ADOBE FIGMA DEAL

Introduction

Adobe Inc, one of the largest software companies worldwide, has announced the acquisition of software design start-up Figma Inc in an attempt to expand its online collaboration tools and reach new customers. The deal, which is valued at around $20bn, is a mix of half cash and half stock and will mark the biggest takeover of a private software company.

About ADOBE

Adobe Inc [NASDAQ : ADBE] is one of the world's largest and most diversified software companies and is headquartered in San Jose, California. It provides digital marketing and media solutions through three businesses: Digital Media accounting for 73% of the total revenue, Digital Experience for 24% and Publishing and Advertising for 3%. The first one provides creative cloud services, the second offers products such as analytics, social marketing and targeting, while the Publishing segment combines legacy products and services for eLearning solutions and technical document publishing. Although tools such as Adobe Photoshop and Adobe Illustrator are almost essential for people in the design and marketing industries, users have complained that Adobe's products are difficult to use and lack the collaboration tools that Figma and other platforms offer.

Adobe Inc, which had a market value of about $174bn before the deal announcement, counts more than 26,000 employees and, in the fiscal year 2021, achieved revenues of $15.79bn. Adobe's quarterly results reported a fiscal third-quarter net income of $1.14 bn and revenue of $4.43bn, which was up 13% year-over-year. Nonetheless, the company is having issues adapting rapidly to the new high demand for cloud services. The impact of this delay is reflected by the new annual subscription sales connected to the creative cloud service, which were reported to be lower than the company's projections.

About Figma

Figma Inc is a design platform for teams to build projects together. It is headquartered in San Francisco, California and was founded in 2012 by Dylan Field and Evan Wallace. This web platform allows software developers and designers to collaborate remotely across teams and time zones. Figma's features make the design process faster, more efficient, and more stimulating than other design platforms. Together with Australian start-up Canva, it led a wave of new web browser-based design products that are accessible to millions of non-designers around the world. This allowed the start-up to expand its market and become a potential threat to Adobe, the traditional leader in design software.

The rise of Figma was rapid even for the standards of Silicon Valley. In 2018 the firm was valued privately at $115m, while last year, in another fundraising round, the valuation reached $10bn and Figma received $200m in financing.. This appreciation is impressive because, over the same period of time, the prices of other major technology companies, both private and public, declined. The main explanation behind such a high valuation is that Figma's customer base increased exponentially during the pandemic as people worked remotely. As CEO Dylan Field said, Figma's future target is to reach new markets that have not been addressed yet.

Industry Analysis

Adobe Inc and Figma Inc are key players in the software industry, which includes businesses for software development, maintenance, and publication. The industry can be divided into four main sectors: Programming Services, System Services, Open Source and software as a Service (SaaS). The Programming and System Services sectors have historically been the largest segments and they provide solutions to companies to analyze, store and organize data or supply programs to run machinery. Nowadays, however, the sectors that are experiencing rapid growth are the Open Source and SaaS ones, mainly because of their collaboration features. Open Source software allows developers to access and modify an existing code with the purpose of redistributing it to the cloud for better reusability and accessibility. Finally, Software as a Service (SaaS) has become the most popular sector due to the rise of cloud computing. This software is stored on the creators' servers, and clients can purchase a subscription and access it through the internet. Figma completely reflects the SaaS business model while only some of Adobe's products are considered SaaS. The multinational company is attempting to move further toward cloud-based solutions and the deal with Figma is a clear example.

Differently from other sectors, the software industry has endured the pandemic relatively well. While office closures and stay-at-home restrictions have disrupted many industries, tech businesses emerged from the crisis almost unscathed. This is because lockdowns increased people's daily screen time by a third, and speeded up businesses' adoption of digital technologies by several years. As a result, some segments of the software industry performed better during the pandemic than they were previously. This is also reflected by the spending on digital innovation during the pandemic. According to reports, 70% of businesses in the UK increased or sustained investments in digital technologies and only 19% of them reduced the budget allocated towards digital innovation.

The software industry has reached total revenues of \$593.40bn. As of March 2022, the leader in the industry was Microsoft Corp, with \$192.6bn in revenues and a market capitalization of \$1.94tn. Other important key players in the industry are Oracle Corp, SAP SE, and Adobe Inc. With the rise of cloud computing, the software industry is radically evolving. Today, the Software as a Service sector represents around a third of the overall software market. It is forecast for continuous growth over the next year, expecting a CAGR of almost 11% by 2025. SaaS offers easier implementation and lower total ownership costs compared to traditional models. All the major software powerhouses are slowly adapting to these new changes in demand and technology. For example, in 2021, Oracle Corp offered \$28.3bn to acquire Cerner Corp. Although the deal did not happen, it showed the company's attempt to progress. Similarly, two years ago, International Business Machines Corp acquired Red Hat Inc for around \$34bn to boost its presence in the hybrid cloud market.

Deal structure

On Thursday, 15th September, Adobe announced that it has entered a definitive merger agreement to acquire Figma, in a deal worth roughly \$20bn, at 10 times its valuation in 2019. The deal is half cash, half stock, with Adobe stating that it expects the cash consideration to be financed on hand, or through a term loan, if needed. Roughly 6m additional restricted stock units, with a vesting schedule of 4 years, will be granted to Figma's CEO and employees after the deal's closing, expected to come in 2023.

The acquisition also values the company at 50x EV/ARR, a multiple typically used to value SaaS companies. Figma's annual recurring revenue is forecasted to surpass \$400m by the end of 2022. This valuation would have made sense in the stock boom during the pandemic, at 50x ARR, but multiples for most companies this year have dropped to around 20x, in a period of low M&A levels. For the top cloud companies, tracked by the BVP Nasdaq Emerging Cloud Index, forward multiples are roughly 9x revenue at the moment, down from 25 in February 2021.

The acquisition is forecasted to be dilutive for the first to year, breaking even in year three and subsequently becoming accretive. This will mainly be due to revenue synergies, which will take a while to impact Adobe's growth rate, subject to the speed with which the company manages to create a clear product roadmap and integrate Figma's products. For now, FigJam, one of Figma's most universally appealing offerings, is expected to drive revenue synergies in the short term.

Once the acquisition is complete, Dylan Field, CEO and co-founder of Figma, will maintain his position at the helm of the company, but will report to David Wadhami, president of Adobe's Digital Business.

Deal rationale

The 50x multiple seems astronomical compared to recent transactions, so let us look at the rationale of this deal. Adobe CEO defended the price tag on this deal by saying that through tapping into Figma's capabilities in imaging, 3D, video, browser-based approach and collaborative tools, Adobe will be able to significantly boost its overall market. Figma's customers are currently in the millions, after the company enjoyed a boom during the pandemic and added companies like Twitter, Google, and Netflix to its client portfolio.

There are two main reasons behind this deal, covering both why Adobe bought Figma in the first place, but also why they paid this price tag. The first one is killing the competition, and doing it quickly. Figma makes a collaborative-design workspace that is a direct competitor for Adobe XD, and lately users of the latter have been opting for Figma's platform. That is mainly because Figma has a try-before-you-buy model, allowing individual users to use the platform for free, which means employees of large companies can adopt it without the hassle of getting permission from the IT department. This has hit Adobe's most profitable segment of products, its Creative Cloud, that includes programmes such as Illustrator, Photoshop and XD. Adobe predicts revenues of $150m from this segment, $400m less than forecasted at the start of the year.

This being said, Adobe's only response is a killer merger, a strategy that is typical of industries such as pharma, rather than tech, in which the acquirer buys the target company for the sole purpose of extinguishing the threat posed by it. The company could not afford a radical change in the pricing of its products, as it would have meant risking a sudden decrease in its $7-8bn annual free cash flow. Therefore, it employed a killer merger strategy, which is atypical for tech. The usual trend in M&A done by big tech is acquiring a company and taking advantage of the useful parts, in a way replacing R&D.

So the rationale behind the deal was to extinguish the growing threat that Figma posed, as opposed to having to completely change its pricing strategy. But the unusually large price tag in the current M&A environment is not only due to time pressure, which is the second reason this deal took place. Prior to the acquisition, Figma was courted by the likes of Microsoft, but was also considering going public. The former outcome looked very close to happening and widely predicted by analysts, as Microsoft became one of Figma's largest customers after the company's employees fell victim to the try-before-you-buy model. Furthermore, Danny Rimer, a partner at one of Figma's largest backers, Index Ventures, came forward saying that the company was on track for an IPO. These two pieces of news added further pressure on Adobe to put an offer on the table quickly, and also a sizable one, which was the outcome eventually.

Market reaction

After Adobe (NASDAQ:ABDE) announced its acquisition of Figma, the company's shares closed at $309.13, down 16.8% from the previous day. The drop in stock price wiped roughly $29bn off the company's market cap and pushed the value of the deal to $18.3bn. The announcement came alongside a mixed earnings report for the fourth quarter, with the company reporting earnings of $3.50 per share on sales of $4.52bn, with analysts having forecasted $3.47 a share on $4.6bn revenues. The same happened in the previous quarter, Adobe coming short on analyst's forecasts of revenues ($4.43bn to a forecasted $4.44bn), while beating EPS forecasts ($3.40 to $3.34).

Investors were instantly sent into selling mode for three main reasons. The first is the aforementioned forecast of a dilutive acquisition for the first two years, indicating that Adobe's earnings will take a hit in the short-term. The second is the massive price tag paid by the company, prompting a series of analysts to dub it as a desperate buy in order to stop the momentum that Figma was having. This also came at a questionable time, considering the current harsh macroeconomic conditions and the fact that the company lost more than a third of its value this year. Lastly, a handful of Wall Street analysts had already downgraded Adobe's shares, ahead of the announcement of the deal and the company's quarterly earnings report.

Deal Advisors

Adobe was advised by Allen & Company LLC on the Figma deal, while Wachtel, Lipton, Rosen & Katz acted as a legal advisor on the transaction. The closure of the deal is pending approval of Figma's shareholders and a series of regulatory clearances.

Tags: Adobe, figma, Corporate Finance, Software Industry, Mergers and Acquisition