ALLIED ADVISERS

2H 2023 Update

Navigating M&A in Uncertain Markets

Investment Banking for Technology Companies and Investors

Navigating M&A in Uncertain Markets

Since our last report on Navigating M&A in Uncertain Markets in Q3 2022, we have observed certain key trends emerge in the M&A markets that are highlighted in this update. While the years starting in 2010 through 2021, have been a robust market for M&A and capital raises for technology companies, the markets today have changed significantly in terms of deal volume and lower valuation though we are seeing improvements to a more rationale and sustainable market. Lately, with volatile markets like we've had in 2022 and 2023 (with the major indices rebounding this year from the lows of 2022, NASDAQ Composite index is up ~34% from January 1st to August 30th); the question of **"are the market conditions right"** still remains in the minds of investors and executives interested in exploring M&A. This article covers some of the **M&A trends we are observing** and our perspectives on **how to achieve a successful M&A outcome** in the current environment.

Despite a muted technology M&A market, there have been block-buster deals; PE is major driver

Sector	Target	Status	Acquirer	Deal size	Date
Product Design	Figma	Proposed acquisition by	Adobe	$20.0B	(2023)*
Consumer Electronics	TOSHIBA	Proposed acquisition by	JIP Japan Industrial Partners, Inc.	$15.2B	(Mar 2023)
Survey Tech	qualtrics XM	Acquired by	Silver Lake	$12.5B	(Jun 2023)
Investment Mgmt.	Adenza	Proposed acquisition by	Nasdaq	$10.5B	(Jun 2023)
Spend Management	coupa	Acquired by	Thoma Bravo	$8.0B	(Feb 2023)
Information Management	Micro Focus	Acquired by	opentext	$7.3B	(Jan 2023)
Internet Services	Yandex	Proposed acquisition by	VTB	$7.0B	(May 2023)
App Performance Monitoring	new relic	Proposed acquisition by	FP Francisco Partners	$6.5B	(Jul 2023)
Social Application	vezbi	Acquired by	WPF Holdings	$4.9B	(Apr 2023)
Spend Management	Apptio	Acquired by	IBM	$4.6B	(Aug 2023)
Event Management	cvent	Acquisition by	Blackstone	$4.6B	(Jun 2023)
Cybersecurity	imperva	Proposed acquisition by	THALES	$3.6B	(Jul 2023)
Data Management	talend	Acquired by	Qlik	$2.4B	(May 2023)
Survey Tech	momentive	Acquisition by	STG	$1.5B	(May 2023)
AI/ML	iRobot	Proposed acquisition by	amazon	$1.4B	(Aug 2022)

* Deal is expected to close in 2023.

It is encouraging to see emergence of new technology buyers among unicorn private companies

AI/ML	Cybersecurity	Analytics	Conversational AI	Conversational AI
mosaicML Acquisition by databricks	Laminar Acquired by rubrik	Mode Acquired by ThoughtSpot.	Red Box Acquisition by uniphore	HEXAGONE behavioral technology Acquisition by uniphore
Deal size: $1.3B (Jul 2023)	**Deal size: $250M (Aug 2023)**	**Deal size: $200M (Jul 2023)**	**Deal size: NA (Feb 2023)**	**Deal size: NA (Feb 2023)**

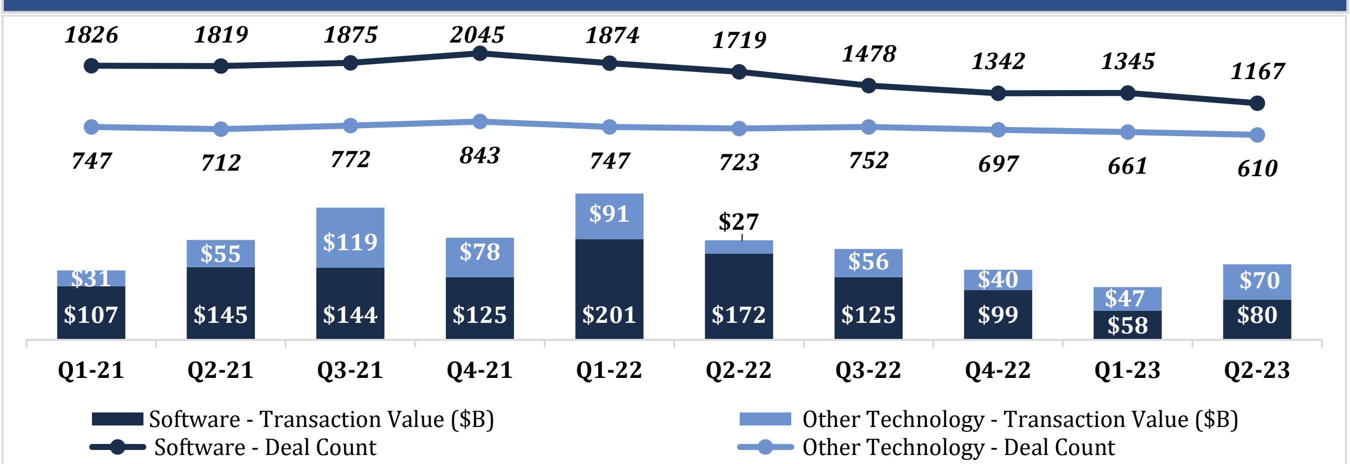
Allied Advisers has advised mid-market clients on exits to Fortune 50 Companies, top tier PE firms and software consolidators in the last 12 months

Allied Advisers, in the last 12 months, advised clients on their exit to: **Activision Blizzard King**, the world's largest game network and a Fortune 500 company; **Walmart**, a Fortune One company; **Dura Software,** a software consolidator; **PSG Equity**, a top tier PE fund ($22.1B AUM); and **Virtana**, a growing PE backed company among others. We expect to close a few more transactions by the end of the year.

While the market saw megadeals in 2021-2022 like the $69B acquisition of Activision Blizzard by Microsoft and the $61B takeover of VMware by Broadcom, we have not seen transactions of this size in 2023. We believe that this deal compression is symptomatic of the following trends in the M&A markets in 2023.

Encouraging stabilization in tech M&A deal volume and deal value 1

Global Technology M&A Deal Volume and Deal Value (Software Vs Other Tech) *



* Other Technology includes: Communication & Networking, Computer Hardware, Semiconductor, IT Services, and Other IT.

The value of global technology M&A declined from $199B in Q2-22 to $150B in Q2-23, a drop of 25%. Similarly, the volume of deals has also decreased, with 2,442 deals in Q2-22 vs 1,777 deals in Q2-23, a drop of 27%. However, M&A deal value increased 43% from Q1-23 to Q2-23. This trend is consistent with our experience that the middle market segment has been somewhat active for software deals through the downturn, while big-value tech deals have slowed.

Based on these trends and what we are hearing from strategic and private equity buyers in our client mandates, we are encouraged by the setup for a rebound in M&A volume and value in the later part of 2023 and especially for 2024.

The trends in deal volume and deal value can be explained by a few key factors:

- **Increase in interest rates impacting private equity; interest rates expected to moderate:** The sharp increase in cost of borrowing for private equity (PE) funds and reduced access to credit from fewer lenders in the market translated to fewer deals. We expect the interest rate increase to stabilize and potentially even be lowered next year by the Fed, creating liquidity. Notwithstanding, the amount of dry powder yet to be invested by financial sponsors is currently at $1.35T[1] which shall continue to drive investments. This also bodes well for a quick rebound in both volume and value of deals as market conditions improve.
- **Greater risk-averseness of corporate buyers reducing to managed bullishness:** Despite the fact that the stockpile of cash at corporations has increased, companies have preferred to conduct tuck-in, less-risky acquisitions as they themselves battle the headwinds in the market. Even the largest strategic buyers have shied away from complex and high-risk mega deals, instead focusing on smaller transactions that are highly strategic to their product portfolio. We are now seeing private technology companies like Uniphore (acquired Hexagone, Redbox Recorders, and Colabo), ThoughtSpot (acquired Mode) and Databricks (acquired MosaicML), and Rubrik (acquired Laminar) step into the M&A market creating a new pool of buyers which bodes well for the eco-system. In addition, we are seeing a slowdown in the number of headcount reductions and businesses are now focusing on avenues for growth given the cost-cutting is largely behind them.
- **Exit valuation recalibrating with decline in the public markets:** We are now seeing more and more sellers aligning exit valuation expectations to the market conditions. For venture backed companies whose rich valuations were out of line with their financial metrics, we are seeing increased creativity in deal structure (with earnout, rollovers, management carveouts where liquidation preference is higher than exit proceeds) to get transactions over the finish line.

PE share of tech deals remain steady, notably increasing in SaaS M&A

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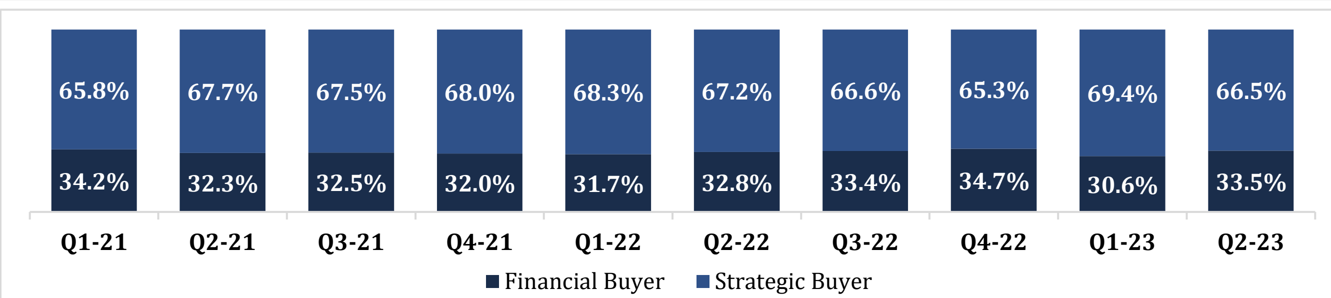
Global Technology M&A Deal Volume Split by Financial vs. Strategic Buyers*



*Technology represents the 'Information Technology' sector.

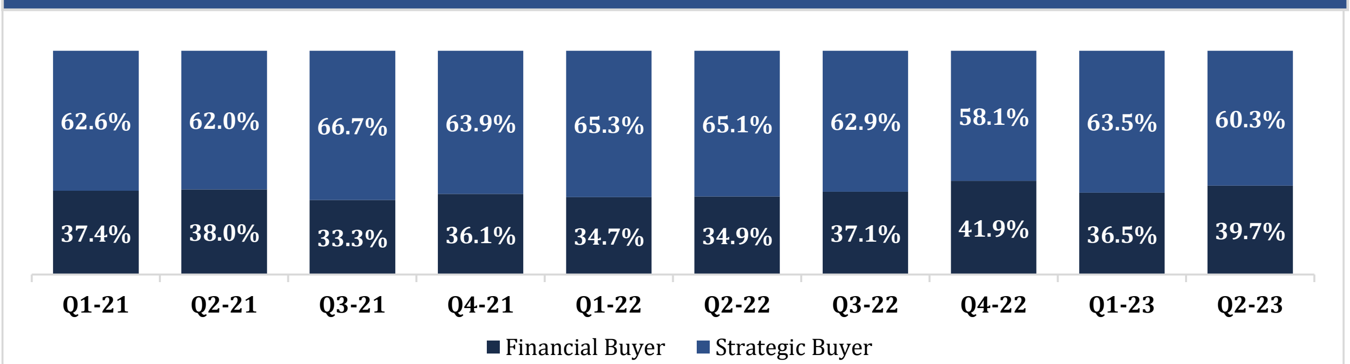
[1] *Pitchbook*

Financial sponsors continue to be a driver of M&A growth in the broader technology sector as shown in the above chart. The tightening of credit markets has somewhat impacted both mid-market and large PE funds in their ability to conduct larger transactions, while the near-record dry power levels continue to pressurize them to deploy equity in a greater number of mid-market deals. In addition, financial sponsors are under increasing pressure to divest their portfolio companies to return capital to their limited partners. We saw two major PE deals; Vista sell Apptio to IBM and Thoma Bravo exit Adenza to Nasdaq.

Strategic buyers also continue to invest in tuck-in transactions that are less complex and risky, and which can be closed at attractive valuations. We expect that the large cash reserves of corporations (top 100 technology companies have a cash balance, including short-term investments, of $627B) will continue to drive a steady velocity of mid-market dealmaking and allow corporates to buy technology companies which can refresh and differentiate their own product stack.

PE funds have continued to increase their investments in SaaS M&A and have been aggressive acquirors of software businesses given the attractiveness of the recurring revenue models and strong gross margins. PE deals have accounted for nearly 40% of total SaaS deals in Q2-23 as compared to 35% in Q2-22 and we expect this trend to continue from our own experience noting how active PE funds have become in our client's sell-side processes.

SaaS M&A Deal Volume Split by Financial vs. Strategic Buyers



Stabilization of valuation multiples and significant improvement over Q1

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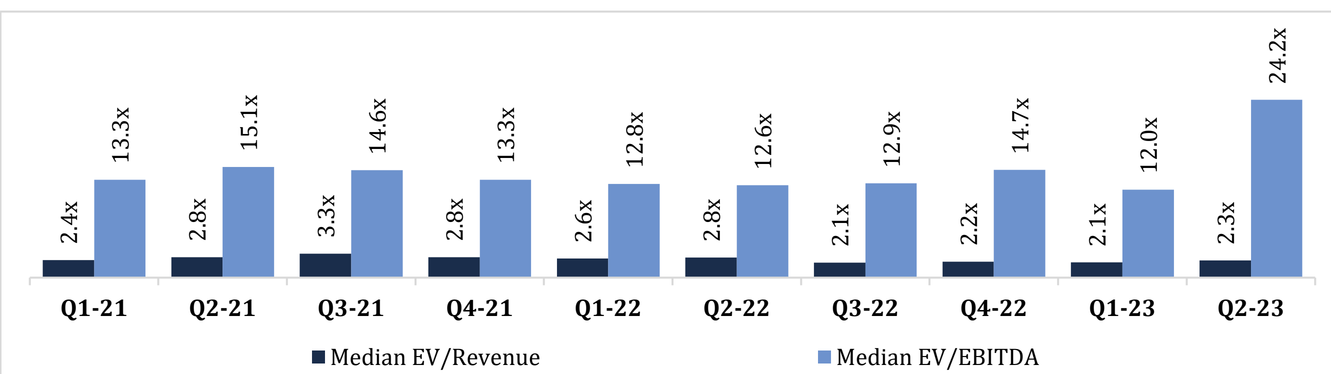
Median Multiples for Tech M&A Deals (Technology)*



*Technology represents the 'Information Technology' sector.

Valuation multiples in the broader technology market have been in correction mode, from a high of 3.3x Revenue in Q3-21 declining 36% to 2.1x Revenue in Q1-23. We are observing a recent rebound of pricing metrics in the market, with both revenue and EBITDA multiples increasing in Q2-23. It is to be noted that SaaS multiples have been traditionally higher than other technology segments and continue to trade at a premium to the above multiples.

There is a positive correlation between enterprise value multiples paid and the size of the deal; higher the deal size, higher the multiple paid typically. Since the size of deals over the last 2-3 quarters has been relatively small, the median price multiples have been somewhat muted.

IPO market developing green shoots which should create currency for M&A 4

The tech IPO market that effectively shut down since the IPO of Hashi Corp and Samsara in December 2021 continues to remain very slow in 2023, with no SaaS companies having IPO'ed in almost 2 years. The silver lining in gray clouds is that the NASDAQ Composite stock index, which is often considered a proxy for tech IPOs, is up ~34% from January 1st to August 30th, so far this year. The volatility of the public markets has declined compared to 2022, which also bodes well for upcoming IPOs.

While not a tech company, the Mediterranean restaurant chain Cava (NYSE: CAVA) IPO'ed on June 15, 2023 and its stock nearly doubled on its first day of trading. The beauty tech company Oddity is planning to launch its IPO in Q3 while text-message marketing company Attentive has intentions of going public next year. British chip designer, Arm, with a net income of $524M, filed for its IPO in August 2023. Additionally, marketing and data automation company Klaviyo, along with Instacart, an online grocery delivery company, also filed for their IPO in August, making them the first major venture-backed firms to approach the public markets in almost two years.

An interesting point is that, Arm (Semiconductor), Klaviyo (Software), and Instacart (Internet) are all profitable, from different sectors of technology and growing in a capital efficient manner, unlike prior IPOs, which should help them attract investor interest in a market that has been relatively starved of new issuances. Klaviyo achieved profitability in H1'23, reporting an operating income of $8M and a net income of $15M over a span of six months. Furthermore, the company exhibited a growth rate of 57% in the twelve months leading up to June 2023. Instacart attained profitability in FY'22 with a 39% revenue growth. Over the last twelve months (LTM) ending June 2023, its net income stands at $744M with LTM adjusted EBITDA of $486M.

A slew of companies in the tech arena that are in the IPO process, or are potential IPO/mega-exit candidates:

Company Name	Revenue/ARR	Capital Raised ($M)	Last Known Valuation ($M)
Already in IPO process (IPO filed)			
arm	$2.5 Billion+	NA	64,000
instacart	$2.5 Billion+	2,860	12,000
klaviyo	$550 Million+	779	9,500

Select SaaS companies which are growing well and are potential candidates for IPO or mega exits:

Company Name	Revenue/ARR*	Capital Raised ($M)	Last Known Valuation ($M)
databricks	$1 Billion+	3,500	38,000
gusto	$500 Million+	751	9,630
deel.	$295 Million	680	12,100
EGNYTE	$200 Million+	139	460
Gainsight	$200 Million+	NA	NA
algolia	$200 Million+	334	2,250
talkdesk	$200 Million+	481	NA
	$200 Million+	110	820
dataiku	$200 Million+	848	3,700
checkr	$200 Million+	680	4,720
RIPPLING	$200 Million+	697	11,750
Brex	$200 Million+	1,230	12,300
narvar	$200 Million+	NA	NA

*ARR Numbers from Jason Lemkin blog.

Increasing secondary transactions in VC market creating some liquidity 5

With IPOs and M&A exits being at their lowest levels in the last few quarters, VC funds which anticipated distributing peak cash to their investors (Limited Partners) in 2022-2023 have fallen far behind the distribution to paid-in capital (DPI) pace. The VCs are therefore exploring other options to generate liquidity for their LPs, like selling secondary stakes in their portfolio companies to other investors.

The secondary market is growing rapidly as LPs pressure the VCs for DPI. Since the market participation in secondaries is not very broad and buyers are averse to purchasing stakes in anything but the best companies at low valuations, shares of portfolio companies are often traded at deep discounts to their last round of funding. This provides an opportunity for savvy PE and strategic growth investors to swoop in and acquire a high-quality business for discounts, and benefit from their potential future increase in valuation.

Guidance for Achieving a Successful M&A Outcome

The M&A trends shown in this report reaffirm the fact that while we are in a weaker M&A market compared to 2020-2021, transactions are still happening. Though the level of activity has recently improved as public markets strengthen and macroeconomic conditions stabilize, M&A processes are harder and taking longer. There is a "flight to quality" and buyers now prefer companies which are close to break-even or cash flow positive. We recommend the following actions that companies can take to achieve a good M&A outcome.

Become ready – Fortune favors the prepared 1

Being well prepared going into an M&A transaction ensures that the process will go smoothly and on a timely basis; time is the enemy of all deals. It also demonstrates to buyers that your company is well managed and creates confidence in your business and people.

- **Appoint an investment banker:** Select a qualified investment banker early in the process. The banker should take the lead in preparing the buyers' list, marketing materials (e.g., executive summary, management presentation) and a well-stocked data room for interested parties. This also allows the management team to focus on running the business by providing a supporting team and strategic guidance, and levels the playing field by adding skillful team members on your side during an exhausting M&A process. As a seller, you will get a better outcome by talking to many buyers vs. dealing with a few and having a banker can help in negotiating with buyers who do multiple transactions a year (in comparison to a seller who does it only once in 5 to 8 years over the life of the company) and who understands market for transactions.
- **Get books in order:** Work with internal or external financial professionals to ensure that you have at least 3 years of financials in good standing – per GAAP, consolidated, etc. For early-stage companies have a good set of statements that shows your expenses.
- **Prepare key data (financial forecasts, KPIs, etc.):** This might include 3-5 years of detailed financial projections, 3-4 years of customer-wise ARR/MRR data, net revenue retention (NRR)/gross revenue retention (GRR) metrics, customer acquisition costs (CAC), win ratios, etc. (Allied Advisers: Customer Retention Metrics in SaaS).
- **Clean up corporate structure / legal documents / Cap Table:** Seek advice from legal and tax counsel on how to create an optimal legal structure for your company and implement any recommended changes. Ensure that documents such as "Assignment of IP" for developers who have worked on your product are in place as buyers will want this documented. Also ensure that all customer/vendor contracts and shareholder agreements are in executed form. Ensure your cap table is readily available showing investments in each round, ownership on a fully diluted basis, etc.
- **Ensure adequate runway for M&A transaction:** M&A deals are taking longer to close as buyers' level of scrutiny and diligence of target businesses has increased and deal terms are more negotiated in a risk-averse environment. Sellers should ideally have at least 9 months of cash reserves to fund the business during the course of the transaction, or should raise additional bridge financing or cut costs to build an adequate runway to get a deal past the finish line. Also, buyers view seller's balance sheet and can take advantage of poor cash situations.
- **Consider getting management carveout of deal proceeds depending on waterfall*:*** In the go-go days over last decade, it was not uncommon to see companies raise capital at 50x or even 100x ARR. If you have not grown into your last round valuation, given that the current exit valuations are nowhere near these multiples, have an open conversation with your board about scenarios where the exit proceeds are lower than the liquidation preference, in which case the founders and management will not make anything. A solution to this problem might be to have a carveout in place for key members of the management team so that they are incented to run a proper M&A process for the company.

Improve profitability – Cash is king again

2

The balance between revenue growth and profitability has shifted. Back in 2020-2021, you might have been considered an attractive business if your revenue was growing at 80% and your margins were -40%. Now, a company growing at 40% with breakeven profitability, or growing at 20% with 20% margins is much more preferred by buyers. High burn rates are anathema to deals in this market. Our report (Allied Advisers: Rule of 40) shows that in both bull and bear markets companies that follow the Rule of 40 trade at a significant premium to companies that don't follow the Rule of 40.

- **Rationalize excess OpEx to improve EBITDA:** This might include trimming headcount, reducing rent and travel and moving work offshore (Allied Advisers: Strategic Considerations When Outsourcing Your Software Development).
- **Shift product/vendor strategies to improve gross margin:** If you have the benefit of time and are more than a year away from running a M&A process, consider improving product pricing, shopping for cheaper cloud hosting options and using a product-led growth strategy (PLG) to reduce engineering / client support costs.
- **Show cost synergy model:** On a stand-alone basis, sellers carry costs which can be redundant under a larger company such as HR personnel, finance, marketing and sales teams. It is useful to catalog these expenses so that buyers can have an estimate of costs-savings should they choose to make cuts.

Build partnerships – Bridge to successful M&A

3

Building commercial/strategic partnerships in the normal course of business helps a company showcase its products and people to a partner/potential buyer. If the synergies in the partnership are high enough, the partner may be compelled to acquire your business to fully realize the value creation. Our report (Allied Advisers: Partnerships Can Serve As Catalyst For Premium Exit Outcomes To Strategics) provides a deeper look.

Run a competitive M&A Process – FOMO is real

4

While valuation analysis and current comparable yields a certain baseline value, competition for your company from PE or strategic (ideally both) helps to achieve premium valuation. We have often been in situations where there is a wide range of valuations with several strategic and PE buyers in the mix since they assess synergies differently and have different abilities to pay. Well run processes create multiple options by generating multiple term sheets from PE and strategics, thereby creating competitive tensions that can be favorably leveraged for the seller. Our report (Allied Advisers: A Strategic Or PE Firm Wants To Buy Your Company. Now What?) provides additional color on this topic.

Allied Advisers: Investment Banking for Technology Companies and Investors

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