



The Next Frontier of Software Investment and the Private Markets

How Private Equity Is Uniquely Positioned
to Enable the Future of Software



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INTRODUCTION

Global adoption of technology is rapidly accelerating, further propelled by the dynamics of the pandemic. With this digital leap, technological advancements are supercharging business performance and reshaping the economy. Amidst rapid innovation and significant capital flows into digital platforms, software has been one of the fastest-growing sectors over the last three years. With a median growth rate of 465%, there is potential for plenty more upside.¹

And yet, today, it's estimated that 98% of all software companies remain private.² Therefore, in order to enable rapid productivity and opportunity creation through software, the private markets must play an active role in the next frontier of software development.

The Private Markets Landscape: A Catalyst for Growth

Since the Great Recession, capital allocations to the private markets have tripled from \$2.5 trillion to \$7.7 trillion today.³ And it's easy to understand why: according to McKinsey, private equity has outperformed reasonable public market benchmarks over the last five-, 10- and 20-year periods. In fact, over the long term, private equity has remained the highest-returning asset class in the private markets since 2006.⁴

This backdrop creates the driver of growth for technology and software companies, which are increasingly reaching valuations of \$1 billion through private financing.⁵

Reflecting on the Past: The Beginning of Enterprise Software Expansion

Even before the pandemic, global digitization trends had been spurring business transformation within the Fourth Industrial Revolution, also referred to as the Digital Revolution. These trends, including the acceleration of computing power, pace of connectivity and adoption of cloud computing, were driving rapid growth of software into nearly every market vertical.

Powered by these trends, global digital infrastructure has grown exponentially. In the past 20 years, the number of servers shipped in the U.S. has increased from 3.9 million units in 2000⁶ to over 12.1 million in 2020.⁷ Meanwhile, the transistor count, a measure of integrated circuit complexity, has doubled every two years since the 1970s to become the most widely manufactured device in history.⁸ This increase in

the availability and power of computing has been amplified with the expansion of and access to high-speed internet, with available internet speeds growing from 7-8 megabits per second in 2009⁹ to over two gigabits today.¹⁰

These forces, coupled with the advent of cloud computing, which has snowballed in the past 10 years, have enabled enterprises to adopt software more easily and effectively, creating a hotbed for software company growth. As a result, investments in the sector have been steadily increasing.

10x

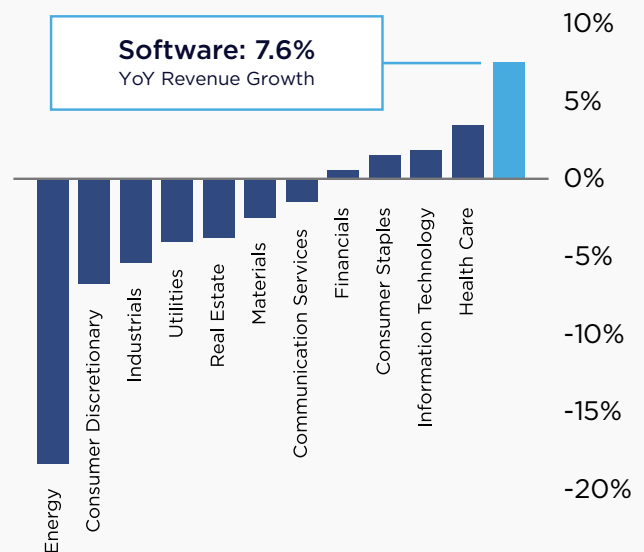
Increase in the number of dollars going into private cloud companies in the past decade, reaching over \$180 billion in 2020.¹¹

15.6%

The amount of dealmaking in software in relation to overall deal value in 2020, a 10 percentage point increase since 2009.¹²

In 2020 alone, software company market capitalizations grew 20% through July 2020, faster than all other sectors.¹³ Software also had the highest year-over-year growth rate in revenue (at 7.6%) and earnings before interest, taxes, depreciation and amortization (EBITDA) margin (at 22.2%).¹⁴

Software Companies Have Outperformed Through COVID-19¹⁴



The Pandemic as an Accelerant

This growth in revenue and EBITDA correlates with the mission criticality of software during the pandemic. Prior to the pandemic, some leaders viewed technology initiatives primarily for their cost saving abilities and believed that they could be difficult to implement. However, during the pandemic, businesses moved more quickly than they thought possible to implement necessary changes - from remote collaboration to using advanced technologies - to enable agility and connection. Given the speed and immediate benefit of the changes, these executives now view digitization as a competitive advantage or are aligning their entire business around digital technologies.¹⁵



Expediting Small Business Relief

With the passing of the Coronavirus Aid, Relief and Economic Security (CARES) Act, the Paycheck Protection Program (PPP) was flooded with applications. This program was critical for business owners struggling to pay salaries, rent and other costs during the pandemic. While large banks and businesses were handling the PPP process successfully, smaller businesses and lenders, particularly in underserved communities, were having trouble navigating the complexities of the program.

To help companies claim their loans from the disbursement, Finastra,¹⁶ a global financial software solutions provider, launched a self-service application tool. This tool provided automated transmission to the Small Business Administration's E-Tran portal to small community banks and credit unions for free.

Within 24 hours, 500 new banks downloaded the software. Finastra's solution enabled small business owners to streamline and expedite the loan documentation and closing process, helping to make funds available to small business owners as quickly as possible.

The Company powered more than **90,000** loans across more than 800 lenders and supported **1,700** small community and minority-focused lending institutions.

The shift to digitization has had a particularly striking impact on the small-to-medium business (SMB) market, which was further behind on the tech adoption curve than enterprise businesses.

84% of SMBs

adopted new software in response to COVID-19.

64% of those businesses

saw an increase in revenue compared to just 25% of businesses that didn't implement a tech solution.¹⁷

While tech-enabled process improvements were executed quickly during the pandemic, the adoption and ensuing impacts are likely to persist long-term. For example, 20% to 25% of the workforces in advanced economies are predicted to continue to work from home three to five days a week, facilitated by virtual collaboration and productivity software.¹⁸

Given the importance of software in this new paradigm, revenues in the sector are projected to grow at a 7.4% compound annual growth rate (CAGR) through 2025, with enterprise software revenues, in particular, projected to grow at a 9.1% CAGR.¹⁹ As the market continues to evolve, the role of investment in cultivating a thriving capital ecosystem becomes even more important.



Enabling Remote Learning

The pandemic brought many issues to the surface, such as technological disparity and the digital divide in K-12 education. With schools closing their doors and opening digital classrooms, PowerSchool²⁰ helped to ensure learning could continue with its distance learning solutions.

The Company offered its distance learning software to any school district in the country with delayed billing until the end of the 2020 school year. Meanwhile, teachers could access PowerSchool's basic software for free. Furthermore, districts already using PowerSchool could increase the number of distance-learning licenses at no additional cost to reach as many students as possible remotely.

PowerSchool enabled over **145 million** virtual student assessments and **1 trillion** remote student interactions, a 400% increase.

The Role of the Private Markets in Software Growth

As a predictable and highly resilient business model, software presents an evergreen opportunity for investors. Software fundamentals also provide a compelling value proposition, including:

- **Mission criticality:** Customers rely on enterprise software to run their businesses.
- **Recurring revenue:** Sales are generated from licenses, maintenance and subscriptions, with long-term contracts.
- **Customer stickiness:** Enterprise software solutions are deeply integrated into customers' operations and are difficult to remove once implemented.

Within the private markets, which have outperformed their public counterparts, software investments have exceeded the broader private equity landscape, with a rate of 2.8x pooled multiple of invested capital. Additionally, software has generated a greater proportion of 3x returns than all other tech (and non-tech) private equity sectors.²¹



Leader in Identity Access Management (IAM)

Vista invested in Ping Identity²² (NYSE: PING) in 2016. Over the course of its private investment, Ping doubled its solution offering while expanding its go-to-market channels to position itself as the leader in the IAM space for large enterprises.

Following a successful IPO in September 2019, Ping has continued to expand annual recurring revenue (ARR) by **-34%** on a cumulative basis. As of 5/28/21, Ping was trading at a **-61%** premium to its initial IPO price.²³

With the potential for strong returns, investors are flocking to the sector. Tech funds accounted for 22.5% of all private equity capital closings in 2020, significantly more than the

14.1% five-year average.²⁴ As more investors seek to gain from software, sector-specific expertise and experience will continue to differentiate investors leading the market.

The private equity industry has proven its ability to fuel transformative growth in enterprise software companies while preparing some to go public. For example, despite the pandemic, private equity firms counted \$74.5 billion in exit value in 2020 across 22 IPOs, the highest annual value in over a decade.²⁵ This dynamic provides increased opportunities for retail investors to invest in mature, de-risked software businesses in the public markets.



Leading Provider of Apple Device Management Software

Vista invested in Jamf²⁶ (NASDAQ: JAMF) in 2017. Throughout the investment period, Jamf furthered its position as the standard in Apple Enterprise Management via go-to-market strategies and product expansion to accelerate growth and solidify its market leadership.

Following a successful IPO in July 2020, Jamf has continued to expand ARR by **-28%** on a cumulative basis. As of 5/28/21, Jamf was trading at a **-33%** premium to its initial IPO price.²⁷

Future Trends and Opportunities for Software Investment

With digital transformation fueling increased adoption of software, there will continue to be ample buying and investing opportunities. According to Grand View Research, global business software is expected to expand at an 11.3% CAGR from 2021 to 2028.²⁸

Digital Forces Press Forward

The amount of data created over the next three years is **greater than** the amount of data created over the past three decades.²⁹

\$30TN

Amount that deep learning will add to the global equity market capitalization during the next 15-20 years.³⁰

12MM

Number of jobs that will result from machine learning and automation by 2025.³¹

SOFTWARE INVESTMENT IN THE ASIA-PACIFIC (APAC) REGION

Technology continues to play a vital role in the economic strategy for many countries across the APAC region, including China, India, Japan and South Korea. APAC countries accounted for 52% of global growth in the revenue of technology companies between 2006-2008 and 2016-2018.³² Yet, despite investments in underlying infrastructure, many countries still lack a crucial layer of the technology stack – software.

25% CAGR

Rate of growth on spending on the public cloud and related services across Asia-Pacific, faster than in the U.S. and Western Europe.³³

\$24BN

Amount China has outspent the U.S. on 5G since 2015.³⁴

14%

Fraction of technology purchases made by software in Asia in 2019, compared to 50% of purchases in the U.S.³⁴

This white space presents opportunities for today's enterprise software businesses and investors. Given its current trajectory, the APAC region will play an even greater role in providing investment opportunities to tech and software companies.

CONCLUSION

As the connective tissue of the digital economy, enterprise software remains mission critical to business success as it continues to permeate all functions in our society. As investors look for new opportunities within the sector, the private markets will continue to be the most fertile, and sector specialists will be best positioned to succeed.

Digital transformation is only accelerating, and it's clear that private equity will remain a valued capital partner for software companies whose solutions enable an even better future - a healthier planet, a smarter economy, a diverse and inclusive community and a broader path to prosperity.

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