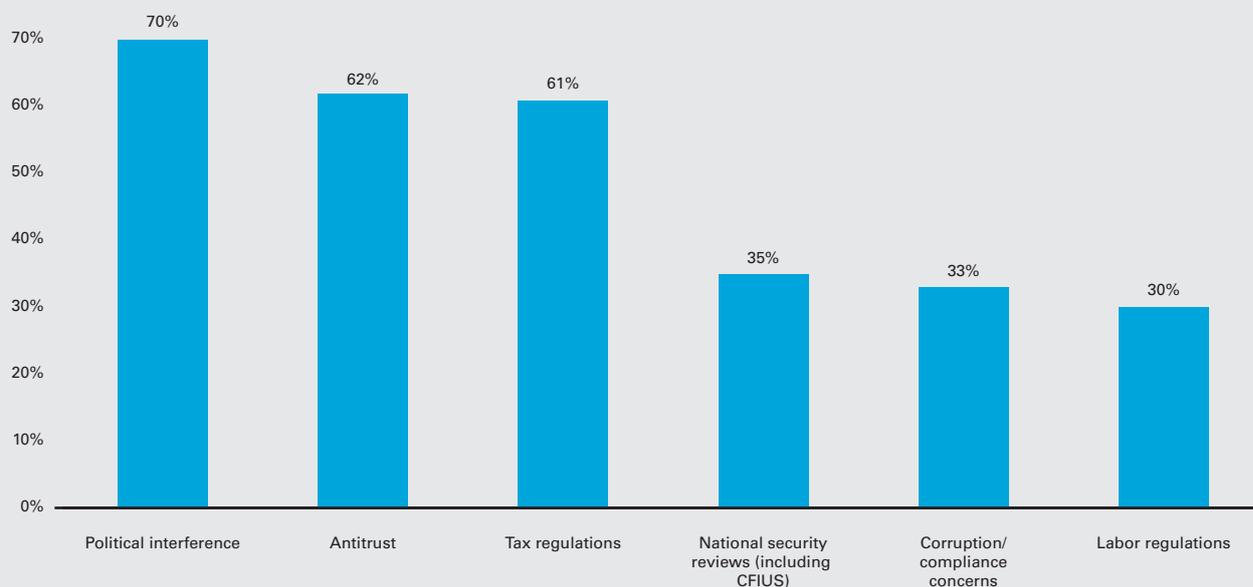
What was the biggest challenge you faced in the area of technology & IP due diligence?



In the most recent case where you have walked away from a potential cross-border acquisition, what operational factors caused you to walk away? (Select all that apply)



In the most recent case where you have walked away from a potential cross-border acquisition, what legal or regulatory challenges caused you to walk away? (Select all that apply)



Meanwhile, more than half of respondents (55 percent) say that incompatibility with the target’s management has prompted them to leave the table, while 52 percent say that lack of confidence in a target’s growth prospects has put them off. When it comes to legal or regulatory issues, political meddling is the number-one reason why acquirers have abandoned a transaction, highlighted by 70 percent of respondents.

“The breaking point for us was the high level of political interference,” says the strategy director of a Japan-based semiconductor business. “The government was trying to influence the deal and had its hand in negotiations, but when it came to deal structure and directly placing people to oversee our acquisition, we decided to let the deal go.”

A China-based tech acquirer says: “There was direct interference from the government when we wanted to acquire a target in Western Europe. We tolerated this to an extent but when the interference got to the strategic level, we had no option but to walk out of the deal.”

Antitrust rules are also turning deals sour, with 62 percent of



44%

Percentage of respondents who said they had, in the past, walked away from a potential cross-border acquisition

respondents who have walked away from deals citing uncertainty around competition regulations.

Tech acquirers are optimistic but pragmatic

The outlook for cross-border tech M&A is positive, with buyers vigorously pursuing overseas opportunities as they look to grow their customer base and acquire IP. However, this is taking place against a tightening regulatory background and shifting geopolitical dynamics.

Governments are increasing the level of scrutiny under national security policies that apply to foreign investments. The regulatory environment is becoming less forgiving, and businesses will need to take this into account as they plan their future transactions.

Despite these pressures, our research shows that acquirers are taking a pragmatic approach. They’ll fight hard to close good deals, but they are not afraid to cut their losses and walk away when diligence reveals problems or the macroeconomic environment shifts in an unfavorable direction.



When it comes to legal or regulatory issues, political meddling is the number-one reason why acquirers leave the negotiating table.

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