TECH M&A REPORT

Mergers & Acquisitions in the time of Covid

January 2021

Presented by Valeo Corporate Finance. Providing sell-side investment banking services to small cap technology companies looking to exit.

IN THIS ISSUE

FIELD NOTES

2020 has been an unprecedented year in so many ways, not the least of which has been the effect of COVID-19 on the markets and on Mergers & Acquisitions activity.

All our clients, including two that were put into market last year before Covid, saw substantial activity. One client received five viable LOIs and another, three. In both cases the buyers bid low (not surprisingly), but still within an acceptable range. As neither client needed to sell (they were both profitable, growing SaaS companies) it was decided to continue growing the company with a view to going out to market in mid to late 2021 as conditions improve.

We closed a sale for another client in September 2020. Plurilock Security Solutions (a deep tech cybersecurity company) was acquired by Libby K Industries in a platform consolidation play. This deal closed much later than expected as we signed the LOI in November of 2019. The slowdown was directly attributable to Covid, which affected the buyer's financing.

And while two other clients were not put into market, both received significant unsolicited inbound interest including from some Fortune 100 tech companies. We expect this interest to increase in 2021 and activity in late November and December supports this thesis.

In the last two weeks of December and the first week of January, clients have received three LOIs with a fourth being indicated. A promising start to 2021.

Nine months into 2020, both deal count and total deal value were down substantially.

In absolute terms, deal value to end of September 2020 almost equaled total deal value reported for all of 2010, and is on track to end up down at least 25% to 30% year over year from 2019.

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2020 TECH M&A IN REVIEW

Not surprisingly, overall M&A activity in the technology sector in 2020 took a hit. In Q2 of 2020, the effects of Covid and the closing up of the credit markets saw overall M&A activity in the tech sector drop by over a third compared to the same period in 2019 in terms of both deal volume and cumulative value of deals consummated.

In recent years, the data shows that tech sector M&A activity in both total deal value and deal count saw close to a doubling between 2010 and 2018, then dropping slightly in 2019. Most of the growth was shown in the early years, flattening out between 2015 and 2019. Nine months into 2020, both deal count and total deal valuation were down substantially.

In British Columbia there were more deals closed in November of 2020 than in any other month (see Local Deals, page 25). Since the sample set is small, it is hard to draw any concrete conclusions. However, this may suggest forward movement in the markets as light begins to appear at the end of the COVID-19 tunnel.

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Not surprisingly, Healthcare IT performed better than other sectors in 2020, representing over 13% of deal count amongst seven technology sectors tracked, which is more than double its share in 2019. B2B software and IT infrastructure slowed down, while Materials Tech was slightly up and Fintech flat. B2C software was also up, possibly reflecting the increase in ecommerce as people stayed home and shopped online.

Looking back over the last ten years, acquisitions driven by VC-backed companies showed a gain in 2020, while acquisitions by PE-backed companies and public companies dropped. However, in absolute terms, VC-backed acquisitions still fell slightly short of PE-backed deals, and both exceeded public company deals by more than double.

Multiples in the public markets for SaaS companies were in the 10X range averaged over January to the end of October 2020 and, somewhat surprisingly, were slightly up year over year.

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BIGGEST TECH DEALS OF THE YEAR

NVIDIA buys Arm for $40B

AMD buys Xilinx for $35B

Salesforce buys Slack for $27.7B

Analog buys Maxim for $21B

Morgan Stanley buys eTrade for $13B

Marvell Tech buys Inphi for $10B

NVIDIA buys Mellanox for $6.9B

Visa buys Plaid for $5.3B

Insight buys Veeam for $5B

KKR sells Epicor to CD&R for $4.7B

Vista buys Pluralsight for $3.5B

Twilio buys Segment for $3.2B

Macquarie buys Cinci Bell for $2.9B

NASDAQ buys Verafin for $2.75B

Uber buys Postmates for $2.65B

i-Squared buys GTT div. for $2.15B

Amazon buys Zoox for S1.5B

Adobe buys Workfront for $1.5B

BIGGEST TECH DEALS...CONTINUED

Salesforce buys Vlocity for $1.3B

SoFi buys Galileo for $1.2B

Vista buys Armis for $1.1B

Ericsson buys Cradlepoint for $1B

Intel buys Moovit for $1B

F5 Networks buys Shape for $1B

Tibco buys Info Builders for $1B

Facebook buys Kustomer for $1B

CONSOLIDATORS' ACTIVITY IN 2020

The three big consolidators in the tech industry, Constellation, Thoma Bravo and ESW Capital continued to be active, but the numbers suggest less so.

Constellation reported north of 60 deals into the Fall which, pro-rated to the end of the year, would leave them slightly below their peak years of over 100.

Thoma Bravo appears to be going upmarket, doing a smaller number of mega deals. They reported over 60 deals to date including acquisitions, sales, and financings.

Late in December they announced the acquisition of RealPage in a deal valued at approximately $10.2B.

Public info on ESW is not fully available, but they have been actively tied up in a hostile takeover bid of Toronto-based, TSX-listed Optiva for a transaction valued at close to $300m.

This transaction begs the question of whether more hostile bids are to be launched in the coming year as PE and Corporate Balance Sheet cash frees up.

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VALUATION METRICS & DATA

In the Spring of 2019, we issued a full market review of the metrics driving software company valuations. The data showed that between 2014 and 2019 the average revenue multiple for public SaaS companies had swung between a low of 3.3X (2016) and a high of 7.7X (2014), ending above 7.0X in 2019 and growing.

Private software company multiples, typically a 25% to 30% discount off public company multiples, have averaged between about 3.5X and 5.5X trailing revenues. Companies with a recurring revenue model, SaaS or otherwise, typically sit towards the top of that range depending on their percentage of recurring revenues (85% or better being the desired threshold).

Some of the important valuation drivers in software over the last ten years have included:

METRIC	FAVOURABLE	IN BETWEEN	UNFAVOURABLE
YoY Revenue Growth	>30 – 40%	15% - 25%	<10%
% Recurring Revenues	>85%	70% - 80%	<65%
Gross Margin	>85%	70% - 80%	<60%
Profitability/EBITDA*	>30 – 40%	10% - 20%	<10%
Annual Churn (B2B software)**	<5%	10% - 20%	>30%
Annual Churn (B2C software)**	<20% - 30%	35 – 45%	>50%
LTV:CAC	>4:1	3:1	<2:1
ROI Payback Period	<12 months	12 – 24 months	>24 months
Revenue per Sales Rep (Sales Quota:Base Comp)***	>3:1	3:1	<3:1

* The Rule of 40 is still being used as one valuation metric, where growth rate plus profit should exceed 40%.

** Churn measured in dollars, not number of customers.

*** Gross Sales Efficiency is the current catch phrase for this measure, being new ARR/S&M expense, with Net Sales Efficiency also factoring in churn.

Another metric that has driven valuation multiples is the size of the company, with companies with annual revenues between US$50m and US$200m often attracting the highest multiples. In addition, public companies sport valuation multiples typically between 25% to 30% higher than for comparable (size/sector/revenue model) private companies.

There are many other metrics which influence valuation including:

- revenue per employee (capital efficiency)
- conversion rate in the sales funnel (sales efficiency)
- customer concentration (lack of is better)
- geographic penetration (more the better)
- team (deep domain knowledge is valued)
- intellectual property (patents)
- product lifecycle (current code versus legacy)
- market size (bigger the better and greenfield versus saturated)
- market position (dominant or material)
- age of the business (at least three to five years of material performance)
- average contract value (ACV – higher the better)
- the nature of the customer contracts (locked in versus not)

In one reported analysis, the six biggest drivers for valuation—for all software companies, not restricted to recurring revenue companies (meaning an exception to the metric of recurring revenue as a percentage of revenues)—were:

1. Annual growth rate
2. Gross margin
3. Churn/retention
4. ROI payback period to the customer
5. TAM
6. Whether the company was public versus private

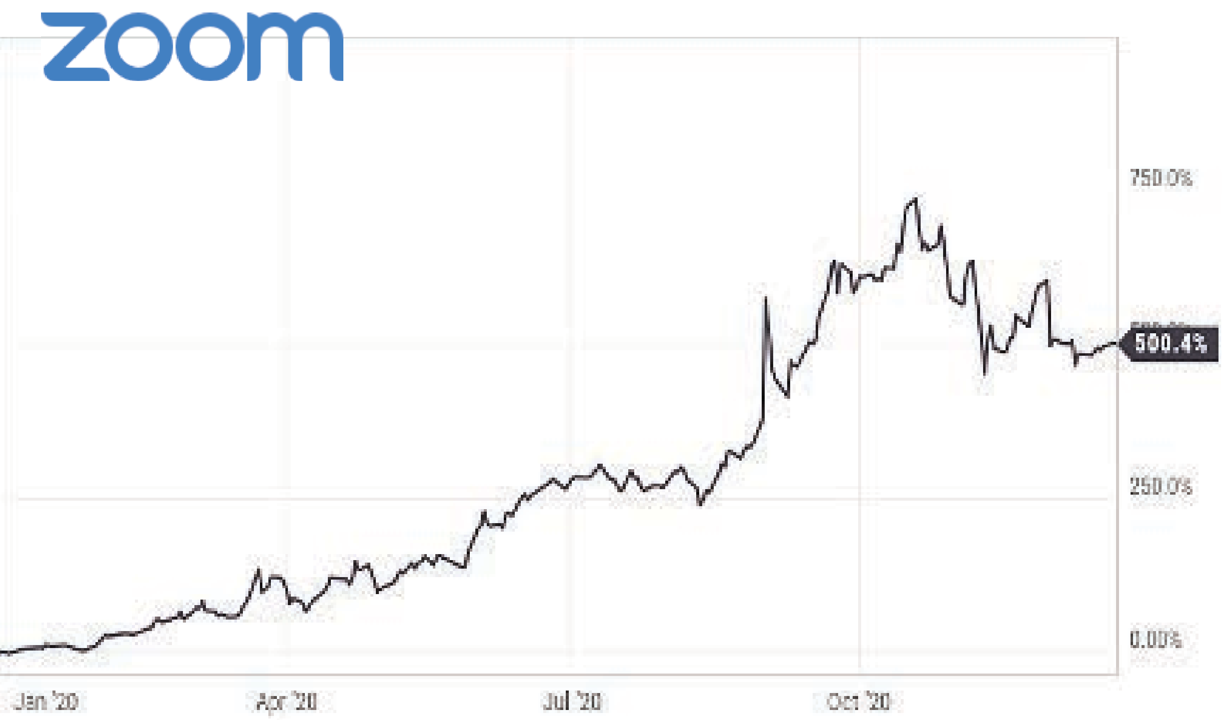
Notwithstanding the many other metrics that have become table stakes to track, overall annual revenue growth continues to be the single biggest driver of valuation for software companies.

VALUATION DATA

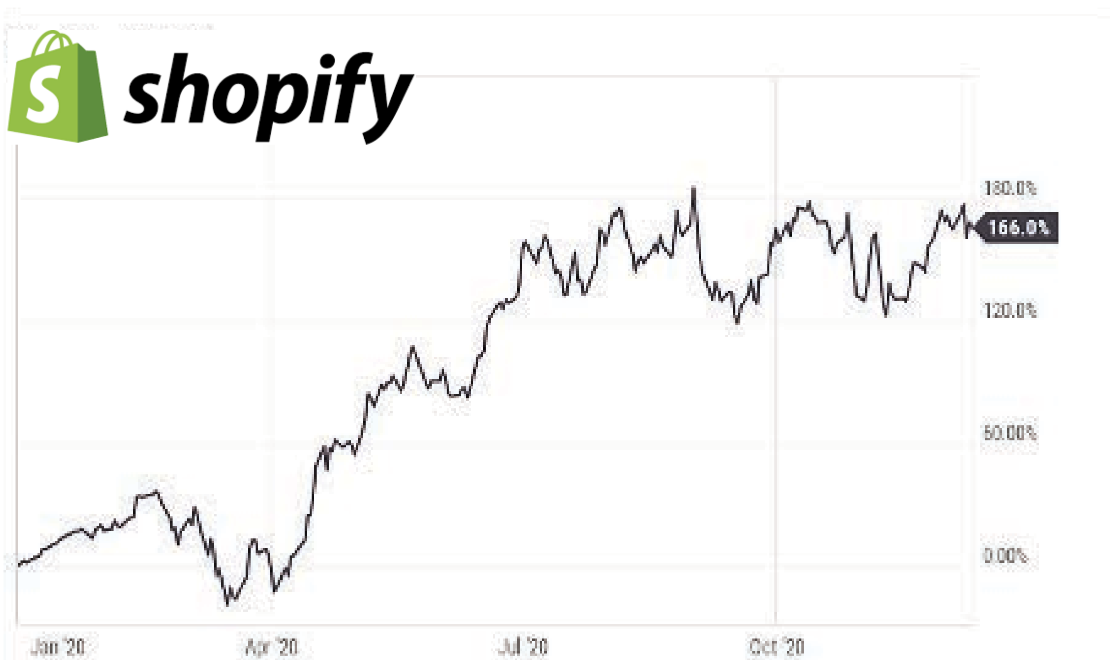
While deal volume was down, valuations in the technology sector showed the opposite trend.

Surprisingly, in 2020 public company SaaS multiples have continued the growth that began in 2019 reaching a peak of over 11X revenues in October, up from over 9X entering the year. As one would expect, multiples dipped – dramatically – in March (down to 7.0X) and took until July to get back to the level they were at entering the year. Overall, the index for public SaaS companies was up at the time of writing by over 25% and has led all other major indices.

VALUATION DATA...CONTINUED



And 2020 has seen some very big winners in the tech sector, with companies such as Zoom, at one point up almost 8X and currently still up just under 6X, Shopify up 100%, Amazon up over 60%, Apple up over 66%, Microsoft up 35%, Facebook up 33% and Salesforce up 25%.



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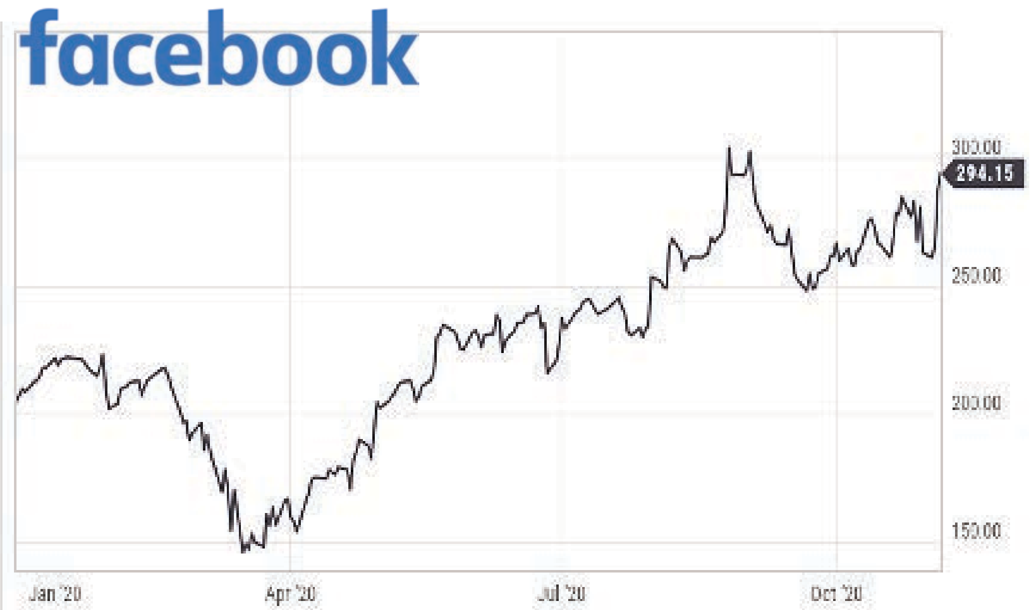
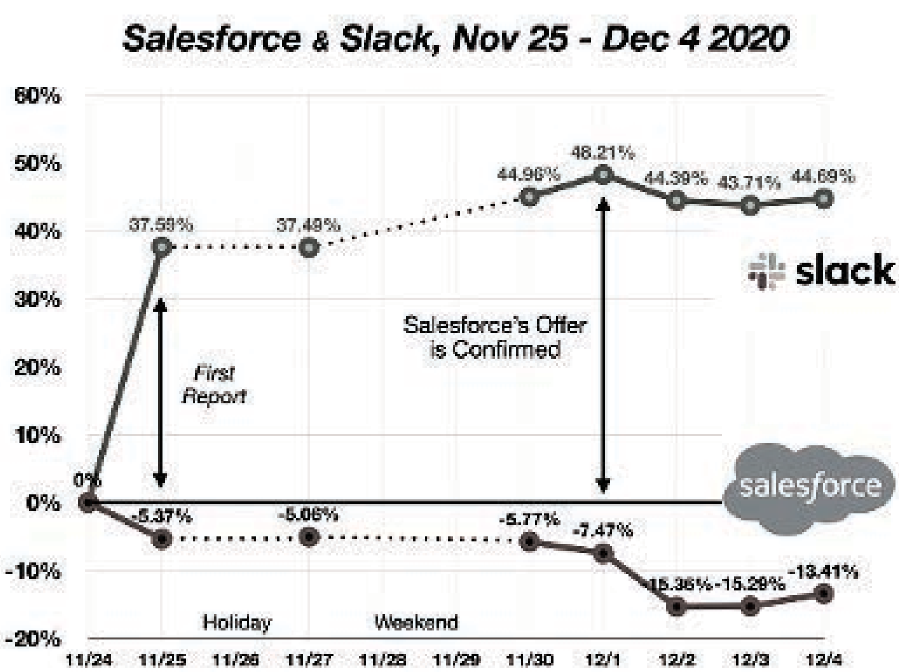


There are also numerous smaller winners, a few of which are companies whose names may not be as familiar such as Fiverr up 8X, Fastly up 4X, ACM up almost 4X and Etsy up 3X. And this is just a small sampling, with plenty more examples of winners notwithstanding the challenges faced this year.

With a local connection, December saw the announcement of Salesforce buying Slack in a cash and stock deal for a whopping $27B, making it one of the largest tech acquisitions in recent history. For Slack, this resulted in a near doubling of their stock price from earlier in the year, and up over 40% once news of the takeover broke.

Slack, with an office in Vancouver, was founded by Stewart Butterfield, who previously founded Flickr and is from Victoria, BC. Congratulations to Stewart and his team.



With respect to private tech companies, Canada can point to Newfoundland for one of this year's Canadian homeruns. Verafin, a St. John's based digital security company, announced in November that it was being acquired by NASDAQ for $2.75B.

Public company SaaS multiples continued growth from 2019 reaching a peak of over 11X revenues in October, up from over 9X entering the year.

Overall, while deal volume was down in 2020, valuations in the technology sector held up and in some cases were actually up year over year.

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DRIVERS IN TECHNOLOGY ACQUISITIONS

The Salesforce/Slack deal points to a recent trend in software acquisitions. Over the past five years, the data shows that the number one driver of acquisitions has been "scope expansion". In 2019, over 80% of technology acquisitions (meaning all technology, not just software) were scope related acquisitions, up from approximately 50% in 2015.

Loosely defined, scope expansion covers such things as adding new product capability, entering new business segments, adding intellectual property, and acquiring talent. This is very clear in the Slack acquisition which helps position Salesforce directly against Microsoft by adding capability. For Slack, it provides an opportunity to expand out of being primarily a business communications tool. This continues Salesforce's product expansion which also drove their acquisition of Tableau, the visual data analytics company, as well as their acquisition of local company Mobify (see Local Deals, page 25).

Scope expansion reflects a need for narrowly focused companies to look for new markets as their current market becomes saturated or no longer offers double digit growth opportunities. This is encouraging for smaller, private vertically or product focused technology companies looking for exit opportunities. It also means thinking outside the box about who a prospective buyer might be.

One must look beyond the obvious players and think about the wildcards that should be approached. And this will also drive valuations as these deals will be strategic as opposed to financial.

The recent trend of scope acquisition is encouraging for smaller technology companies looking to exit sooner than later, and should result in strategic valuations.

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FORECAST FOR 2021

So, what does 2021 hold for technology company valuations and M&A? The prevailing opinion seems to be that, given several successful vaccines rolling out in 2021, the markets will, as usual, be ahead of the curve.

A pick up in M&A activity is being predicted by most pundits for the first half of 2021, but a material increase is not expected until at least the second half of the year. Timing may be affected by how fast the vaccines roll out and their efficacy amongst the broader population.

Early 2021 will be a good time to start preparing for an exit for companies looking to do so late in 2021 or 2022.

Driving M&A activity will be a number of factors:

- There is over $2.5 trillion in private equity funding currently on hand, the highest amount ever reported. PE needs to move to generate returns, so Fund Managers cannot sit on their hands forever.

- There is almost the same level of cash sitting on the balance sheets of corporate America, again some of highest reported in a significant period.

- The re-opening of the credit markets, which all but dried up in Q2 2020.

- Continued low interest rates.

M&A activity in 2021 will also be driven by opportunities relating to distressed situations. Cash flush buyers will be looking to move fast on companies with challenging balance sheets and flat sales, but solid technology. As far as performance in 2020, flat will be seen as the new up and won't rule out a sale.

Not factored into forecasts for M&A activity at this point is a fifth factor. The effect of government stimulus packages worldwide and especially in the US as these will drive further confidence in the market in the short term. With the full scope of the US plan still under debate, markets will reflect where it all lands and this will in turn impact M&A activity.

M&A activity in 2021 will be driven by a number of factors including a surplus of PE funds, flush corporate balance sheets, the reopening of the credit markets and continued low interest rates.

LOCAL DEALS IN 2020

A good year for acquisitions and exits in BC

2020 was a surprisingly good year for BC-based companies, with numerous acquisitions (BC-based buyers noted by an *) and exits.

Company Acquired	Buyer	Valuation	Head Office	Sector
JANUARY				
Intrinsyc Software	Lantronix	est. USD $18m	Vancouver	IoT, Secure Data Management
Lenderspotlight	Lendesk*	Not public	Vancouver	FinTech
TOIS	CloudAdvisors*	Not public	Vancouver	Insurtech
Moltin	Elastic Path	Not public	Vancouver	eCommerce Platform
Blue Mesa Health	Virgin Pulse	Not public	Vancouver	Digital Health
FEBRUARY				
Colligo	Olbia Software	Not public	Vancouver	Workflow software
TWT Group	Fully Managed*	Not public	Vancouver	Managed IT Solutions
ChargaCard	Intellabridge Tech*	Not public	Vancouver	AI & Machine Learning, Blockchain
Grouse Software Labs	RBC Ventures	Not Public	Vancouver	Mobile Health App
MARCH				
Leadpages	Redbrick*	Not public	Burnaby	Marcom, CMS
BCL Tech	PDFTron*	Not public	Vancouver	Document processing technology
DG Group	LNG Productions*	Not public	Vancouver	3D Technology, Design & Printing
MAY				
DarkVision Tech	Koch Bros.	Not public	North Vancouver	Imaging technology
AR/VR Tech (Finger Food Advanced Tech Group)	Unity	Not public	Coquitlam	Software development services
Habitat Botanicals	Pela	Not public	Kelowna and Langley	Wellness
JUNE				
ActivePDF	PDFTron*	Not public	Vancouver	Document processing technology
Sea Breeze Power	Synex Intl*	Not public	Vancouver	Renewable Energy
JULY				
Chewse	Foodee Media*	Not public	Vancouver	Food Delivery Tech
Cycura	Well Health*	$2.55m	Vancouver	Wellness
AUGUST				
Apteryx Imaging (TSX:XRAY)	Planet DDS (backed by Level Equity)	$55m	Vancouver	Dental Imaging technology
Coastal Genomics	Yourgene Health	$17.9m	Burnaby	Life Sciences
Lotron Industries	Sotera Health	Not public	Port Coquitlam	Irradiation Technology

Company Acquired	Buyer	Valuation	Head Office	Sector
SEPTEMBER				
Plurilock Security	Libby K	$7.2m	Victoria	Cybersecurity
Button	Tiny Capital*	Not public	Victoria	Software consulting, 60% majority control acquisition,
Founded	RBC Ventures	Not public	Vancouver	Legal tech
Site Docs	K1 Capital	Not public	Abbotsford	Workplace software
Navarik	Vela Software	Not public	Vancouver	SaaS, cargo inspection
OCTOBER				
East Side Games	Leaf*	$150m, $50m cash balance stock	Vancouver and Nanaimo	Games
Mobify	Salesforce	Not public	Vancouver	eCommerce, CMS
Enbala	Generac	Not public	North Vancouver	Power tech
Finmo	Lendesk	Not public	Vancouver	Fintech
Chinook Therapeutics	Aduro Biotech	Not public	Vancouver	Life Sciences, Merger
NOVEMBER				
IUGO Games	DECA Games (Embracer Group)	Not public	Vancouver	Games
Trianni	AbCellera*	$90m	Vancouver	Life Sciences, Merger
ehsAI	Intelex Tech	Not public	Vancouver	AI, Machine Learning, compliance software
Clevest	IFS	Not public	Richmond	Workforce management software
Pepper Esports	TGS Esports (TSXV:TGS)	$6.07m	Burnaby	eSports
Piranha Games	EG7	$24.2m (plus potential earn-out up to another $63.4m)	Vancouver	Games
aThinking Ape	DECA Games (Embracer Group)	US$105m	Vancouver	Games
Maestro Tech	JDM Tech*	Not public	Vancouver	Construction & Project Management Software
PLAYR.gg	Trufan	Not public	Kelowna	Digital Marketing
Walleye Networks	Plume	Not public	Kelowna	Network Security
Carta	Mogo*	$24m	Vancouver	FinTech
RiseTech	Tantalus	USD$65m	Burnaby	Power tech, Merger
DECEMBER				
More information on December transactions will be available in January 2021				

THIS JUST IN

To kick off 2021, Vancouver-founded Hootsuite, the social media management firm, just announced the acquisition of Sparkcentral, a messaging app-focused customer engagement platform.

Hootsuite

AND ONWARD

The AbCellera deal was only the beginning for this company. Since that merger, AbCellera completed an IPO raising over $500m, brokered by Credit Suisse, Stifel, Berenberg, SVB Leerink and BMO Cap Markets. The company added noted Bay area VC, Peter Thiel, to its already stellar board.

AbCellera

The stock, which came out at $20, has hit a high of $50 and sits above $40 at the time of writing. A wonderful local story.

SUCCESS STORY

On a personal note, I led and managed the sale of Plurilock Security Solutions to Libby K Industries in 2020. The underlying business driver for Libby K was a desire to undertake a roll-up of cybersecurity companies. The deal was north of 10X in revenues as the primary driver was the strategic value of the IP and team in Plurilock, and the ability for the company to serve as a platform for a roll-up. As well as the Plurilock IP, the Libby K team identified Plurilock CEO, Ian L. Paterson, as one of the key parts in leading the rollup strategy.

Plurilock recently announced a collaboration with prominent open-source identity and access management (IAM) software vendor, Gluu, Inc. As a result, Plurilock will gain the ability to offer solutions which support Gluu's cutting-edge IAM platform and Gluu will be able to offer Plurilock's AI-driven invisible MFA and continuous authentication technologies.

"This is an exciting strategic collaboration," says Paterson. "Deeper integration with Gluu expands our potential market footprint in new ways and provides Plurilock with the ability to support an in-demand IAM solution for enterprise clients."

IN THEIR WORDS

IAN PATERSON, CEO
PLURILOCK

"David was an exceptional advisor, having worked with us for a long period of time on a growth strategy leading up to this exit, which he sourced, led and managed. Every step of the way he kept us on track and buttoned up. We were able to maintain valuation even though the deal was announced pre-Covid and closed well into the after-effects the pandemic had on the market. I cannot recommend him highly enough."

BARRY CARLSON, DIRECTOR
PLURILOCK

"This is the third time I engaged David to sell a company, and this is the third successful exit he has engineered. I could not be happier with the result."

ABOUT THE AUTHOR

David Raffa is the founder of Valeo Corporate Finance, a BC-based company providing sell-side investment banking services to small cap technology companies looking to exit .

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