Dear Valued Reader,

Welcome to the September 2017 edition of the Venue Market Spotlight. This month, we will examine the latest trends in cybersecurity.

The first six months of 2017 have been marred by a string of cyberattacks and breaches. Among them, on May 12, a strain of ransomware called WannaCry hit public utilities and large corporations across the globe: from the UK’s National Health Service (NHS) to FedEx in the US, and Deutsche Bahn rail services in Germany. Just one month later another cyberattack hit US pharmaceutical Merck, Danish shipping company Maersk, and Russian oil giant Rosneft.

But it’s not just corporate hacks stealing the headlines recently, as cyberattacks also targeted the US presidential election in 2016 and French President Emmanuel Macron’s campaign in May. Today, dealmakers are more aware than ever of the inherent risk in acquiring a company that could be or has already been breached.

The ISACA’s State of Cyber Security 2017 report found that 53% of enterprises experienced more attacks this year than in the year prior. Further, four out of five say it is likely or very likely that they will experience a cyberattack this year.

At Donnelley Financial Solutions, we understand how arduous it can be when navigating the transactional and regulatory environments within today’s evolving marketplace. Virtually every sector is in a state of constant change, requiring partners and advisors that help streamline business processes from top to bottom. This is why we are committed to aggressively investing in and building upon our DFS technology and service platforms to maintain our position — year after year — as the global leader in financial communications.

As always, please enjoy this month’s Spotlight.

Sincerely,

Craig Clay
President, Global Capital Markets
Donnelley Financial Solutions

Our respondents have no doubt that cybersecurity has increased in importance when considering target companies over the past 12 months. And they don’t have to look far to see examples of why this has become a crucial consideration — reports of new cyberattacks seem to grace news headlines almost weekly.

These headlines include the widely publicized breaches to Yahoo that were not discovered until 2016 — one in 2013 that is said to have impacted one billion consumers, and a second in 2014 that affected 500 million — that caused its sale price to Verizon to plummet during their acquisition negotiations last year. And a more recent cyberattack, on consumer credit reporting agency Equifax, is said to have potentially impacted 143 million consumers in the US.

While these attacks help to keep the issue of cybersecurity front-of-mind for corporates, the issue of upcoming changes to cyber regulations is equally pressing, such as the European Union’s incoming General Data Protection Regulation (GDPR), due to come into force in May 2018.

Respondents are becoming more savvy to the threat of cybercrime and its potential impact on an M&A transaction. Some, however, fear that the rate at which businesses become more aware of cybersecurity does not match the pace of development by criminals looking to take advantage of weaknesses in a company’s data and intellectual property safeguards.

Cybersecurity considerations are becoming the norm for bidders seeking out acquisition targets, respondents say, with cyber due diligence now playing an increasingly crucial part of the screening process.

Other key findings include:

- Respondents were unanimous in their opinions that the importance of cybersecurity has increased in the past 12 months, some 44% say significantly so.
- More than half (52%) of respondents say 26% – 50% of the companies they have targeted for an M&A deal have experienced data security breaches at some point in the past 24 months.
- Some 76% of respondents say that the consumer and e-commerce sector will be the most targeted by cybersecurity threats in the coming 12 months.
Q1 Over the last 12 months, how has the importance of cybersecurity issues at target firms in M&A deals changed for you, if at all?

As large-scale corporate and political hacks become an all-to-frequent occurrence, businesses are taking heed. Our respondents say, unanimously, that the importance of cybersecurity at the companies they target for deals has increased over the past 12 months. And many add that this is only going to continue: “Cyber issues now have the potential to bring down an entire business,” says the managing director of a private equity firm in Australia. “It is a serious issue. In any deal, cybersecurity is an important aspect, and in some industries it is quite critical. The importance of cybersecurity is only going to increase further.”

A senior director of corporate development at a private equity firm in the US says that while the concept of cybercrime has evolved over the years, the growth rate of cybercrime has been faster than the growth of cyber awareness and security.

“Our company depends on a digital structure where we contain our client information, business, and investment plans,” explains a managing partner at a private equity firm in the US. “If we acquire a target company which has a fragile cybersecurity structure, we might be at risk of acquiring a company whose digital assets might’ve already been compromised, and that puts us at risk, too.”

Q2 At roughly what percentage of M&A targets have you uncovered data security issues in the past 24 months?

According to the annual Symantec Internet Security Threat Report, there were more than 1,209 cybersecurity breaches in 2016, exposing an estimated 1.1 billion identities. Ransomware attacks grew in the number of detections, rising to 463,841 in 2016 from 340,665 in 2015. With figures such as these, it is no surprise that 80% of respondents say that they have uncovered data security breaches in between 26% and 75% of M&A targets.

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A managing director at a private equity firm in China says his firm has faced data security issues in at least 50% of its targets. “The data security issues varied quite a lot according to the market the target was based in, and also to an extent the sector the target was operating in. In regions like APAC, Africa and the Middle East, the data security issues were much higher and critical than in Europe or North America.”

“Over the past two years we’ve noticed an increase in demand for cybersecurity solutions,” explains a managing director at a PE firm in the US. “Cyberattacks like ransomware and Wikileaks have made it really clear that cybercrime exists in every industry. Though there are M&A targets that haven’t achieved the utmost level of expertise in cybersecurity, we see that they’re definitely willing to work towards it.”

**Q3** In which sectors are cybersecurity issues currently most important in M&A transactions? (Select top two)

Consumer and e-commerce convincingly topped the ranking of sectors in which cybersecurity is most important, with 76% saying the threat of cyberattack was strongest in this industry. “Cyberattacks aimed towards the consumer and e-commerce sector have more to them than just the monetary factor; there’s a breach of confidentiality,” explains a director of corporate development at a US corporation. “People get affected, their private lives get compromised, and nobody likes that.”

Financial services and technology, media and telecommunications were the second and third-ranked sectors most at risk from cyberattack, with 48% and 32% citing them respectively.

**Q4** In which regions are cybersecurity issues currently most challenging in M&A transactions? (Select top two)

Developing economies in the Asia-Pacific region are the most likely to encounter challenges with cybersecurity, say an overwhelming 88% of respondents. “There’s definitely an increase in cyber threats in the Asia-Pacific region, and the attacks that have been executed in recent times have done a lot of damage” says a managing director at a PE firm in Hong Kong. “The last thing an investor would want is to invest in a platform which has threats that cannot be comprehended or controlled.”
A managing partner at a PE firm in the US explains further: “In the Asia-Pacific region, the digital world is growing very fast, and that invites a lot of cybercrime or hackers, but they don’t have a strong cybersecurity structure. However, even in countries like America, where companies are investing a lot of money in cybersecurity, they are also witnessing the growth of cybercrime at an unbelievable speed.”

**Q5** When evaluating cybersecurity threats at an M&A target, what is usually your greatest concern? (Select one)

The potential theft of intellectual property or data is overwhelmingly the greatest concern for acquirers when assessing a target for cybersecurity threats. Some 60% of respondents cited this as their top concern, with 20% each naming the potential for legal liability and potential reputation damage.

“The intellectual property of a company is its foundation,” says a head of corporate finance at a corporation in India. “It literally defines the movements, the actions, the growth, and the direction of the company. In the wrong hands, it could be responsible for the downfall of the company.”

Another respondent, the CFO of a corporation in Japan, says that the concern of lost data or IP and potential legal liability go hand-in-hand: “Intellectual property consists of all the confidential information that is under the disclosure policies, and we become legally liable once the IP is stolen. Therefore, both would be our greatest concern.”

**Q6** Compared to other types of due diligence, how important has cybersecurity diligence become in a typical M&A deal?

There is no doubt among respondents that cyber due diligence is an important aspect of the wider due diligence process. During Verizon’s acquisition of Yahoo, the internet giant disclosed two massive data breaches that affected more than one billion user accounts. Consequently, Verizon cut US$350m off its offer, even though the companies had initially agreed on a sale price months before Yahoo disclosed the breaches. What’s more, publicized data breaches can lead to a drop in stock price and devaluation of the company.
“We’ve seen what cybercrimes lead to and are capable of doing. The damage is too high; we can’t afford to move ahead with a target company that has a vulnerable cybersecurity system. Hence, it has to be one of the top priorities in M&A deals,” says a director of corporate finance at a corporation in Germany.

The CFO of a Chinese corporation puts it plainly: “Cybersecurity diligence can make or break a deal. An acquirer wouldn’t want to put its entire company under risk of being invaded and then dealing with major damages.”

**Q7** Over the last 24 months, have you walked away from any deal due to cybersecurity issues at a target firm?

Even when a breach or insufficient cybersecurity measures are discovered at a target company that may not be the end of the deal. Like Verizon, who pushed ahead with their acquisition of Yahoo despite the large attacks the company had endured, more than half (60%) of respondents have not walked away from a deal because of cybersecurity issues.

A director of corporate development at a corporation in the US explains that his company is usually able to work around a potential cybersecurity risk. “If we spot cybersecurity issues at a target firm, we bring them the solution too, and then we restructure the deal accordingly. So far, it’s always worked for us. We have walked away from deals, but not for cybersecurity issues.”

Other companies draw a harder line on the subject: “We were in talks with a product-based company looking at expansion, and it was going to be a direct investment,” explains a managing director at a PE firm in France. “We analyze our targets inside-out and that exposed their casual approach towards the cyber threats that were out there. This company had a small budget and didn’t want to invest further in cybersecurity. Therefore, the deal was terminated.”

According to respondents, investors can also influence the decision of whether or not to go ahead with the acquisition of a company that has encountered a breach or one that has low cybersecurity safeguards.
VENUE® Market Spotlight: Cybersecurity

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## NOTABLE DEALS IN THE ROOM

Venue® data room: A special report

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<th>Target</th>
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