Oaklins

Grounds for optimism in the eye of the storm

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"What makes SaaS companies particularly adaptable to changing market conditions is the continuity of the sales model combined with the flexibility of the cost structure. While sales and marketing spend typically accounts for approximately 30% of a SaaS company's cost base, one of the key ways to manage uncertainty is to limit growth investment. Focus on upsales and cross-sales to existing customers is emphasized, as sales to new customers is slowing down for many businesses."

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MARKET OVERVIEW

The relevance and impact of software as a service (SaaS) companies on the economy, but also society in general, has seen continuous growth in recent years. With better infrastructure, sophisticated devices and software solutions, SaaS is deeply involved not only in large institutional processes, but also in our daily lives. The Oaklins SaaS team has solid expertise in the industry regarding trends, M&A rationale and strategic drivers. In this Spot On, we would like to present some insights into the industry and valuations. Furthermore, we want to assess the impact of the drastic change in the world that COVID-19 has brought us.

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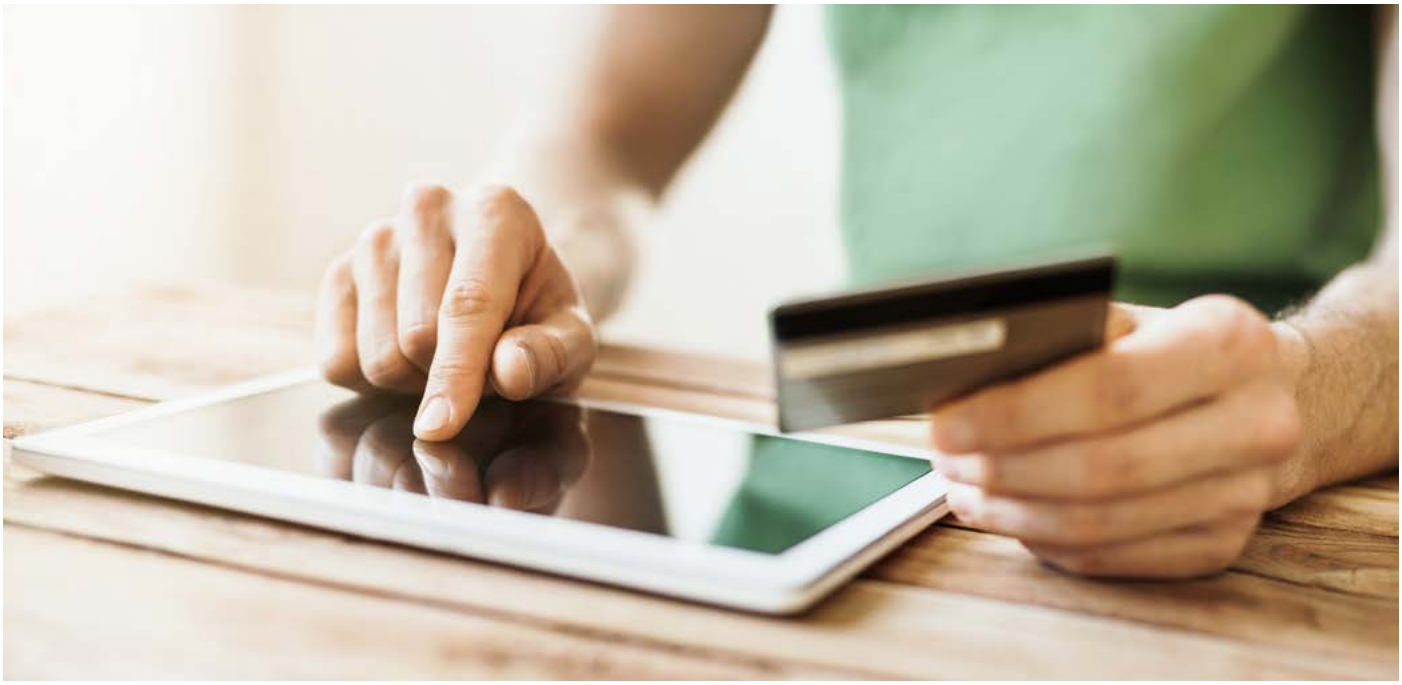


Market overview

SAAS BUSINESS MODEL SHOWING RESILIENCE AMIDST MARKET TURBULENCE

The COVID-19 turbulence shook the world, but despite this, it has been a defining moment for the SaaS industry. For the better part, most companies have never faced market adversity. Let's compare the current situation to 2007: before the Great Recession, there were only 18 public SaaS companies and less than 60 SaaS acquisitions. Fast forward to 2019, there are more than 100 public SaaS companies in US exchanges and more than 1,200 transactions.

SaaS businesses have been an attractive and appealing investment throughout the past 10 years. The major factor is their business model, which focuses on a long-term customer relationship, gaining recurring revenue and maintaining high retention rates, thus generating strong margins. Furthermore, around 70% of the typical SaaS company's operating expenses are attributable to labor — with a small proportion of fixed costs, companies have the flexibility to bring costs in line with decelerating or declining revenue growth. Considering these factors, the SaaS business model sounds optimal for an economic downturn.

How has the COVID-19 turbulence affected the market?

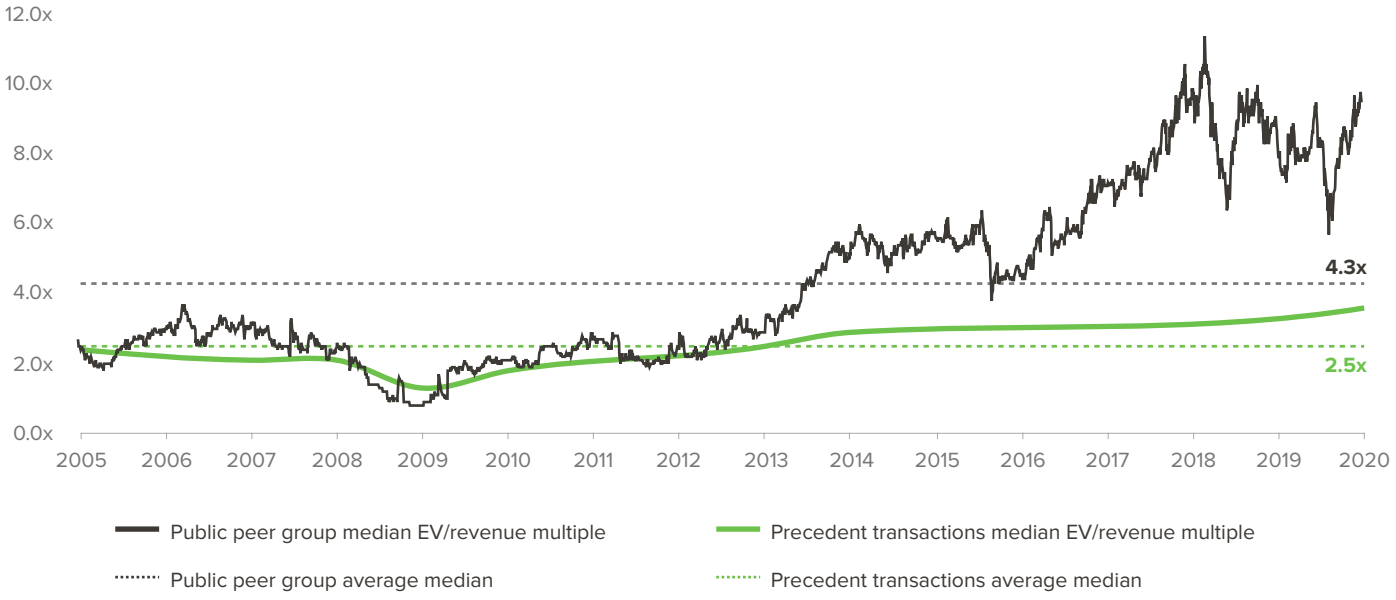
The high valuations of SaaS companies plunged between March and April — as did practically the entire stock market — but had returned to their former highs by July, and in some cases even surpassed them. Both the SaaS business model and many providers' focus on client companies' core business activities (e.g. enterprise resource planning [ERP] or customer relationship management [CRM] software) make the industry well-designed to survive volatile markets. The industry's financial performance has been rather resilient — during the crisis, most stock-listed SaaS companies have shown consistent growth while maintaining their profitability. Due to this, they have generally outperformed the biggest indexes.

Private SaaS valuations remain high

Despite poor short-term visibility and big demand shifts in certain industries, M&A transactions involving private software companies have seen even higher multiples than before. EV/Revenue multiple development in global software market transactions showed an increase from 3.2x in 2019 to 3.6x in Q1 2020. However, it is noteworthy that transaction volume has dropped to 58 in 2020 compared with 109 in 2019.

Looking at the past 15 years, the valuations of privately owned software companies have remained more stable compared to the stock-traded peer group, and during the last six years the private companies, on average, have been traded with an increasing discount compared with listed peers, which have seen both high increase and high volatility. The reasonable valuation level is likely to provide private transaction valuations some resilience in relation to the recent public market share price drops during the first quarter of 2020, driven by the uncertainty in the stock market resulting from the COVID-19 outbreak.

Public peer group median EV/revenue vs. precedent transactions median EV/revenue



Source: S&P Capital IQ

The valuation development trend of the M&A market tends to follow the general movement in listed stock prices with a delay of three to six months months. The precedent transactions consist of:

- transactions with disclosed EV/revenue multiples between 1/1/2005–31/6/2020
- transactions with an implied enterprise value of at least US$5 million
- the public peer group was created by Oaklins Merasco and consisted of a selection of software companies (a total of 78, of which 52 are from North America, 24 from Europe and two from other regions)

The gainers

During economic slowdowns, some companies fall and others boom as new opportunities arise. COVID-19 has pushed companies to adopt new modern solutions to enhance their business model. Amongst the most prominent COVID-19 winners are working-from-home (WFH) service/solution providers. Zoom Video Communications Inc. has performed extremely well, with an approximate 290% rise in price from the beginning of 2020. The communications and collaboration SaaS sector has been notably resilient and kept the same last twelve months (LTM) revenue growth between Q1 and Q2. Consequently, these companies have increased their valuation multiples during the COVID-19 pandemic. In comparison with communications companies, ERP & supply chain management (SCM) and business intelligence (BI) & analytics sectors have had little to no change to their LTM revenue growth and valuation multiples.

M&A activity during Q1 2020

Overall, software M&A deal volume was heavily impacted by the market downturn. With less than 150 deals in Q2 2020, SaaS M&A deal volume declined around 25%. Moreover, this implicated a decrease in annual deal volume for the first time in 10 years. The M&A market reacted to the turmoil with a delay of a few months, facing its lowest deal volume in May. Nevertheless, the market saw a great recovery in June, continuing to the beginning of August. Due to these factors, the Q2 2020 SaaS M&A EV/revenue multiple was in line with the prior quarters. While there was close to no difference in the share of private equity and strategic-driven deals during Q2 2020, most of the highly active acquirors were strategic. These companies consisted of VMware, Volaris Group, MRI Software, Microsoft and Thoma Bravo.

Market insight

Due to the short history of the SaaS business model, the industry has never faced such economic uncertainty as the world is facing now. We wanted to truly understand how businesses feel about the current situation and furthermore have adjusted to the drastic change. We sat down for in-depth interviews with over 10 SaaS executives and M&A professionals — including both strategic players and financial investors — to discuss their views of the current market. On the agenda were operative key performance indicators (KPIs) both prior to and after COVID-19, the M&A appetite and mid-term forecasting.

Measuring success

The SaaS business model is built in such a way that it relies more on recurring revenue and not as much on one-time fees. Thus, metrics such as annually recurring revenue (ARR), monthly recurring revenue (MRR) and net retention are crucial for measuring businesses' success. Many executives believe that SaaS companies ought to focus on growing the length of subscriptions and reducing the amount of subscriptions lost over time. This highlights the importance of measuring net churn. In addition, sales and marketing efforts, cash EBITDA, net working capital and cash flow and revenue should be key indicators to follow.

Eyes to the future

During our interviews we found out that some believe that the pandemic might sweep the financially struggling firms out of business, and after a period of time that will possibly heal the valuations levels. Reinforcing this statement, there were several views that the current market conditions will stabilize by the end of the year. In contrast, there are opposing views that are based on the belief that a second wave of COVID-19 will lead to growing market uncertainty and further economic downturn.

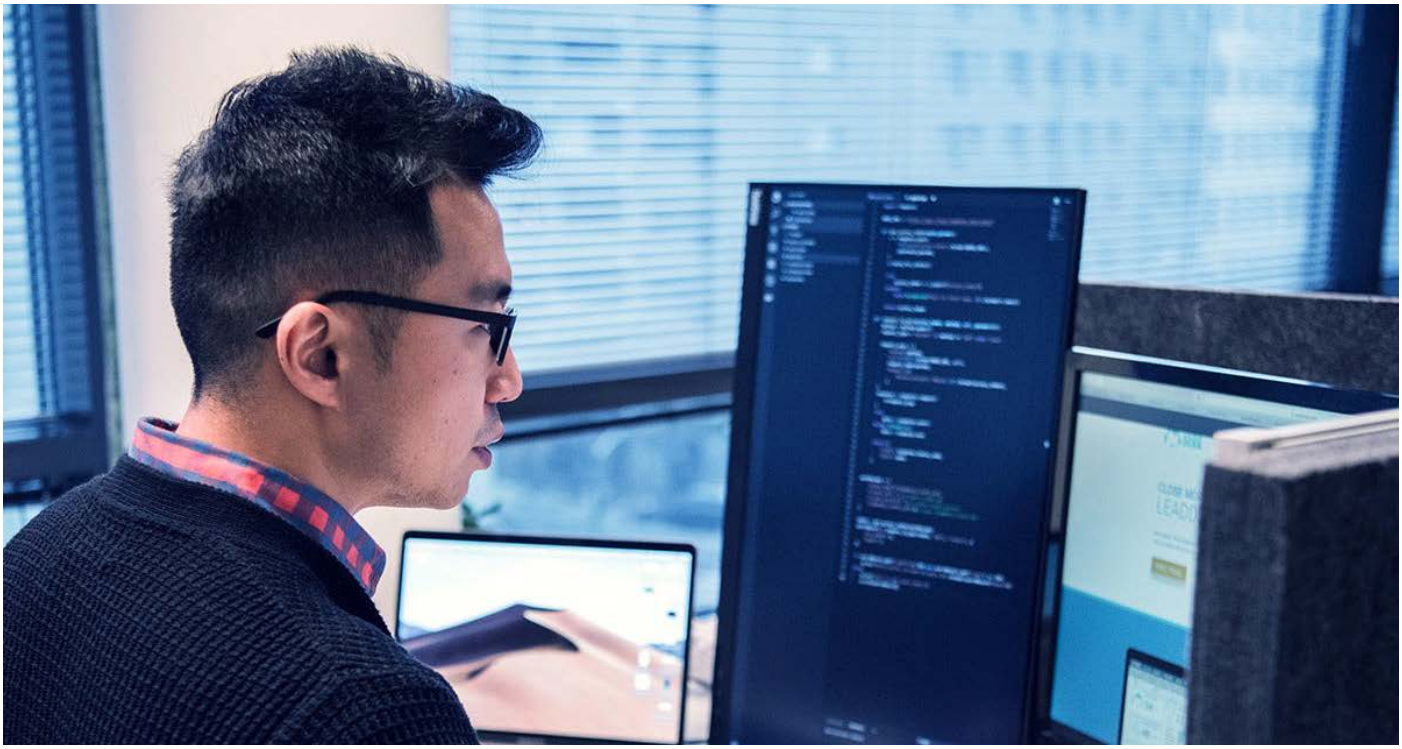
Due to the current market conditions, many companies have closed their doors temporarily. This has stressed the need to focus on customer loyalty even more than before. Many companies now focus on learning cross-selling and upselling and putting efforts into these actions. In the middle of market turmoil it is also an optimal time to focus on R&D and to make sure the company is ready to grasp its long-term growth potential. In general, SaaS companies with high growth and strong financials want to put more effort into investing for long-term success. Focus points for investment seem to be research and development (R&D) as well as sales competence (upselling and cross-selling), while some companies have found this a great time to acquire smaller players with significant expertise in niche focus areas.

Seizing the opportunity through M&A

In Q2 2020, the share of horizontal SaaS M&A transactions (54%) was slightly higher than the share of vertical. The most active industries were healthcare, consisting of 23% of all the vertical transactions, and financial services companies, with a share of 14%.

Companies are assessing their acquisition options, but it seems that they have a consensus of not rushing to buy companies that might be for sale. For the companies, the current valuations still seem to be high, despite the fact that the financials of target companies may not be in the best shape. This has led to the belief that there might be more room for the valuations to go lower. Henceforth, some smaller companies might be good targets for acquisition now.

Due to the markets being unreliable, it is hard for buyers to make low-risk investments. This has been the major factor for them to be exceptionally cautious before pursuing an acquisition.



Spotlight: **LeadDesk**

The contact-center-as-a-service (CCaaS) market has been growing rapidly in the past few years. Amidst the pandemic, we have seen a few notable transactions driven by companies' need to adopt new remote-working practices. Talkdesk and Aircall completed large series C fundraisers during the summer: Talkdesk managed to raise US$143 million at a valuation of more than US$3 billion and its French competitor, Aircall, raised US$65 million. Both companies are backed by leading technology and SaaS investors, such as Draper Esprit, Balderton, Viking Global Investors and Franklin Templeton. The CCaaS segment consists of several smaller players and we expect significant consolidation by the larger players in the field in the near future. This kind of consolidation has been seen previously, for example by Salesforce in the CRM SaaS segment.

We talked with Olli Nokso-Koivisto, the CEO of LeadDesk, a rapidly growing, international cloud-based CCaaS provider currently operating in the European markets. LeadDesk provides software solutions for high-volume sales and customer service businesses, covering outbound sales, inbound sales and customer service. With offices in eight European countries in the Nordics and Central Europe, LeadDesk's solutions are used by over 10,000 agents, and over 300 million client contacts are executed annually via LeadDesk's platform.

In February 2019, LeadDesk completed an initial public offering (IPO) on Nasdaq First North Helsinki with the backing of several institutional investors. The most notable early investor in LeadDesk has been UK-based venture capital firm Dawn Capital, which initially invested in the company in 2015. Due to being a high-growth leader in its field in the Nordics and Central Europe, LeadDesk has performed in line with its targets after the IPO. Furthermore, LeadDesk has started to shift its growth strategy to focus more on acquiring smaller players, and the company has publicly stated that it's actively looking for acquisition opportunities of companies that can provide new technologies or customers. In line with its M&A strategy, LeadDesk announced its first acquisition, of Nordcom, in June 2020.

Olli Nokso-Koivisto shared his thoughts on how the company has handled the turmoil during the spring and what actions have been taken to ensure the company's continuing growth.

Q&A

What has been the impact of the pandemic on LeadDesk's business?

In general, business has been more active during COVID-19, and generally the pandemic has raised interest in SaaS companies. Certain segments have naturally become more attractive now than others, such as consumer demand for entertainment and domestic services, driven by WFH practices and the restrictions to outdoor activities. Public sector demand also increased during the spring. In these areas LeadDesk's performance has been impressive. On the other hand, the nature of the pandemic has caused activity in certain sectors, such as taxi centers, to plunge.

What are the main KPIs for LeadDesk and how has COVID-19 affected them?

As for most SaaS companies, the most essential operational metrics for LeadDesk to follow on a regular basis are ARR, net retention and churn. During the past few years, LeadDesk has particularly focused on net retention, which has been one of the company's top priorities during the pandemic as well. Increasing net retention is one of the major indicators for long-term success and comprehensive understanding of churn and its underlying drivers has become crucial for LeadDesk. During the spring, the company put significant emphasis on new sales through promoting upselling and cross-selling of its solution offering.

One of the more specific indicators studied more thoroughly during the spring has been outstanding trade receivables, which LeadDesk has followed actively. Via this, LeadDesk has been able to monitor its customers' short-term solvency and has found that there have not been substantial discrepancies between normal business conditions and current market conditions.

What measures has LeadDesk taken as a company to survive these challenging times?

Olli Nokso-Koivisto and the management team have taken several measures to make sure the company was prepared for the uncertain and exceptional circumstances. To avoid the contamination of COVID-19 and to ensure 24/7 operative capabilities, LeadDesk has divided its employees into smaller teams that are not in direct contact with each other. As in many other sectors, extensive use of remote working tools has become a new normal as well.

How has the current situation affected M&A plans?

The rapid development of the pandemic and market turbulence brought high uncertainty and very limited visibility into decision-making on longer-term strategic initiatives, including M&A. Thus, LeadDesk took time out to assess the situation and its effects on the market and the company. However, it returned quite quickly to its original plans.

Nokso-Koivisto views the current valuations as somewhat inflated, especially in private companies. However, some realism can be seen as businesses adjust their expectations.

What type of acquisitions is LeadDesk seeking?

According to Nokso-Koivisto, LeadDesk's M&A strategy focuses on acquiring companies close to its core competencies within the CCaaS sector. The target company's existing assets and competencies should support LeadDesk's existing business and provide potential synergies. For example, a partnership with another company with complementing sales channels might provide a good fit. With high growth ambitions, LeadDesk is of course considering simply acquiring a company to obtain access to a broader client base or to grow its existing footprint in the market. Close geographical proximity makes acquisitions more probable. However, already being active in several European countries keeps LeadDesk's focus across Europe.

With regards to the softer aspects, Nokso-Koivisto wants a potential partner company to be agile and dynamic, with the capabilities to proactively support its customers while facing adversity, especially in the current rapidly changing business environment. In defining the right partner for its growth journey, Nokso-Koivisto also puts a lot of emphasis on the cultural fit of the company.

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CEO
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Recent M&A activity

A selection of private transactions in the enterprise SaaS sector

Date	Target	Country	Target description	SaaS sector	Bidder	Country	Valuation		
							EV (US$m)	EV/ Rev	EV/ EBITDA
Aug-20	Linx		Point of sale (POS) and ERP management software for retail businesses	ERP for retail business	TOTVS PROTHEUS		1.176	6.8x	64.6x
Aug-20	VISMA		Large SaaS consolidator company	ERP/CRM/ e-commerce	Hg		12,172	6.5x	30x
Apr-20	GALILEO		Online payment processing and payment platform	Financial services	SoFi		1,200	12.0x	N/A
Apr-20	BlueJeans		Online event management and webinars for SaaS businesses	Communications	verizon		N/A	4.0x	N/A
Apr-20	DivvyCloud		Cloud security posture management (CSPM)	Security	RAPID7		145	N/A	N/A
Apr-20	CASTLETON		Housing management software and IT services for the social housing sector	ERP for real estate	mri REAL ESTATE SOFTWARE		104	3.3x	15.4x
Jun-20	PDX		Outpatient pharmacy management system for pharmacies	ERP for healthcare	CHANGE HEALTHCARE		208	N/A	N/A
May-20	HINTMD		Customer payment platform for aesthetics sector	Billing & service provisioning	revance		148	N/A	N/A
Mar-20	INSTRUCTURE		Provides learning management software for education	Learning management/ education	THOMABRAVO		4,400	2.0x	N/A
Feb-20	saba		Human capital management, ranging from employee training to compensation management	Human resources (HR) & talent management	cornerstone		1,395	5.4x	N/A
Feb-20	Vlocity		Salesforce-based omnichannel CRM	CRM	salesforce		1,330	N/A	N/A
Jan-20	veeam		Cloud data management SaaS	Data management	INSIGHT PARTNERS		5,000	5.0x	N/A
Jan-20	UBS		Risk and investment portfolio management software	Financial services	clearstream DEUTSCHE BÖRSE GROUP		789	N/A	N/A

Source: Capital IQ and Oaklins analysis

Recent Oaklins' transactions

A selection of recent enterprise SaaS transactions

Legal SaaS firm CaseLines has been acquired by Thomson Reuters

Oaklins Cavendish, working closely with one of Oaklins' teams in New York, advised the founders of CaseLines on the sale of the business to Thomson Reuters.

Bright Network has completed a fundraising to help support its continued growth

Oaklins Smith & Williamson acted as corporate finance lead advisor to Bright Network in a growth equity fundraising to grow sales and for further technological development of the company.

Unprecedented deal that represents a trend that is reshaping the banking sector

Oaklins' team in Brazil acted as the exclusive financial advisor to the shareholders of Zup in the sale of the company to Itaú Unibanco, Brazil's largest private sector bank.

Dutch Star Companies ONE successfully executed a business combination with CM.com

Oaklins' team in the Netherlands initiated, participated in and advised DSCO on all aspects from its initial listing to the successful execution of a business combination with CM.com.

Finland's largest digital marketing software provider finds a new majority owner

Oaklins' team in Finland acted as the exclusive financial advisor to the shareholders of Liana Technologies in the sale of a majority stake in the company to Ilkka-Yhtymä Group.

The management of Groupe JVS has led a new ownership buyout (OBO) alongside Parquest Capital and Bpifrance

Oaklins' team in France assisted Groupe JVS and its shareholders throughout this highly competitive sale process.

Sogelink has been acquired by Keensight Capital

Oaklins' team in France assisted Sogelink and its shareholders throughout a highly competitive sale process.

Semantix has received a growth capital investment

Oaklins' team in Brazil acted as financial advisor to the shareholders of Semantix, a leading company in Latin America on big data and artificial intelligence (AI) open-source solutions.

Deep local roots, global commitment

Oaklins brings you opportunities from across the world and we meet you with our expertise wherever you are

OAKLINS OFFERS A COMPREHENSIVE RANGE OF SERVICES

- M&A advisory (buy- and sell-side)
- Growth equity and equity capital markets advisory
- Debt advisory
- Corporate finance services

Enterprise SaaS is one of our focus areas. Combining comprehensive sector knowledge with global execution has led Oaklins to become one of the most experienced M&A advisors in the enterprise SaaS sector, with a large network of relevant market players worldwide. This results in the best possible merger, acquisition and divestment opportunities for enterprise SaaS companies.

If mergers, acquisitions, or divestitures of businesses or business units are part of your strategy, we would welcome the opportunity to exchange ideas with you.

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Alpo leads Oaklins' enterprise SaaS team and is also a director at Oaklins Merasco. He has advised several clients in the enterprise SaaS sector, most recently in the sale of Liana Technologies Oy, a provider of marketing automation software, and Admicom Oyj, a provider of SaaS ERP systems for small and medium-sized enterprises (SMEs), in its IPO on Nasdaq First North Growth Market. Alpo continues to act as a certified advisor to Admicom with regards to the trading of its shares. As part of his sector focus, he continuously follows market developments and maintains regular contact with the key players. Consequently, he has a deep understanding of the market dynamics and value drivers within the industry.

Oaklins is the world's most experienced mid-market M&A advisor, with over 850 professionals globally and dedicated industry teams in more than 45 countries. We have closed 1,700 transactions in the past five years.

Oaklins