
M&A Market Report

Software Engineering

Q2 2021

Introduction

The \$342B software development and digital transformation market is expected to grow by 15% + annually over the next several years. And subsequently, many companies are looking to capitalize on that growth via acquisitions making for a very active M&A market in this space. The fallout from the COVID-19 pandemic has only accelerated the urgency for digital transformation initiatives. In fact, 62% of executives believe their organizations must undergo radical digital transformation over the next two years, according to the EY Digital Investment Index.

Executives are looking outside of their company's core business model to plan the company's tech-enabled future. This demand for innovation and digital transformation is expected to be a key driver for deal-making as businesses look to pivot operating models post-pandemic.

According to EY Digital Investment Index, 52% of executives pursued digital technologies via M&A and said the approach exceeded expectations. 45% of executives reporting similarly for digital partnerships. Further, over 64% of industry leaders (growth and revenue) Shifted focus from in-house development to M&A and partnerships to accelerate digital initiatives.

Executives and investors see value in companies that deliver end-to-end solutions focused on software engineering and digital transformation services. These companies are seeing more demand in the marketplace than companies with more of a pure staff augmentation focus. Subsequently, end-to-end solutions providers can produce higher margins and create higher barriers to entry, typically resulting in higher valuations.

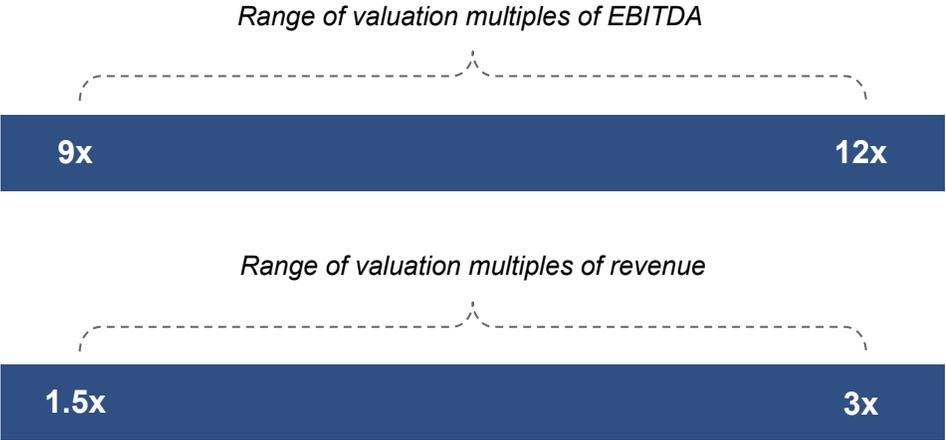
Several trending technologies under the digital transformation umbrella are expected to continue to drive the industry forward. These include Robotic Process Automation, Cloud Technologies, IoT & Edge Computing, Cybersecurity, Blockchain, Data Science, Artificial Intelligence and Quantum Computing.

The success of digital deals and partnerships, combined with industry leaders' focus on digital M&A, and general demand for digital transformation is likely to fuel 2021 to see an increase in deals and partnership investments in services-based software engineering and digital transformation firms.

Valuation Trends

Like most assets across the world, digital transformation assets have not been immune to extreme volatility in the past twelve months. Cheap capital supplied by the Federal Reserve and central banks, combined with relaxed monetary policy drove asset prices to all-time highs in early 2021, especially in "pandemic-resistant" industries, such as technology. More recently, interest rate yields in the bond market have worried investors causing large sell-offs in many high flying technology sectors. Still, with many active buyers in the space, the demand for software engineering and digital transformation companies has remained strong.

BMI has seen valuations rise due to the external market forces mentioned and expects to see offers for digital transformation companies between 9x – 12x EBITDA. For companies generating revenues of greater than \$20 million, investors and acquirers are valuing organizations based on top-line revenue multiples in a median range of 1.5x – 3.0x revenue.



Acquisition Activity

Deal activity across the board was down in 2020, largely due to the impact of the COVID-19 pandemic. However, acquisitions in the software engineering digital transformation services space remained strong.

Strategic acquirers have become more aggressive and prominent buyers of digital transformation companies in recent years. These acquirers tend to be led by aggressive, forward-thinking executives who realize their core business models are susceptible to technological innovation.

Management consulting firms continue to be one of the most active strategic buyers in the digital transformation space. Large, multinational firms like Accenture and McKinsey & Co. have made digital transformation a core piece of their service offerings to clients and used M&A to gain further market share. When making acquisitions in the space, management consulting firms are looking to enhance, complement, or add to the services already provided to their clients. Management Consulting firms across the country are looking to purchase digital transformation assets and demand from the industry for digital transformation assets is not expected to slow anytime soon.

In recent years, leaders in other industries like manufacturing, distribution, transportation & logistics, energy, healthcare, and financial services among others have made strategic acquisitions with the hope of steering their organization into a tech-enabled future. These deals are generally made by companies who recognize that not adopting digital transformation initiatives will result in losing sizeable market share moving forward.

Digital Transformation Select 2021 & 2020 Transactions

Accenture acquires Multiple Digital Transformation Assets

Accenture has been an extremely active buyer over the last several years, including multiple acquisitions of software engineering companies focused on digital transformation:

- Imaginea – March 2021
 - A cloud-native software engineering & professional services firm for AWS, Microsoft Azure and Google Cloud Platform (GCP) projects.
- Sentelis – June 2020
 - Independent data consulting and engineering company specializing in designing and scaling data and artificial intelligence capabilities.

McKinsey acquires Multiple Digital Transformation Assets

McKinsey & Co. has made multiple acquisitions of software engineering companies in the last several years to help bolster the firm's suite of consulting services:

- Venturetec – February 2021
 - A boutique consultancy specialized in digital innovation and venture building.
- Hypothesis -- February 2021
 - Digital-focused firm specializing in designing digital products and concepts, data science, developing tools and solutions including software engineering and product interface, and the adoption of agile ways of working.

Kin + Carta acquires Cascade Data Labs

(December 2020)

Kin + Carta announced the acquisition of Cascade Data Labs, a digital transformation company with a focus on data science. The acquisition supports the expansion of Kin + Carta's data transformation practice. Cascade Data Labs offers end-to-end data science expertise across all of the interrelated disciplines required to execute and drive business value, including data integration, data architecture, data science, data engineering, and data visualization.

PwC acquires EagleDream Technologies

(November 2020)

PwC has announced it will acquire EagleDream Technologies. EagleDream's cloud services include UI and UX design, application modernization, development, security and operations, data transformation, and digital differentiation.

Conclusion

While 2020 was a challenging year, demand for software engineering digital transformation services companies remained strong as the future of the global business ecosystem continues to move towards a digital future. 2021 is expected to see increased demand not only from an M&A perspective but also a general increase in consumption of software engineering and digital transformation services. Expect the rapid pace of deal-making to continue as financial buyers and strategic acquirers look for disruptive companies with staying power.

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About BMI Mergers

For over twenty-five years, we have been successfully engaged in the practice of buying, selling and managing the business acquisition process. Our professionals have been engaged in transactions in a multitude of industries. They have completed multi-million dollar deals, and they have also successfully integrated businesses post-merger. Whether your business is worth \$5 million or \$100 million, this experience is put to work to achieve your desired result.

About The Author

Matt Tortora brings over fifteen years of business ownership, sales leadership, and consulting experience in both technology and professional services. He has founded three companies and held strategic leadership positions at growth stage technology companies. Most notably, Matt was the co-founder and CEO of a Chicago based software company which he successfully grew and sold to a strategic acquirer.