PE Firms Seeking Software

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SOFTWARE IS POWERING EVERYTHING FROM SUPPLY CHAINS TO HEALTHCARE, AND PRIVATE EQUITY FIRMS HAVE TAKEN NOTICE.

It's well documented that private equity firms are sitting on more dry powder than ever before, and software is poised to see more than its fair share of those investment dollars globally, particularly in Europe where valuations are often lower than in the US. While PE buyers were historically less interested in software investing, they now have built more internal technical expertise, have a greater understanding of software revenue models and are focused more on expanding platforms than simply harvesting cash flow. In addition, whereas software investing was initially the province of specialist funds, more generalist funds have now gotten into the act.

THE RESULT?

A surge in software deals:

- According to PitchBook, private equity deals in software have increased every year since 2010, reaching a high of 101 deals in 2017.
- In the first half of 2018, Pitchbook reports that software accounted for nearly 12% of all PE buyouts.
- In Europe, Mergermarket reports $11.2 billion in private equity software deals in 2017, nearing 50% of the overall deal value for the first time.

WHAT'S DRIVING INTEREST?

Buy & Build

Part of the attraction of software as a service (SaaS) and software companies is their recurring revenue model that typically offers predictability and less risk. For private equity investors, there is also significant opportunity to make add-on acquisitions to software platforms in order to realize premium valuations for companies of scale. With the average PE hold period at three years or less, most businesses can't grow organically fast enough to drive good returns on a large investment. By seeking bolt-on companies with complementary offerings, PE firms acquire more catalysts for growth that will earn the returns they need.

Essential Enterprise

Software isn't just reshaping the tech industry – it's transforming and creating opportunities in nearly every sector. Opportunities to capitalize on advancements in IoT, AI, cybersecurity, payments, and other technologies, have led corporates and private equity funds to increase their investment in the companies driving those advancements. As a result, competition is heating up. EY reports that non-tech acquirers (PE firms + non-tech strategics) paid a 15% premium on software acquisitions in 2017, compared to tech-acquirers. EY also reports that assets in business intelligence, IoT and security earned the highest valuations, while CRM and ERP saw the most deal activity in the first half of 2018.

LINCOLN PERSPECTIVE

We foresee no slowdown in activity in the near term. Although valuations are certainly robust, the unique characteristics of software subscription models – meaningful growth with downside protection – are keeping most acquirers solidly in the game. And although the U.S. is the most active market for software deals, Europe is also a pioneer in the growing regulation of data and privacy, which is impacting all industries and is creating opportunities for software companies to assist in data tracking, management and protection. When it comes to deal outlook, we see continued potential for platform deals and add-ons, as well as strategic partnerships.