

Private Equity Thoma Bravo to Acquire Cybersecurity Vendor Proofpoint for \$12.3B

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“Today’s announcement is a testament to the strength of Proofpoint’s people-centric approach to cybersecurity and compliance and underscores our important role preventing, defending and responding to today’s threats.” - G. Steele, CEO and Chairman of Proofpoint

Deal Overview

- Acquirer: Thoma Bravo, LP
- Target: Proofpoint, Inc. (NASDAQ: PFPT)
- Industry: Cybersecurity, Compliance
- Transaction Amount: \$12.3B
- Announcement Date: Apr. 26, 2021
- Target Advisor: Morgan Stanley Co. LLC

Thoma Bravo is a leading private equity firm focusing on application, infrastructure, and cybersecurity software and technology-enabled business service sectors for enterprises. With the acquisition

of the cybersecurity vendor Proofpoint Inc. (NASDAQ: PFPT), Thoma Bravo is growing its portfolio further in the critical security segment of the business application software sector. The total deal volume of the all-cash transaction amounts to \$12.3 billion, where the shareholders will receive in total \$176.00 per share in cash. The transaction is expected to close in the third quarter of 2021. Consequently, Proofpoint’s common stock will no longer be listed. After the privatization, Proofpoint will continue to provide cybersecurity solutions upholding its leadership position in the industry. Moreover, Proofpoint will utilize the deep sector expertise of Thoma Bravo and will benefit from the operating capabilities and capital support of the successful software investor. Additionally, Thoma Bravo will partner with the firms’ management team to operate in best practice, invest in accretive acquisitions and growth initiatives to increase the revenue and earnings, enhancing the value of the business.

Companies Overview - Acquirer

With over \$76 billion in assets under management as of December 2020, American private equity and growth capital firm Thoma Bravo is a leading player in the software and technology-enabled business service industry with offices in San Francisco, Chicago, and Miami. The firm was founded in 1980 by Stanley Golder and Carl Thoma as Golder Thoma Co, which became Thoma Bravo in 2008 after multiple split-ups and is now led by Carl Thoma, Orlando Bravo, Seth Boro, Scott Crabill, Lee Mitchell, and Holden Spaht. Thoma Bravo continues a longstanding focus on the middle market and is primarily credited for creating a solid and innovative “buy and build” investment strategy. In

addition, the ability to generate competitive first-mover advantages in the software and technology industry for 20 years has contributed to Thoma Bravo’s success and position as a leading player. Considering Thoma Bravo’s most prominent portfolio companies, such as Qlik, Riverbed, Flexera, Sophos, Veracode, a clear focus on infrastructure software and technology-enabled service sectors for corporates is noticeable. With the acquisition of Prophet21, a software provider for durable goods distributors, in 2002, Thoma Bravo started to invest in the software for enterprise sector. Since then, it has acquired a portfolio of over 40 software firms generating annual revenues of more than \$15 billion and over 300 deals worth more than \$85 billion. Forbes valued Thoma Bravo at \$7 billion in 2019, as analyses suggested a promising performance of the firm’s funds in the recent past while returning 30% net annually, 25 investments were sold or listed at \$20 billion since 2015, which represented four times their cost.

Companies Overview – Proofpoint

Proofpoint Inc. (NASDAQ: PFPT) is a leading player in the cybersecurity and compliance sector, implementing an integrated suite of cloud-based solutions helping companies globally to address the entire security segment with the prime focus on reducing cyber threats, regulatory compliance, and brand imposter fraud. Proofpoint was founded in 2002 by the former Netscape Communications CTO Eric Hahn in Sunnyvale, California. After raising a Series A funding of \$7 million, Proofpoint’s first products were released in 2003. Benchmark Capital and Stanford University backed up as investors and later with an additional \$9 million Series B funding

by PRE Ventures. In 2012 Proofpoint became a public traded company with a share price of \$13 and purchases of 6.3 million shares by investors through the IPO, raising \$80 million in capital. Now more than half of the Fortune 1000 organizations rely on Proofpoint's security and compliance solutions for their employees to mitigate critical security risks. According to Gartner Magic Quadrant for Security Awareness Computer-Based Training (CBT) report published in 2020, Proofpoint is ranked as a market leader. It is the only vendor to model their awareness training according to the actual cyberattacks people are receiving.

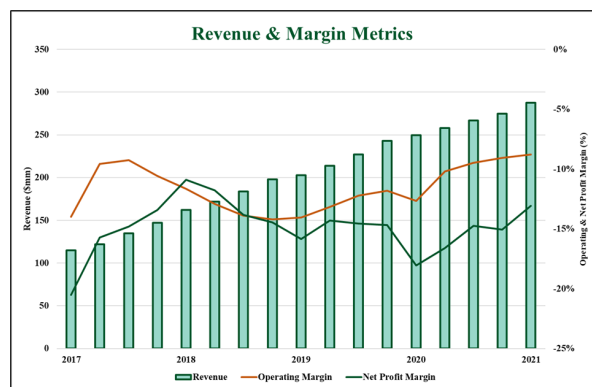


Figure 1: Source: Factset – Own illustration.

From a financial perspective, Proofpoint can sustain a steady increase in revenues for more than a decade. Our analysis shows that a significant contributing factor to the high revenue was the acquisition of multiple companies to offer a broad product portfolio over the last years. In the last decade, the annual average growth of revenues was approximately 32%. There has been a decline in the rate of growth in the previous three years. Until 2019, despite the increase in revenue growth, the

operating margin continued to decline. In 2020 Proofpoint was the first SaaS-based cybersecurity company to generate an annual record revenue of over \$1.01 billion. Despite this record revenue, the net losses accounted for over \$35.1 million in 2020, thus resulting in a continuous negative net profit and operating margin. It continued to be in the negative territory with some improvement in the first quarter of 2021. This has to be juxtaposed with the addressable market of \$13 billion that Proofpoint targeted in 2020.

State of the Industry – Cybersecurity

In the immediate aftermath of the COVID-19 pandemic, the businesses immediately shifted online. The cybersecurity aspect failed to address this transition. As the companies realized now that the trends generated in the immediate aftermath of the pandemic will sustain for a longer time, the secondary impact in terms of the cybersecurity aspects will also be a continued concern. This includes all aspects of cybersecurity, including regulations, reducing digital threats, and phishing attempts. The tech industry accounted for more than 28% of the private equity deals in 2020, demonstrating the sector's vibrancy during the pandemic. Since the beginning of the pandemic, cybersecurity has a high priority for many corporates, especially for the financial services industry, as the shift to remote working involves a higher risk of cyber threats. In the last decade, the demand for cybersecurity-related products boomed with increased cloud services, online transactions, and the fast growth of connected devices. It is necessary for companies to bulk up their cyber protection as the number of new types of cyber threats for the IT infrastructures is steadily

increasing. This leads to the high growth of peers in the cybersecurity industry and a challenging market for Proofpoint. The SaaS-based applications by Proofpoint have minimal operational challenges and low customer onboarding time, making them scalable to demand spikes in this period of uncertainty. The cybersecurity market is an emerging industry sector with several large established players such as Microsoft, Alphabet, etc., having their own cybersecurity divisions and solutions. In the case of the niche players, the revenues and costs, and returns are not financially stable. The Return on Invested Capital (ROIC) of some niche players displays heterogeneous performance, which is typical for an emerging market with several players at an early stage of innovation.

Deal Structure

The total deal volume of the all-cash transaction amounts to \$12.3 billion and is, therefore, the largest private-equity-backed buyout in the software industry. The shareholders will receive in total \$176.00 per share in cash, including a premium of approximately 34% over the closing share price in the last trading day before the announcement and a 36% premium to the volume-weighted average price over the previous twelve months. Proofpoint's share price rocketed over 32% after the announcement of the acquisition. At the Special Meeting of Shareholders regarding the transaction, the shareholders are requested by the Board of Directors to vote for the acquisition. As part of the agreement, Proofpoint can consider alternative proposals from other parties within a time frame of 45 days, expiring on June 9, 2021. However, Proofpoint clearly stated only to use this agreement if the disclosure is appropriate and required. After the closing conditions are

¹Quarterly Revenue and Margin Metrics from 2017-2021

defined, the shareholders approve the acquisition, and all the regulatory approvals, the transaction is expected to close in the third quarter of 2021. Proofpoint will be continuing its headquarters in Sunnyvale, California, and its common stocks will no longer be listed on any public market.

Company	Ticker	ROIC Q2 2021
Proofpoint Inc.	PFPT	-5.41%
NortonLifeLock Inc.	NLOK	13.35%
FireEye	FEYE	-6.38%
VERITAS Technologies LLC.	VRTS	6.11%
Broadcom Inc.	AVGO	11.09%
Mimecast Ltd	MIME	5%
Fortinet Inc.	FTNT	18.49%

Figure 2: Source: Factset – Own illustration.

Potential Risks & Potential Upsides

A decisive factor in evaluating the Proofpoint acquisition by Thoma Bravo is the dimension of the price paid for the acquisition, revenues, future investments to realize synergies, and the addressable market. Thoma Bravo completed the acquisition of RealPage in an all-cash transaction amounting to \$10.2 billion announced on 21st December 2020. This is comparable to the acquisition of Proofpoint at \$12.3 billion, particularly since the 2020 revenue of RealPage at \$1.2 billion compared well with that of Proofpoint at \$1.01 billion. Thoma Bravo has made 46 acquisitions and 39 investments across multiple industries such as Cybersecurity, AI Apps, and Banking Technology. The ability of Proofpoint to benefit from synergies with other previous acquisitions from the operational and the market integration aspects is very limited. The success of this acquisition will be primarily relying on the financial

acumen of Thoma Bravo to address the opportunities in the large cybersecurity market with judicious investments in developing SaaS-based applications. Developing proper cloud cybersecurity on-demand service model promises to address unpredictable scale and demand spikes, mainly since this is an emerging market. However, defining a technological path has its own challenges and may require specialized resources and investments. The approximate RD spend of SaaS vendors in the pre IPO stage is 25% of revenues, with smaller companies even spending much higher around 40%. At the same time, several aspects of cybersecurity are already addressed by major IAAS vendors and Hyper-scalers such as Microsoft. This, in addition to all other niche vendors in the Gartner Magic Quadrant, represents a constant requirement to reinvent and innovate in the medium term. The fundamental justification for the acquisition is the size of the cybersecurity market. The primary inflection point has been COVID-19. According to a UK-based survey, approximately 71% of decision-makers believe that remote working has increased the need for the kind of solutions provided by Proofpoint. The overall market stands at approximately \$173 billion in 2020, which is projected to grow to \$270 billion by 2026, with a large part of spending on externally managed services standing about 77% of the market. This provides a solid bedrock to \$13 billion currently identified of the addressable market of Proofpoint. The success of the acquisition will primarily rely on external factors such as cybersecurity threats and regulations but also on internal factors in the form of agility of Thoma Bravo to invest in niche services with the ability to scale and some first-mover advantage.

²Return of Invested Capital (ROIC) of selected peers in the industry