

Romania has become a magnet for investors in technology (TMT)



Romania has a growing population of technology start-ups thanks to its pool of talented programmers, innovative entrepreneurs, and an increasingly sophisticated financial ecosystem.

As the digital transformation has gathered pace, it has facilitated an increasing appetite for software assets, with investors' growing interest being reflected in the high level of M&A activity in the telecoms and IT sector.

Romania has become a magnet for investors due to the innovation of its entrepreneurs supported by the increasingly sophisticated technology and financial ecosystem around them, as well as investors looking at the next generation of technology companies/digital champions.

Software is expected to continue dominating TMT M&A, driven by software companies' attractive business models that combine predictable and growing revenues, high margins, and strong revenue generation. IT services segments such as Cybersecurity and digital transformation are also seeing above-trend growth and margins, as organisations undergo digital transformation and security risks continue to grow.

As legal advisors on both the sell-side and buy-side in some of the most important M&A transactions in the TMT sector, CMS lawyers have a valuable experience in successfully advising major international clients but also local players to navigate the process from beginning to end.

We are going to share in this article some of the key issues and practical challenges clients are confronted with when considering and conducting an M&A transaction in this area.

Difference between buyer target buying-price and seller target selling-price

When owners/stakeholders consider selling a company, their primary financial goal is to maximise the cash they receive for their business. However, to estimate the cash flow of a transaction, it is critical to understand the fundamental elements of valuation, including enterprise and equity values, multiples and goodwill.

In an M&A transaction, there is typically a difference between the purchase price proposed by the prospective buyer and the shareholder

equity because buyers naturally assign a value to a company's intangible assets as well, such as company reputation and intellectual property, which is not reflected on the balance sheet.

In the TMT sector, trading multiples vary, with smaller businesses generally traded on lower multiples and larger businesses with sometimes very high multiples. However, many times at the beginning of the process synergies and the price to be paid by the buyers are overestimated, and performance subsequently proves that is materially below expectations. Further to the due diligence exercise, the adjusted EBITDA proves to be significantly below reported figures. This causes disagreement with the sellers on financial definitions, price adjustment, related warranties, as well as from a tax perspective.

A way to overcome this from a buyer's perspective is to base the price on a conservative scenario and be ready to negotiate, whilst for the sellers to take into account such potential differences as compared to the price initially offered by the buyer.

Specific legal elements

• Various legal structure(s) in place with key employees/consultants, who are typically one of the greatest assets of targets in the TMT area

Individuals in the TMT sector (software engineers and other specialists) have an increased degree of independence, which is reflected in various legal structures that are put in place, such as: employment agreements; service agreements with individual contractors (PFA – *persoana fizica autorizata*); and service agreements with limited liability companies (SRL – *societate cu raspundere limitata*) ultimately owned by the individuals.

Due to the essential role that individuals have in TMT businesses, it is important that these structures are properly understood and scrutinised during the due diligence. Based on the results of the due diligence, potential risks identified in these agreements must be addressed in the transaction documents either by amendments to these structures, or by completely changing the structure, depending also on the business model of the buyer or the investor.

Further, the transaction documents should include provisions aimed at securing and retaining such key employees/contractors after the transaction closes, depending on the target's existing legal structure with key employees/ consultants, by way of legal instruments such as retention plans, potentially ESOP, non-compete/non-solicitation, etc.

• Insufficient protection of IP rights (at least for smaller companies) in employment agreements or with third-party providers

In the case of employees, pursuant to the law computer programmes-related intellectual property rights ("IPR"), created by an employee in his/her job and under the employer's instructions, are presumed to belong to the employer, unless the employment agreement provides otherwise.

However, this rule, applicable in relation to employment agreements, cannot be extended to business-to-business relationships when

engineers/consultants are employed under services agreements. Consequently, the result of work conducted by independent contractors may not belong to the company and the company may find itself in the position of not being able to transfer the benefits of the project it has financed, as the intellectual property (“IP”) ownership rights may be unclear or belong completely to a third party.

It is therefore advisable to have clear and undisputable IP ownership provisions in the employee/services agreements, to identify ownership of IP even between co-founders, and to be cautious of critical work that is outsourced to external partners to ensure that all relevant IP belongs to the company.

In addition, if the transaction is implemented as an asset/business transfer, special attention needs to be paid to the assignment clauses in the transaction documents, which should enable the onwards transfer of the respective IPR to the buyer. To achieve indisputable IPR assignment, clear specifications about the type of assignment (as full, exclusive, and irrevocable), content of the rights assigned, territory applicable for the assignment, remuneration and other conditions to frame the assignment, must be provided in the transaction documents.

•€€€€€€€€€€ Significant Compliance and AML issues. Lack of internal policies/procedures on compliance matters

For start-ups in particular, compliance can be sensitive because they often operate with limited resources and may not have the expertise or resources to conduct an in-depth review of applicable laws and regulations. This can leave them vulnerable to potential liabilities if they are found to be in violation of laws or regulations, which may lead to costly fines or even criminal prosecution.

Compliance is important because it can help create a good reputation for the concerned business. Customers, investors, and other stakeholders will be more likely to trust a company that demonstrates a commitment to follow the law and act ethically. Finally, compliance is important because it helps businesses create an environment of accountability in the organisation. By establishing clear policies and procedures to which all employees must adhere, start-ups/companies in the TMT sector can ensure that everyone is held accountable for their actions.

However, companies in the TMT sector have more than a times faced significant compliance and AML issues, which would need to be properly investigated and addressed in the transaction documents.

•€€€€€€€€€€ Personal data protection and security-related matters

In practice, the provision of certain services such as computer programmes-related services and, generally, software engineering, and connected services, involve accessing and automatically processing certain personal data in the beneficiary’s (target’s) systems by the service provider.

It is therefore important for the players to assess their roles from a personal data security and processing perspective, and put in place adequate data protection covenants/agreements.

Transactional elements**•€€€€€€€€€€ Sell-side advisors not experienced in similar transactions**

Again due to reasons such as limited resources, sellers of companies in the TMT sector often use legal advice that is inadequate, e.g. entrepreneurs try to manage costs by handling the necessary legal assistance in-house, or opt for cheaper but not so qualified outside service providers. Poor legal advice can be worse than not benefitting from legal advice at all, and errors can be very expensive to rectify, assuming they can be rectified.

Hence, entrepreneurs prospecting selling their business in the TMT sector must carefully budget for legal costs, including attorneys' fees. Buyers should also consider these issues, as they could lead to delays and higher costs for both sides of the transaction.

•€€€€€€€€€€ Exogenous brake (government regulation, failure to obtain necessary approvals)

Regarding target companies that have a turnover of over EUR 4m, the parties should also factor a potential merger clearance process into the transaction timeline if the purchaser also has a Romanian turnover of over EUR 4m.

Of course, in practice there will be various transaction structures and a case-by-case assessment is recommended; however, if a mandatory merger clearance will be triggered by the transaction, the parties would need to consider the additional timing required for the process, which is approximately ten weeks in a simplified filing and three-to-four months in a complete filing.

In addition, if the parties' combined market shares would be close to 40% on the relevant market, this would need to be factored in, as it would trigger a much more complex merger clearance process where it is likely that the purchaser would need to undertake certain commitments.

However, irrespective of whether a mandatory merger clearance process would be triggered, the parties need to also consider the review of the transaction from a national security perspective into the transaction timeline.

The foreign direct investment (FDI) regime was amended in 2022 and the implementation legislation and practice of the authorities is still changing. However, as the security of information and communications systems is one of the areas of interest from an FDI perspective, most TMT transactions would be subject to an FDI review.

Given that the legislation is recent and still undergoing changes, it is recommended that an assessment is carried out in the early stages of a transaction, as the FDI review could also take approximately ten weeks. If a merger clearance is also required, the two processes would run in parallel; however, if no merger clearance is required, the FDI process could itself bring an additional delay to the transaction.

Although there is no filing deadline for the above processes, the transaction may not be implemented before the clearance decision(s) is(are) obtained. A failure to observe such prohibition is sanctioned with a fine of up to 10% of the total worldwide turnover of the buyer's group.

Hence, the parties should assess the need for such filings very early in the process to ensure that there is no risk of fines and that the envisaged timeline of the transaction is feasible in practice.

•~~€€€€€€€€€€~~ Not being ready to close the deal on the due date

Matters which could impact the transaction timeline and additional delays might be caused by the need to ensure business continuity in parallel with the time and resource efforts generated by the prospected transaction. Hence, sellers could be in a position where they are not ready to close the deal on the due date. This can be overcome by concentrating on closing date readiness and anticipating as much as possible any complexities (both on the closing date and post-closing, such as on integration matters), to avoid delays and a failure to close.

The TMT sector is continually advancing and developing new technologies, platforms and solutions to enhance capabilities across every industry. Sophisticated dealmakers appreciate these dynamics and will continue to engage in M&A that is accretive to their strategy and portfolio.

The CMS TMT team is recognised as the 'go-to' firm for key M&A transactions involving TMT companies, being frequently mandated on some of the most substantial projects on the market. The practical experience gained from working on deals and projects in this sector gives us an in-depth insight into the issues the investors and the sellers will likely encounter and the ways to manage them, and helps clients anticipate and effectively deal with operational, project and transactional issues that may arise.