

MERGERS&ACQUISITIONS

Opinion Why dealmakers like digital marketers and advertising agencies

By Kevin Jolley

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Spending on digital advertising continues to explode, mainly because Americans love their screens. We spend nearly 11 hours a day—more than two-thirds of our time awake—staring into a phone, computer, tablet, wearable device or other screen-based product. Given this attraction (addiction?) digital marketing has become the largest part of many advertisers' budgets.

According to eMarketer, digital ad expenditures surpassed spending on TV ads for the first time in 2016, and strong growth in digital ad spending is expected to continue for the foreseeable future. eMarketer projects that digital spending in the U.S. will continue to experience double-digit growth rates, expanding from an estimated \$83 billion in 2017 to more than \$129 billion in 2021.

The robust growth in digital advertising has supported strong merger and acquisition activity for digital ad agencies, which help clients spend their digital marketing dollars more efficiently.

Interest in acquiring digital agencies is widespread, with global consultancies and private equity firms joining traditional advertising agencies in the hunt for companies that will benefit from the sector's rapid growth.

Traditional agencies, such as WPP and Dentsu, are actively building up their digital capabilities and relationships to garner a larger piece of the ever-expanding digital pie. Already, the biggest advertising agencies have 30 to 40 percent of their revenue coming from digital. That percentage should grow, as traditional media continues to be pushed aside by the digital bully.

Global consultancies such as IBM, Deloitte, PwC, and Accenture, are pushing further into the sector and continue to buy up digital marketing firms. In one recent deal, PwC's digital services division acquired the brand strategy, innovation and digital services business of Stockholm-based consultancy Pond. PwC's acquisition of Pond reflects the trend of consultancies buying marketing firms to add chief marketing officers to their potential client base.

The buying spree makes sense. According to Gartner, marketing budgets continue to rise and the chief marketing officer (CMO) is responsible for an ever-increasing amount of technology spend. In fact, Gartner predicts that "CMO marketing technology spend is on track to exceed overall CIO (chief information officer) technology spend in 2017." With CMOs becoming more prominent, it is logical for large consultancies to broaden their service offerings to capture a portion of expanding marketing budgets.

Private equity is also attracted to the burgeoning digital marketing sector, not only for its rapid growth, but also for its size and fragmentation. According to IBISWorld, the U.S. Digital Advertising Agencies industry generated revenue of approximately \$13.7 billion in 2016 and over 7,200 business participated in the industry. IBISWorld predicts the industry will grow at an average annual rate in excess of 11% through 2021.

As a general rule, private equity firms love to find opportunities to invest in large, fast-growing industry segments that are highly fragmented, which gives them ample opportunity to build a large business

quickly through rapid organic growth and by combining several companies together. Private equity firms such as Baird Capital, BV Investment Partners, Mountaingate Capital, Stagwell Group and Svoboda Capital Partners have invested in digital agencies and others continue to look for their chance to enter this growing, attractive industry segment.

The robust appetite for acquisitions of digital marketing agencies has led to attractive valuations for business owners that sell their companies. Currently, according to various industry analysts and MHT Partners' research, digital agencies tend to garner valuations of 7 to 8 times trailing Ebitda or more. Healthy valuations are expected to continue as strong buyer demand for digital agencies is anticipated to continue in the near term.

Bottom line: Hungry, aggressive acquirers will continue to seek differentiated, high-growth digital agencies as marketing budgets continue to shift towards delivery of personalized advertising to increasingly mobile Americans.

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