

# SOFTWARE & SERVICES INDUSTRY REPORT



# WHITEHORN

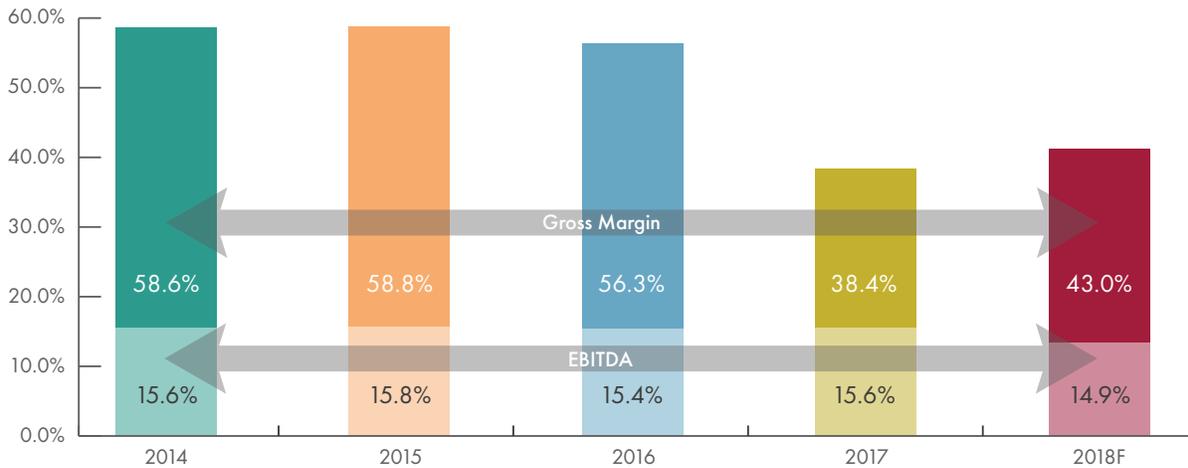
FINANCING | ACQUISITIONS | SALE OF BUSINESS

## Q3 2018

# Q3 2018 Industry Performance & Trends

Whitehorn Merchant Capital Inc.'s Software and Services (SaaS) Industry Report includes performance trends and transactional activity observed in this space. This industry is comprised of companies active in Application Software, Data Processing and Outsourced Services, Internet Software and Services, IT Consulting and Services, and Systems Software. All financial data has been sourced from *Capital IQ*.

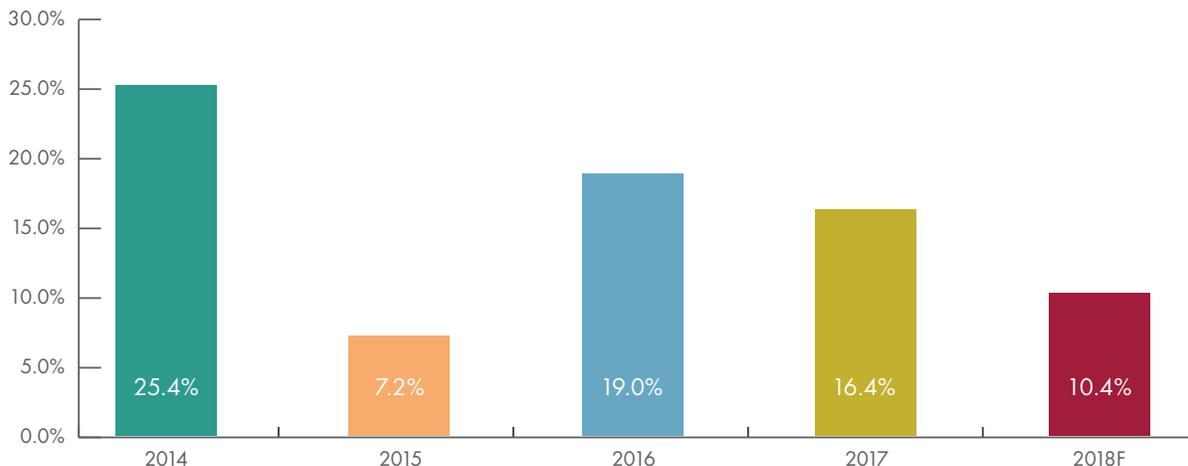
## Average Gross Profit & EBITDA Margins



Note: 2018 financial performance charts and data are based upon 2018 YTD reported results plus analysts' consensus estimates for companies Whitehorn tracks.

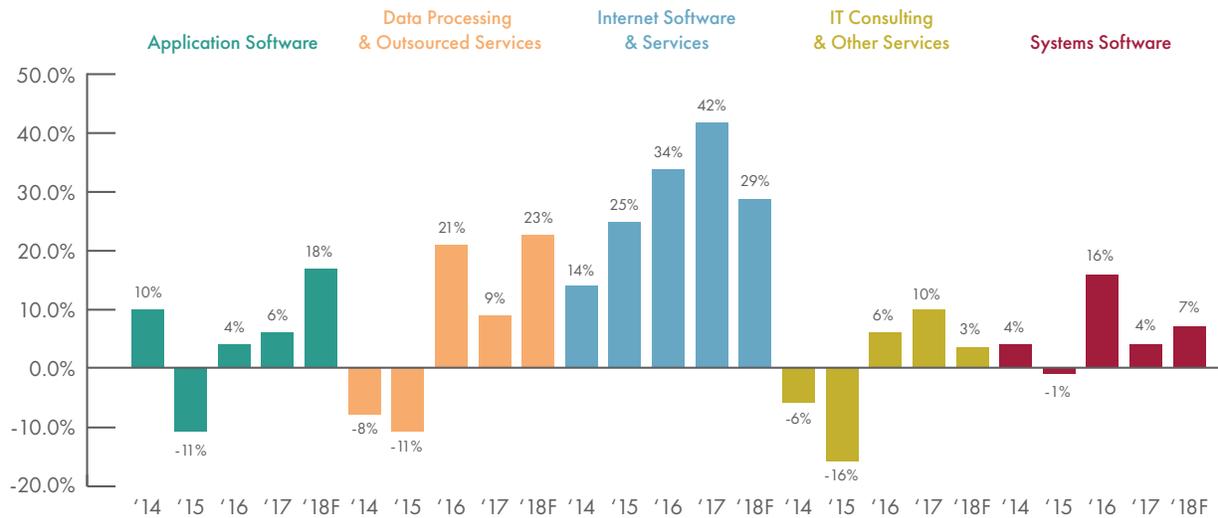
- The forecasted gross margin in 2018 is 43.0%, consistent with the previous forecast at the end of Q2 2018. This represents an increase from 2017 levels, but still lags the gross margins achieved from 2014 to 2016.
- The forecasted EBITDA margin in 2018 is 14.9%, a slight decrease compared to the previous forecast of 15.3% at the end of Q2 2018. The forecast shows a slight decline in EBITDA margins compared to the past few years since 2014.
- The average industry revenue growth in 2018 is 10.4%, revised lower from the 13.9% forecasted at the end of Q2 2018. Revenue growth is forecasted to continue its slowdown in growth since 2016, but is expected to still be in double digits.

## Average Industry Revenue Growth

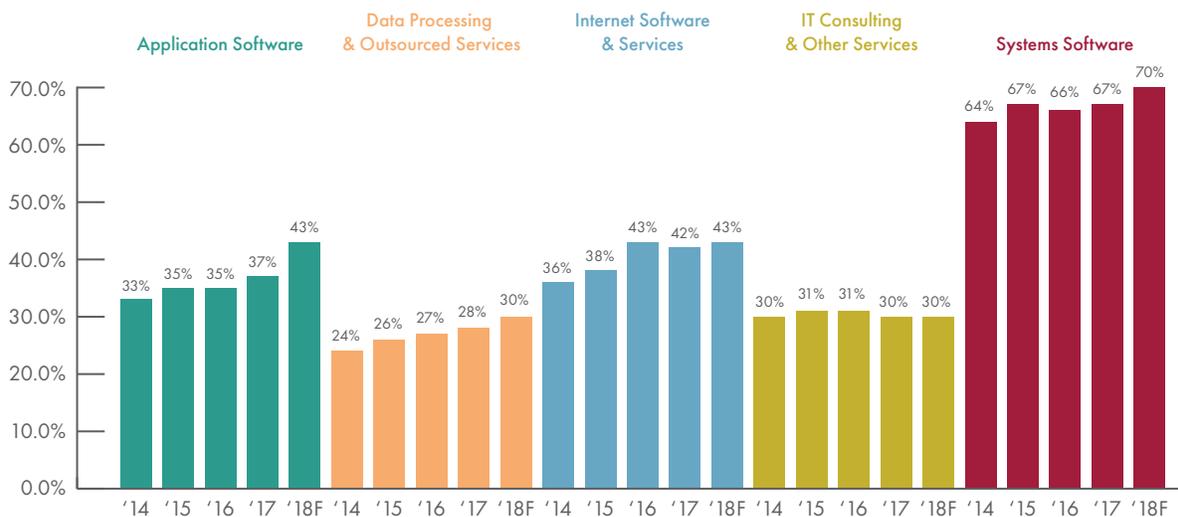


# Sector Performance Updates & Outlooks

## Average Revenue Growth by Sector



## Average Gross Margins



## Key Takeaways

- The Internet Software & Services sector is expected to lead the other sectors in revenue growth in 2018 with an expected revenue growth of 29%.
- The Data Processing & Outsourced Services sector's revenue growth has been revised higher to 23% from the previous 12% forecasted at the end of Q2 2018.
- The Systems Software sector and the IT Consulting & Other Services sectors are expected to experience single digit revenue growths, lagging behind the other sectors.
- The Application Software and the Systems Software sectors are expected to see improvements in gross margins in 2018, whereas the other sectors are expected to experience steady margins compared to the previous year.

# Quarter in Review

## Q3 2018 Key Highlights

- The Canada, the US and Mexico have reached an agreement and 25-year-old NAFTA has been replaced with the new USMCA.
- US Federal Reserve raises interest rates, says more hikes coming.
- Amazon came out with a long list of new Alexa items, including the Smart Plug, AmazonBasics Microwave, Echo Sub subwoofer, Echo Link and Link Amp in a race against its major competitor, Google, in the voice assistant world.
- New study shows the Okanagan tech sector has contributed \$1.67 billion to the regional economy with nearly 700 businesses and more than 12,000 jobs and the sector's year-over-year economic growth since 2013 has been pegged at 15 per cent.

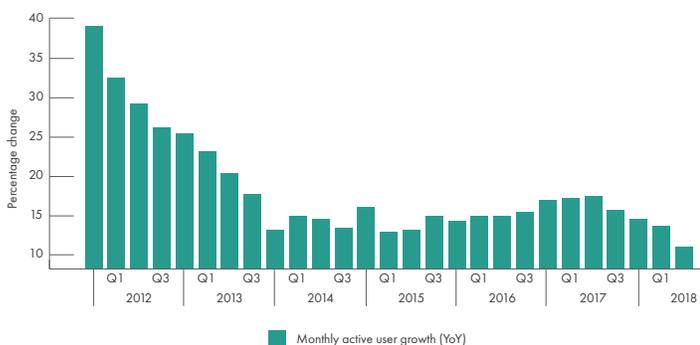
## Facebook Security Breach

Facebook announced a security breach in late September which allowed hackers to access the accounts of over 50 million users, including that of CEO Mark Zuckerberg and COO Sheryl Sandberg. Shares of the company fell 2.6 per cent to close at US\$164.46 in New York, leaving them down 6.8 per cent this year.

A loophole in Facebook's code which allowed users to view their profile as if someone else was looking at it, known as "View As" made it possible for hackers to steal access tokens, which are saved digital keys that keep users logged in so that they don't need to enter a password every time, and use them to take control of users accounts.

The breach adds to concerns that too much personal information is being collected by Facebook and the social media giant is not doing enough to protect it. Class action suits have now been filed in northern California and Toronto over the matter.

Facebook Monthly Active User Growth



Source: Bloomberg

## USMCA

The US, Canada and Mexico finally reached a consensus on September 30 and the three nations struck a deal on trade, announcing a revised NAFTA, now known as the United States-Mexico-Canada Agreement (USMCA). The terms, which all countries have said are agreeable are highlighted below:

### USMCA

- Improved access to Canada's dairy market for US farmers.
- Tighter rules of origin for auto production – Steel and aluminum tariffs imposed by the US earlier this year are to remain in effect. There is no update or timeline as of yet regarding when these will be lifted. However, USMCA creates limited carve-outs for both Canada and Mexico. All auto industries are unlikely to be significantly affected.
- Canada agreed to raise the threshold for applying duties to cross-border purchases, a key demand from the US. Canada's new so-called 'de minimis' level will be \$150 for customs duties, up from the current \$20, and \$40 for sales taxes.

### Dispute Panels

- NAFTA had three kinds of dispute settlement systems.
- Two will remain in USMCA, basically unchanged but renamed.
- Chapter 20 – State-to-state dispute settlement.
- Chapter 19 – Dispute settlement agreement mechanism, which Canada was fighting strongly for. The US felt this undermined the autonomy of their courts, as it called on a panel of representatives from each country involved in a dispute instead of the country filing the dispute resolving it within their own court system. Trudeau felt the panel was the only fair way to resolve disputes. Canadian lumber companies often use Chapter 19 to remove blocks on their exports to the US.
- Chapter 11 – Investor-state dispute settlement. This has been phased out between the US and Canada, but remains for Oil & Gas, infrastructure and telecommunications between the US and Mexico.

### Intellectual Property Extended

- Canada has agreed to extend copyright from 50 years after the death of a work's creator to 70 years.
- This could minimize development opportunities around technology as the US tends to hold more intellectual property than Canada.
- According to Innovation Minister Navdeep Bains, it is important for Canada to become a leader in leveraging and developing intellectual property (IP). Bains says "the IP chapter of USMCA will support the competitiveness of our creators and innovators, while providing Canadian exporters and investors with a predictable and transparent framework of rules."

# Quarter in Review

## Data Sovereignty Enforcement Blocked

- The digital trade section of USMCA limits requirements placed by the government on where data is stored or transferred.
- The federal government cannot require that data centres be located in Canada in order to conduct business in the country.

## Privacy and Spam

- Governments agree to “adopt or maintain a legal framework that provides for the protection of personal information of the users of digital trade.”
- Users should be provided with a transparency and be able to choose not to receive unsolicited information or messages.

## Artificial Intelligence

A new study by Forbes Insights has found that Artificial Intelligence (AI) deployment in Canadian organizations has not yet been a “real success.” According to The Canadian Press, the report, which details the findings of an online survey of over 300 executives, ranks Canada last out of 10 countries, with just 31 per cent of adopters of the technology claiming successful AI deployment behind 59 per cent in India and 58 per cent in Germany. Canadian companies were also last for full deployment through their firms and encountered the most resistance from employees due to concerns over job security. Jodie Wallis, head of AI at Canada for Accenture says this is likely because Canadian organizations fully consider the ethical impact of deploying AI whereas other countries deploy AI first and consider ethical ramifications later. Nearly 75 per cent of Canadian firms have AI ethics committees, the highest proportion of all countries surveyed. Ethical issues include consent, transparency, bias, and job impact. A possible factor in the low ranking, adds Willis, is that “Canadian executives tend to be humble in their self-assessment” compared to other countries.

Though businesses are finding it difficult to facilitate AI deployment, tech investor and industry expert Salim Teja remains highly optimistic about the future of AI in Canada. According to Teja, Canadian universities have long been investing in AI research and Canada “now has one of the most significant concentrations of AI talent anywhere.” Teja also points to major Canadian AI developments over the past year, such as the opening of Vector Institute, a \$170 million research centre steered by Geoffrey Hinton (“the godfather of AI”) in Toronto, the announcement by Geoffrey Gordon, a researcher in Carnegie Mellon University’s renowned machine learning department, that he is moving to Montreal to lead the Microsoft Research Lab there, and Google’s DeepMind, the developer of the first software to successfully defeat a human player at the strategy board game Go, opening its first lab outside of the United Kingdom in Edmonton. Canada also has a strong culture of collaboration among technology-focused researchers and universities, which Teja says “ensures that the best engineers can continue to undertake research driven by curiosity and a desire to fix real-world problems, increasing the likelihood that AI will develop in ways that will benefit all of society.”



## Seeking Liquidity or Financing?

At Whitehorn we maintain regular contact with key strategic buyers and financiers from North America and around the world. We are able to connect potential clients with financiers who are an ideal fit for whatever transaction they may be considering, namely management buyouts and acquisitions.

If you are seeking liquidity from your business or are interested in partnering with a financial group to expand your operations, we currently have an experienced financial partner seeking companies that fit the following criteria:

### Geography



- North America-based.

### Ownership & Size



- Majority control; up to \$10 million in EBITDA.
- Control buyout of platform companies; up to \$400 million in enterprise value.
- Non-control; \$5 million or more in EBITDA.

### Partnership Characteristics



- Offers businesses both financial and strategic resources to fuel growth.
- Vast access to executive network, polled purchasing and consulting opportunities in a variety of areas.

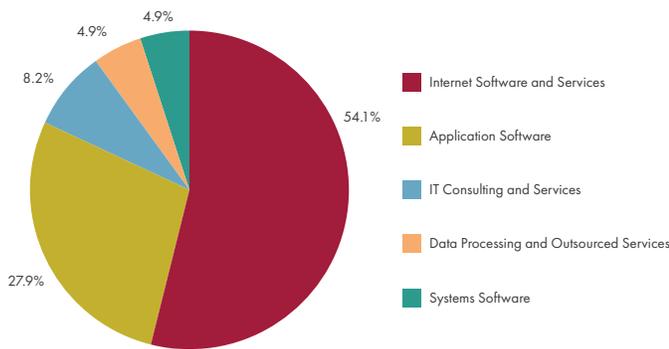
Should you be considering raising capital to grow your business or are seeking liquidity from your business, contact Whitehorn today for more information and to learn how we can connect you to financing tailored to your specific needs.

# North American SaaS Companies

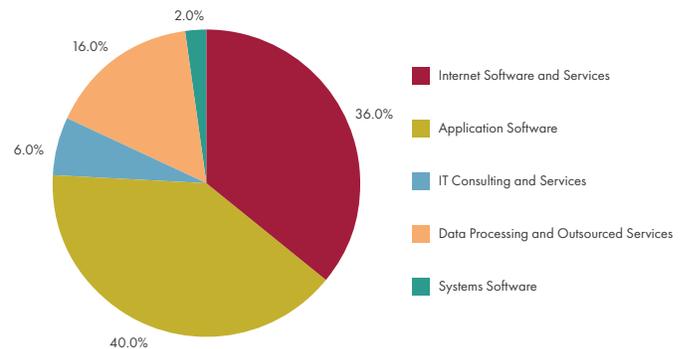
## M&A Activity

Whitehorn closely follows the M&A activity in the North American Software and Services space. Sectors in this space include companies active in Internet Software and Services, Application Software, IT Consulting and Services, Data Processing and Outsourced Services, and Systems Software.

Q3 2018 Software and Service M&A Activity by Sector



Q2 2018 Software and Service M&A Activity by Sector

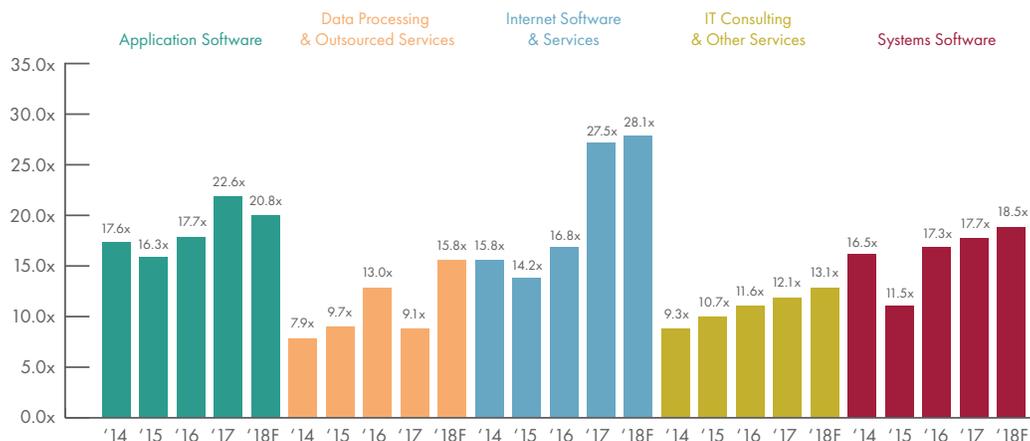


## Q3 2018

- There were 61 M&A transactions tracked by Whitehorn in Q3 2018, a 22% increase compared to the 50 transactions tracked in Q2 2018.
- The Internet Software and Services sector led all other sectors with 33 transactions, followed by the Application Software sector with 17 transactions tracked.
- The total disclosed transaction volume in Q3 2018 was \$65 billion, compared to the \$28 billion tracked in the previous quarter and the \$24 billion tracked in Q3 2017.
- Of all disclosed transactions, the average EBITDA multiple in Q3 2018 was 15.3x, compared to the 10.3x tracked in Q2 and the 15.0x tracked in the comparable period last year.
- 56% of all transactions tracked involve software companies being acquired for under \$100 million, representing a healthy amount of M&A activity happening across the industry regardless of company size.

## EV/EBITDA

Average EV/EBITDA of North American Internet and Software Companies



## Recent North American SaaS Transactions

The table below summarizes a selection of recently closed and announced transactions in the Software and Services sector involving companies in North America that are active in mergers and acquisitions. Transactions this quarter include geographic and strategic expansions, as well as new product and service line offerings.

Date	Acquirer	Acquirer Location	Target	Target Location
September, 2018	Highground Technologies Corp.	Toronto, ON	<b>Breaking Data Corp. (TSX:BKD)'s Toronto based technology team</b>	Toronto, ON
	<i>Undisclosed acquisition of Toronto based technology team that allows Breaking Data to continue using its artificial intelligence systems in online sports betting.</i>			
September, 2018	GTY Technology Holdings Inc. (NasdaqCM:GTYH)	Las Vegas, NV	<b>Bonfire Interactive Ltd.</b>	Kitchener, ON
	<i>Acquisition of cloud based collaborative decision making tool developer assisting purchasers in evaluating supplier proposals.</i>			
August, 2018	Encompass Digital Media Group Inc.	Los Angeles, CA	<b>Babcock International Group plc's (LSE:BAB) Media Services business</b>	London, UK
	<i>Acquisition to expand Encompass' scale in Europe, the Middle East and Africa and extends its combined channel payout, transmission and digital products portfolio while adding international radio distribution to its service offerings.</i>			
August, 2018	Breaking Data Corp. (TSXV:BKD)	Concord, ON	<b>Oryx Gaming (AA Acquisition Group Inc.)</b>	Toronto, ON
	<i>\$15.5 million acquisition as part of strategy to create a global gaming group and to leverage synergies through the combination of businesses.</i>			
August, 2018	The Descartes Systems Group Inc. (TSX:DSG)	Waterloo, ON	<b>PinPoint GPS Solutions Inc.</b>	Mississauga, ON
	<i>\$18 million acquisition of manufacturer of GPS fleet tracking and mobile workforce management devices to extend its command of logistics operations, and thus reduce its costs and improve its service offerings.</i>			
August, 2018	VerticalScope Inc.	Toronto, ON	<b>RedFlagDeals Division of Yellow Pages Digital And Media Solutions Ltd.</b>	Montreal, QC
	<i>\$12 million acquisition of RedFlagDeals division with an average of 37.4 million page views per month, payable in two \$6 million tranches.</i>			
July, 2018	Xero Limited (ASX:XRO)	Wellington, NZ	<b>Hubdoc Inc.</b>	Toronto, ON
	<i>USD \$70 million acquisition of mobile application developer that converts receipts, bills, invoices into usable data, with more than 1.4 million subscribers across 180 countries..</i>			
July, 2018	Visa Canada Corp., Air Canada (TSX:AC), CIBC (TSX:CM), Toronto-Dominion Bank (TSX:TD)	Multiple	<b>Aeroplan Loyalty Program Business of Aimia (TSX:AIM)</b>	Montreal, QC
	<i>\$2.3 billion acquisition consisting of \$250 million in cash and the assumption of \$2 billion of Aeroplan points liability.</i>			
July, 2018	Salesforce.com, Inc. (NYSE:CRM)	San Francisco, CA	<b>Datorama Inc.</b>	New York, NY
	<i>USD \$800 million acquisition of venture backed provider of cloud based, AI-powered marketing intelligence and analytics platform to complement existing product offerings and further develop its marketing capabilities.</i>			

*Whitehorn Merchant Capital is an independent, Western Canadian financial advisory firm that provides business owners and management teams with capital raising, acquisition, and sale of business transaction solutions.*

## Our Services

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Whatever milestone transaction you are considering, Whitehorn's leaders can guide you through the process. We have the network in your industry and the experience to implement a tailored, effective strategy for you and your business.



Sale of Business



Financing



Acquisitions



Management Buyout

## The Whitehorn Advantage

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### Transaction Management

Whitehorn's senior professionals will lead your transaction from initiation to closing. We will support you and your transaction so you can ensure your business performs through closing, which is critical to obtaining an industry leading valuation.

### Marketing and Presentation

Whitehorn creates comprehensive, industry leading marketing materials which help buyers and investors understand your business, your competitive advantages, growth potential, and unique value proposition.

### Industry Focused Network

Whitehorn knows the buyers and investors in your industry. We know which strategic and financial parties are active in the market today, the transactions they've done, what they want, and what they're willing to do.

### Maximizing Value

Maximizing your value maximizes our value. By presenting your business in the best way possible, to the most motivated buyers and investors, we will add significant value to your transaction.

*Contact Whitehorn today for expert advice on accessing capital, planning for business growth, and addressing business succession. We look forward to helping you reach the achievement of your goals.*

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