The Impact of Covid-19 on Israel's Economy and Legal System

Notwithstanding the global COVID pandemic and economic recession, 2020 is proving to be a record-breaking year for Israeli technology start-up companies.

INTRODUCTION

While the current state of the Israeli economy may or may not be wanting in divine intervention, there is still no lack of silver linings protruding from behind the ominous Covid-19 storm clouds. This article will look at how the Israeli economy has faired during the rage of Covid-19 including its impact on business as well as the legal system during the first three financial quarters of 2020. Notwithstanding the global COVID pandemic, 2020 is proving to be a record-breaking year for Israeli technology start-up companies. While in North America high tech investment is down 10% compared with 2019 and while in Europe we have seen a 20% reduction, in Israel there seems to be a 40% increase compared to the first half of 2019. The above data is hard to extrapolate but what does seem evident is that Israel including Israeli policy makers, are working very hard to stimulate the economy in the midst of this unprecedented international recession.

HIGH TECH INVESTMENT

Workforces are transitioning (albeit not always by their own choosing) to telecommuting and in the process saving on office related expenses, namely rent. And while consumer demand is down, the need for innovation is up. There are opportunities to identify companies that have abnormal growth potential that are not seen during "normal" times. Companies like Zoom and Monday.com are helping employees make a smooth transition to domestic work environments. People are staying at home streaming content at rates never seen before. People are ordering online instead of going to the mall. Workouts are at home and not at the gym. The world is being forced to change its habits, and the hi-tech industry is providing it with all the tools it needs to implement such change.

The average exit value in Israel has increased by 14% compared to the first half of a Covid-19 free 2019. These exits in 2020 included major deals that took place during the peak of worldwide lockdowns, like Intel's acquisition of Moovit for approximately US$900M (in which our firm, Yigal Arnon & Co., represented Intel). These rosy numbers are arguably a bit misleading, given that US$3.25B (62%) of the US$5.24B in exits in H1 2020 were deals that were rooted in pre-Covid-19 times. This means that only 38% of the exits had their roots during the crisis.

Investments on the other hand have stayed more resilient, with a 39.4% increase for H1 2020 compared to the same period in 2019. Artificial intelligence start-ups continue to lead the field, with 100 investments in H1 2020 alone. One ongoing trend is the significant increase in late stage large investment rounds. Investments of over US$ 100M are up 42.9% compared to H1 2019. Q2 2020 was the second strongest quarter for raising venture capital in Israel's history, only being outperformed by Q1 2020. This shift from M&A to investment funding may signal a shift in long term growth strategies of Israeli startups. The downturn in the general economy may be leading investors to believe that this is a prime time to build a portfolio at "bargain" rates. Investors have been able to "use" the downturn in the economy, and the cumbersome and high-risk process of M&As to score "deals" on what may prove to be undervalued investments. With rising unemployment, declining wages, and an all-time high demand for software technologies, it is an investors market. It is also quite possible that the increase in venture capital funding especially in "mega rounds" will lead to significant exits in years to come.

NEW ISRAELI INNOVATION AUTHORITY PROGRAM

"It is well understood, even by the Finance Ministry, that the high-tech industry in Israel holds the key to pulling us out of the economic crisis following the coronavirus pandemic" – Aharon Aharon, CEO at the IIA (Israeli Innovation Authority).

With manpower being the most important resource of any startup, it is crucial that governments do all in their power to ensure that even during economic hardships, the capital that powers the startup ecosystem does not dry up. The recent economic downturn may have provided a glut of highly skilled workers which may provide a short-term cost saving benefit to start-ups. In the long run, highly skilled workers exit the startup industry, or move to other countries, and the founders stop establishing companies.

Fortunately for Israel, there are government supported bodies like the IIA. The IIA is a well-established program headed by the Israeli Ministry of the Economy known for providing funding to Israeli R&D companies even during periods of recession. The IIA recently unveiled a new program which promotes institutional investors financing late stage Israeli start-ups. The new program aims to assist startups in raising capital from institutional investors by providing incentives to the institutional investors. An approved investor will be given a 40% return guarantee if its investment portfolio declines. If there is net appreciation after the program, the institutional investor will give 10% of the difference between the ROI received and the return on Israeli government bonds, as applicable, for the period of investment, taking into account expenses. The State of Israel guarantees the investments made during the first 18 months of the program.

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PEACE WITH THE UAE

The recently announced agreement and normalization of ties between the UAE and Israel is also likely to be a boon to the Israeli economy, and its hi-tech sector in particular. Mohammed Ali Al Shorafa, chairman of the Abu Dhabi Department of Economic Development was quoted as saying after the announcement of the agreement "[Officials want to develop] the knowledge sector and innovation by attracting technology companies to put down roots in Abu Dhabi." The UAE rooted Gothams start-up accelerator program has already begun inviting Israeli based entrepreneurs to participate in start-up accelerator programs in Abu Dhabi. With it reported that the UAE real-estate market was down 5% even before the pandemic hit, the Israeli hi-tech sector offers a prime opportunity for UAE investors to diversify their portfolios. The immediate impact of the new formalized relations is estimated to be approximately US$ 500M. It has been estimated that within a few years UAE investors could even make up to 10% of tech investments in Israel.

NATURAL GAS INDUSTRY

Another important recent focus is the success of the Israeli natural gas industry, and namely the development of the Leviathan natural gas field off of Israel in the Mediterranean Sea. The Leviathan field was jointly developed by Delek Drilling (holding 45.33%), Noble Energy (holding 39.66%), and Ratio Oil Exploration (holding

15%). The field went operational on December 31, 2019, and there is estimated to be approximately 35,000×109 cu ft (990×109 m^3) of gas in the field, of which 22,000×109 cu ft (620×109 m^3) is believed to be recoverable. These natural resources are an amazing asset for a State that was once known to be devoid of any meaningful natural resources.

As a result, Israel has become a major regional exporter of natural gas, having already signed deals with Jordan and Egypt, worth US$ 10B and US$ 15B, respectively. These deals are not only wonderful for the Israeli economy, but they also bolster its soft power in a region where geopolitical relations are fragile, to say the least. The recent acquisition of Noble Energy by Chevron in a US$ 13B deal and the US$ 2.25B global bond offering by Delek Drilling (one of the largest energy bond offering in 2020, in which our firm represented the Joint Bookrunners and Initial Purchasers) further illustrates the newly found global importance of the Israeli natural gas sector.

ISRAELI PRIVACY LAW

Israel is taking advantage of existing counterterrorism technologies for Covid-19. These measures include monitoring the location of citizens' mobile phones without their consent to monitor the exact movements of people infected with the virus, warning people of new cases in their neighborhood, and enforcing lockdown measures. Even the Israeli Supreme Court has had to intervene when it ruled that only citizens who have tested positive for the virus can be subjected to digital tracking of their movements and can receive isolation orders from the government.

There does appear to be a price to Israel's use of tracking and counterterrorism technology to fight the pandemic. A recent ruling by the European Court of Justice jeopardizes Israel's approval of adequacy which allows it to use EU residents' information to sell them products. Israel may be forced to scale down the encompassing exemptions granted to Israeli security bodies in regards to information security. If Israel fails to do so, it will make it much more difficult for Israeli companies to do business with the EU.

CONCLUSION:

The above highlights certain aspects of Israel's response and reaction to the what can certainly be described as tumultuous times. Despite the rosy picture painted by certain economic indicators, like most of the world the Israeli economy is in recession, with an estimated 8.1% 2020 Q2 contraction. It is estimated, however, that Israel will be able to make up for any 2020 losses in 2021, with 1% growth compared to 2019 GDP levels. Just like in the 2008 recession, Israel is proving that it is not afraid to confront the dynamic challenge of the day, and that the "start-up" nation is still finding the silver linings as well as innovative ways to combat a difficult financial climate. ■

ABOUT THE AUTHORS

The authors are Simon Weintraub and Nimrod Vromen, who are partners in the High Tech Department of Yigal Arnon & Co., Israel's leading technology law firm. Simon has been a partner at Yigal Arnon since 2008 and specializes in high-tech, life sciences, venture capital, private equity, M&A and banking. Simon regularly represents Israeli and international venture capital funds, angel investors, private equity funds, especially with respect to complicated cross-border financing transactions. Most recently Simon represented HSBC and JP Morgan Chase as Joint Bookrunners in the USD $2.25 billion global bond offering raised by Delek Drilling Limited Partnership. Nimrod has been a partner at Yigal Arnon since 2015, with his practice focusing on the representation of hundreds of startups, and is CEO of both Consiglieri, a consulting firm for tech companies, and YTech Runway Ltd., operator of www.ytechrunway.com, a platform for content and tools for entrepreneurs.

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