FE INTERNATIONAL

Technology M&A: 2021 Outlook

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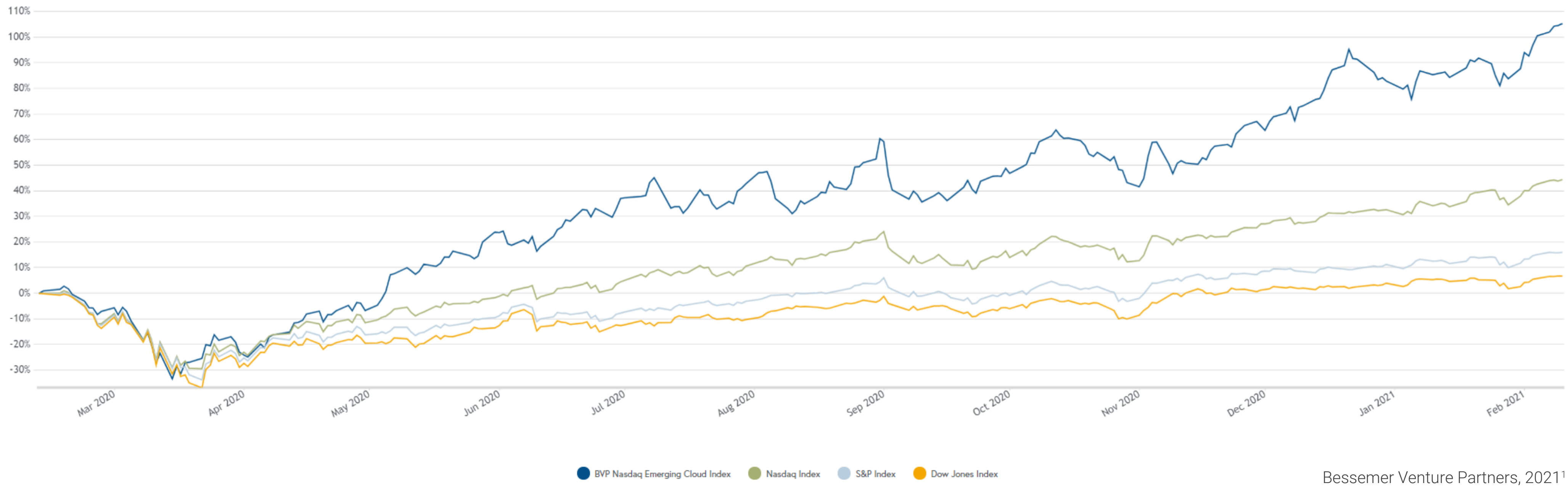
2020 TECHNOLOGY M&A IN REVIEW

The onset of the global COVID-19 pandemic brought economic activity to a near standstill, as many countries were forced into government-mandated lockdowns. However, as businesses began operating almost exclusively on a virtual basis, the technology and e-commerce sectors thrived.

Though the shift to cloud-computing capabilities has been occurring for years, 2020 brought a dramatic increase in corporate adoption of tools like Zoom, Slack and Microsoft Teams.

Businesses that were able to successfully transition to, or expand their cloud capabilities strengthened their competitive advantage. Not surprisingly, technology and e-commerce businesses were able to achieve impressive growth in the last year, as demonstrated with the BVP index, which significantly outperformed the S&P 500 - with the S&P 500 itself up 16% year-over-year.



Bessemer Venture Partners, 2021[1]

Major corporations weren't the only ones to see growth, however. This same effect was seen across all levels for technology businesses, with 2020 being a breakout year for many mid-market business owners and buyers. This was certainly true for clients of FE International, where we saw record-high levels of SaaS, e-commerce and content acquisitions in 2020.

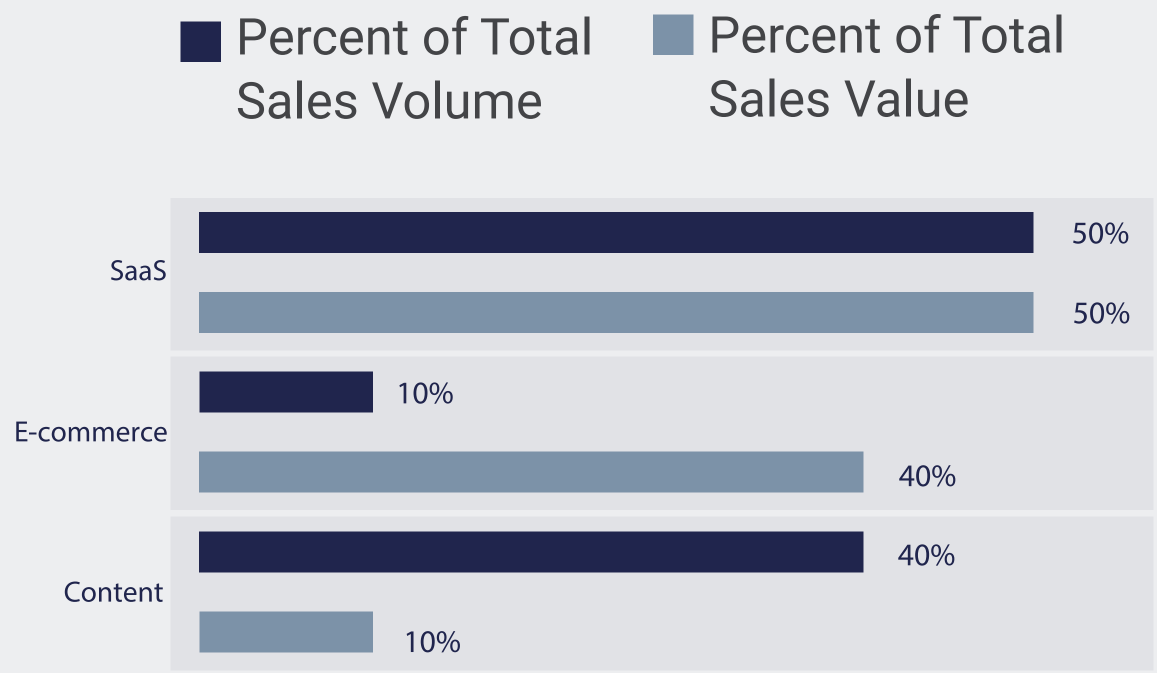
Looking forward, the reliance on technology-driven solutions to manage remote workforces and distributed operations will see demand for cloud-based technologies continue to increase in 2021 and beyond. While many businesses benefited from this trend in 2020, new ways of working will continue to drive innovation in technology and related services. As a result, more SaaS, e-commerce and content businesses will enter the M&A sphere in 2021.

TRENDS BY BUSINESS MODEL

2020 saw buyer demand increase greatly in e-commerce, with SaaS also growing and content holding steady. Part of the shift to e-commerce was driven by alpha-seeking investors looking to capitalize on the global shift in consumer behavior.

Demand in e-commerce was also in part driven by the emergence of multiple funds pursuing roll-up strategies in the Amazon FBA (Fulfillment by Amazon) space, which has resulted in billions of dollars of fresh capital seeking acquisitions in 2021. Further, more founders are opting for e-commerce as the business model of choice for new ventures.
This is due to Amazon FBA's improved fulfillment infrastructure, which has opened new international markets to small and large retailers alike, providing both expansion opportunities and increased diversification.

With growing levels of demand and healthy levels of new businesses being created and becoming profitable, e-commerce is set to continue rising in value across the rest of the decade.



2020 saw e-commerce businesses dominate acquisitions, with c.40% of total M&A value driven from this sector. This is particularly impressive given the average implied size of each business (c.10% in acquisition volume) from a standing start for Amazon FBA M&A four to five years ago.

SaaS continued to see consistently high levels of demand. While standalone SaaS businesses remain popular, marketplace SaaS applications, like Shopify and Atlassian apps, have also proven to be highly sought-after, as investors seek SaaS businesses with exposure to e-commerce brands and remote workflow optimization.

Content business multiples remained robust throughout the year. With Google continuing to optimize its algorithm in 2020, investors were left with fewer, but stronger, investment opportunities. 2021 is set to see more supply as content businesses adjust and optimize to many of these updates.

With more e-commerce and SaaS businesses looking to expand their content marketing efforts, content business acquisitions seem like a natural target for many firms looking to increase scale and reduce their customer acquisition costs. All this indicates a strong year for content businesses.

SaaS

2020 in review

2020 was a strong year for SaaS businesses. SaaS acquitions made up the majority of both volume and value of deals, with an increase of 20% in volume and a 15% increase in value compared to 2019. Since 2018, there has been an overall 40% increase in SaaS acquisition volume.

A large portion of 2020 figures were attributed to marketplace apps. Shopify and Atlassian apps specifically have gained market share in terms of volume and value, increasing by 25% over the past three quarters.

25%

Increase in volume of Shopify app acquisitions over last three quarters

87%
Shopify merchants who rely on Shopify apps to run their business

84%
apps on Shopify marketplace that have earned revenue

Driving forces

With larger companies forced to operate remotely almost overnight, the need to pivot to SaaS-based offerings increased dramatically, making SaaS an attractive M&A target for companies to supplement their current offerings and capabilities.

The pandemic also radically accelerated digital commerce and payments, and since the beginning of 2020, Shopify stock has surged almost 200%. Due to state-mandated closures of retail stores, new merchants looking to start up their e-commerce stores flooded Shopify, growing the platform over 70% in Q2 2020, compared to Q1 2020. This, of course, dramatically increased the opportunity for developers to create B2B SaaS products to service Shopify merchants. 87% of Shopify merchants rely on Shopify apps to run their business, and 84% of apps on the Shopify marketplace have earned revenue for their owners.[2]

Atlassian, which also hosts a marketplace for developers to upload their B2B SaaS products, experienced impressive growth, with its stock rising nearly 100% in 2020. Due to the pandemic, cloud-based collaboration tools have become a necessary investment for companies with the shift to remote work, and Atlassian has consistently been a market leader in software and collaboration tools.

The increase in popularity of the Shopify ecosystem and Atlassian Marketplace, as well as merchants' dependency on Shopify and Atlassian apps to keep their businesses up and running, also offered a unique opportunity for developers to divest.

On the buy-side, purchasing a marketplace app is particularly attractive for several reasons:

- **Readily addressable audience to market to, keeping customer acquisition costs (CAC) low**
- **Strong technical development, since app marketplaces have stringent rules around the quality of software coding**
- **The ability to add-on and roll-up other apps and cross-sell to existing users**
- **Diverse user base, so low monthly recurring revenue (MRR) concentration risk**

Looking ahead

As the pandemic’s impact on ways of working and shopping becomes more permanent, we expect Shopify and Atlassian growth to continue. Beyond marketplace apps, we also anticipate corporate interest will pick up for small- and medium-sized business (SMB) SaaS acquisitions in 2021, particularly given the strong valuation multiples already being commanded by privately held large-cap SaaS companies like Stripe.

Additionally, interest in strategic acquisitions is also likely to continue, with larger firms looking at SMB purchases as the shift to the cloud accelerates. While many companies believed they were set up for remote working capabilities in some capacity, the stress test that was 2020 showed that many had to quickly increase their rate of adoption for existing and new technologies. Companies have seen an acceleration in the digitization of internal operations by three to four years due to the pandemic, and the share of digital products and digitally-enabled products in companies’ portfolios has accelerated by almost seven years.[3] Additionally, executives have expressed an interest in making strategic investments in technology that will ensure their long-term success.

While larger companies complete deals at the top – such as Salesforce’s acquisition of Slack – we expect there to be a continued trickle-down effect, as was observed in broader terms in 2018-20. Investor confidence in the sector has been felt across the value range, and investors are increasingly looking to small- and mid-cap markets for high growth businesses that can drive above-market returns, with a view to a possible top-tier exit in years to come.

E-commerce
2020 in review

Despite the challenges faced in the first half of 2020 for many e-commerce businesses, the year overall was a huge success for most well-run companies in this sector, many of which posted record sales. This drove an increase in acquisition demand, with special-purpose funds and private equity firms looking to capitalize on the change in consumer behavior by acquiring profitable businesses and increasing scale through access to additional levels of working capital and cross-portfolio synergies.

The sale of FBA businesses is largely responsible for this shift. Such acquisitions have gained traction over the past two years, now dominating the e-commerce market – with a higher total acquisition value and more consistent volume of deals. Whereas, FBA acquisitions made up less than a quarter of all e-commerce deals in 2018. And with e-commerce platforms growing at rapid rates, FBA businesses are readily able to scale, diversify and expand in 2021.

> “Fulfillment by Amazon businesses made up the majority of e-commerce acquisitions in 2020

Driving forces

One reason for this growth is a recent influx of startups aiming to compete with mega-consumer brands like Unilever or Procter & Gamble. In total, startups have received over $1 billion in funding, with much of that targeted at brand new companies. For example, HeyDey and Boosted Commerce – which combined raised $362 million in funding (including equity and debt) – were all founded in 2020.

Also, investors saw how a rapid change in consumer behavior could prove profitable. Simply put, more people were buying online because of the pandemic. In turn, major startups began buying more small- and medium-size FBA businesses. This makes sense – it's easier to purchase a successful business with a built-in audience and sales platform than it is to start one from scratch.

Amazon has proven that it can scale on-demand, so there are high hopes for it being able to handle demand into the future. Plus, Amazon is also becoming more store-friendly with the introduction of offerings such as brand-gated products. This gives more confidence to buyers that their investment – at acquisition and beyond – is in a secure platform that values its store owners as well as end-users.

Finally, there is no shortage of such businesses in the marketplace. In fact, Amazon reports that small- and medium-size third parties sellers account for nearly 60% of all their physical product sales. Amazon is conscious that their business model relies on these merchants, and as such is doing more to support them, including working capital loans, allowing merchants to sell as their own brand, and providing merchants and their customers with consistent, high-quality customer support.

With such benefits, it is no surprise that independent merchants were estimated to see over $200 billion in revenue last year alone.[4]

Looking Ahead

The bottom line? We expect both the total sales volume and value of e-commerce businesses to increase in 2021.

> "FBA businesses demonstrated their ability to scale exponentially and profitably in 2020; this has driven up buyer demand and multiples headed into 2021

Content
2020 in review

In 2020, content businesses were in the unique position of benefitting both buyers and sellers. For those looking to sell, there were fewer large competitors on the market. Thus, the demand of content businesses trumped the supply, which speaks to the robust content multiples observed through 2020.

Additionally, with Google continuing to optimize their algorithms over the last year, investors were left with fewer, but stronger, investment opportunities.

Driving forces

Since most content businesses rely quite heavily on SEO to drive traffic, Google's algorithm can largely dictate a content site's revenue. Whenever Google updates its search ranking algorithms, website rankings will perform one of three ways: better, worse, or – in some cases – no change at all.

In 2020, Google rolled out three different Core (algorithm) Updates: one in January, one in May, and one in December. The May 2020 update was the largest, with the highest amounts of search ranking volatility reported, affecting travel, real estate, and health sites the most.

We observed that sites that were affected the least were the ones that most regularly updated their content, adding and removing as necessary to maintain relevance and timeliness. While this may seem obvious in hindsight, SEO has for a long time been focused on aged, long-form content to maintain Search Engine Results Page (SERP) rankings, so many business owners were caught by surprise by this update.

Google updates essentially weed out the content businesses that are not up to standard, so from an investor's perspective, the best time to purchase a content business is following a Google Core Update.

Since the most recent update was in December 2020, we believe that more content businesses will become available for acquisition in mid- to late-2021.

Looking ahead

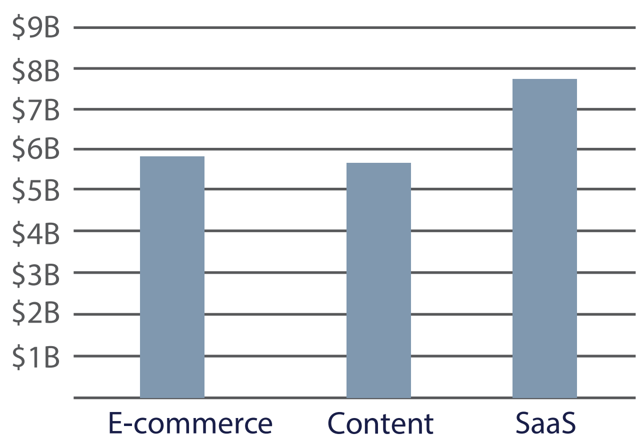
In 2021, buyers can feel confident purchasing strong businesses after a big year of updates. Meanwhile, sellers will continue to command good multiples, as they have Google'se validation and supply is low.

TRENDS IN LIQUIDITY

2020 in review

The buyer universe increased in both volume and value across 2020. Suitors in our network represented c.$20 billion in capital by the end of the year, with a relatively equal distribution across e-commerce and content business buyers, and a larger sum for SaaS buyers. Of this, 47% of investors are looking to acquire in the first half of 2021.

In 2020, the largest gain for a single business model was e-commerce, rising from nearly $1.3 billion to over $5.8 billion. The chart below details the total amount of liquid funds available to buyers in our network and where they expect to allocate those funds.



Driving forces

The increase in funds stems from several economic factors:

- Investor confidence – The technology M&A space has been growing in a slow-and-steady fashion for nearly 15 years, and with the macro-move to the cloud, these assets are becoming less alternative and more mainstream.
- Greater available funds – Buyers are re-investing capital from previous exits or looking to purchase new businesses with investor backing. In addition, buyers are capitalizing on the opportunity to re-invest gains from stock markets as they diversify exposure outside of all-time high markets. Further, in December 2020, the Federal Reserve said that it plans to keep the federal funds rate (the benchmark for most rates) between 0% and 0.25%. The Fed said it intends to keep rates at this low level until inflation is at 2% for the long term – something it doesn't think will happen until 2023. As a result, buyers can expect low interest rates throughout 2021.[5]
- More representation by M&A and due diligence firms – These firms can move sellers and buyers through the acquisition process in a safe, secure, and successful way. Bankers and attorneys are also now more experienced in digital assets, and therefore better able to assist clients and M&A firms during acquisition processes.
- Private Equity – According to PwC, "Through mid-November, PE firms did nearly 4,100 deals in 2020 – 5% more than all of 2019 and on pace to be the largest annual volume ever. Nearly half of those acquisitions have been in just two industries, with 36%of said acquisitions in tech."[6] PE firms are therefore searching lower down the valuation spectrum for both supply and more attractive multiples.

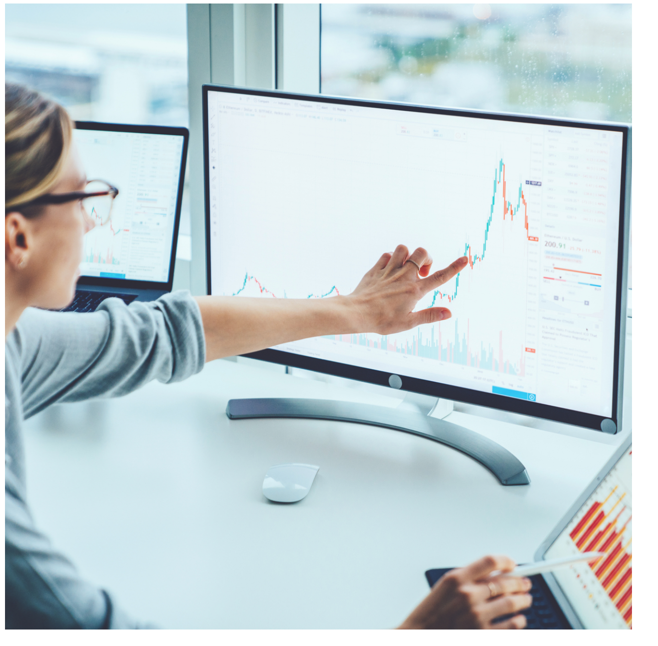
Looking ahead

While the greater M&A market showed signs of slowing in activity, technology M&A remained strong through 2020. With greater access to capital, acquisitions will accelerate, and the next six months will display more M&A activity than ever before.

Here are a few additional, potential drivers for 2021:

- The possibility of more stimulus spending expected to be rolled out in early 2021, which has a trickle-down effect onto consumers
- The stock market continuing to trade at all-time highs, which increases access to capital and debt facilities for institutional as well as individual investors
- Increased investor confidence and assets migrating from alternative to mainstream due to greater awareness of these types of businesses across the investment community

> "Buyers have more capital to deploy and are looking to allocate it quickly



TRENDS IN BUYER CHARACTERISTICS

Experience dictates budget: only 15% of first-time buyers are seeking to deploy 7- and 8-figure sums, whereas 28% of second-time buyers are seeking to deploy funds in that range.

Increased experience, subject matter expertise, and operational efficiencies leads second-time buyers to refine their criteria more closely, which in turn increases comfort levels around larger follow-on acquisitions.

In 2020, we also observed a significant increase in the average amount of offers per deal. There was an overwhelming demand for businesses above the $10 million mark, averaging about six to eight qualified offers per deal (and many more unqualified, which contributed to the higher exit multiples achieved across the board.

28%

of repeat buyers have 7- and 8- figures to deploy, compared to only 15% of first-time buyers

As the budget increases, so does the interest in purchasing an older or more mature business. Naturally, investors are approaching new acquisitions with cautious optimism – willing to spend more but wanting to ensure that the businesses they are looking to acquire are both time-tested and established. 40% of buyers within our network with an 8-figure budget (and above) are looking to purchase businesses four years and older, whereas 45% of lower budgets are seeking businesses in the one- to two-year age range.

The increase in average amount of offers per deal also informs us that the demand for businesses 8 figures and above has risen considerably going into 2021.

40%

BUYERS WITH > *$10M* BUDGET LOOKING TO BUY A BUSINESS *4 YEARS OR OLDER*

45%

BUYERS WITH > *$25K* BUDGET LOOKING TO BUY A BUSINESS *1-2 YEARS OLD*

Looking ahead

Buyer demand continues to increase, with record acquisitions levels posted year-after-year since 2010. Institutional capital has also started flowing into the sector at the small- and mid-cap level, as financiers become more familiar and confident over the sector – a trend only partially driven by the pandemic-led shift to cloud and e-commerce in 2020.

With greater access to capital and more buyer experience driving up demand, we expect continued growth in multiples in 2021 and beyond for well-run, profitable businesses that have stood the test of time. Buyers will continue to refine their criteria and increase selectivity over acquisition targets, however, they will likely be less concerned with multiple levels over long-term value drivers.

VALUATION RESOURCES

Accurately valuing a technology business for sale can, for many, be the most challenging part of the exit or purchase process. The inconsistency in valuating intangible assets (like intellectual property) across valuations ranges can prove challenging. However, an awareness of the generally accepted methods and best practices can help you arrive at an appropriate, accurate valuation.

With tens of thousands of businesses analyzed over the past decade and over a thousand completed acquisitions, FE International's insight into technology businesses is unrivaled. FE holds the largest global database of privately sold technology businesses.

The FE valuation approach uses multiple financial models relying on different variables to come to a holistic, current and future view of a business. FE analyzes a traditional Discounted Cash Flow model, Historic Price Regression, Historic Revenue Regression and Comparable Multiple data. These methodologies are then combined using weighted averages (on a case-by-case basis) to attain accurate valuations that have helped drive a 94.1% acquisition success rate and average selling prices within 5.8% of target prices over the past decade.

For more information on how to value a SaaS, e-commerce or content business, please follow the links below:

- **SaaS**
- **E-commerce**
- **Content**

KEY TAKEAWAYS

- The reliance on technology-driven solutions to manage remote workforces and distributed operations will see the demand for cloud-based technologies continue to increase into 2021, resulting in strategic investments in technology that will ensure companies' long-term success
- With the rapid transition to remote work and the need to rely on cloud-based technologies to work-from-home with ease, companies will continue to make strategic investments in SaaS offerings
- With greater access to capital, acquisitions will accelerate, and the next six months will display more mid-market M&A activity in the technology space
- FE International saw an increase in acquisition multiples for both SaaS and e-commerce businesses. In line with the broader business environment, multiples will continue to increase as higher-revenue businesses continue to come to market

ABOUT FE INTERNATIONAL

FE International is an award-winning global M&A advisor of SaaS, e-commerce and content businesses. It has completed acquisitions for thousands of founders, owners and acquirers, and is the preeminent valuation thought leader in the industry. Its team includes experts in exit planning, valuation, accounting, legal and more.

Founded in 2010, FE is known for its extensive network of pre-qualified international investors. With headquarters in New York and regional offices in Miami, San Francisco and London, FE is an international company serving clients worldwide. It was named the 8th fastest-growing financial services company in the Americas (133rd overall) by the Financial Times in 2020 and is a two-time Inc. 5000 company.

For more information, visit **FEInternational.com**.

Endnotes

1 “The BVP Nasdaq Emerging Cloud Index.” Bessemer Venture Partners, www.bvp.com/bvp-nasdaq-emerging-cloud-index. Accessed 12 Feb. 2021.

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5 “The Fed - December 16, 2020: FOMC Projections Materials, Accessible Version.” Board of Governors of the Federal Reserve System, www.federalreserve.gov/monetarypolicy/fomcprojtabl20201216.htm. Accessed 24 Jan. 2021.

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