AliDigital Broker

9 REASONS
TO ACQUIRE OR SELL A TECH COMPANY

Introduction

The last year has had numerous impacts – on people, on the economy, and on the digital evolution. The COVID-19 pandemic has quickly advanced technology and consumer habits, with IBM estimates giving the adoption of e-commerce up to a five-year acceleration due to the pandemic[1]. It is thus no surprise that interest in technology and tech-enabled (digital) companies has surged. Here are our top reasons to buy or sell a technology or digital company.

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1 For tiny App companies, there are fewer fees on the iOS App Store

On October 18, 2020, Apple announced the launch of a program called the App Store Small Business Program. This program lowers its commission fees in half – from 30% to just 15% – for developers producing up to $1 million USD a year, which went into effect on January 1, 2021.[2]

Apple explains that the goal of this program is to help small developers. For a potential buyer, this means that the opportunity to grow a mobile app company that generates less than $1 million USD in sales per year is accelerated.

iOS developers that are members of the Apple Developer Program, an Apple account for app developers for creation and distribution of their apps via the App Store, had until December 18, 2020 to apply to this new App Store Small Business Program in order for their proceeds to be adjusted by January 1, 2021.[3] Members of the Apple Developer Program can still submit their enrollment for the App Store Small Business Program, however their proceeds will be adjusted fifteen days after the end of the fiscal calendar month in which their enrollment is approved.[3]

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There is also an opportunity to become a member of the Apple Developer Program for those who were not as of December 18, 2020. Once approved, these new members can then submit their enrollment for the App Store Small Business Program. In this scenario, with no proceeds, the future proceeds are adjusted upon the approval of the enrollment.[3] However, it is important to note that app transfers are not allowed within this program, thus this was an advantage for those who sold or made an acquisition before December 31, 2020.[3]

2 Tech acquisition is the main motive for investors when looking to make an acquisition outside of their industry

In a survey conducted by OnResearch and analyzed and published by Deloitte in 2020, 1000 executives – 750 at US-headquartered corporations and 250 at domestic-based private equity firms – were polled to gauge their expectations for M&A activity in the upcoming 12 months as well as their experience with recent transactions.

Both corporate and PEI (private equity investor) survey respondents generally expected to look for acquisitions within their own industry or a closely related sector in the upcoming years.[4]

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However, when asked where they were interested in doing acquisitions outside of their own industry or sector, technology was the most common choice, at 16 percent of all corporate respondents.[4] In fact, 12 percent of corporate respondents stated that their company's primary M&A strategy over the course of the next 12 months is seeking deals that will help them acquire new technology.[4] Furthermore, 17 percent of corporate respondents answered that the top method they expect to use to achieve their company's M&A strategy in the year ahead was expanding/diversifying products or services and acquiring technology.[4]

As Susan Dettmar, Principal, M&A Services, Deloitte Consulting LLP states, *"Everyone is trying to add technologies—smart technologies that in many cases are very new to the world—and incorporate them to show growth and demonstrate an ability to innovate."* [4]

3 Contactless and more efficient due diligence

The process by which the buyer analyzes a tech company to ensure the viability of the investment is more efficient than the process for other types of companies for a variety of reasons.

Firstly, the need to be physically present at the business location to perform due diligence, as with traditional M&A, is not required. Throughout 2020, due to the COVID-19 pandemic, most traditional M&A companies were forced to adapt and make management presentations of sellers' companies via virtual meeting platforms such as Zoom.

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Thankfully, this is something that we are very accustomed to here at AliDigitalBroker and have been executing much before COVID-19. Not always having to travel to a business location to perform due diligence is an advantage for buyers, saving costs.

Secondly, the acquirer can use an array of digital tools to perform due diligence, whereas compared to traditional M&A, the acquirer must rely on external experts to perform due diligence, with tasks such as analyzing the business model, the market competition and marketing share. Relying on people to analyze such crucial and intangible data, albeit experts, can create a highly subjective result. That is where digital due diligence comes in handy with the use of digital tools.

In the same analysis by Deloitte of the survey conducted by OnResearch mentioned above, participants were asked how digital tools and accelerators impacted their companies' most recent M&A transactions. The results show the many advantages of using digital tools to complete the due diligence process:

- 53% of participants answered that the use of digital tools provided additional insight into their model.[4]
- 51% of participants found that digital tools minimized the risk and uncertainties through further analysis in the diligence phase.[4]

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- 40% answered that digital tools helped plan for post-close operations/integration.[4]
- 35% of participants stated it increased speed to close deals.[4]

As explained by Andy Wilson, Partner, M&A Services, Deloitte & Touche LLP, *"Sellers are sharing more data. With the right digital tools and techniques to analyze that data, buyers get significantly better information than was previously possible with a team of people pounding away on spreadsheets. Today, the buyer may have an interactive dashboard that helps show the profitability specific customers are driving. You can drill down into product sales, product costs and margins, and come away with insights that can move the needle on valuations."* [4]

For instance, the use of tools such as SemRush can help acquirers assess a target company's web presence, web traffic, competition and even geographic coverage. With the use of tools such as CB Insights, it is possible to employ AI technology to determine a company's competitive advantage, dynamics, growth and technology, as well as several other aspects that could make one feel as though they have their own personal spy tool. Hootsuite, among others, helps you monitor what people are saying about a target company on social media and elsewhere with their social listening technology.

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As for financial due diligence, given the digital nature of many technology companies, revenue and expenses can be independently verified by buyers since these payments are often processed through digital platforms. These digital platforms, such as Google, Apple, or digital payment processing platforms such as Stripe, are entirely independent of their user and cannot be manipulated. This gives the buyer a direct look at precisely how much a company is making in sales instead of analyzing an income sheet prepared by accountants. Quite literally, it is as though you are being offered a candid look at the PDQ or POS terminal – those card payment machines used to pay in stores – of the company.

Tech companies’ due diligence is more digital and data-driven due to the nature of the technology company’s assets, which tend to be intangible.

4 Tax advantages for American buyers

Bonus depreciation is an incentive used by the United States government to encourage businesses to develop more aggressive buying patterns, thus stimulating the economy. Organizations can reduce their taxable income by purchasing assets, allowing them to take accelerated depreciation deductions in the first year of purchase.

Due to a change to the Tax Cuts and Jobs Act in the US, during the first year of acquisition, a business can now deduct 100% (instead of 50%) of the value of new and used software assets acquired.[5]

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In other words, software purchases can be fully deducted in the year of purchase, meaning a 100% deduction of the software purchase price would be available to a buyer. This rate is applicable in the first year of acquisition until 2022, with the deduction rates decreasing as follows:

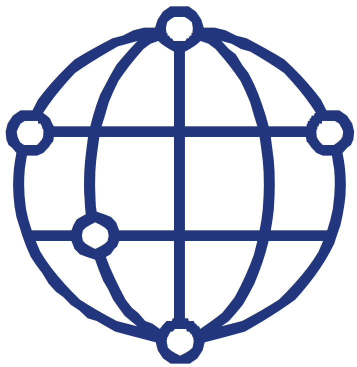
- 80% in 2023
- 60% in 2024
- 40% in 2025
- 20% in 2026[5]

For American buyers, now is the time to consider acquiring new software assets and take advantage of this bonus depreciation.

5 Digital companies are often not bound by physical borders

Due to the digital nature of technology companies, they tend not to be restricted geographically in their operation or their management. This is an important advantage for a buyer, which means less cost. Furthermore, in the context of a pandemic, such as the COVID-19 pandemic with borders being closed, this will have no effect on investors when considering a tech company that is fully digital.

In addition, Deloitte reported that foreign target acquisition decreased in 2020 compared to the previous year, which may be due to trade tensions and uncertainty about the policy and timing of tariffs.[4] This would not be a concern for technology companies. Oftentimes, due to the intangible nature of tech companies' assets, they can easily be transferred without being affected by physical borders.



6 The future of shopping is digital and has arrived earlier

As we mentioned at the beginning of this article, the COVID-19 pandemic has greatly accelerated e-commerce adoption, with digital insights and marketing research published by Facebook stating that years' worth of e-commerce penetration has occurred in only a matter of months.[6]

Consumers are shifting away from brick-and-mortar stores to digital shopping, and business owners are looking for ways to digitize the entire consumer journey. This major increase to digital adoption should have been expected in five years, according to IBM's US Retail Index estimates.[1]

The increased use of smartphones has also been a major contributing factor, with mobile e-commerce sales growth being projected at 19% in 2020 worldwide.[6]

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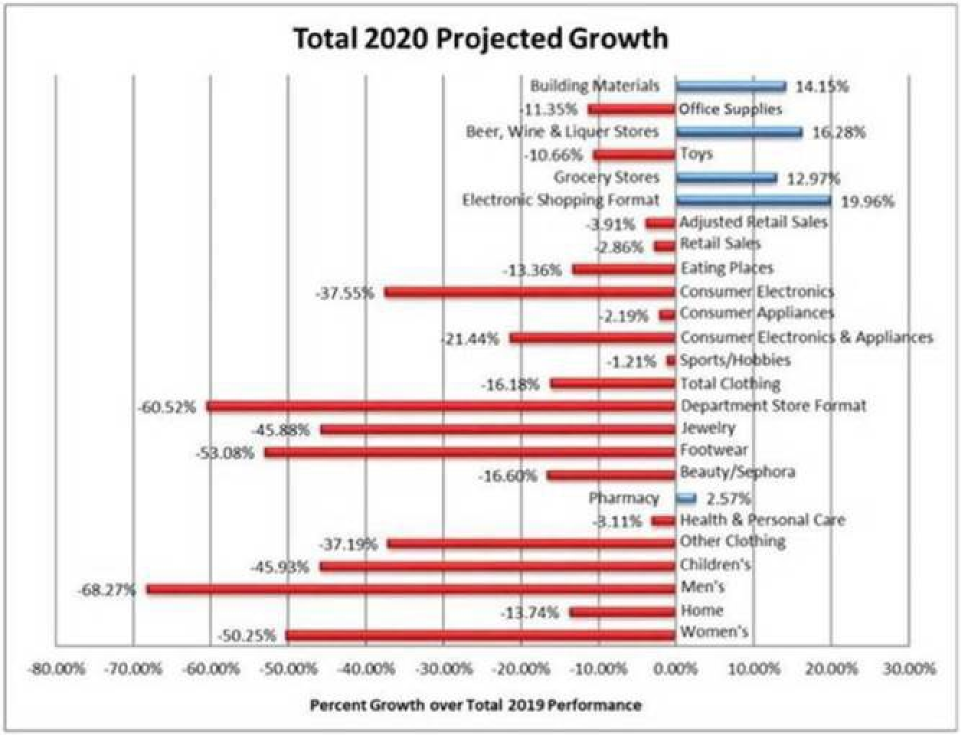

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As Nicola Mendelsohn, Vice President EMEA at Facebook, explains, *"As shelter-in-place measures pushed people across the globe to switch from shopping in-store to online, 2020 has shouldered a decade's worth of behavior change. This mass digital education of the public has been a cross-generational phenomenon that's very quickly had a cross-category impact: digitalizing entire consumer journeys, from interest to purchase to customer experience."* [6]

This shift in consumer behaviour is here to stay, according to well-respected experts in e-commerce, both external and from Facebook, as published by Facebook in the same marketing research and digital insights.[6]

"The biggest question today is: To what extent will the behavioral shifts toward digital experiences stick organically, or will businesses need to work harder to retain these behaviors? My guess is there will remain a large shift in consumer behavior toward online, but retail isn't going anywhere. Depending on evolving consumer comfort levels, there may be more appetite for merged online and offline experiences like BOPIS (buy online and pick up in store) like driving to a fast food location and ordering your meal on your phone to speed things up." (Ian Simons, Head of Industry for E-commerce at Facebook)[6]

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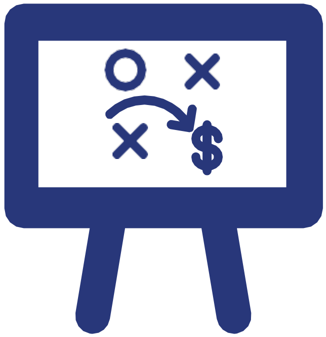
"I'd say, in a large part, that these behaviors are going to stay. From a consumer psychology point of view, it only takes about six weeks to create a new habit, and they've had a lot longer than that. I think there might be a novelty factor when hopefully things normalize and people look forward to going back to a shop where they can browse, touch things, try things on. But actually, businesses that have made shopping online convenient and accessible and have remained in communication with customers through social channels will remain connected through digital channels and may drive footfall as a result of that back to their shops in the future. But people will have learned to favor digital from a convenience point of view, and I do not expect things to drop back to January 2020 levels ever again." (Clare Bailey, Founder of The Retail Champion)[6]

7 The COVID-19 pandemic forced investors to consider a tech M&A strategy

A company's M&A strategy is generally driven by its most challenging underlying needs. In many cases, this means acquiring new technology. With the increased shift to e-commerce over the last year due to the COVID-19 pandemic, this has forced investors to in turn shift their focus on tech and digital companies as department stores and brick-and-mortar businesses are experiencing a decline.

As Susan Dettmar, Principal, M&A Services, Deloitte Consulting LLP explains, *"Often, innovation is happening elsewhere, and established players know they have to get attached to it. M&A presents a clear path to do this, and using your dealmaking to acquire technology is a trend that's likely to continue or even strengthen as companies see how powerful new technologies, such as artificial intelligence, can help their businesses."* [4]



8 Digital and technology companies tend to be valued higher

On an apple-to-apple comparison, a digital company is valued higher than a brick-and-mortar company because digital companies tend to have fewer tangible assets. Tangible assets, physical assets with a finite monetary value, depreciate over time. Digital companies that often come with other, intangible assets, such as intellectual property or patents, are valued higher as intangible assets offer greater value long-term. For example, a patent for a new technology may continue generating money for decades, whereas the products that are based on this patent may have value in inventory for only a short period.

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Although it may come as a surprise that an asset-light business, such as a software company, is typically valued higher than an asset-heavy business with the same revenue and income, it is important to remember the depreciation of tangible assets, such as machinery and equipment. These tangible assets will wear out, need to be repaired, or replaced, thereby using cash flow that could have instead gone to the business owners, lenders, or investors.

Furthermore, digital and tech companies are omnipresent – they are not geographically restricted and can operate globally from day one. This means there is less customer concentration risk by geographical area, thus further increasing the valuation.

9 Technology and digital companies have greater scalability compared to more traditional companies, especially those not tech-enabled

Scalability is the ability to sustain tremendous and rapid growth without increasing operation costs tremendously; that is, the operation costs are not linearly proportional to the growth. In terms of a software product, scalability refers to the ability of the software to be easily expanded to manage workload increases using its current infrastructure. Software systems that are not scalable often require the development or purchase of completely new systems or significant rewrites to the existing systems.

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When Facebook acquired WhatsApp in 2014, the popular text messaging app used globally, it had over 500 million monthly users, and was adding more than one million users per day.[7] This drastic increase in users each day, while maintaining the existing infrastructure and with a team of only 55 employees (32 of which were engineers)[8], would be extremely difficult for any traditional business to achieve today. Furthermore, the app was launched in 2009 and boasted 1.5 billion users as of 2020.[7] No traditional brick-and-mortar business can handle and maintain such growth in such a short period of time.

A more scalable tech or digital company is more adaptable to the changing needs and demands of its users or clients, which is often a sign of competitiveness and stability. This increases its value, making it attractive to investors and those looking to buy or sell a technology or digital company.

Make all your M&A ideas a reality.

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