

The Technology M&A Market Is Active, Open, And Offers Attractive Exit Valuations, Despite What You May Have Heard Recently

Normally, we start our blogs with background, followed by data and analysis, and end with what we hope are some interesting and useful conclusions. In this blog, however, we would like to start with our conclusion: *Despite all the apparent “bad news” in the economy and stock market, companies with profitable business models that are seeking to sell their businesses today are able to get attractive exits at historically attractive valuation levels.* Because this message runs counter to so much of what we read in the popular press, we encourage you to not believe everything that you hear about the state of the technology M&A market.

Negative news indeed has seemed prevalent lately. Layoffs at many leading technology companies. Stubborn core inflation. The Federal Reserve focused on fighting inflation through increasing interest rates. Fear of the economy tipping into a recession. Relatively low amounts of venture capital being raised. IPO volume being at historically low levels. Wow, things seem to be really difficult in the economy and in the markets.

Indeed, parts of the market have been negatively affected. Early-stage venture capital investment has declined significantly; large capitalization private equity transactions are more challenging given high interest rates and lower leverage ratios; and unicorn valuations (private companies valued at over \$1 billion) based on hyper growth assumptions have become fewer and farther between.

Given this steady drumbeat of challenging news, the environment for companies considering selling their business or raising capital would seem difficult indeed. But is this statement actually true? Have the popular press provided an accurate view of where the M&A market stands today? Or, might there actually be bright spots in the M&A market, particularly for technology companies in the middle market?

Navidar wanted to carefully examine the current state of the M&A market—with particular focus on the middle-market—and put current market conditions into historical perspective. What we are seeing first-hand in the M&A middle market suggested that it would be wise to take a closer look at what is really happening and let you draw your own conclusions.

We hope that our commentary below will give you a fair appreciation of current market conditions once they are *situated in their appropriate historical context* and encourage your company to pursue M&A opportunities today—as a seller or as an acquirer—if that is something that you are considering as part of your strategic roadmap.

A Quick Word About The Middle Market Before We Dive In

Navidar provides M&A and Capital Raising services primarily to technology companies and technology-enabled businesses in the middle market. When we refer to “middle market M&A” throughout this article, we are referring to deal values under \$1 billion, which historically has been a fairly common dividing line for middle market transactions. Is there anything magical or sacrosanct about the \$1 billion number? Not really. We understand that any strict dividing line, regardless of where it is drawn, will have an element of arbitrariness to it, but we find it highly useful for our analysis, nevertheless. We use this line throughout our analysis as the upper limit of middle market transactions, with deals below \$1 billion falling into the middle market and deals above \$1 billion being considered large transactions.

SURPRISE #1: The M&A Middle Market For Technology Companies Is Surprisingly Robust: *Interestingly, the middle market for technology M&A is significantly less volatile and more resilient* than M&A activity for deals with above \$1 billion transaction values.

Although one could get the impression that all parts of the M&A market are affected equally by challenging economic conditions, this is not true. One of our most important insights for companies considering the current M&A market is that all parts of the market are not similarly robust in changing economic times and do not behave similarly in difficult periods, and that is true of the most recent downturn.

In fact, both historically and in the most recent period, M&A for middle-market transactions has been *significantly more consistent, more resilient, and less volatile* than has M&A activity for those larger transactions over-\$1 billion, where deal volumes and number of transactions have fluctuated more significantly over time.

In Exhibit 1, we show the yearly deal volume for technology M&A transactions since 2005. Using this data, we then compared the annual changes in *total deal value* for technology deals under \$1 billion to those for deals over \$1 billion. To do so, we calculated the absolute value of each of the year-to-year changes and then took the average of those averages to give us a proxy measure for the relative volatility of each market. Interestingly, we found that this overall average of averages was 33% for deals under \$1 billion but 58% for technology transactions over \$1 billion, thus underscoring our point about the relatively lower volatility, greater robustness, and greater consistency of middle market technology transactions.

In addition, if we were to look at the year-to-year variation in the *number of technology M&A transactions*—as opposed to the change in overall value—that figure would be 16% for deals under \$1 billion versus 30% for deals above \$1 billion, again reaffirming our views about middle market technology M&A.

This data on some levels should not be totally surprising for several reasons. First, larger M&A deals often involve more strategic risk to the acquirer, sometimes even involving “bet the company” transactions that significantly redirect, change, or shift the acquirer’s strategic focus. In addition, the appetite to do large, potentially transformative acquisitions—and therefore the level of associated deal activity—often diminish when the economic outlook becomes less stable, such as when inflationary pressures mount or recessionary indicators increase, both of which are occurring now. Third, larger M&A deals also often require significant amounts of financing and lender appetite to provide and make available this financing to buyers is often sensitive to economic conditions and overall sentiment. Finally, and relatedly, the cost of capital rises when interest rates rise, making debt financing more expensive.

Key Take-Away: Today’s middle market conditions actually highlight the robustness and significant activity in this market, so if your company is waiting to pursue an M&A transaction for fear that the market will not be receptive, we would urge you to reconsider. We turn to additional data in support of this view below.

SURPRISE #2: M&A Transaction Multiples for the Broad Market of Information Technology Exits Are Actually At The High End of Historical Levels: One very positive, and perhaps surprising, development is highlighted in Exhibit 2, which shows that Enterprise Value/Revenue acquisition *multiples are currently above their long-term trend and are actually at the highest they have been for many years*, with the exception of 2021 which was an outlier year in many regards.

The point about 2021 being an outlier deserves particular emphasis. First, using 2021 as the basis of comparison—as the media have done and continue to do—creates a highly misleading impression. 2021 itself was a remarkable year in technology M&A (and overall M&A), but it was far above the more general trend line in many ways. Thus, comparisons only to 2021 are, in a sense, artificial and misleading because 2021 was such an outlier in terms of number of transactions, total deal value, valuations, and valuation multiples in many of those deals.

Returning to Exhibit 2, we see that M&A acquisition multiples for the overall IT market—which includes sectors as diverse as software, services, computer hardware, and semiconductors—have not fallen off the proverbial cliff as the economy has experienced increasing inflationary pressures, but rather stand at historically high levels. Moreover, these multiples are relatively steady and constant from 2017 to 2020, with a major spike in 2021. In 2022, the multiples paid in M&A transactions were above the long-term trend and this is an important message to all of the technology entrepreneurs in the middle market.

Key Take-Away: Overall valuations in Information Technology M&A are still quite attractive, so to refrain from pursuing M&A primarily because of expected “low valuations” or “a bad market environment” is an assumption that should be revisited. In fact, because the market is at relatively high historical multiples (albeit down from outlier 2021), the downside of waiting may exceed the benefits of exploring the M&A market.

SURPRISE #3: M&A Exit Valuations for Profitable Private SaaS Software Companies Are Very Attractive: Profitable private SaaS software companies that are growing are highly sought after by strategic acquirers.

Exhibit 3 looks at the changes in M&A Enterprise Value/Revenue multiples for, on one hand, unprofitable and growing private SaaS companies (left-hand side) and, on the other hand, profitable and growing private SaaS companies (right-hand side) with revenues above \$10 million from 2021 and 2022. Clearly, something important is going on in this chart, which shows once again that the market is differentiating among different types of SaaS companies.

Exhibit 3 shows that acquisition multiples for high-growth, unprofitable SaaS companies have declined from 17x in 2021 to 4x in 2022, a staggering decrease of over 75%. However—and this is the key point—revenue multiples for high-growth, profitable SaaS software companies still stand at 11x. Thus, while the multiples for these companies have declined approximately 25% from 2021 levels, they still are high by historical standards and reflect the market’s bullishness about private SaaS companies that have profitable business models.

Key Take-Away: While unprofitable SaaS companies have experienced a significant revaluation, SaaS companies that combine growth with profitable business models are in high demand and are generally being acquired at very attractive valuations. So, if you are a profitable, growing SaaS company and are thinking about exploring strategic alternatives, you should know that the technology M&A market is highly receptive and that very attractive valuations are being paid for companies just like yours.

FINAL SURPRISE: Private Equity Activity In Technology Continues To Be Strong: Sponsors remain active and are in investment-making and deal-doing mode. Private equity firms have not disappeared from the technology deal scene, contrary to what some would have us believe, and they continue to be active and play a significant role in the M&A market.

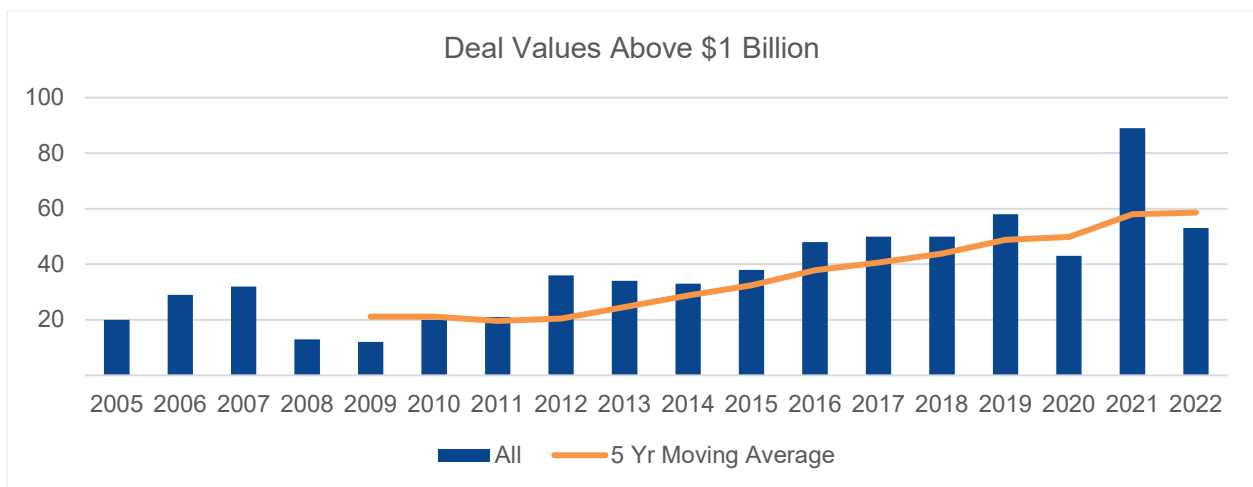
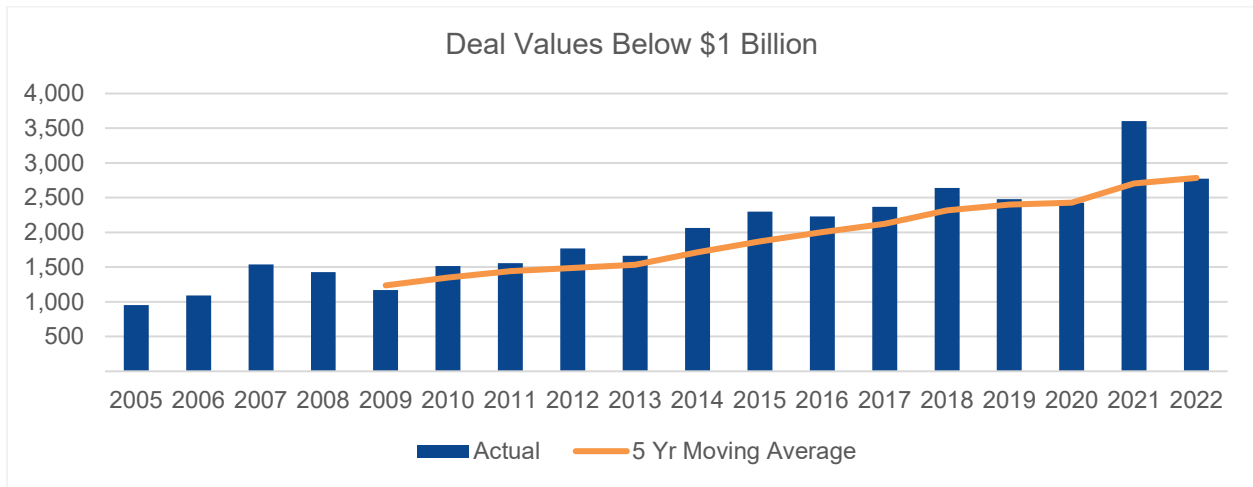
Exhibit 4 shows the quarterly rate of sponsor-backed acquisitions since 2017—expressed as a percentage of the total number of IT M&A deals. The numerator, in other words, is the number of technology companies acquired by financial sponsors and the denominator is the total number of information technology transactions. Exhibit 4 shows clearly the important *historical* rate of participation of financial sponsors in the technology M&A market, with their participation at significant levels ranging from approximately 25% to 35%. Second, the data show that financial sponsors have continued to be very active in the technology market *recently*. Sponsor activity thus has been and remains an important and relevant contributor to technology deal activity.

Anecdotally, this data supports what we at Navidar have been hearing in our conversations with financial sponsors. They have noted that they are active in the marketplace seeking new deals, that their pace of investment is generally unchanged, and that their portfolio companies are continuing to invest for growth. If anything has changed due to the current economy, some sponsors have suggested that they may be scrutinizing a bit more closely how their portfolios companies plan to use capital to grow their businesses.

Key Take-Away: Financial sponsors are active today in the technology M&A market and should be included—along with strategic acquirers—as potential buyers for middle-market technology companies considering sale transactions.

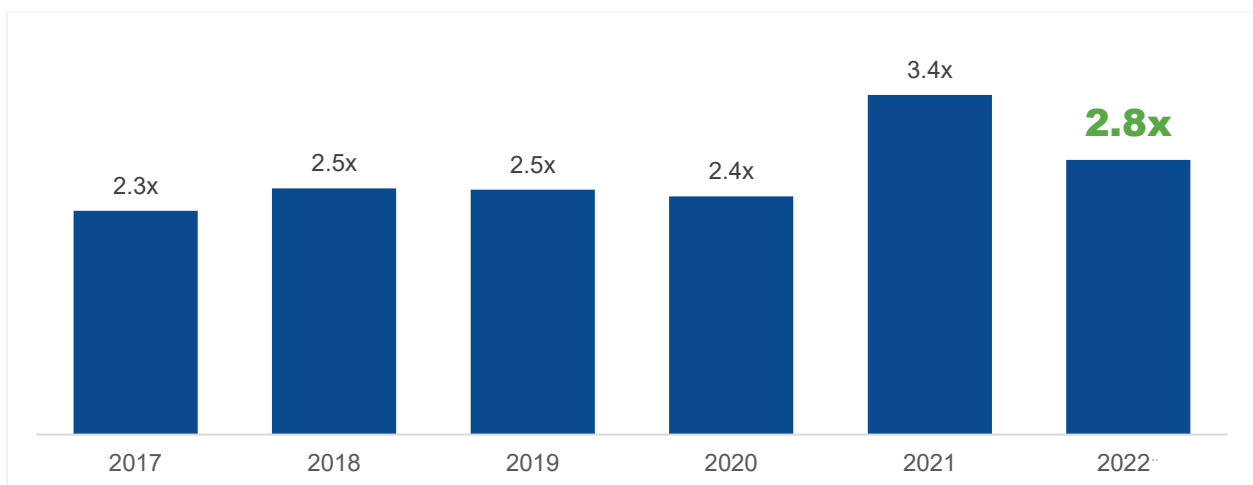
We hope that this article has shed some light on the true current state of the technology M&A market and that this knowledge will help you in evaluating your company's path ahead.

Exhibit 1: US Technology M&A Transaction Deal Volume



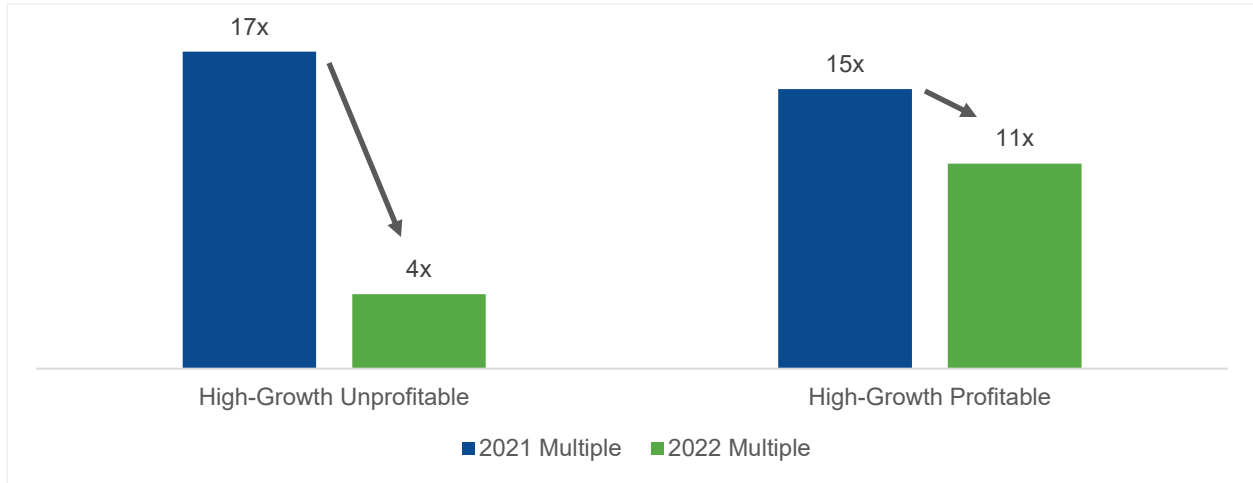
Source: Pitchbook.

Exhibit 2: Enterprise Value/Revenue Multiples Paid In Global IT Acquisitions



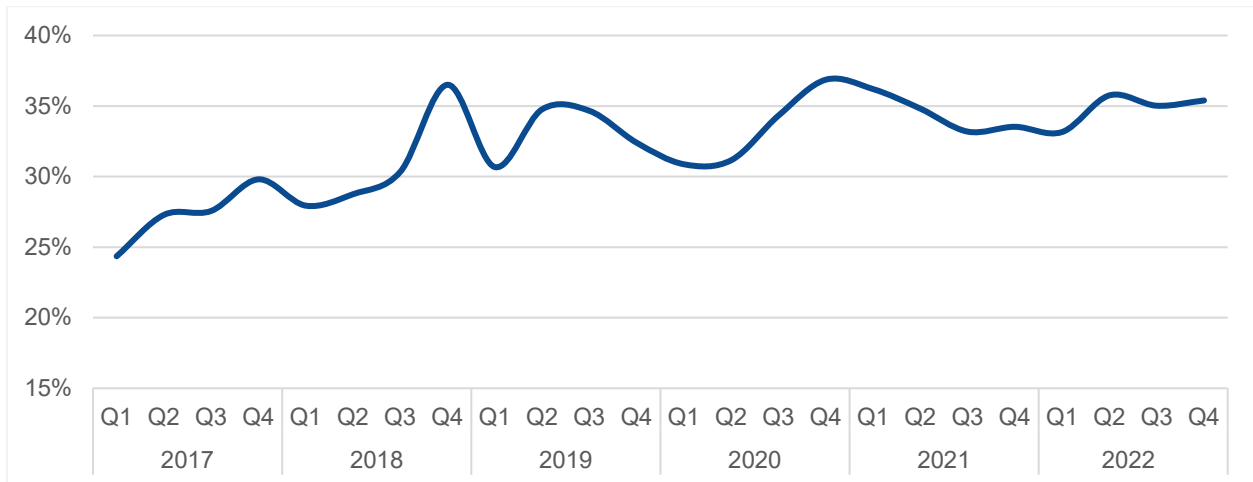
Source: Pitchbook.

Exhibit 3: Private SaaS Software M&A Enterprise Value/Revenue Multiples



Source: Kayne Anderson presented at Venture Dallas in November 2023. Data relates to private companies with ARR greater than \$10 million.

Exhibit 4: Sponsor-Backed Acquisitions As A Percentage of Global IT Acquisitions



Source: Pitchbook.