ALTERNATIVES RESEARCH

Resilient Tech Trends in Europe

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The coronavirus pandemic has created significant uncertainty across the European economy. In our view, technology remains one of few secular growth opportunities in this market, with COVID-19, and we also suspect Brexit, further accelerating tech adoption.

Wilshire's Approach to Technology Investing in Europe

Wilshire considers technology an irreversible long-term trend that, fueled by the current crisis, will see accelerated investment in and adoption of digital solutions, providing favorable market conditions for technology and software investors. Within buyouts, Wilshire focuses on investment opportunities in companies active in asset-light industries such as software & cloud, business services and IT services, with significant recurring revenues, solid and sustainable margins with high cash conversion and strong potential for organic and acquisitive growth. While sector specialized funds have been present in the U.S. for some time, often large scale, Europe is at an earlier stage and there are significant opportunities to partner with smaller, dedicated technology buyout funds investing in these types of companies. Within growth equity, we note that while the supply of growth equity investment continues to be on the rise, the funding environment for growth stage companies in Europe is still very much one of scarcity for high quality opportunities. Moreover, fund sizes in the sector are growing rapidly and so is overall pricing, particularly in our more favored technology sector. Meanwhile, valuations in Europe venture capital (VC) remain more favorable and lower than the U.S. As European investors welcome the U.S., the valuations should converge providing European investors a higher return on investment. Wilshire expects that the COVID-19 crisis and its aftermath will create a shake-out in the EU VC ecosystem, resulting in market consolidation and the formation of a select group of top-tier investors. At the same time, Wilshire foresees a wider spread in investment performance, making access to top-tier VC funds, particularly in technology, and manager selection increasingly important going forward. In Europe we therefore like to invest in technology centric buyout and VC investments. Below we will cover the development of four important technology trends in Europe that continue to drive strong investment opportunities across these strategies.

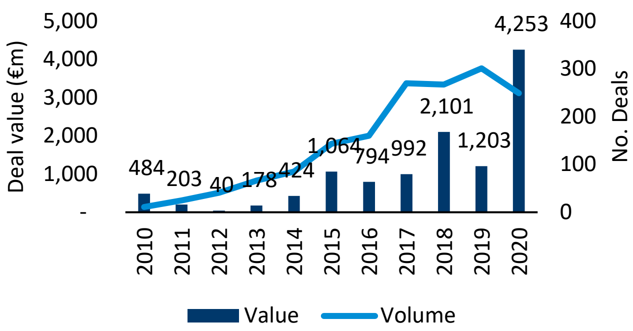
Cybersecurity – VC, Growth, Buyout

The COVID-19 pandemic has caused businesses to quickly adapt their operating models, particularly on work from home policies, which widens the cybersecurity threat landscape and offers compelling opportunities to back high-quality cybersecurity companies. Several high-profile data breaches recently have shown the scale of the potential impact on the value of a company. Forrester Research expects the European cybersecurity market to grow 18% to 20% by the end of 2021, compared with 2019. Europe's cybersecurity industry has a multibillion-dollar funding gap compared with the U.S. and China. The European Commission plans to propose new rules in the coming months that will affect how the bloc develops artificial intelligence, cloud-computing, and cybersecurity products. A group of European venture capital firms have spoken out to the intention to create a €1 billion fund to invest in homegrown cybersecurity companies over the next five years. Tech-enabled cybersecurity businesses tend to be valued on revenue multiples instead of EBITDA multiples, as they operate in fast-growing markets, with business models that are highly scalable, often with high operating leverage and large, sticky, repeat customer bases. Valuations in the cybersecurity sector have stayed strong, with enterprise value to sales multiples trading at around 5x, compared to around 3x in the wider enterprise software M&A market, according to Hampleton Partners[1]. All in all, we believe the cybersecurity market offers compelling investment opportunities across strategies. Indeed, investment firms have funneled significant investment into European cybersecurity companies more recently – including via their portfolio companies – with a focus on larger, more established targets, as shown in Exhibit 1 below.

Financial Technology (FinTech) – VC, Growth, Buyout

The COVID-19 pandemic has underscored the importance of FinTech companies to the financial services sector as they provide competitive advantages in a changing landscape that is increasingly dependent on digital solutions. We expect to see FinTech growth accelerate over the coming years, particularly in sub-sectors such as capital market and trading platforms, ecommerce payments, RegTech, data management and analytics and governance software. In the near term, we expect to see a flight to scale with investors focusing primarily on established targets with scalable products, established client bases, proven economics and strong balance sheets. European Fintech investment is growing rapidly and 2020 was a record year, as shown in Exhibit 2. One of the key drivers of FinTech's rapid growth in Europe is the adoption of the European Union Payment Services Directive, known as PSD 2, which was introduced in 2019. PSD 2 requires banks to establish open interfaces for programming applications. This allows customers to exchange data seamlessly with third-party providers, including FinTechs, who may be able to offer them better and more cost-effective services.

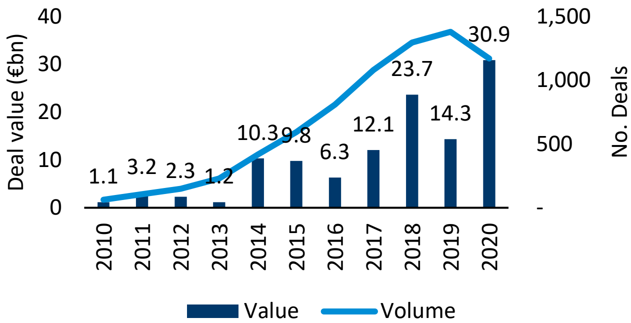
EXHIBIT 1 – European Cybersecurity Activity (€m)[2]



[1] Hampleton, "Cybersecurity M&A market report H2 2020".

[2] Pitchbook, December 31, 2020.

EXHIBIT 2 – European Fintech Activity (€bn)2



Industrial Technology (Industry 4.0) – VC, Growth

The manufacturing industry is currently going through a period of great change characterized as "Industry 4.0." Industry 4.0 is characterized by digitalization and is driven by four technical disruptions: (i) the rise in data volumes, (ii) computational power and connectivity, (iii) analytics capabilities and (iv) advanced robotics. These technologies have been under development for some time and some aspects are not yet ready for implementation, however the changes that they potentially represent are substantial. It is estimated that by digitalizing industrials an additional $11.1 trillion a year in economic value could be generated by 2025 globally. The European Union supports industrial change through its industrial policy and through research and infrastructure funding. Member states are also sponsoring national initiatives such as "Industrie 4.0" in Germany, the "Factory of the Future" in France and Italy, and "Catapult" centers in the UK. Industrial Technology generally encompasses technology solutions (primarily software and data analytics) that enable corporates to digitalize their processes/operations, customer interface and/or create "smart" products (i.e., software-enabled hardware). Additionally, this includes technologies that support "white collar" processes such as pricing solutions, supply chain risk analysis and management software and CRM. We believe this represents an attractive investment opportunity for Industrial Tech focused firms.

Artificial Intelligence - VC

The enterprise Artificial Intelligence (AI) market is in its infancy but provides significant potential for a forward-looking investor. With almost unlimited access to computing power and the exponential growth in Big Data, AI emerges as one of the most disruptive core technologies during the current decade. AI's potential contribution to the global economy by 2030 amounts to $15.7 trillion, equal to China's current GDP.3 The economic impact of AI will be driven by (i) productivity gains from businesses automating processes (including the use of robots and autonomous vehicles), (ii) productivity gains from businesses augmenting their existing labour force with AI technologies (assisted and augmented intelligence) and (iii) increased consumer demand resulting from the availability of personalized and/or higher-quality AI-enhanced products and services. The adoption of AI by enterprises (healthcare, financial services, and professional services seeing the greatest increase in their profit margins as a result of AI adoption) is still at an early, often experimental stage, making it an interesting area for seed and early-stage VC investments. European leaders have recognized the importance of driving growth in AI and the new European Commission has made AI a top priority for the next five years. Collectively, a study from 2018 noted that Europe is second only to the United States, with 769 AI startups (22 percent of the global total)4. While single European countries may not be globally competitive, Europe has the potential to be a major player in AI if it can strengthen its digital single market, though Brexit will have long-term consequences on such efforts. Private equity and venture capital firms have

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[3] PwC, "Sizing the prize What's the real value of AI for your business and how can you capitalise?" 2017.

[4] Axelle Lemaire, Romain Lucazeau, Tobias Rappers, Fabian Westerheide, and Carly E. Howard, "Artificial Intelligence – A Strategy for European Startups: Recommendations for Policymakers," Roland Berger and Asgard – Human Venture Capital, 2018, 7.

accounted for 75 percent of AI-related deal volume in Europe in the last ten years.5 Wilshire believes that AI will remain an interesting growth trend to capitalize on through VC investments.

Wilshire's Assessment

Technology is not only here to stay; technology adaption is clearly accelerating. We see significant opportunities around automation and AI, cloud, security, and technologies that can impact the customer or employee experience. We also note the favorable market dynamics in Europe in specific VC and buyout strategies. All in all, we remain very active in European VC and technology buyout investments in Europe to make sure we capitalize on the opportunities seen in the market.

[5] Jacques Bughin, Eric Labaye, Sven Smit, Eckart Windhagen, Jan Mischke, and Sarah Forman, "Europe's Economy: Three Pathways to Rebuilding Trust and Sustaining Momentum," McKinsey and Company, January 18, 2018.

Important Information

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