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M&A: The Last 12 Months at a Glance

The Covid-19 pandemic has put a brake on many new M&A deals. How did the normally vibrant M&A market in Israel fare over the past year, and what can be expected for the future?

In the world of global mergers and acquisitions, the last 12 months have been roller-coaster. While 2019 was particularly strong – M&A transactions totaled over \$20 billion – the Covid-19 pandemic has put many new transactions on hold. In fact, since the end of the first quarter of 2020, mergers and acquisitions around the world have come to a grinding halt. In March 2020, the Israeli M&A market nearly froze with only nine transactions closing as compared to twenty-three closings in March 2019, the strongest month for M&As that year.

fund for \$1.9 billion, as well as the acquisition of Checkmarx, a pioneer in the field of cyber security and data protection with over 600 employees worldwide, for \$1.15 billion. (In this transaction EBN has acted as the Israeli counsel for the acquirer, Hellman & Friedman).

Another notable transaction in the high-tech sector was the acquisition of Moovit by Intel for approximately \$900 million. Moovit, an Israeli company founded in 2011, launched a highly successful public transport and mobility journey planner application. This transaction is the second major acquisition by Intel in Israel in 2020, following its acquisition of chipmaker Habana Labs for approximately \$2 billion at the end of 2019. It is interesting to note that Intel has invested over \$22 billion in Israeli companies over the past years and is one of the largest employers in the high-tech sector in Israel.

A particularly noticeable trend in mergers and acquisitions over the last twelve months is the increased investment in, and acquisition of, Israeli cyber-related companies. The volume of investment in the Israeli cyber security industry was just over \$4 billion from 2015-2019. Toward the end of 2019, ObserveIT, a developer of an insider-threat defense system was acquired by Proofpoint, a U.S. cybersecurity company for \$225 million, and Insight Partners, a U.S. private equity and venture capital firm acquired Armis, an Israeli Internet-of-Things security company for \$1.1 billion.

During 2020 several high-profile acquisitions

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On the Israeli landscape, notable transactions were the acquisition of Forescout (an Israeli provider of solutions for control and security of devices connected to an enterprise network) by Advent International, a U.S. private equity

were made.

A significant transaction that closed in spite of the Covid-19 pandemic was the acquisition of Mellanox Technologies, an Israeli big data connectivity equipment developer, for approximately \$7 billion by NVIDIA Corp, the U.S. graphics processing giant.

The energy sector has also shown some resistance to the effects of the Covid-19 pandemic. Among the prominent transactions were the merger of Arko Holdings with Haymaker resulting in a combined company valued at \$1.5 billion; the acquisition of Chevron's North Sea oil fields by Delek Group for \$2 billion; and the acquisition of Competitive Power Ventures by OPC Energy for approximately \$750 million.

As Nils Bohr, the Nobel prize physicist once humorously proclaimed: "Prediction is very difficult, especially if it's about the future", we will nevertheless try to forecast the M&A market in light of the recent trends mentioned above and our acquaintance with the different players in the market: private equity funds, strategic investors and c-level executives, as well as scholars and experienced accountants and lawyers.

THE IMPACT OF COVID-19

The Covid-19 pandemic will continue to affect the world economy. Covid-19 has put nearly every aspect of business operation to a test. We have seen a slow-down in the number and scope of M&A transactions in the first and second quarters of 2020. Whereas 2019 was phenomenal for the Israeli M&A market, it is clear that 2020 and even 2021 will be challenging. The M&A market will need to re-invent itself.

Strategic acquirers have less appetite for growth acquisitions and expansion into new markets and are more focused on maintaining current market-share and profitability. Therefore, it is to be expected that strategic acquirers will be less dominant in the near future and high-range acquisitions such as Intel's of Mobileye will become less frequent. As private equity firms have a limited window in which to utilize their committed funds and acquire target companies, it is to be expected that they will continue to "feed" the M&A market. A dramatic rise in bankruptcies with a concurrent increase in distressed M&A activity is expected as a result of the economic turmoil. For many strategic



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purchasers and private equity firms with relatively strong cash positions, the wave of insolvency auctions will present significant opportunities to acquire valuable assets at discounted prices.

The decrease in M&A transactions indicates that we are in a pro-buyer market. In recent years,

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cross-border M&As have turned to pro-seller "lock-box" price methodology (where purchase price is based on the target business' financial statements at a specific date before signing of the purchase agreement). Since use of "lock-boxes" is not all that common in Israel, Israeli cross-border M&As will probably use more traditional post-closing purchase price adjustment mechanisms ("completion accounts"), wherein the purchase price is adjusted ("trued-up") to the state of the business at closing.

One of the challenges that the M&A market now faces is how to evaluate target companies.

Traditionally, last twelve month (LTM) financial metrics are used to determine target company's valuation and are the basis for the agreed purchase price. Although short, a 12-month period is useful because it indicates a company's most recent performance and reveals the company's current financial state. It seems that post-coronavirus this method is no longer sufficient, since it disregards the impact of Covid-19 on a business and the overall market in which the target company operates. Therefore, it should not be employed to predict the business outlook in the years post-closing. One of the ways to mitigate the complexity of determining company valuation is to introduce more nuanced price adjustment mechanisms and payment structures like earn-outs and other conditional payment structures. These structures entitle sellers to receive the full purchase price

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only if the business going forwards meets certain benchmarks. This splits the risk of low performance post-closing between sellers and acquirers and protects the acquirer from overpaying for an over-valued asset. We envision that until the global effect of the Covid-19 pandemic on markets is fully understood, more M&A transactions will include these conditional apparatuses.

M&A transactions are financed both through purchasers' own resources and debt financing. Financial institutions will be more reluctant to participate in high-risk transactions and therefore it is expected that the financing of these type of transactions will be prolonged and in certain very high-risk markets may not even be provided. This

will have a negative impact on the transaction cycle, including extending it by several months. There will be a direct impact not only on the number of the transactions concluded but also on the dollar-value of such transactions. We note that the exponential growth of unicorn companies (i.e., companies with over \$1 billion in valuations) in recent years is expected to decrease.

Investment in early-stage companies by venture capital funds continue to flourish, especially in the arenas of cyber-security, artificial intelligence and deep learning. This is an indication that when M&A markets revive and return to their 2019 level, many opportunities will present themselves and Israel will continue to be a vibrant market for M&As.

PROMISING INDUSTRIES

While Covid-19 has devastated sectors like travel and tourism, transportation, culture and entertainment, it has had the opposite effect on cyber-security, telemedicine, fintech, e-learning and digital services. The company Zoom is a case in point: as a business, it was primarily known only among tech-companies, but now it is widely used by everyone. Zoom's success is evident in the greater than 300% increase in its stock price since the onset of the pandemic. As it is now clear that Covid-19 will not disappear in the near future, businesses will be forced to learn how to identify and actualize business opportunities specifically for these times.

Israel as a hub for both defensive and offensive cyber-security companies, has in recent years specialized in addressing issues of cyber-attacks upon organizations. Now, working remotely has significantly increased such risks, exposing industries to even more complex threats. During 2015-2019 an aggregate \$4 billion was invested in cyber-security companies and the average value of deals for 2015-2019 was approximately \$1.5 billion per year. In the first half of 2020 more than \$800,000 was invested. M&As of cyber-security companies during the first half of 2020 reached \$4 billion (which includes the acquisition of Checkmark and Armis). We expect that by the end of 2020 this number will increase and growth both in investments and M&A transactions in this sector will be experienced.

We predict that the next trend in mergers and

acquisitions, as well as in capital investments, will be in education technology (Ed-tech). Even before the Covid-19 pandemic, there was high growth and adoption of Ed-tech related projects, with global investment in 2019 totaling approximately \$18.5 billion. The market cap expectation for 2025 (prior to the pandemic) was estimated at \$350 billion. In the first quarter of 2020, Ed-tech companies raised more than \$803 million in the United States alone. This amount was invested across more than 60 transactions, although this was a 17% decline when compared to the \$962 million raised in the first six months of 2019 (a record year in the Ed-tech sector for raising capital). Therefore, we believe that it is merely a matter of time before Israeli companies join this trend and we see more acquisitions in this sector.

Telemedicine is a sector that has been neglected over past decades. Coronavirus has accelerated the long overdue telemedicine revolution. The global telemedicine market is currently valued at \$185 billion. Since March 2020 we have seen increased interest in this sector. During the first half of 2020, an aggregate amount of \$3.6 billion was invested in telemedicine companies, representing a more than 100% increase. Since this market is undeveloped its potential is huge. We expect to see exponential growth in the near future.

THE EMIRATES-ISRAEL TREATY

On August 13, 2020, the State of Israel and the United Arab Emirates (UAE) reached a landmark peace deal – dubbed the “Abraham Accord.” The deal was announced following a call between Sheikh Mohamed bin Zayed, the Crown Prince of Abu Dhabi, U.S. President Donald Trump and Israeli Prime Minister Benjamin Netanyahu. The three leaders agreed to “full normalization of relations” between Israel and the UAE. The UAE is now the first Gulf state and the third Arab country after Egypt and Jordan to establish diplomatic relations with Israel. This step officially revoked the UAE economic boycott of Israel, thereby allowing trade and financial agreements between the UAE and Israel to flourish. Companies and individuals in the UAE can now legally enter into agreements with companies, individuals or organizations residing in Israel or belonging to it by nationality as part of commercial or financial operations or other

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dealings.

This historic peace accord will provide new opportunities for mergers and acquisitions. The UAE hopes that Israel will help it to lay the foundation for its transformation into the world’s next startup nation. The UAE do not necessarily want to buy Israeli technologies as finished products but as investments that will allow companies in the UAE to expand these ventures over time. The expectation is that the UAE will make strategic investments in Israel that will be a “game changer” for the Israeli economy. Tech and innovation relating to irrigation, desalination, agriculture, fintech, cleantech, healthcare and cyber security are likely to be of particular interest. A fair projection would be that a solid relationship between the two countries will boost both nations’ economies. Saudi Arabia and other Gulf countries may follow the UAE, which will obviously have dramatic positive geo-political, commercial and financial consequences for the entire levant region.

CONCLUSION

World finance will need to accommodate to the Covid-19 pandemic. We already see an increase in the number of transactions finalized during the second and third quarters of 2020. In light of the nearly universal adoption of digital technology across all industries and sectors it is not surprising that high-tech will be the sector exhibiting the highest durability in the Covid-19 era. This trend will likely continue into 2021. As the premier start-up nation, there is hope for optimism in the M&A market in Israel. ■

ABOUT THE AUTHORS

Viva Gayer is a partner in the firm's corporate and M&A department. Viva's practice is focused on domestic and cross-border M&A, investment transactions in the hi-tech arena and representation of technology companies. Viva's business orientation and in-depth understanding of market trends makes her the ideal professional for handling business complexities requiring creative legal solutions. Viva represents foreign and domestic clients, capital funds and angel investors. She handles their transactions, both in Israel and abroad. Viva also advises start-up companies, throughout their life cycle and in their day-to-day activity, which includes joint ventures, licensing agreements, distribution agreements, sale and procurement agreements and other.

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