

Software as a Service

Following a decade of revolutionary activity and exacerbated growth from the Covid-19 pandemic, the SaaS industry aims to continue to capitalise on businesses and wider society's desire to utilise SaaS products.

The industry is attracting record making M&A and investment activity at some of the economy's highest multiples.



SaaS Overview

Software at control of the customer

SaaS is a service that delivers information and applications to users over the internet. As it uses the internet, users gain access to the application through web browsers, eliminating the need to download the software to a user's device. Well-known SaaS products are data sharing sites, such as Dropbox and Office 365; web hosting sites, such as Amazon Web Services and Salesforce; and creative editing software, such as Adobe Photoshop and Canvas.

SaaS products are ingrained into everyday uses and are heavily relied on in both B2B and B2C contexts, with B2B becoming much more popular in recent years. The increased popularity is driven by numerous factors - the biggest being the increase of working from home, accelerated by the recent Covid-19 pandemic. B2C products have also increased as consumers switch to online shopping and virtual collaboration.

The last decade was revolutionary for the SaaS industry as users and companies alike move from on-premises software to cloud-based software, as part of the digital revolution. As a result, the market growth for SaaS is strong, evidenced by a CAGR of 27.9% from 2015 to 2022.

Forms of SaaS

SaaS products are typically classified as either horizontal SaaS products or vertical SaaS products. However, in reality, many products contain a combination of horizontal and vertical traits, forming a hybrid variant.

Horizontal products apply to a wide range of industries, often providing Customer Relationship Management (CRM) systems and resource & staff management services. These services are used by many organisations and the software tends to focus on 'big data', offering little room for tailoring.

Vertical products, on the other hand, provide a detailed approach to specific scenarios or industries. A vertical software product is typically developed to address a specific industry challenge and cannot be leveraged by organisations in different industries.

veeva

RetailNext

shopify

Office

salesforce

Verical

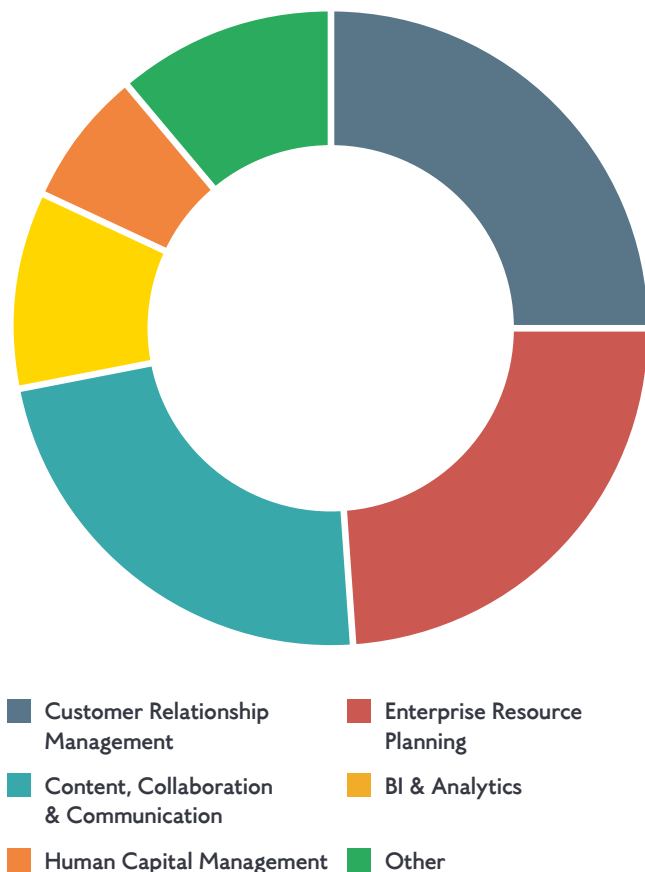
Horizontal

Market Structure

The SaaS market is still very young and many years away from reaching maturity. Countless new entrants enter the SaaS market every year, with both horizontal and vertical software products developed and launched daily. As noted in the chart above, CRM systems made up 25% of the SaaS market in 2020, closely followed by enterprise resource planning (ERP) systems. Both CRM and ERP are classified as horizontal products. It is therefore unsurprising that horizontal SaaS products received the most success in recent years, given that they can reach a larger audience. The two front-runners of successful horizontal products are Shopify and Salesforce, where the market value of these companies has grown over 150% in the 20 months up to September 2021, to \$185 billion and \$161 billion, respectively.

The vertical SaaS products, which are industry specific, have experienced some success, albeit not to the same level as the horizontal products. Recently, however, industry experts suggest that this will change as the bespoke nature of the vertical SaaS products allow for full digitalisation.

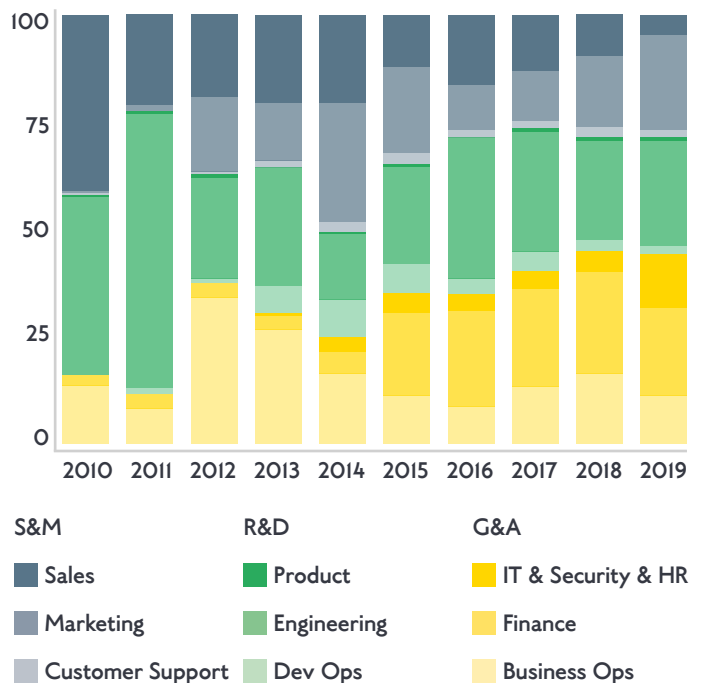
Global Software as a Service (SaaS) Market Share, By Application, 2020



The chart below demonstrates SaaS spending by an organisation’s ‘core’ departments. Initially, to achieve stronger revenue growth, organisations focussed their spending on the sales and marketing functions. However, it is clear that, more recently, organisations have increased spending on ‘back office’ functions, such as IT, HR and finance.

This is driven by the increased popularity of controlling overheads, improving cost control and increasing efficiencies to improve an organisations operating margin. Horizontal products, such as ERP systems, directly assist organisations in achieving these goals. We, therefore, expect this trend to continue, especially with high inflation rates threatening cost control.

SaaS Spending by Department



Deal Activity

The SaaS Mergers and Acquisitions (M&A) environment is one of the most deal-active markets. SaaS Initial Public Offerings (IPOs) have been extremely popular in the last few years, with SaaS seeing a record number of IPOs in 2021. The largest 27 of these IPOs now represent more than \$150 billion in total market capitalisation as of January 2022.

Specifically, the largest SaaS IPO in 2021 was Qualtrics, which was valued at over \$15bn and listed in January 2021.

We have summarised the 5 largest 2021 SaaS IPOs below:

Month of Deal	Years Between Incorporation and IPO	Company	2021 Run-Rated Revenue	Market Cap March 2022
January	18.1	Qualtrics	\$771m	\$16bn
April	15.5	UiPath	\$580m	\$13bn
June	8.5	Sentinel One	\$150m	\$9bn
December	8.6	HashiCorp	\$329m	\$6n
September	11.1	FreshWorks	\$353m	\$5bn

Although the IPO option appears to be more popular for SaaS companies, there were still significant M&A transactions in the market. As of Q4 of 2021, the median Enterprise Value/Revenue (EV/R) multiple, a common multiple to value a SaaS company, was 5.7x - significantly higher than more traditional industries.

There were two headline SaaS deals in 2021: Salesforce's acquisition of Slack, a communication product, for \$27 billion (31x EV/R); and Thoma Bravo's purchase of Proofpoint, an internet security company, for \$12.3 billion (12x EV/R). We have summarised other notable M&A transactions below:

Company	Company Operations	Buyer	Deal Type	Deal Value	Date
A Cloud Guru	Online Training	Pluralsight	Acquisition	\$2 billion	July 8 2021
Ascent Business Technology	Risk Assessment Software	TraqIQ	Acquisition	Not shared	May 12 2021
Changepoint	CRM and Enterprise Resource Planning	Planview	Acquisition	Not shared	January 12 2021
Clarizen	Enterprise Resource Planning	Planview	Acquisition	Not shared	February 23 2021





Outlook

The rise of SaaS is becoming more prominent every year. Both small and large businesses are utilising SaaS in some form, and as the number of products available to users grow, the market will only increase. The UK market is amongst the hottest SaaS markets globally, with venture capital (VC) investment hitting \$15bn in 2020 (third in the world), after achieving the highest growth rate globally of 17%. London specifically stands fourth for tech VC investment globally behind San Francisco, Beijing and New York at \$10.6bn. This investment demonstrates that the UK is a global leader in cloud computing.

The Covid-19 pandemic accelerated SaaS' growth, as users were forced to work virtually allowing collaboration and communication products to thrive. Following the pandemic, the market is expected to see further investment into these products as the new way of working looks to be set in place for the long term. This growth is supported by researches, such as Gartner, who forecasts end-user spending on public cloud services to reach \$482 billion in 2022 (22% up from 2021). Specifically, the global SaaS market is expected to reach \$436.9 billion in 2025, from \$250 billion in 2021, a CAGR of 15%.



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