Big deals, big ideas, and big challenges spur TMT activity

Hogan Lovells Partner, Peter Watts, discusses how intense innovation, diverse deal structures, and political protectionism are changing the face of M&A in the technology, media, and telecommunications (TMT) space.

What are the main drivers for cross-border deals at the moment?

Peter Watts: There are number of long-term drivers in the TMT sector. The first is the relentless pace of innovation across all aspects of the industry. And innovation can take a number of different forms. For example, lots of deals have been driven by acquiring particular data analytics or machine learning (AI) capabilities.

Innovation is not confined to technology itself – innovation is also changing how content is distributed. So we are seeing the explosive growth of subscription VOD services versus traditional broadcast media.

We have long been grappling with convergence between tech, media, and telecoms. As important in recent quarters is convergence between tech and a wide range of other sectors – pharmaceutical companies acquiring cutting edge technology firms or acquiring new capabilities in mobility.

Finally we shouldn’t forget that old-fashioned consolidation plays are driven by a number of factors. The underlying rationale are time-honored – a wish to expand one’s footprint; to leverage existing assets; to bring in new assets that drive economies of scale; or a desire to consolidate customers.

What do you think has been the most interesting deal of Q3, and why?

Watts: It’s hard to look further than the Sky/Comcast deal. It’s particularly interesting because, first, it illustrates the rapid evolution of a sector where business models are changing very quickly. And, second, it demonstrates the globalization of content consumption in a way we haven’t seen before. Not long ago, Sky was a disruptive insurgent in traditional broadcasting markets; now it is an incumbent.
which was fought over by two global giants – each looking for a strategy to counter the media insurgency from Silicon Valley. Similar factors are driving valuations and will almost inevitably drive more deals across the media sector.

*With innovation as a major driver of deals, do you feel that M&A is the best way for companies to nurture that kind of innovative spirit?*

Watts: Many deals that we observe or are involved in are about innovation in its truest sense. The TMT sector contains a vast number of companies that can create a new product or service, but don't have the skills, capital, or network to really exploit that invention – they are inventors but not innovators. In the good deals, established players with global networks, skills, and resources, can take those inventions to the next level.

If we look back over the past five to ten years, a lot of companies including some of the West Coast tech leaders, have made acquisitions in which they have bought a company or product as part of a strategy to drive that product further forward as part of a wider portfolio.

Of course a minority of deals end up stifling innovation but they are definitely the exception rather than the rule.

*Does the drive for innovation differ across other sub-sectors?*

Watts: Parts of the sector are fundamentally driven by a constant process of creating new output – whether a TV show, video game, or online content. So it is about talent and revenue rather than capital investment which can deliver returns over the long term. These businesses are constantly innovating – after all their fundamental planning horizon is the next season rather than the next decade.

But talent can be fickle and is often driven by a sense of ownership and control as much as by pure financials. So these acquisitions can also be more challenging than in the more technology-driven end of the business where innovation is often about constantly refreshing a portfolio of long term assets.

*What are the major challenges to M&A in the sector?*

Watts: TMT can generate real political sensitivities. The idea of a foreign company acquiring a media outlet with domestic cultural significance, a technology company which handles cybersecurity defenses, or a telecoms company which is critical to national connectivity is always going to raise political questions. With protectionism apparently on the rise, TMT deals are going to be an increasing focus for regulatory scrutiny.

There are also some signs that increasing valuations may be cooling the level of enthusiasm in some parts of the market for deals at the more speculative end of the spectrum. Over the last five years we have seen a boom in companies across the economy "gambling" on investment in a portfolio of tech start-ups in the hope of securing a foothold in the next wave of technology driven innovation. This has driven tech values to a level where even buying chips in the casino has become very expensive.

Both these trends would tend to suggest some shift in the direction of travel being back towards strategic partnerships. Deals which can address regulatory and cultural sensitivities by balancing the global and the local can enable established players to combine with creative talent to drive innovation.

A further complicating factor is the pace of innovation. The attitude of regulators is changing fast because they are having to try to keep up with continuous change in
the marketplace. For example, in October, the UK Chancellor of the Exchequer Philip Hammond, spoke about how the UK policy on large technology platforms is going to evolve. This is a debate about the role of large platforms, fake news, and new forms of economic dominance which is going on all around the world.

Regulators, even absent a protectionist thrust, are having to face a new set of challenges. For the TMT sector, there is a risk of a perfect storm of regulators, who are already faced with some very tricky questions, having to deal with cross-border acquisitions that raise questions about national sovereignty.

As we move towards 2019, what advice do you have for companies looking to do deals in the sector?

Watts: As pricing rises and regulatory hurdles increasingly influence outcomes, TMT companies who are looking to do deals will need to continue to exercise discipline on the assets they are seeking, as well as in how they engage with advisors to address regulatory hurdles early in the process. Not just with the sort of traditional antitrust functions, but also with their public policy and their broad regulatory thinking.

The challenges from issues such as monopolies, fake news, and data abuse, coupled with intense scrutiny from regulators mean that the public policy function and the transactional team, which traditionally have been a bit separate and culturally a bit different, have to start thinking together.

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