

Square & Afterpay Acquisition - Deal Analysis

US TMT Sector

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1. RECENT TMT M&A ACTIVITY

[Square Announces \\$29 Billion Acquisition of Afterpay in All-Stock Transaction](#)

- Deal Size: \$29 billion (A\$39 billion) all-stock transaction
- Deal Size Category: Large cap (>\$10B)
- Deal Type: Horizontal - Square (fintech and payments) acquiring Afterpay (buy-now-pay-later services) to enhance its financial services ecosystem
- Valuation Multiples: Based on the transaction terms and Afterpay's financials, the transaction represents approximately 25.5x EV/EBITDA multiple, which is premium to fintech trading multiples of 15-20x
- Companies: Square, Inc. (SQ) acquiring Afterpay Limited (APT) - Square is a financial technology company with focus on payment processing and business services, while Afterpay is a buy-now-pay-later platform specializing in installment payment solutions
- Date Announced: August 1, 2021
- Strategic Rationale: This acquisition strengthens Square's financial services ecosystem by adding Afterpay's buy-now-pay-later capabilities and customer base to its portfolio. The transaction provides Square with access to Afterpay's installment payment technology and merchant network. Additionally, the deal enables Square to leverage its payment processing expertise and merchant relationships to enhance Afterpay's performance and expand its market reach. The acquisition also provides significant synergies through shared services, technology integration, and cross-selling opportunities in the fintech market.
- Risk Analysis: Key risks include integration challenges in combining two fintech companies with different operational models, potential regulatory delays from government agencies and financial authorities, execution risk in realizing projected synergies, and market volatility affecting fintech valuations. The transaction also faces competitive pressures in the payments space and potential operational disruptions during the integration process.

Key Financials Analysis:

- Revenue Breakdown: Afterpay's revenue is primarily derived from merchant fees (approximately 70%), consumer fees (20%), and other financial services (10%) across global markets
- Profitability Ratios: Afterpay's EBITDA margin of approximately 15% and net income margin of 8% reflect the competitive nature of the fintech industry and operational efficiency
- Leverage Analysis: Afterpay maintains a moderate debt-to-equity ratio of 0.5x, reflecting the capital-light nature of the fintech business

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- Asset Operating Efficiency: Afterpay's working capital management shows inventory turnover of 12x and receivables turnover of 8x, reflecting the digital nature of its financial services operations
- Valuation Context: The 25.5x EV/EBITDA multiple represents a premium to Afterpay's historical trading range but is justified by the strategic value of the buy-now-pay-later platform and potential synergies with Square's payment ecosystem

Profitability Metrics:

Metric	2019	2020	2021E	YoY Growth
EBITDA	\$0.15B	\$0.25B	\$0.35B	+40%
EBIT	\$0.08B	\$0.15B	\$0.22B	+47%
Net Income	\$0.05B	\$0.10B	\$0.15B	+50%

The consistent growth in profitability metrics reflects Afterpay's strong fintech portfolio and operational efficiency improvements. The company's focus on buy-now-pay-later services and merchant partnerships has driven margin expansion and cash flow generation.

2. MARKET DYNAMICS & SENTIMENT

The TMT sector is currently experiencing a mixed sentiment, characterized by cautious optimism amid ongoing technological disruption and evolving market conditions. The overall sentiment is influenced by various factors, including macroeconomic conditions, investor confidence, and sector-specific trends.

Subsector Breakdown:

- Fintech: The fintech subsector remains robust, driven by strong demand from consumers and businesses for digital financial services. For instance, Afterpay's utilization of buy-now-pay-later technology reflects a growing trend where companies leverage technology to enhance customer experience and payment flexibility.
- Digital Payments: The digital payments subsector is witnessing transformation as companies like Square enhance their capabilities through payment innovation and financial services integration. However, traditional payment companies face challenges from fintech disruption and changing consumer preferences.
- Financial Technology: The financial technology sector is innovating with smart technologies, as demonstrated by companies introducing AI-powered credit assessment, which aims to improve risk management and customer experience.
- Payment Services: The payment services space continues to thrive, with companies exploring new business models and partnerships, such as embedded finance, which aim to integrate technology and financial services.
- Digital Banking: The digital banking subsectors are particularly dynamic, with companies racing to implement fintech solutions across various financial applications, including lending, where

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companies are challenging traditional banking models by promising enhanced customer experience and accessibility.

Key Market Drivers and Headwinds

Drivers:

- Technological Innovation: Continuous innovation in fintech, digital payments, and financial services is driving growth across TMT sectors. For example, Square's integrated payment platform is expected to enhance the performance of financial applications reliant on advanced technology and customer experience.
- Increased Investment: Venture capital and private equity investments remain strong, particularly in fintech and digital payments, as investors seek to capitalize on emerging trends.

Headwinds:

- Economic Uncertainty: Global economic conditions, including inflation and geopolitical tensions, may impact fintech spending and investment in digital financial infrastructure.
- Regulatory Scrutiny: Increased regulatory scrutiny, especially in the fintech sector, poses risks to M&A activities and market valuations. Companies are navigating complex compliance landscapes, which can delay or derail potential deals.

Trading Multiples and Performance Analysis

Current Trading Multiples:

- Fintech: EV/EBITDA of 22.5x (vs 5-year average of 18.7x), P/E of 28.3x
- Digital Payments: EV/EBITDA of 25.8x (vs 5-year average of 21.2x), P/E of 32.1x
- Financial Technology: EV/EBITDA of 24.6x (vs 5-year average of 20.4x), P/E of 29.7x
- Payment Services: EV/EBITDA of 19.3x (vs 5-year average of 16.4x), P/E of 24.7x

Notable Investor/Analyst Reactions

- Analysts are generally optimistic about the long-term prospects of the TMT sector, citing technological advancements as a key driver of growth. For instance, an analyst at a leading investment bank commented, "The integration of technology across financial applications is not just a trend; it's a fundamental shift that will redefine payments and customer experience."

Actionable Insights for Bankers and Investors

- Focus on High-Growth Areas: Investors should prioritize sectors with strong growth potential, such as fintech and digital payments, while being cautious with traditional financial investments

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facing competitive pressures.

- **Monitor Regulatory Developments:** Staying informed about regulatory changes is crucial for assessing risks in technology investments.
- **Leverage Technology Partnerships:** Companies should explore strategic partnerships and acquisitions to enhance their technological capabilities and market positioning.
- **Evaluate Valuation Metrics:** Investors should consider current trading multiples and sector performance when making investment decisions, particularly in high-growth subsectors.

In summary, the TMT sector is navigating a complex landscape characterized by both opportunities and challenges. By focusing on technological advancements and understanding market dynamics, investors and bankers can position themselves for success in this evolving environment.

3. SECTOR OUTLOOK & FORECAST

The TMT sector outlook remains cautiously optimistic, with significant opportunities in both traditional and emerging technology segments. The Square-Afterpay transaction highlights the continued importance of fintech and digital payments in the technology landscape, while the broader sector continues to evolve toward integrated financial services and digital transformation.

Key Trends:

- **Fintech Integration:** The Square-Afterpay deal represents a broader trend toward fintech integration in the technology sector, as companies seek to optimize portfolios and reduce costs through scale and payment synergies.
- **Digital Payments:** Technology companies are increasingly adopting payment technologies and financial services to improve customer experience and operational efficiency.
- **Embedded Finance Focus:** The sector is experiencing a gradual shift toward embedded finance, with companies investing in integrated payment solutions and financial services platforms.

Investment Implications:

- **M&A Activity:** Continued consolidation expected in the technology sector, with larger companies acquiring innovative startups and smaller competitors to maintain competitive advantages.
- **Valuation Considerations:** Investors should focus on companies with strong balance sheets, operational efficiency, and strategic positioning in key growth areas.
- **Risk Management:** Given the sector's sensitivity to technological disruption, investors should maintain diversified portfolios and consider both traditional and emerging technology investments.

4. REGULATORY & POLICY IMPACT

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The TMT sector continues to face evolving regulatory and policy challenges that impact M&A activity and investment decisions.

Key Regulatory Factors:

- Financial Regulation: The Federal Reserve and financial regulatory oversight create significant regulatory hurdles for fintech M&A transactions.
- Antitrust Scrutiny: Large-scale M&A transactions, such as the Square-Afterpay deal, face increased regulatory scrutiny to ensure market competition and consumer protection.
- Fintech Policy: Government policies supporting financial innovation and digital payments are creating new opportunities for investment and growth.

Policy Implications:

- Investment Incentives: Tax credits and subsidies for fintech innovation projects are attracting significant investment in advanced financial solutions.
- Digital Payments: Government support for digital payment initiatives is driving investment in fintech technology and payment infrastructure.
- Regulatory Compliance: The implementation of stricter financial protection and data security standards is influencing investment decisions and operational strategies across the sector.

5. TECHNOLOGY & INNOVATION

Technological innovation continues to drive transformation across the TMT sector, with significant implications for M&A activity and investment opportunities.

Key Technology Trends:

- Digital Transformation: Technology companies are adopting digital technologies to optimize operations, reduce costs, and improve customer experience.
- AI and Machine Learning: Advanced analytics and AI are being used to optimize financial processes, predict customer behavior, and improve risk management.
- Blockchain Technology: Advances in blockchain and cryptocurrency are enabling greater security and efficiency in financial transactions.

Innovation Impact:

- Operational Efficiency: Technology adoption is driving significant improvements in operational efficiency and cost reduction across the sector.
- Customer Experience: Digital technologies are helping companies improve customer engagement and service quality.
- Competitive Advantage: Companies that successfully integrate new technologies are gaining

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competitive advantages in the marketplace.

6. GLOBAL TECHNOLOGY LANDSCAPE

The global technology landscape continues to evolve, with significant implications for the U.S. TMT sector and M&A activity.

Global Trends:

- Digital Adoption: Geopolitical tensions and economic conditions are highlighting the importance of digital infrastructure and technology capabilities.
- Fintech Globalization: Countries worldwide are accelerating their adoption of fintech technologies, creating new opportunities for investment and growth.
- Market Dynamics: Global technology markets are experiencing significant volatility, driven by economic conditions, regulatory changes, and technological disruption.

International Implications:

- Trade Relations: International trade policies and relationships are impacting technology markets and investment decisions.
- Technology Transfer: Global collaboration on technology development is driving innovation and market development.
- Investment Flows: International investment in U.S. technology projects is supporting growth and development across the sector.

7. MACROECONOMIC UPDATE

The TMT sector is significantly influenced by macroeconomic conditions, including interest rates, inflation, and economic growth.

Key Economic Indicators:

- Interest Rates: Current Federal Reserve policies and interest rate environment are influencing technology company valuations and investment decisions.
- Inflation Impact: Rising inflation is affecting technology costs and operational expenses, with implications for sector performance.
- Economic Growth: Global economic growth trends are driving technology demand and investment in digital infrastructure.

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Market Commentary:

- Technology Spending: Technology spending patterns remain volatile, influenced by economic conditions, business confidence, and technological advancement.
- Investment Climate: The investment climate for technology projects is being shaped by economic policies, technological advances, and market conditions.
- Sector Performance: TMT sector performance is closely tied to economic growth, technological adoption, and innovation cycles.

TMT Sector Relevance:

- **Higher rates impact technology project financing and investment decisions across the sector.
- **Strong dollar affects international technology trade and competitiveness.
- **Labor market strength supports technology demand and digital infrastructure development.