

Mergers & Acquisitions in the Marketing Agency Space

Preparing HubSpot Partners For Mutual Growth



Arjun Moorthy
VP of Business Development
& Channel Sales

Agenda

- 1 The State of the Industry
- 2 Valuation
- 3 The Anatomy of a Transaction
- 4 M&A Deep Dives
- 5 M&A Matchmaking Service

1

The State of The Industry

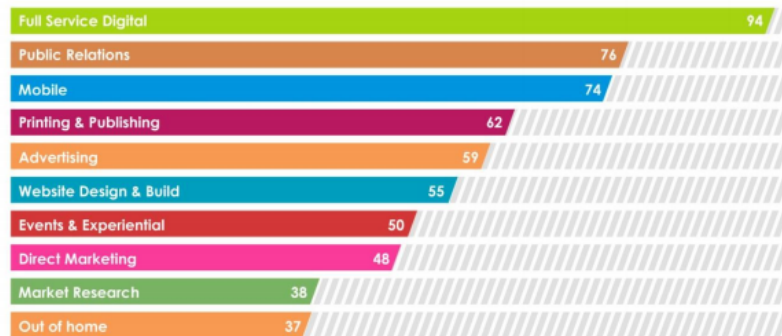
Industry Overview & Trends

- 1 Lines are blurring between MarComs and MarTech → clients are increasingly technology driven
- 2 M&A transaction volume has been increasing over the last 4 years
- 3 HubSpot ecosystem deals tend to be a mix of acqui-hires and revenue-based buyouts

geographical split of targets



top marcoms sectors



deal type



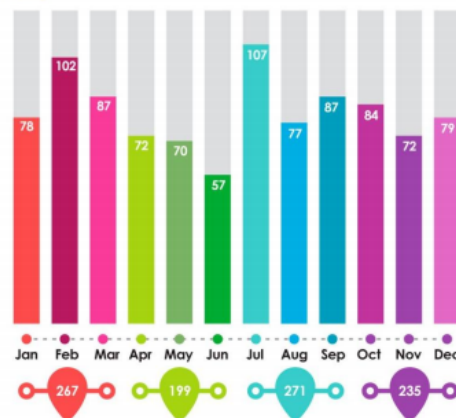
volume of deals



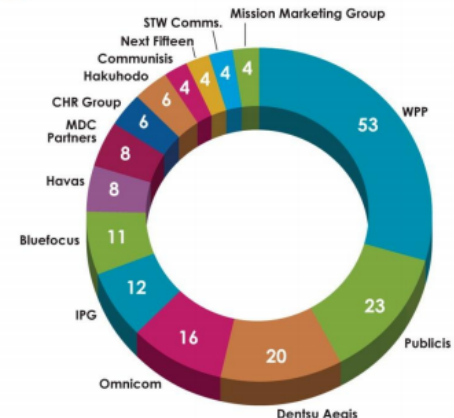
disclosed deal value



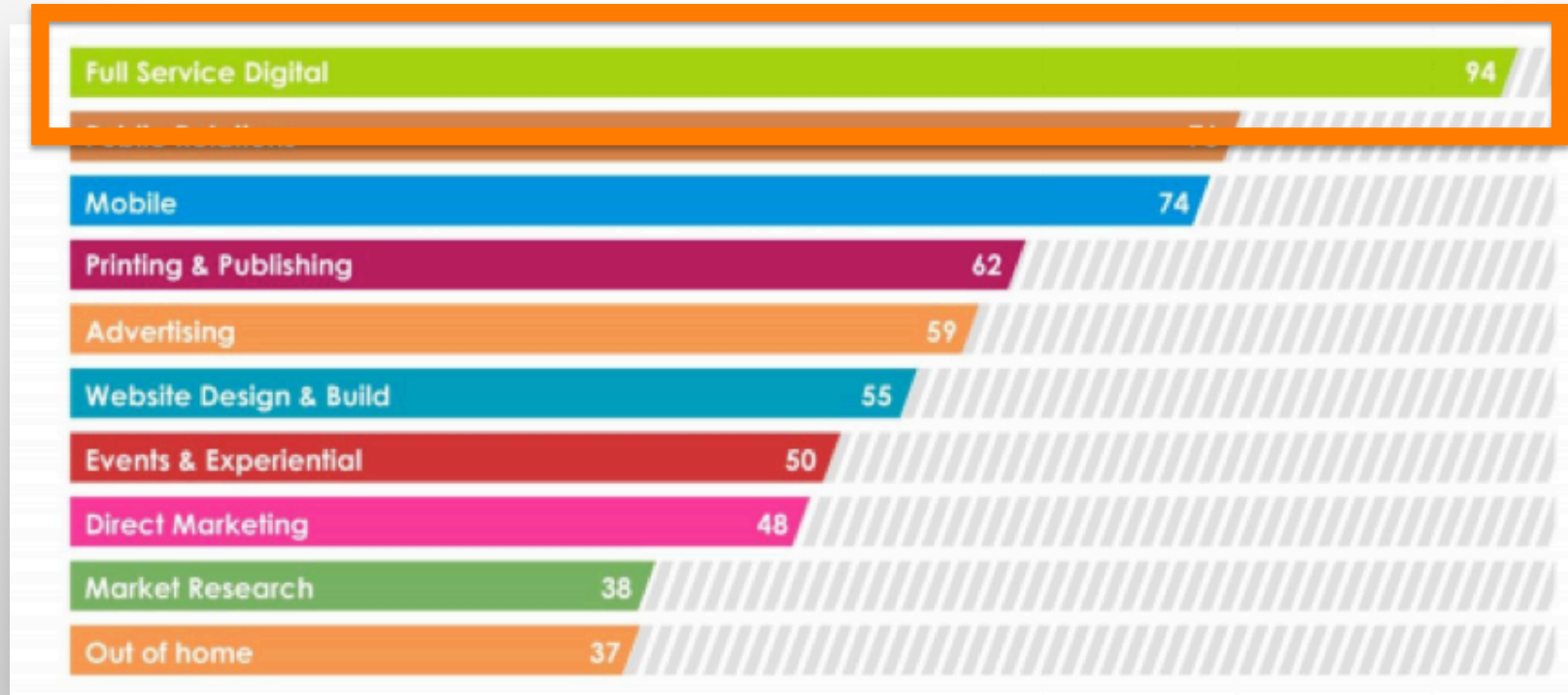
monthly deal volume



top marcoms buyers



Top MarCom Sectors



2 Valuation

What are Buyers Looking For?

- 1 Healthy Margins and Growth
 - 20/20 rule: 20% EBIT margins and 20% annual revenue growth is ideal
- 2 Track Record of Customer Success, Ideally Shared via Clients
- 3 Opportunity to Increase Market Share
 - Consolidation within a market
 - Expansion to a new market
 - Bolstering of functional capabilities

Valuation Range

Varies widely, but primarily driven by EBIT margin and growth

		Revenue Growth				
		15%	20%	25%	30%	40%
Margin	15%	5.0x	6.0x	6.5x	7.0x	7.0x
	20%	6.0x	7.0x	7.5x	8.0x	9.0x
	25%	7.0x	8.0x	8.5x	10.0x	10.0x
	30%	8.0x	9.0x	9.5x	10.0x	11.0x

Typical size for target is \$2M EBIT or \$10M revenue, typically 50 people strong

Courtesy: Results Int.

Valuation: Special Cases

1 Acqui-hires

- Consider typical “hiring cost” for line-level employees – recruiter fees, reduced ramp time, star talent

2 Bankruptcy

- Primarily buying and transitioning clients
- Buy-out can be valued at “acquisition cost” of buyer, or other things such as paying off debt of seller

Non-financial Drivers of Valuation

- 1 Client concentration (the “Goldilocks” rule)
 - Not too large: no client > 20% of revenue
 - Not too small: large in number of clients which drives down margin
- 2 Scarcity of target in particular geo/vertical/function
- 3 Solid succession plan and earn-out model that keeps senior talent on staff for a while

3 The Anatomy of a Transaction

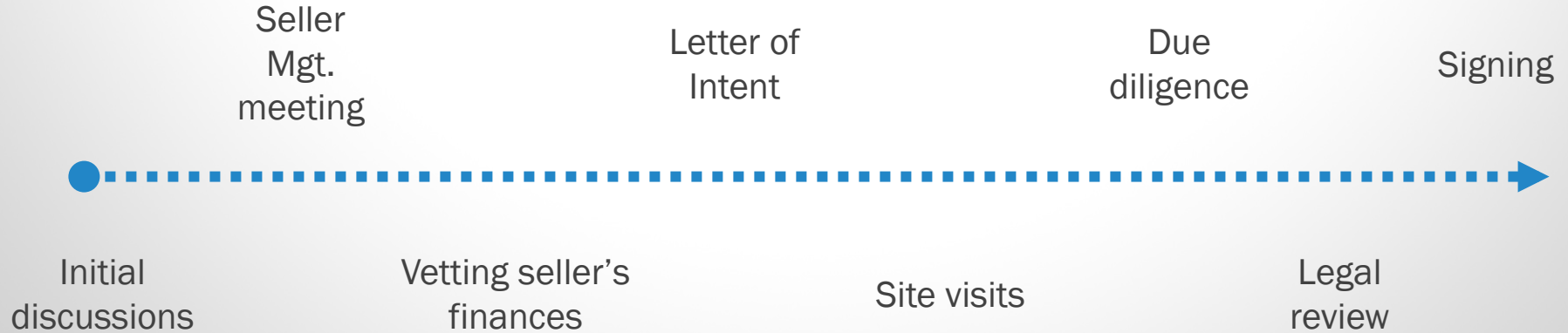
Key Players in a Transaction

1 Financial Advisors and/or Lawyers

2 Fee Structure

- Retainer + % of transaction if deal closes
 - E.g. from Results International: £10-15k/mth for 9 mths max + 3% of deal
- Flat fee per transaction
 - Small scale: e.g. from Tobin Group or Cathedral Consulting: \$4-6k/deal

M&A Process and Timeline



3 – 9 Months for entire process to run

Maintaining Privacy During the Process

1 Avoid Spooking Clients

- Buyer may call a couple of clients but typically not many
- Look at historical payments by long-standing clients as evidence of customer happiness

2 Avoid Worrying Employees

- Except for key employees who likely have an earn-out usually do not disclose discussions under way

Transaction Profiles

- 1 Cash vs. Stock
- 2 Up-front vs. Earn-out over time
- 3 The higher the profitability and certainty of the seller's current assets:
 - Higher % of deal up-front vs. earn-out
 - Higher % of cash vs. stock
- 4 Example transaction
 - 50% up-front, 50% earn-out
 - Earn-out is over 3 year vest of stock granted in buyer's company
 - Earn-out based on hitting upsell targets from acquired client base
 - Earn-out may have minimum value (e.g. a floor that's essentially a salary)

What Happens Post-Sale?

- 1 Notify seller's shareholders of transaction
- 2 Notify employees with detailed transition plans for each
 - Admin staff of seller is often reduced post-acquisition as part of cost-savings
- 3 Contact seller's customers and explain transition process
- 4 Issue PR if necessary

Why M&A transactions fail

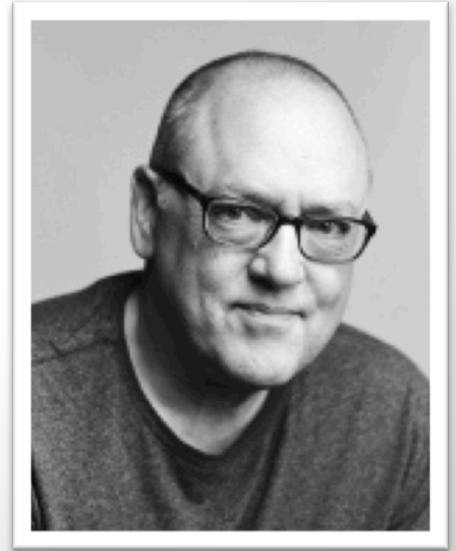
- 60-80% of M&A transactions fail
- Primary reasons for failure
 1. Cultural mismatch - are buyer and seller's teams going to enjoy working together for years to come?
 2. Strategic mismatch - are buyer and seller on same page for why transaction is being done?
 3. Lack of planning – are there clear transition plans that have been communicated to all employees? Have customers been notified with clear plans for each of them?
 4. Overpaying or poorly structuring – is deal price or structure putting too much stress on getting deal to work fast?

Closing the deal is FAR easier than getting the integration to succeed

In closing – don't count on selling your firm

“[An exit] doesn't usually happen. Often the likely buyer is someone in your firm with no money, who wants to use your money to buy you out. If you want to sell, institutionalize your firm. In the process, build a strong retirement fund, assuming you won't sell it. Then try anyway. The value in your business comes from the cash it throws off regularly (and the building you may buy to house it). ”

– David Baker recourses.com
(advised on 750+ transactions)



4 M&A Deep Dives

Deep Dive: Square 2 Marketing & Savvy Panda Transaction



Transaction overview

- Buyer: 60-person agency, 11-yrs old, ~40 clients. \$6M revenue.
- Seller: 6 person agency, ~35 clients. \$0.8M revenue.
- Buyer's motivation: rapid expansion; looking to do 3 acquisitions/year. Looking to bolster web dev. capabilities
- Seller's motivation: merge with established player in space; principal wanted to get out of sales role
- Sourcing: buyer and seller knew each other from Mastermind group
- Price: Combination of up-front and earn-out for principal
- Process: 5 months to close; both buyer and seller had financial consultants and lawyers to advise

Keys to Success

- 1 Matching of buyer's motivation and seller's motivation
- 2 Buyer has structured process to try to convert clients into higher retainer model.
- 3 Buyer runs a tight process which emphasizes both parties spending time with one another, at each other's offices, to feel comfortable with post-sale picture

Deep Dive: Groove & Oomph Transaction



Transaction Overview

- 1 Buyer: 45-person agency, 8-yrs old, ~30 clients
- 2 Seller: 5-person agency, 12-15 clients – only 2 on retainer
- 3 Buyer's motivation: wanted to add branding and traditional media capabilities to add to their strength in Inbound and e-com
- 4 Seller's motivation: principal didn't enjoy running the operations of agency and wanted a more stable income stream
- 5 Sourcing: companies shared incubator space and knew each other in Baltimore agency community
- 6 Price: All-cash deal. 20% up-front; remainder as earn out over 2-5 years
- 7 Process: 6 months to close; only third parties involved was lawyers on either side

Keys to Success

- 1 Matching of buyer's motivation and seller's motivation
- 2 Primarily acqui-hire transaction so aside from structuring principal's earn-out rest of employees came over with modest salary bump
- 3 Upside in potential to upsell seller's accounts but valued at zero

Deep Dive: Blue Frog & eLumina



Transaction Overview

- Buyer: 10-person agency, 5-yrs old, ~50 clients
- Seller: 2-person agency, ~10 clients
- Buyer's motivation: expansion to Denver area where owner has family and wanted to open a second office.
- Seller's motivation: exiting struggling business and taking a regular full-time job
- Sourcing: deal came through as by-product of interviewing employee at seller's firm
- Price: Debt payoff, 50% up-front and 50% after client transition. Finders-fee for future referrals
- Process: 60 days to close; only third party involved was buyer's lawyer

Keys to Success

- 1 Matching of buyer's motivation and seller's motivation
- 2 Buyer's quick recognition of upside hidden in seller's client base
- 3 High degree of trust between two parties and commitment to make transition best for customers. Hence minimal due-diligence and no interaction with customers until transaction closed
 - Lone employee other than owner coming on full-time to buyer so transition even smoother for customers
- 4 No change to customer contracts and perceived excellence of buyer's delivery team so customers happy with change

5 M&A Matchmaking Service

Matching buyers and sellers

- HubSpot partners of any tier who download this M&A deck will see a form which, if filled out, will notify potential buyers of interest in a strategic discussion
- Buyer pool limited to Platinum partners who elect to be part of this program
- Seller may get connected with buyers so they can explore several transaction outcomes
- HubSpot facilitates introduction only (plays no further role in transaction)

Maintaining privacy

- The information provided by sellers on the form is mostly data that can be gathered online
- Only one contact at potential buyers notified
- Notification only mentions interest in “strategic partnership discussions”
- Sellers do not know about any other sellers

QUESTIONS?



<http://bit.ly/hs-merger>

THANK YOU