Livingstone

Software Finland

The State of Tech-M&A and Implications for Software Firms

APRIL 9TH, 2024

Software Finland

Livingstone

Each transaction starts and ends in the same way…
… but our added value unfolds in the meantime

We don't just get deals done, we get…
Deals done right.

MERGERS & ACQUISITIONS

Sell-side
Buy-side
Prepare for sale
Management Buy-Out/In
Private equity transactions

DEBT ADVISORY

Senior secure
Junior/unsecured
Preferred securities
Mezzanine & capital raise

Top 5 midcap M&A advisors	€ 10 - 250m transaction volume	>100 bankers globally	Focus on midcap segment
>50 transactions p.a.	>30 countries with successful transactions	>3/4 of all transactions are marketed internationally	~50% cross-border transactions

Hei kaikille – mukava tavata!

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Partner

with Livingstone since 2018

EXPERIENCE

Houlihan Lokey
Investment Banking

Leonardo & Co
Investment Banking

News Corp
Executive

VIVA Media AG
Executive

Boston Consulting Group
Manager

McGill University
MBA
Management Information Science

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EXPERIENCE

Livingstone Chicago
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PWC
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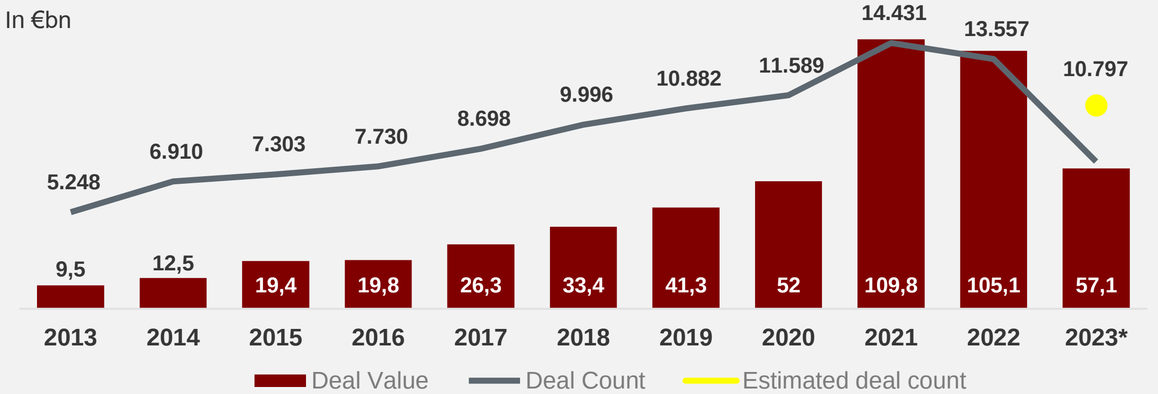
Maastricht University
M. Sc. Finance

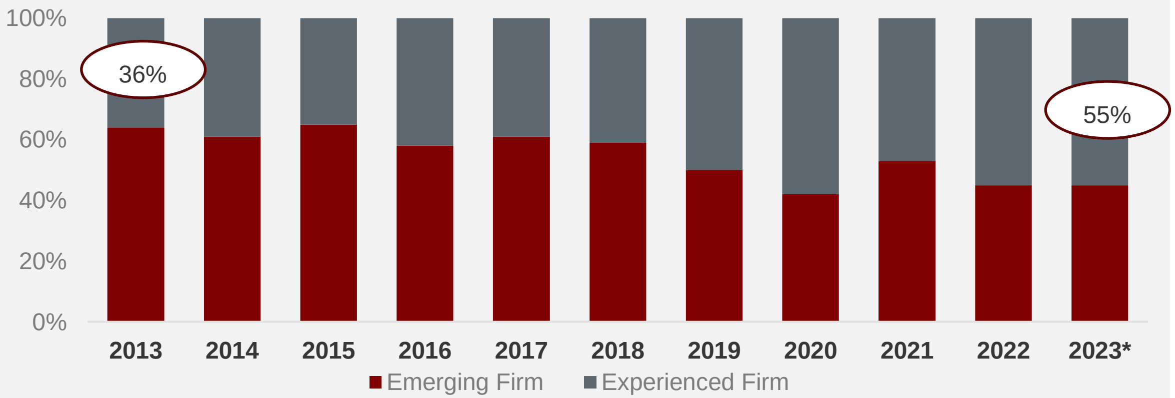
ready2order	mbrain	MACH	psg PSG Procurement Services GmbH	Novosco	FASHIONETTE Designertaschen Online	jedox.	News Corporation	wikifolio
the leading provider of cloud-based POS and payment solutions has been sold to	the leading provider of AI-based business intelligence solutions has been sold to	the leading ERP software vendor for the public sector has been sold to	the leading eProcurement provider for tail spend has been sold to	a leading independent provider of IT managed services and infrastructure services has been sold to	the leading German e-tailer of luxury brands has been sold to	a software vendor for corporate performance management solutions has been refinanced by	has acquired shares in the leading European pay TV provider	Europe's leading social trading platform has secured an investment from
ZUCCHETTI	MONTERRO	MAIN CAPITAL PARTNERS	epsa	CANCOM	GENUI PARTNERS	iris capital	PREMIERE	NEW ALPHA ASSET MANAGEMENT

VC deal activity – the flight to quality

NUMBER AND VALUE OF VC DEALS IN EUROPE



SHARE OF VC CAPITAL RAISED BY STAGE



OBSERVATIONS

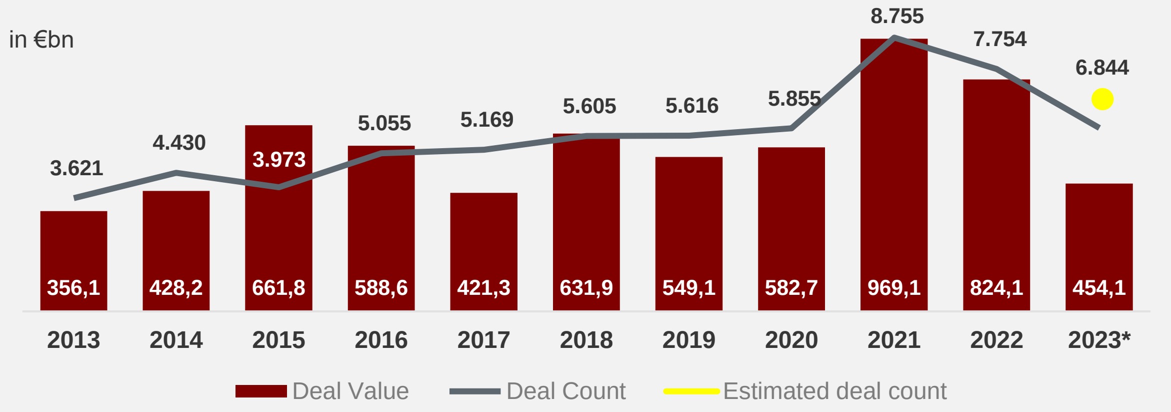
- All VCs now want to invest in the last round before profitability but only very few in a series A
- Focus is on top quality companies with 100% recurring revenues
- Heavy dilutions for non-participating shareholders
- Very unfavorable LPs and ADPs on top

CONCLUSIONS

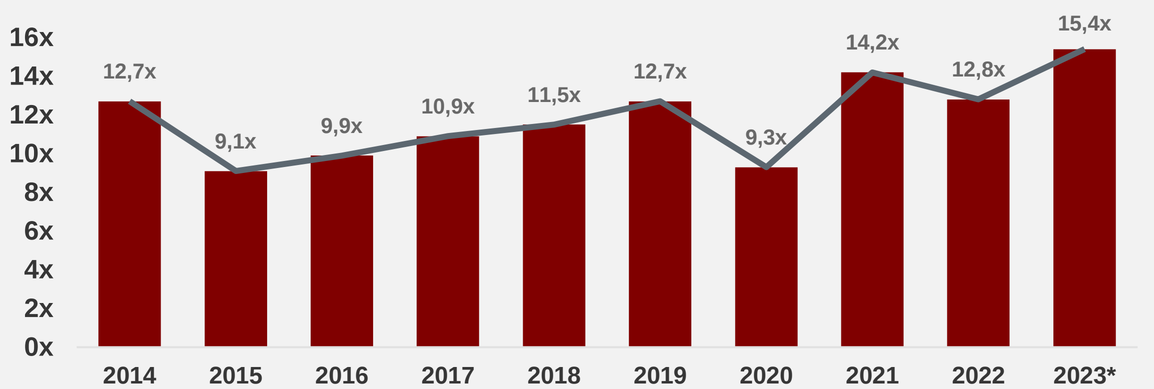
- Only raise what you absolutely need to
- Make sure to explore public VC options
- Don’t hope for family offices
- Explore alternative financing options (e.g. SaaS lending and discounting, asset-based financing etc.)
- Cut cost and growth and try to become profitable faster

M&A activity in IT – the return of the strategic buyer

NUMBER AND VALUE OF IT M&A DEALS



AVERAGE EV / REVENUE MULTIPLES PAID FOR IT DEALS



OBSERVATIONS

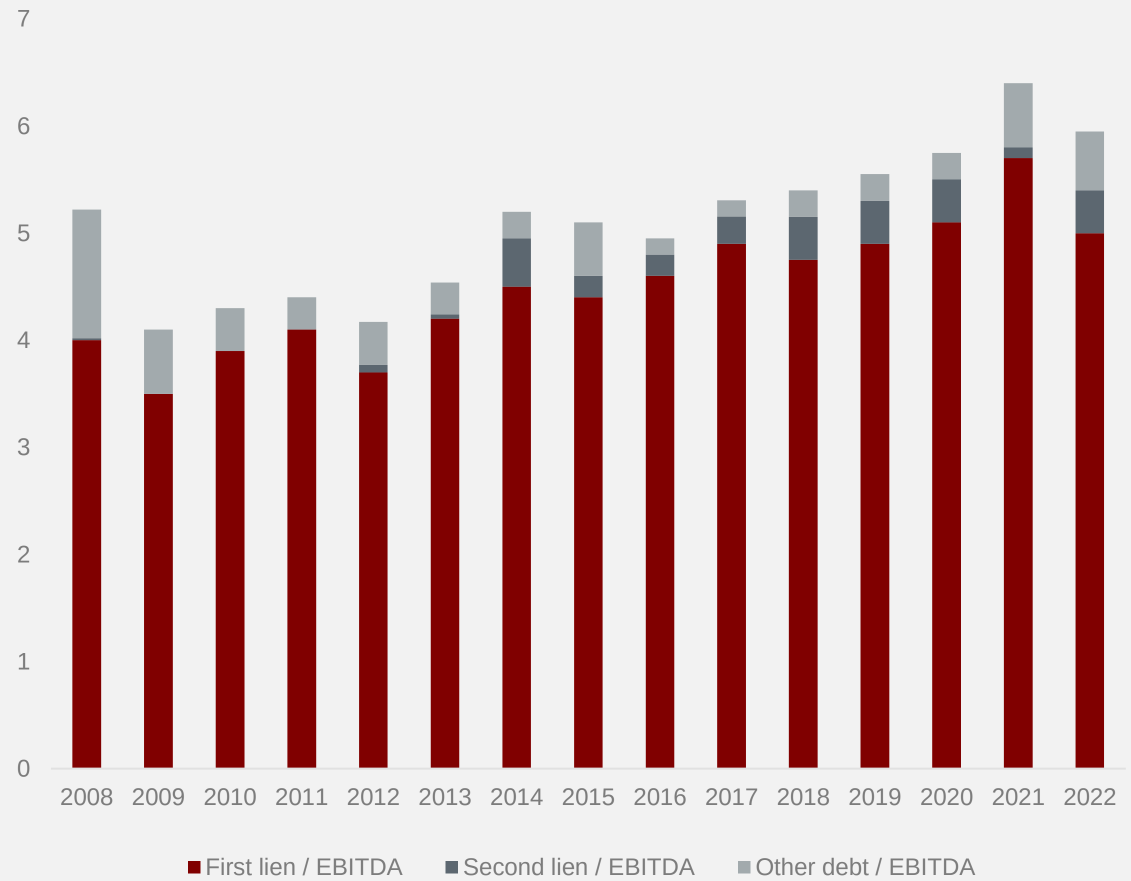
- Number of M&A deals also sharply reduced compared to 2021 but then again actually only slightly below 2020.
- In particular private equity has sharply reduced deal activity due to increased leverage cost
- Strategics in turn partly filling the void and returning to M&A markets
- Valuations are only technically up – as deals with low value / low quality targets simply do not happen

CONCLUSIONS

- Deals still happening but M&A processes have changed considerably
- Understand the buying strategies of strategics and demonstrate how you can create strategic value for them
- Avoid “meet grinder” M&A auction processes; assure reasonable success chances for bidders.

Increased cost of capital driving down private equity deal activity

DEBT TO EBITDA RATIO OF PRIVATE EQUITY DEALS ("LEVERAGE")



OBSERVATIONS

- For private equity buyers obtaining partial debt financing for their deals is key for delivering the type of returns they have to.
- The lower the cost of debt, the higher their returns.
- As debt cost are currently high, PEs simply take less (as shown beneath) resulting in fewer deals getting done at lower valuations.

CONCLUSIONS

- Evaluate potential debt financing options for a MBO before you talk to private equity investors.
- Being able to bring so called staple financing can make a real difference in the current market when trying to appeal to private equity investors.
- So - talk to your bank!

Source: PitchBook

On a like for like basis you simply cannot expect to obtain the same valuations as in 2021

WHAT INFLATION MEANS FOR VALUATION MULTIPLES – A VERY SIMPLE EXAMPLE

Assumed ARR as valuation basis (1)	€ M	10	10	10	10	10	10
Assumed real target IRR of investor	€ M	30%	30%	30%	30%	30%	30%
Inflation Rate	%	0%	5%	6%	7%	8%	9%
Resulting nominal target IRR	%	33%	38%	39%	40%	41%	42%
Sales multiple	X	3,0 x	2,6 x	2,6 x	2,5 x	2,4 x	2,4 x
Entry valuation (pre-money EV)	€ M	30,3	26,3	25,6	25,0	24,4	23,8

THE ABOVE EXAMPLE SHOWS THAT …

- … a business that was valued at 3 x ARR or € 30,3 M EV in a macro environment without inflation …
- … will be worth only 2,5 x ARR or € 25 M in a world with 7 % inflation if the investor still has to deliver the same real IRR.
- Inflation thus has taken off EUR 5 M of the valuation of this business without anything else having changed

(1) For simplicity reasons this is assumed to be an eternal rent

Where do you fit in ? - What matters most is not what you do but how you make money! (1/2)

BUSINESS MODEL	DEFINITION	VALUATION IMPLICATION	INVESTOR INTEREST
PURE SOFTWARE PRODUCT COMPANY	• Fixed monthly license fees with included maintenance (pure SaaS) • Full cloud deployment; installation and customization by channel partners • Ideally inbound sales only	• High sales multiples with corresponding growth rates and EBITDA margins ("Rule of 40")	• Focus of most tech financial investors • Still a very strong seller's market
BUSINESS PROCESS AS A SERVICE (BPAAS)	• End-to-end automation of business processes across company boundaries • Primarily volume-based pricing or revenue sharing	• Single-digit EBITDA multiples depending on: – Profitability – Customer structure – Size	• Strategists in the context of consolidation strategies • Traditional PE investors in the context of roll-ups
SOLUTION / TECHNOLOGY PROVIDER	• High customization requirements • One-off license payments (if any) • Substantial maintenance and service revenues • Selling know how rather than IP	• Single-digit EBITDA multiples depending on: – Profitability – Customer structure – Size	• Tend to be avoided by tech financial investors • Buyers are primarily strategists with make-or-buy logic

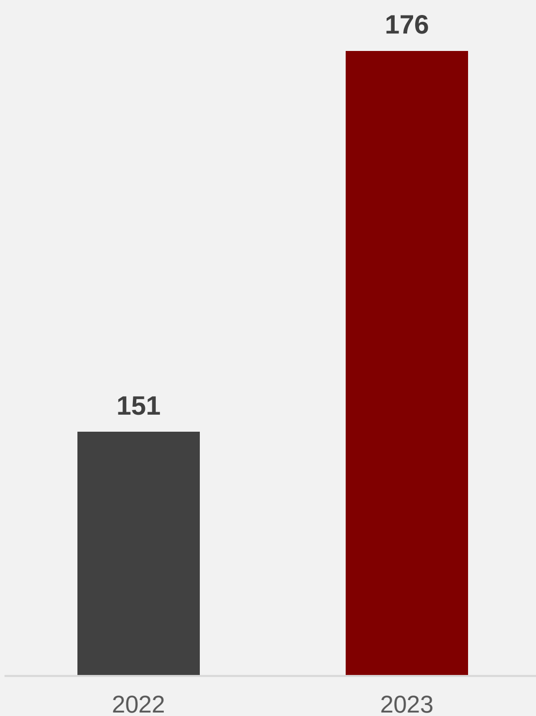
Where do you fit in ? - What matters most is not what you do but how you make money! (2/2)

BUSINESS MODEL	DEFINITION	VALUATION IMPLICATION	INVESTOR INTEREST
SERVICE PROVIDER	• Primarily time & material-based revenues • Project businesses • No scalable product platform	• Single-digit EBITDA multiples depending on: – Profitability – Customer structure – Size	• Strategics in the context of consolidation strategies • Traditional PE investors in the context of roll-ups
INFRASTRUCTURE OPERATOR	• Usage based business models • Capex heavy	• High EBITDA multiple range from low single-digit to significant double-digit depending on scalability and profitability	• Infrastructure investors with low return expectations cf. with PE • Strategists in the context of consolidation strategies
EQUIPMENT VENDOR	• Unit sales-based business models without recurring revenues	• Low single-digit EBITDA multiples	• Largely avoided by financial investors • Strategics with make-or-buy logic

Plan for longer processes and higher fail rates

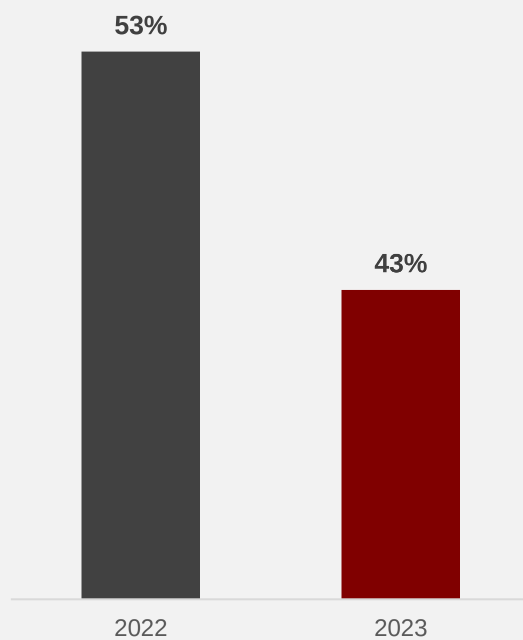
AVERAGE DUE DILIGENCE TIME FOR TMT DEALS AFTER LOI [(1)]

- in days -



AVERAGE CLOSE RATES FOR TMT DEALS

- in % -



OBSERVATIONS

- Buyers are much less in a hurry and rather pass on a deal than “making any mistakes”.
- As a result, the level of diligence with which due diligence gets performed (in particular on the commercial side) has increased substantially …
- … and so has the willingness to walk away from a deal if there is “too much hair on it”

CONCLUSIONS

- Give buyers the time they need, answer all questions and requests (within reason) to the best of your ability and do not try to create artificial pressure unless you really have better options.

Source: Dealsuite

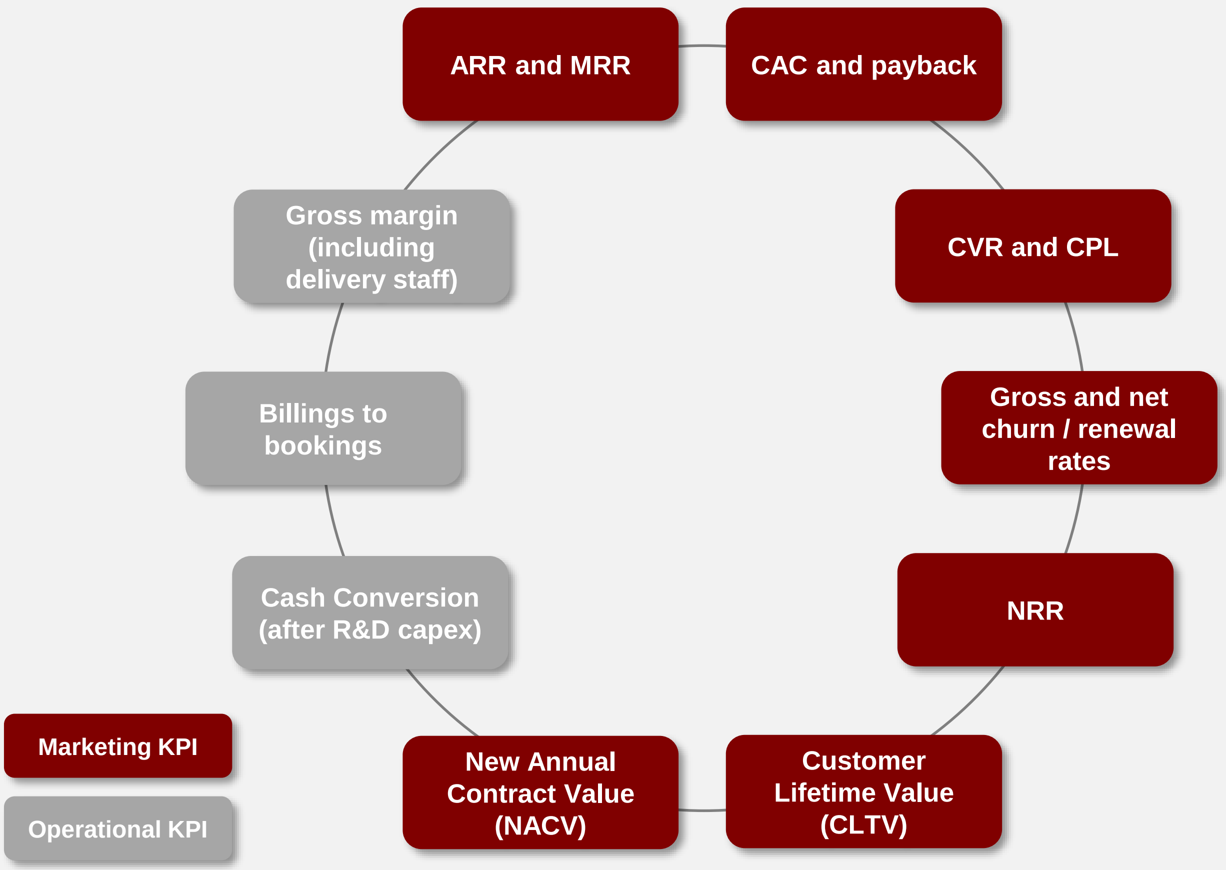
(1) Letter of Intent (non-binding offer)

How to drive value and success probability through an adequate M&A process design

The Saville Row approach	**Right timing the process**	**Careful transaction structuring upfront**	**"We do not know the right Investor, but we find it"**	**Tailored equity story**	**Selling with Data and Analysis**	**Diligent preparation**	**Extensive pre-marketing**	**High-touch process that does not feel like an auction**	**Maximum Probability of Success & Premium Valuation**
The deal factory approach	Adhoc process launch	Aligning expectations with LOIs on the table	„Spray & Pray" or „calling the people we know best!"	„Putting lipstick on a pig" or „one size fits all" positioning	Pure story based selling	Developing data and analysis on the fly	Hitting the market cold	Typical „meat grinder" auction	„Pump and Dump"

Selling with data: KPI have become at least as important as EBITDA

SELECTED KPI



OBSERVATIONS

- Sophisticated software buyers fully understand that accounting data are insufficient for evaluating the underlying profitability of a SaaS business and accordingly focus on KPI instead
- BI tools in this respect have put them into the position to analyse massive amounts of raw performance data and they make full use of this (including scrutinizing and manipulating the raw data themselves) How an opportunity scores on certain key metrices largely determines whether investors want to proceed or not (and this mostly overrules any equity story considerations).
- We thus strongly recommend to do the analysis by ourselves before buyers do them to uncover weak spots and make sure that the "trend is our friend" once we hit the market and key KPI are under control during the marketing phase (no bad surprises).

Selling with data: Selected key pieces of analysis that are a "must have"

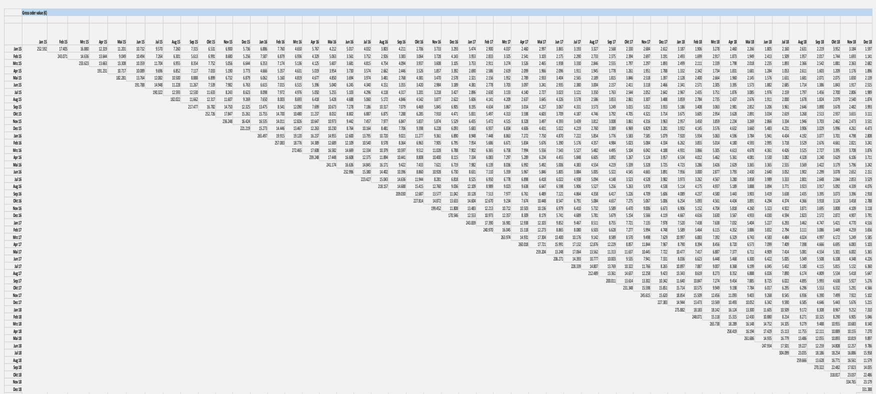
KPI-BASED / BOTTOM-UP 4-5 YEARS BUSINESS CASE

	2ß18 12 YTD Actuals	2019 12 YTD Forecast	% diff. 2ß18-19	2020 12 YTD Budget	% diff. 2019-20	2021 12 YTD Budget	% diff. 2020-21	2022 12 YTD Budget	% diff. 2021-22
Profit & Loss Statement									
Revenue TOTAL	12.951.223	17.582.178	+35,8	24.958.852	+42,0	37.202.609	+49,1	50.642.084	+36,1
thereof: Direct Channel	*9.786.526*	*13.948.441*	+42,5	*16.607.605*	+19,1	*23.163.738*	+39,5	*27.489.256*	+18,7
thereof: Partner Channel	*3.164.698*	*3.633.737*	+14,8	*8.351.247*	+129,8	*14.038.871*	+68,1	*23.152.828*	+64,9
other income	289.771	320.143	+10,5	0	-100,0	0	0,0	0	0,0
Cost of Sales	1.590.832	2.414.134	+51,8	2.723.308	+12,8	5.227.929	+92,0	10.035.610	+92,0
Gross margin	11.650.162	15.488.187	+32,9	22.235.544	+43,6	31.974.679	+43,8	40.606.474	+27,0
Operating Expenses	11.765.337	19.702.581	+67,5	28.007.150	+42,1	36.182.274	+29,2	41.211.595	+13,9
Sales* and Marketing	4.414.526	8.263.671	+87,2	12.098.852	+46,4	15.891.465	+31,3	19.920.021	+25,4
Consulting and Academy	1.713.499	3.260.328	+90,3	5.055.171	+55,1	7.117.764	+40,8	7.050.651	-,9
IT and Support	348.233	794.150	+128,1	1.850.954	+133,1	2.421.747	+30,8	2.744.972	+13,3
Research and Development	2.218.820	2.741.003	+23,5	2.978.505	+8,7	3.288.002	+10,4	3.646.353	+10,9
General and Administrative	3.070.259	4.643.429	+51,2	6.023.668	+29,7	7.463.296	+23,9	7.849.598	+5,2
Operating income	-115.176	-4.214.394		-5.771.606		-4.207.595		-605.121	
interest expense/income	706.573	0		0		0		0	
Non-operating income, net	591.397	-4.214.394		-5.771.606		-4.207.595		-605.121	
(provision for) income taxes	0	0		0		0		0	
Net income	591.397	-4.214.394		-5.771.606		-4.207.595		-605.121	

CUSTOMER LIFETIME VALUE (CLV) ANALYSIS

	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027
annual billings of SaaS client	100.000	100.000	100.000	100.000	100.000	100.000	100.000	100.000	100.000	100.000
annual billings with built in churn	100.000	95.000	90.250	85.738	81.451	77.378	73.509	69.834	66.342	63.025
consulting/services income	10.000									
consulting/services cost	-6.000									
hosting (with built in churn)	-5.000	-4.750	-4.513	-4.287	-4.073	-3.869	-3.675	-3.492	-3.317	-3.151
commissions	-10.000									
gross margin	89.000	90.250	85.738	81.451	77.378	73.509	69.834	66.342	63.025	59.874
cumulated gross margin	89.000	179.250	264.988	346.438	423.816	497.325	567.159	633.501	696.526	756.400
sales cost	-80000									
support cost (with built in churn)	-40.000	-38.000	-36.100	-34.295	-32.580	-30.951	-29.404	-27.933	-26.537	-25.210
contribution margin	-31.000	52.250	49.638	47.156	44.798	42.558	40.430	38.409	36.488	34.664
cumulated contribution margin	-31.000	21.250	70.888	118.043	162.841	205.399	245.829	284.238	320.726	355.389

COHORT ANALYSIS

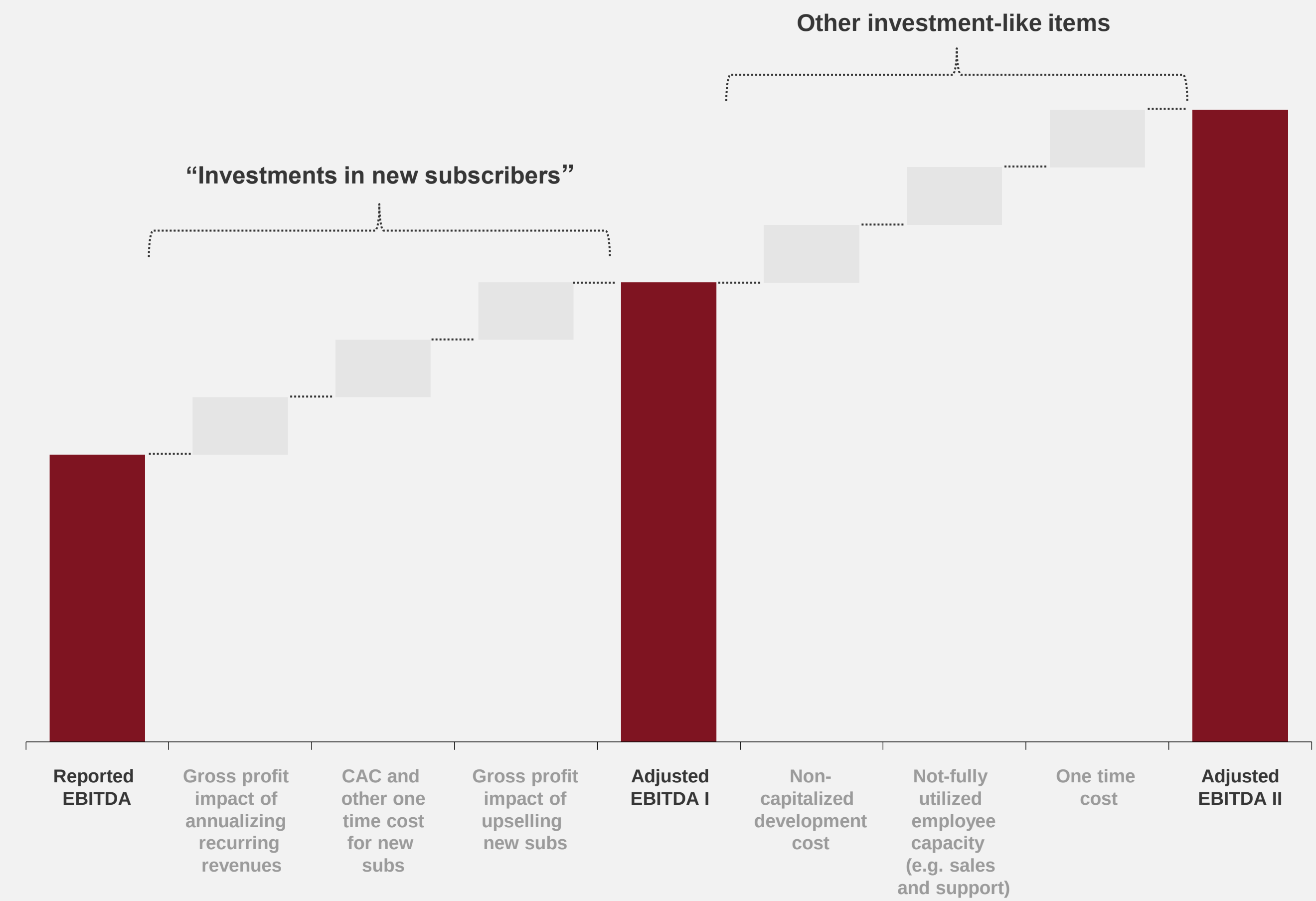


HISTORICAL SALES FUNNEL & CONVERSION

Company	Product/ application	Pot. vol. p.a. (€)	Next steps	Probability	Weighted potential (€)
Prospect 1	SB	> 25,000,000	Q2 2019	90%	22,500,000
Prospect 2	SB	>15,000,000	Q4 2019	25%	3,750,000
Prospect 3	SB	> 15,000,000	Q3 2019	25%	3,750,000
Prospect 4	SB and catalogue	> 5,000,000	Q4 2019	10%	500,000
Prospect 5	SB and catalogue	> 5,000,000	Q2 2019	90%	4,500,000
Prospect 6	SB	> 750,000	Q3 2019	10%	75,000
Prospect 7	Crowdfox/Beneering/PSG-Content	> 1,000,000	Q3 2019	10%	100,000
Prospect 8	SB and catalogue	> 1,000,000	Q4 2019	10%	100,000
Prospect 9	SB and catalogue	> 5,000,000	Q3 2019	25%	1,250,000
Prospect 10	Catalogue	> 750,000	Q2 2019	90%	675,000
Prospect 11	SB and catalogue	>1,000,000	Q4 2019	10%	100,000
Prospect 12	SB and catalogue	> 2,000,000	Q3 2019	10%	200,000
Prospect 13	SB and catalogue	> 1,000,000	Q3 2019	25%	250,000
Prospect 14	SB and catalogue	> 2,500,000	Q1 2019	100%	2,500,000
Prospect 15	Crowdfox / PSG Content	> 1,000,000	Q4 2019	10%	100,000
Prospect 16	SB and catalogue	> 1,000,000	Q3 2019	10%	100,000
Prospect 17	SB and catalogue	> 1,000,000	Q4 2019	10%	100,000
Prospect 18	SB and catalogue	> 2,500,000	Q2 2019	25%	625,000
Prospect 19	SB and catalogue	> 2,500,000	Q2 2019	25%	625,000
Prospect 20	SB	> 750,000	Q3 2019	10%	75,000
Prospect 21	SB and catalogue	> 3,000,000	Q2 2019	90%	2,700,000
Prospect 22	Crowdfox / PSG Content	> 1,000,000	Q4 2019	10%	100,000
Prospect 23	Crowdfox / PSG Content	> 1,000,000	Q3 2019	10%	100,000
Prospect 24	SB and catalogue	> 1,000,000	Q3 2019	10%	100,000
Prospect 25	SB	> 7,000,000	Q2 2019	50%	3,500,000
Prospect 26	SB and catalogue	> 1,000,000	Q3 2019	10%	100,000
Prospect 27	SB	> 1,000,000	Q3 2019	10%	100,000
Prospect 28	Model analog to MBPS Portal	> 1,000,000	Q2 2019	25%	250,000
Prospect 29	SB and catalogue	> 1,000,000	Q3 2019	10%	100,000
Prospect 30	Crowdfox / SB	> 6,000,000	Q3 2019	75%	4,500,000
Prospect 31	SB and catalogue	> 750,000	Q3 2019	10%	75,000
Prospect 32	Catalogue	> 500,000	Q3 2019	10%	50,000
Prospect 33	SB	> 2,500,000	Q2 2019	25%	625,000
Prospect 34	Model analog to MBPS Portal	> 1,000,000	Q2 2019	25%	250,000
Prospect 35	SB and catalogue	> 1,000,000	Q2 2019	75%	750,000

Selling with data: Uncovering the true profitability of a SaaS business

SELECTED EBITDA ADJUSTMENTS FOR A SAAS BUSINESS



COMMENTARY

- Despite the unsuitability of accounting EBITDAs for evaluating a SaaS business, buyers of course nevertheless look at them – in particular for determining whether an opportunity meets their minimum size requirements
- Growing SaaS businesses here are naturally disadvantaged as accounting standards do not allow them to capitalize most of the investments they are making. However, we can actually make up for this by ourselves through adjustments in the sales documentation.
- While buyers are generally skeptical about adjustments, they can be made comfortable with them if the underlying analysis is well grounded and solid.

Systematic identification of potential strategic buyers: Let’s understand who is “in the neighbourhood”

HIGH-LEVEL EXAMPLE: SOLUTION-ORIENTATED FUNCTIONALITY MAPPING FOR IDENTIFYING BUYERS FOR A COMMERCE SOFTWARE COMPANY

COMMENTARY

- The best possible buyer for a software company frequently is not its direct competitor as few people who already have a relevant tech stack in a given domain need or want a second one.
- Rather the best buyers are those who have a white spot in their functionality and capabilities map in the respective domain or are stuck with a legacy platform. Those typically are vendors that are active adjacent domains and functionalities and have potential benefits from integration.
- The wider commerce software space currently is very appealing in this respect as a number of players (some of them PE backed) are seeking to build larger commerce suits through buy and build creating a stop shopping solution for e-tailers.
- So, let’s jointly take a look across the fence and see what else our clients are subscribing to (or considering to subscribe to).

Don‘t hit the market cold!

BE WELL PREPARED!

Don’t wait for buyers to tell you what they are looking for and then scramble to get things prepared on the fly

When doing so you will always give a bad impression and lose a lot of momentum as you will have to take time during the process to prepare things.

Don’t belief buyers when they say that they will be very light on due diligence. They are investing other people’s money and thus have to do what they have to do.

Thus, anticipate what they will ask for and prepare this BEFORE you go to market. Scrutinize yourself (or get yourself scrutinized) on the quality of your sales documentation.

Remember: The preparation phase is the only time during a M&A process where you will not be under time pressure. So, take your time; it pays off.

MAKE USE OF PRE-MARKETING!

If you (or your advisor) sends out 100 teasers on day x the likelihood is very high that you will hit a lot of people unprepared and at a bad time.

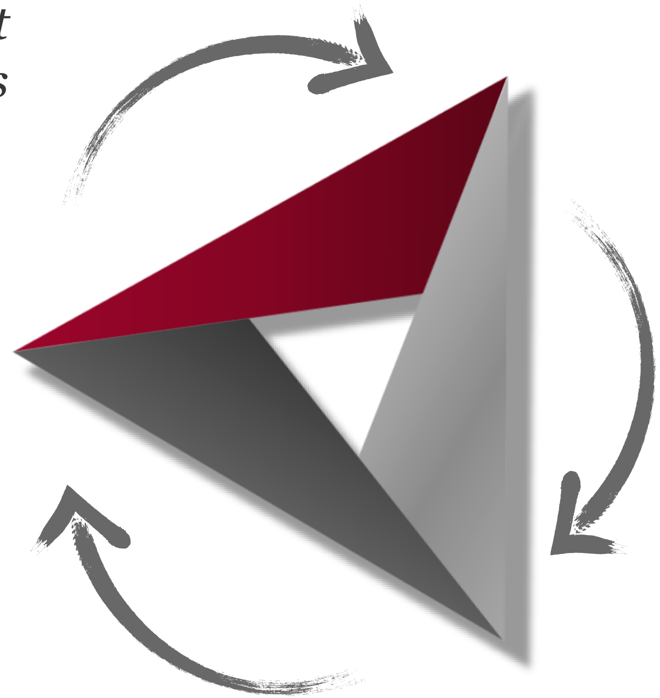
Moreover, many buyers much rather engage when they already know about an opportunity and have been following it for some time.

Accordingly let at least your top buyers know ahead of time that you might be coming to market soon.

Use the opportunity for informal conversations (fire-side chats) and seek to learn about their wants and needs. Build this into your sales documentation to maximize fit.

The right attitude for a successful and value maximizing M&A process.

„Miracles happen but unfortunately never to me, but that‘s not a problem as long as I work hard enough and I am well prepared.“



„The best possible buyer is not necessarily the one that I (or my advisor) knows best.“

„Once I have found the right buyer, I will destroy any and all arguments he can come up with for not doing the deal with data and facts“

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