



Avalara

Avalara (NYSE: AVLK)

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Andrew Cassidy, Brant Hadzima, Brandon Sun, Garrett Sullivan



Core Investment Thesis



Thesis

Avalara (NYSE: AVLR) is a rapidly expanding company positioned to capitalize on new tax code developments by utilizing its strong competitive advantage to aggressively expand into undervalued international and domestic tax compliance markets

1 **Increasingly Complex Tax Codes Increase Need for Tax Automation**

Countries around the world are constantly adopting more complex tax codes, placing pressure on businesses to allocate significant amounts of human and financial capital to remain compliant and avoid penalties

2 **High Barriers to Entry Mitigate Competitive Threats**

Highly sophisticated cloud-based database capabilities offer service packages superior to competitors, creating strong customer relationships and stable recurring revenues

3 **Aggressive Domestic and International Expansion Being Overlooked by the Market**

Through both acquisitions and organic growth, Avalara is expanding its reach into the American tobacco and alcohol industries while pushing to grow international customers in countries possessing complex tax codes

Price Target Downside:

\$63.72

(16%) downside to current price

Price Target Base Case:

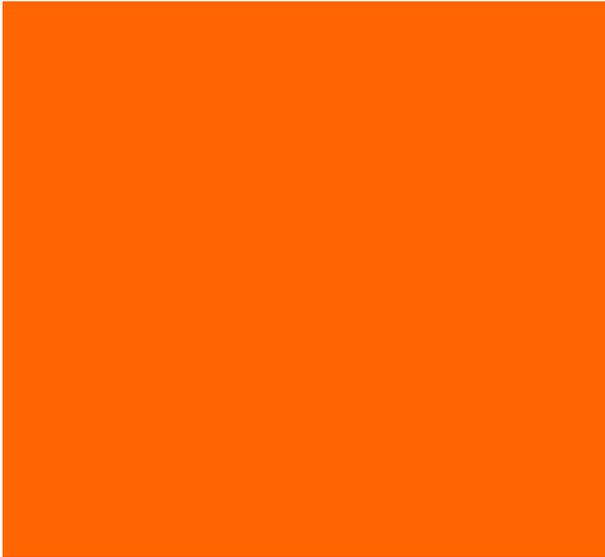
\$96.44

27.2% upside to current price

Price Target Upside:

\$123.44

62.8% upside to current price



- I. **Company & Industry Overview**
- II. Competitive Advantage
- III. Acquisitions & Expansion
- IV. Final Recommendation
- V. Appendix



Company Overview



Avalara (NYSE: AVLR) is a software company for automated taxation compliance headquartered in Seattle, Washington. Avalara provides SaaS solutions for small, midsize, and enterprise organizations.

Company Description

- Founded in 2004 in Seattle by Scott McFarlane Avalara develops **cloud-based taxation compliance technology**
- Avalara **automates the entire filing and remittance process**, while its CertCapture Software manages exemption certificates
- Avalara **seamlessly integrates** within a business and produces the correct sales tax decision on every individual transaction

Documents	Returns	Calculations
Fiscal	Insights	Licenses

Managing Team



Scott McFarlane - *Co-Founder and CEO*

- Scott has previously launched LifeCycle, one of the most popular computerized exercise bikes on the market



Ross Tennenbaum – *CFO*

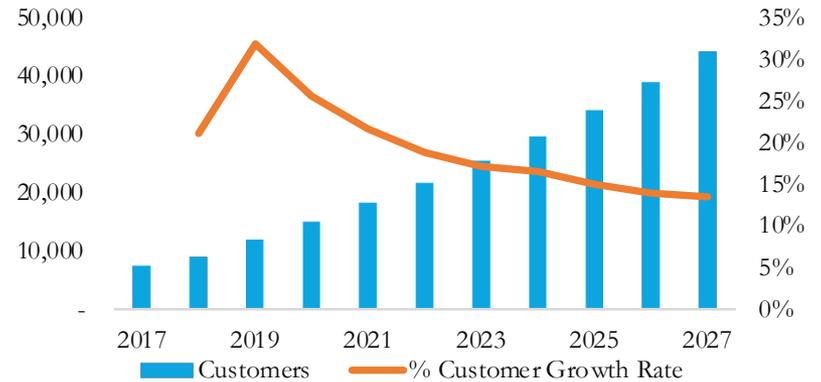
- Ross was previously a managing director in the TMT division of Goldman Sachs.



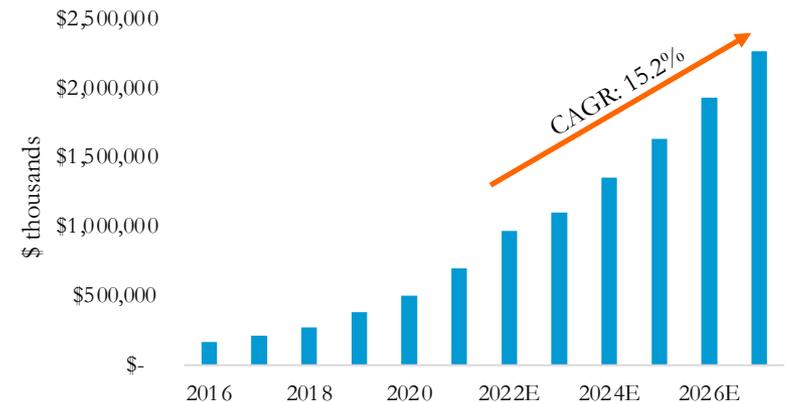
Amit Mathradas - *President and COO* of Avalara.

- Actively manages growth operations while overseeing sales, marketing, business development, customer experience, and professional services.

Growth in Customers

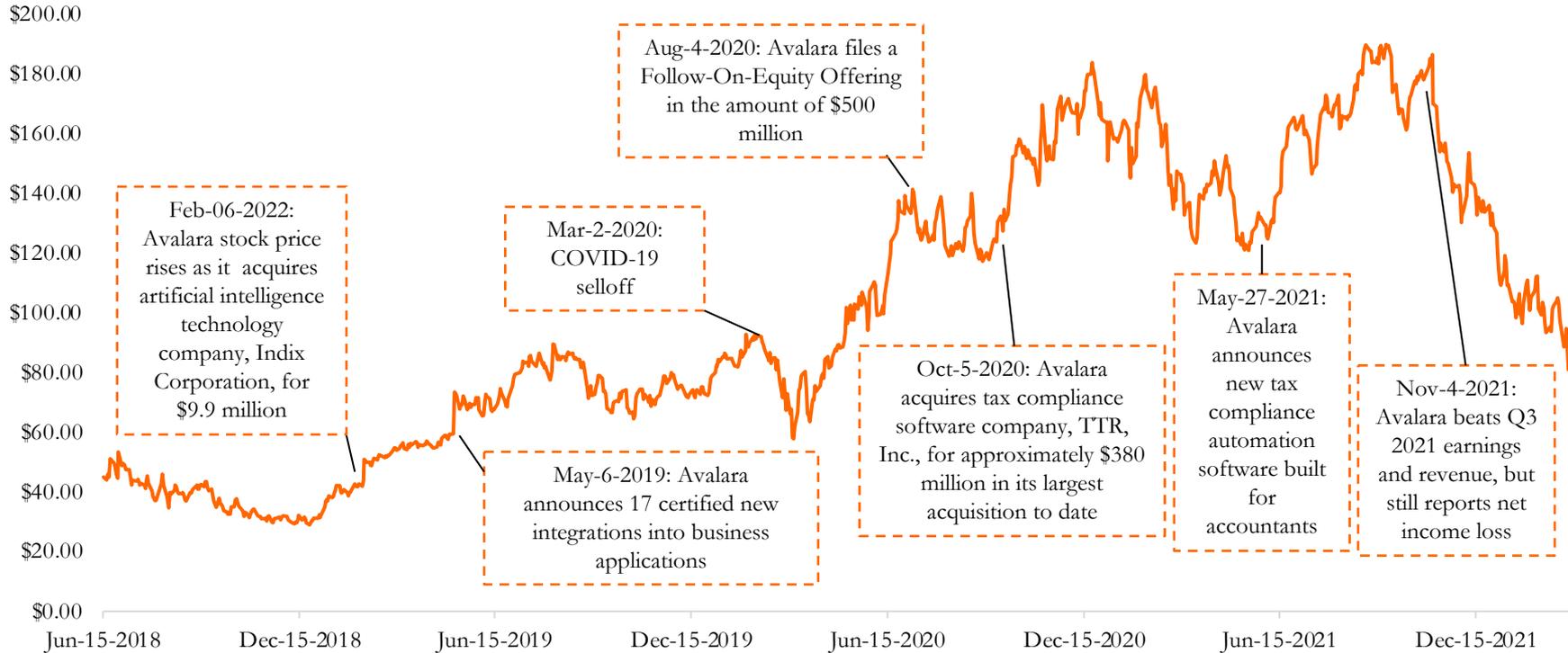


Company Revenue





Annotated Stock Chart



Commentary

Prior to its IPO in June of 2018, Avalara had aggressively pursued tax compliance software development and integration but **had limited industry coverage and was very localized**

Avalara has become a **leader in a market still adopting to tax compliance automation** technology. As businesses embrace omnichannel models, expand to new jurisdictions, and shift to e-commerce operations, Avalara is **uniquely positioned to provide businesses with the tax compliance automation needed** to adjust to the ever-changing regulatory environment.

Since November 2021, Avalara has seen its stock price plummet. Investors are mainly concerned about profitability and the viability of the company's international expansion plan due to macroeconomic uncertainty



Tax Management Software Industry Overview



The tax management software industry maintains positive outlook as governments continue to shift towards more complex tax codes and live reporting requirements to gain greater transparency into future tax revenue streams

Major Players



THOMSON REUTERS

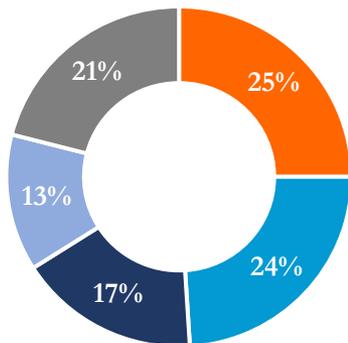
- Thomson Reuters targets accounting firms, providing **tax compliance and data collection services**
- Prepares and reviews **tax statements**, ensuring accuracy and preventing corporate tax penalties



- Vertex offers **tax determination, tax data insights, and compliance reporting services**
- Targets both **small e-commerce and large cap corporations**

Because of Avalara's comprehensive database they have built over the past decade, competitors are not able to enter the sales tax compliance space without significant human and capital investment

Industry Segmentation



Banking, financial services, and insurance has consistently held the largest share of industry revenues at 25%

The growth of e-commerce projects substantial retail segment expansion, led by small sized business owners

■ BFSI ■ Manufacturing ■ Retail ■ Healthcare ■ Other

Industry Headwinds & Tailwinds

Headwinds

Increasingly complex global tax codes require costly software development

Data security concerns due to inherently sensitive information

Difficulty acquiring talent in tax compliant software development

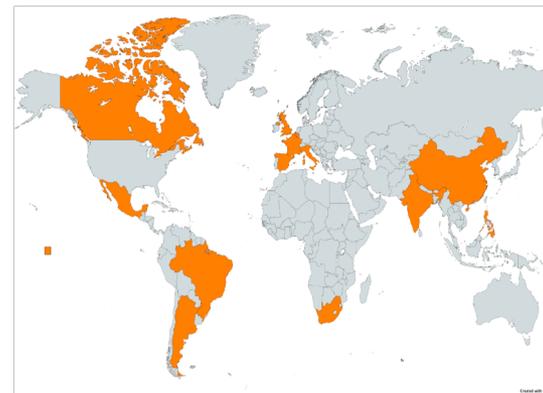
Tailwinds

Governmental requirements for more transparent tax reporting measures

Increasing complexity of global corporate tax laws

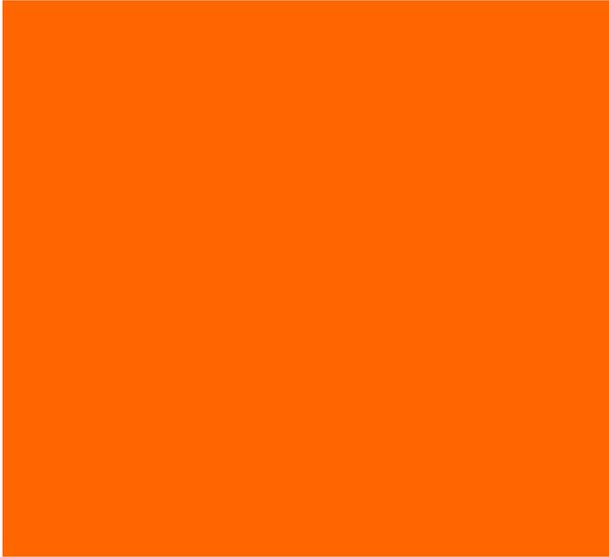
Small and mid-sized businesses adopting online tax solutions

Industry Expansion



The industry is rapidly expanding globally, targeting markets that possess highly complex tax codes

Brazil and India are among the countries where the industry has grown quickest



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Increasing Complexity of Tax Code Regulations



Transaction tax regulations change frequently and are far from intuitive or consistent across jurisdictions. Taxation requirements are only increasing in complexity as products and technology evolve

Regulation Environment

- Over 11,000 sales tax jurisdictions in the United States
- The average cost of an audit for a business can be tens of thousands of dollars in unpaid tax, penalties, and interest.
- Most Emerging small businesses devote **131 hours** equating to **\$11,968 per month** on sales and use tax compliance
- Similarly Midsize business spend **163 hours** and **\$17,672** monthly

Taxation Types Covered By Avalara

Sales and Use

Consumer Use

International

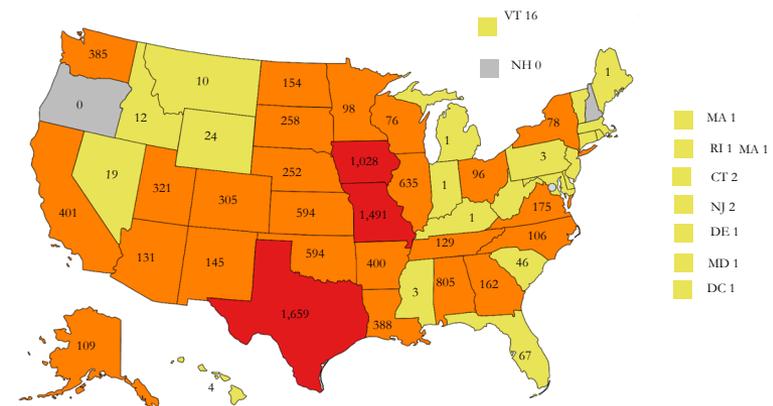
Sales Tax Vs. Communication Tax

- Avalara provides simple and innovative solutions for both sales tax and communications tax.
- Communication tax refers to the variety of taxes imposed at the federal, state, and municipal level and ranges from telecommunication services to streaming services.
- Three broad types of services which encompass commutation tax include **Voice, Video, and Tech.**
- Communications tax, presents various opportunities for complicated mathematical equations and are which are highly error-prone if not automated.
- Companies working with **VPNs, web hosting, and the internet**, are all exposed to communication tax.

Tax Complexity Examples

- New York:** A bagel is taxed differently if it is “altered”; some examples include being sliced, toasted, or having cream cheese
- Kansas:** There is a tax for amusement rides that are tethered to the ground yet unattached rides (Go-Kart and Hot Air Balloons qualify as transportation and tax exempt)
- Illinois:** Charges a 5% tax on candy on top of the 1% food tax and the 5% tax is exempt for candy containing flour (Kit Kats & Twix)
- New Mexico:** If someone is over 100 years old, they are exempt from paying state taxes, provided they meet residency requirements.

Sales Tax Jurisdictions by State - 2020





Proprietary Cloud-Based Computing Technology



Avalara's cloud-based technology, bolstered by artificial intelligence, provides a unique advantage for ease of use, integrating across platforms, and quickly adapting databases with changes to tax information in real time

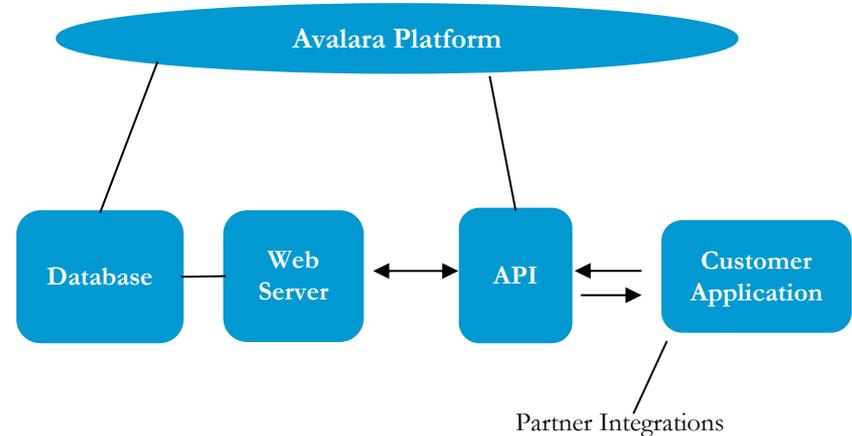
Avalara Compliance Cloud

- Avalara Compliance Cloud is a **multi-product suite of cloud-based solutions** for a variety of transaction tax and compliance requirements
- Combines an **advanced content database with technology** for executing compliance processes, determining taxes, aggregating data, preparing tax returns, filing, and remittance
- Integrates seamlessly with business applications used by customers**, reducing the need for custom configurations and ongoing oversight
- Cloud architecture **automatically applies tax content updates** when called by customers' applications
- Web-based console **simplifies configurations and unifies processes across multiple applications**

Key Product Strengths

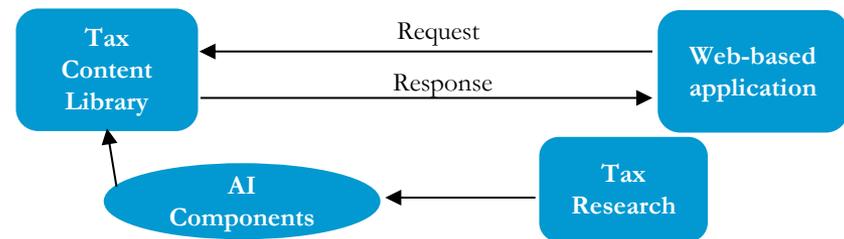
- Easy Setup and Use** Solutions are connected to a wide range of leading business applications for fast and easy deployment, eliminating the need for custom implementation and minimize day-to-day operating and maintenance tasks
- Reliable Platform** Underlying cloud infrastructure scales with customer growth as customers can rely on pre-built software integrations and flexible APIs, and collects and structures up to date content, making integration easy across multiple software platforms
- Broad Array of Solutions** Avalara products cover a range of tax content and documentation for a wide variety of business applications, requiring lower upfront and ongoing costs and eliminating the need for a patchwork of solutions

How Avalara Technology Works



Artificial Intelligence

- Avalara leverages AI and machine learning to improve efficiency
- Technology acquired via Indix acquisition maps product codes to tax decisions, an otherwise highly labor-intensive process
- AI technology continually updates the library of tax data for millions of UPCs in real time





Competitive Advantage



In a competitive environment that favors cloud-based and automation-focused firms, Avalara hold a significant advantage over competitors due to its information advantage, technological moat, and robust partnership structure

Competitive Landscape

Increasing Regulatory Challenges

Transaction taxes for online merchants becoming increasingly complex following South Dakota v. Wayfair (2018) with constant new requirements increasing the need for automated solutions

E-commerce is Driving Complexity

Adoption of online shopping has accelerated due to the COVID-19 pandemic, and commerce across jurisdictions introduces new challenges as the tax compliance burden falls on the seller

Reliance on Suboptimal Solutions

Most businesses rely on rudimentary tax solutions or try to handle transaction taxes manually, and the space of firms that support transaction tax compliance is highly fragmented

Technology Moat

Efficiency

Comprehensive cloud-centric product enables automation and efficient processing

Precision

Geolocation algorithms accurately and reliably apply relevant local tax information

Customization

Administrative console allows for company-specific configuration

Scalability

Customer's can manage compliance from a single point that scales as their needs grow

Information Edge

- Avalara has combined and expanded massive content libraries of statutory tax data that link products to taxability rules
- A large team of tax research analysts assists in continually editing, validating, and applying updates to the proprietary tax database
- The company has used acquisitions as well as internal development to build out its databases, research, and documentation capabilities
- Avalara also holds an extensive library of tax forms for local, regional, state, and national tax returns, tax exemption certificates, VAT and GST invoices, and business license and registration



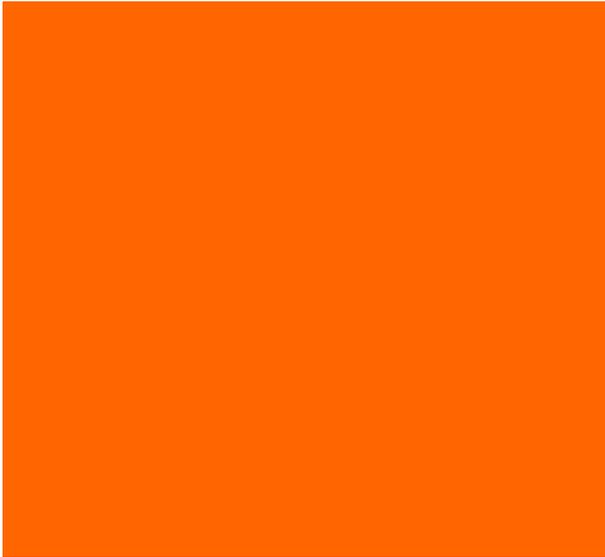
ttr
Get tax right.



Partnership Advantage

- Integrations with some of the most popular enterprise software platforms such as Sage, QuickBooks, and Magento aid in ease-of-use for Avalara products
- Allows for easy management of rules and offloading of manual assessment of use tax
- The Avalara partnership ecosystem encompasses firms in every stage and aspect transactions
- Partner companies include technology partners, systems integrators, and accounting firms
- There are multiple ways to interact with Avalara for partner firms that align the goals of both companies





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Key Acquisitions and Timeline



Avalara's aggressive acquisition strategy has allowed it to rapidly expand its cloud-based services into new markets and establish itself as a pioneer in the emerging tax automation industry

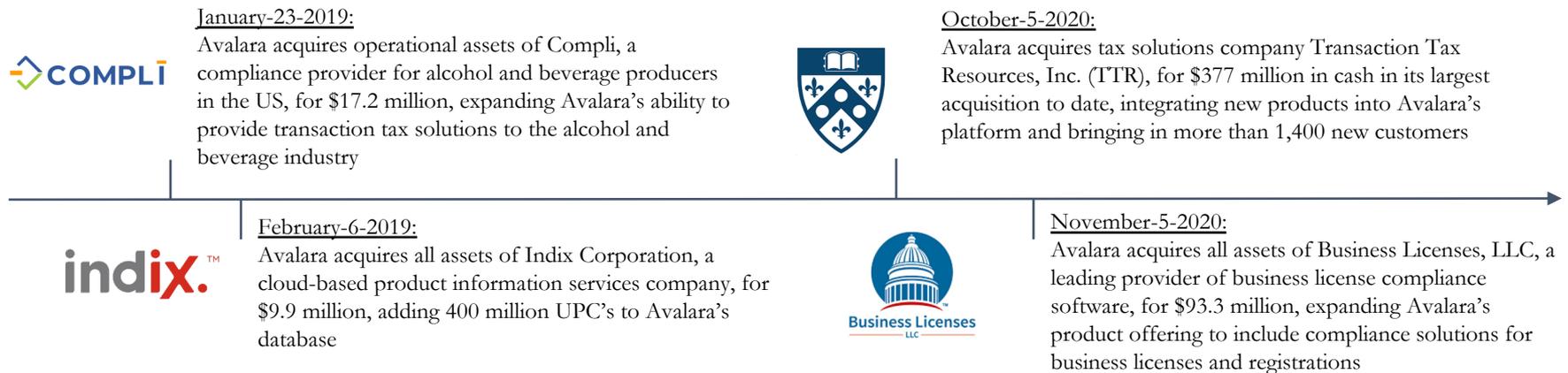
Acquisition Growth Strategy

- Since Avalara's inception in 2004, **M&A has become a key part of Avalara's long-term strategic growth strategy** and has helped accelerate the company's vision of becoming a global compliance platform
- Avalara has taken significant steps to grow its database and services **through the acquisition of talent, additional content, and new technology in its acquisitions**
- Avalara announced and completed about **three acquisitions a year since 2018**, with a record six acquisitions completed during 2021

Impact of Acquisitions

- New acquisitions have allowed Avalara to **increase its strategic partner network** and introduce **AI and machine learning for efficiency improvement**
- Avalara has been able to **successfully integrate these acquisitions into their platform**, allowing the company to **extend its services into new industries and geographic locations**
- Inorganic growth from 2020 **acquisitions of TTR and Business Licenses played a major role in the 40% YoY growth in revenue** during fiscal year 2021

Timeline of Key Acquisitions Since IPO





Expansion Into New Markets



Avalara has aggressively entered new markets possessing complex tax codes and minimal software compliance capabilities, diversifying its revenue streams and strengthening both domestic and international company outlook

Expansion Into Brazil & India



- Brazil possesses one of the **most complicated tax codes in the world**, with an annual **tax compliance burden of 2,600 hours, 8x greater than the US or EU**
- Companies are required to **upload digital records of every transaction** to a government tax system



- India's new **Goods & Services Tax (GST)** added **complicated layers of tax refunds, slabs, and loopholes** that vary among states
- India's E-Way bill **mandates registration of all interstate and intrastate movements of goods** to a tax compliance system

Alcohol & Tobacco Taxation Services

Alcohol Tax Compliance

Alcohol is taxed differently at the federal, state, county, and city

Avalara streamlines sales, use, excise, and markup taxes

Avalara AvaTax Excise constantly updates tax rates and regulatory changes

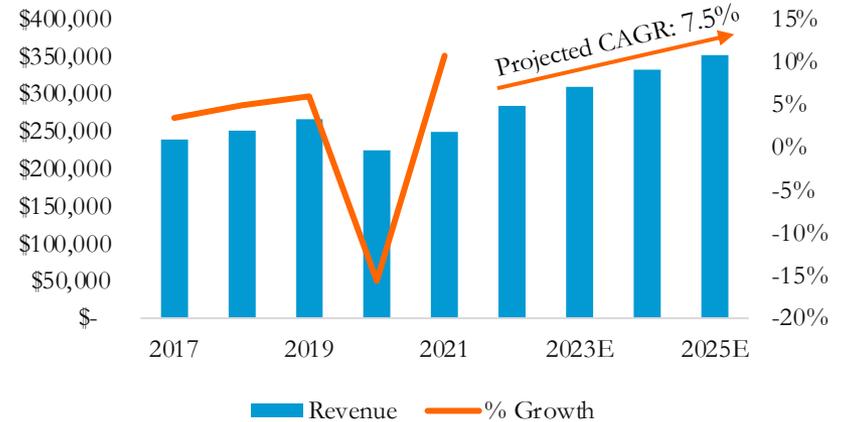
Tobacco Tax Compliance

Tobacco tax is complex, with distinct codes for product flavors

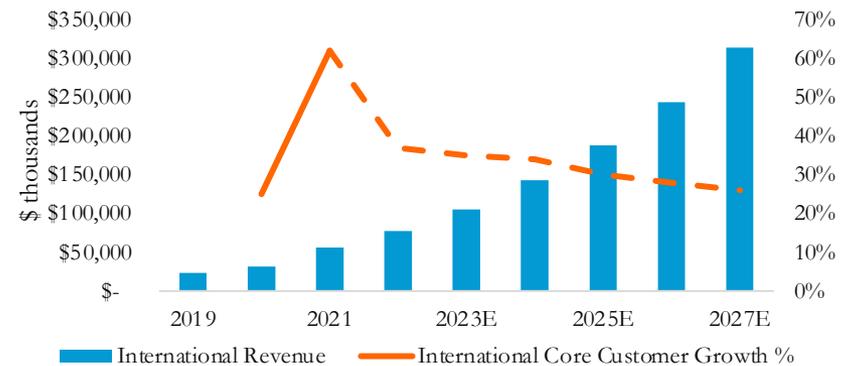
Avalara License Management simplifies complex licensing

Avalara streamlines filings for returns on tobacco and vape excise taxes

United States Alcohol Industry Growth (\$mm)



International Revenues

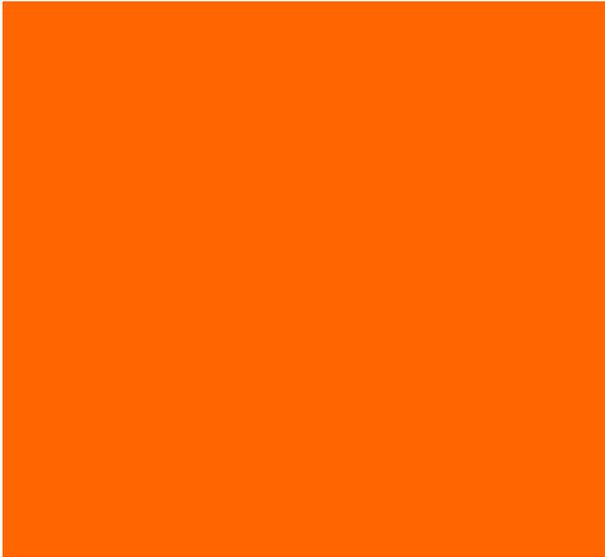




Risks and Mitigations



Potential Risks	Mitigations
Reliance on Third Parties	No single third-party provider is critical to Avalara's ability to provide its services, with the influence of third parties being spread out across different levels of the software platform and data centers
Highly Fragmented Market	Avalara's competitive moat is unmatched within the industry, limiting the ability of its peers to push down prices or poach customers
Cyberattacks and Fraud	The company has made, and continues to make, significant investments into preventing unauthorized access to information and funds as well as remediating cyber threats when they appear
High CAC for Enterprise Customers	Larger, more complex businesses provide much higher sales transaction volume despite greater costs in selling to and acquiring these customers



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- VI. Appendix



Final Recommendation



Avalara

Price Target Downside:

\$63.72

(16%) downside to current price

Price Target Base Case:

\$92.83

22.4% upside to current price

Price Target Upside:

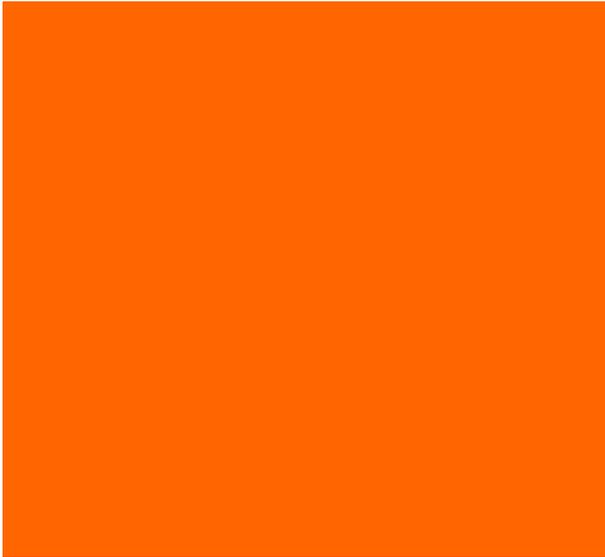
\$123.44

62.8% upside to current price

BUY

Recommendation: Avalara (NYSE: AVLR) stands to realize strong, unrivaled revenue growth as they expand their highly specialized product into new domestic and international markets. In a time when tax codes around the world are increasing in complexity by the day, Avalara serves as a necessary tool for businesses of all sizes. For this reason, we recommend that the Investment Club initiate a position in Avalara immediately.

Catalysts: Companies in markets characterized by high tax compliance requirements are seeking ways to mitigate the compliance burden, while increasing tax reporting requirements and complexities create a growing necessity to use Avalara's services. Additionally, Avalara has aggressively expanded their international footprint, forming relationships with many small but growing businesses; as these businesses grow and Avalara's footprint expands, the company's international revenues will grow significantly.



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DCF Output - Base



For the Fiscal Period Ending	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027
Total Revenue	167	213	272	382	501	699	907	1,142	1,381	1,616	1,829	2,037
Revenue growth		27.3%	27.7%	40.5%	30.9%	39.6%	29.8%	25.9%	20.9%	17.0%	13.2%	11.4%
Cost Of Goods Sold	49	58	79	115	143	205	263	320	373	428	475	509
Gross Profit	119	155	193	267	357	494	644	822	1,008	1,187	1,353	1,528
Selling General & Admin Exp.	139	168	208	241	296	432	544	651	746	824	878	917
R & D Exp.	33	41	52	82	120	167	181	194	207	226	238	204
Depreciation & Amort.	10	11	13	16	20	37	41	51	63	76	84	93
Other Operating Expense/(Income)	-	-	-	-	-	-	-	-	-	-	-	-
Other Operating Exp., Total	182	220	273	339	436	636	767	896	1,016	1,126	1,199	1,214
EBIT	(63)	(65)	(80)	(72)	(78)	(142)	(123)	(74)	(8)	61	154	314
Note: EBITDA	(53)	(54)	(67)	(56)	(58)	(106)	(82)	(23)	55	137	238	407
Less Taxes	1	(1)	(1)	1	(8)	3	2	1	1	3	6	10
NOPAT	(64)	(64)	(79)	(73)	(70)	(145)	(125)	(75)	(9)	58	148	304
Plus Depreciation & Amort.	10	11	13	16	20	37	41	51	63	76	84	93
Less Capital Expenditures	(7)	(14)	(14)	(8)	(5)	(8)	(29)	(29)	(27)	(31)	(39)	(48)
Less Change in NWC	-	22	32	51	52	86	(250)	54	58	77	120	153
Unlevered FCF	(60)	(45)	(48)	(14)	(2)	(31)	(362)	2	85	180	313	503
Stub	1.00	1.00	1.00	1.00	1.00	1.00	0.80	1.00	1.00	1.00	1.00	1.00
Unlevered FCF after Annual Adjustment	(60)	(45)	(48)	(14)	(2)	(31)	(289)	2	85	180	313	503
Discounting Factor							0.75	1.75	2.75	3.75	4.75	5.75
Discounted Cash Flows							(267)	1	64	122	191	276

Terminal Value: PGR

2027 Unlevered FCF	823
Perpetual Growth Rate	4.0%
Implied 2028 Unlevered FCF	856
WACC	11.0%
Terminal Value (as of 2027)	12,216
Discounting Factor	5.75
Discounted Terminal Value	6,700
Implied EV/2027 EBITDA	13.5x

Terminal Value: EV/Revenue

2027 Revenue	2,263
EV/LTM Revenue	5.0x
Implied 2027 EV	11,315
WACC	11.0%
Discounting Factor	5.75
Discounted Terminal Value	6,206

Enterprise Value and Equity Value

	PGR	EV/Revenue
Sum of Discounted Cash Flows (2022-2027)	1,279	1,279
Discounted Terminal Value	6,700	6,206
Enterprise Value	7,979	7,485
Less Debt	(1,018)	(1,018)
Plus Cash, Short Term Investments	1,277	1,277
Equity Value	8,237	7,743
Weighted Average Diluted Shares Outstanding (mm)	86.1	86.1
SHARE PRICE	\$95.70	\$89.96
Current share price	\$75.84	\$75.84
Upside/downside	26.2%	18.6%

Blended Share Price

	PGR	EV/Revenue
SHARE PRICE	\$95.70	\$89.96
Current share price	\$75.84	\$75.84
Upside/downside	26.2%	18.6%
Weight	50.0%	50.0%
Blended Share Price	\$92.83	\$92.83
Upside/downside		22.4%



Revenue Assumptions



For the Fiscal Period Ending	2022E	2023E	2024E	2025E	2026E	2027E	Notes
<i>\$ in thousands, unless per share data</i>							
Revenue							
U.S. Core Customers							
Historical Core Customer Growth %							
Base	14.0%	13.0%	12.5%	11.0%	10.0%	9.0%	Growth based on historical numbers and management estimates. Historical growth domestically begins to taper off as market saturation is reached and marketing is focused internationally
Bull	18.0%	16.0%	14.0%	12.0%	12.0%	10.0%	
Bear	16.0%	15.0%	13.0%	11.0%	9.0%	7.0%	
U.S. Core Customer Count							
Historical U.S. Core Customers							
Base	19,162	21,653	24,359	27,039	29,743	32,419	
Bull	19,834	23,007	26,228	29,376	32,901	36,191	
Bear	19,498	22,422	25,337	28,124	30,656	32,802	
Unit Revenue (U.S. Core Customers)							
Historical U.S. Core Unit Revenue							
Base	42.1	46.1	49.8	53.5	56.7	60.1	We're assuming that United States unit revenue steadily increases as companies scale, bringing in more revenue for Avalara based on their volume pricing model
Bull	43.2	48.0	52.8	57.5	61.6	65.9	
Bear	42.5	46.3	49.5	52.0	54.1	56.3	
Unit Revenue % Growth (U.S. Core Customers)							
Historical Unit Revenue Growth %							
Base	10.0%	9.5%	8.0%	7.5%	6.0%	6.0%	Unit revenue will continue to increase slightly as growing segments (alcohol and tobacco) realize higher pricing due to volume
Bull	13.0%	11.0%	10.0%	9.0%	7.0%	7.0%	
Bear	11.0%	9.0%	7.0%	5.0%	4.0%	4.0%	



Revenue Assumptions (Continued)



For the Fiscal Period Ending	2022E	2023E	2024E	2025E	2026E	2027E
US Total Revenue						
Historical U.S. Total Revenue	\$ 806,489	\$ 997,909	\$ 1,212,459	\$ 1,446,767	\$ 1,686,930	\$ 1,949,079
Base	\$ 857,554	\$ 1,104,186	\$ 1,384,649	\$ 1,690,380	\$ 2,025,751	\$ 2,384,309
Bull	\$ 828,098	\$ 1,038,021	\$ 1,255,071	\$ 1,462,785	\$ 1,658,213	\$ 1,845,260
Bear						
International Core Customers						
Historical Core Customer Growth %	37%	35%	34%	30%	28%	26%
Base	47%	45%	41%	40%	35%	32%
Bull	40%	30%	20%	15%	10%	10%
Bear						
International Core Customer Count						
Historical International Core Customers						
Base	2,002	2,703	3,622	4,709	6,028	7,595
Bull	2,149	3,115	4,393	6,150	8,302	10,959
Bear	2,046	2,660	3,192	3,671	4,038	4,442
Unit Revenue (International)						
Historical International Unit Revenue						
Base	38.7	39.1	39.5	39.9	40.5	41.3
Bull	38.7	39.1	39.5	39.9	40.5	41.3
Bear	38.7	39.1	39.5	41.6	42.3	43.2

Strong growth in international customers as the company seeks to expand through aggressive M&A and advertising. 2021 was the first year the company did a strong focus on int. expansion.



Revenue Assumptions (Continued)



For the Fiscal Period Ending	2022E	2023E	2024E	2025E	2026E	2027E
Unit Revenue % Growth (International)						
Historical Unit Revenue % Growth	3.0%	2.0%	1.0%	1.0%	1.5%	2.1%
Base	4.0%	3.0%	2.0%	1.0%	1.5%	2.1%
Bull	2.0%	1.5%	1.0%	5.4%	1.5%	2.1%
Bear						
Total International Revenue						
Historical International Revenue						
Base	\$ 77,397	\$ 105,620	\$ 143,006	\$ 187,811	\$ 244,013	\$ 314,015
Bull	\$ 83,046	\$ 121,724	\$ 173,420	\$ 245,274	\$ 336,098	\$ 453,114
Bear	\$ 79,091	\$ 103,936	\$ 126,022	\$ 152,803	\$ 170,610	\$ 191,675
Total Revenue						
Historical Total Revenue						
Base	\$ 968,741	\$ 1,103,529	\$ 1,355,465	\$ 1,634,578	\$ 1,930,943	\$ 2,263,095
Bull	\$ 940,599	\$ 1,225,910	\$ 1,558,069	\$ 1,935,654	\$ 2,361,849	\$ 2,837,423
Bear	\$ 907,189	\$ 1,141,956	\$ 1,381,093	\$ 1,615,588	\$ 1,828,824	\$ 2,036,935
Gross Margin						
Historical Gross Margin %						
Base	70%	70%	68%	68%	66%	66%
Bull	70%	70%	71%	72%	73%	74%
Bear	68%	65%	62%	59%	56%	53%

Unit revenue for international core customers does not scale like it does with U.S. unit revenue since Avalara will focus on small/midsized companies internationally. This will hold the

Avalara has minimal COGS, thus we don't see large fluctuations in their gross margins going forward



DCF – Income Statement Assumptions



Base

Income Statement Drivers	2022E	2023E	2024E	2025E	2026E	2027E
Total Revenue	968.7	1103.5	1355.5	1634.6	1930.9	2263.1
% Growth	38.6%	13.9%	22.8%	20.6%	18.1%	17.2%
COGS % of Total Revenue 1	29.0%	28.0%	27.0%	26.5%	26.0%	25.0%
Gross Profit Margin %	71.0%	72.0%	73.0%	73.5%	74.0%	75.0%
SG&A % of Total Revenue 2	50%	45%	40%	35%	30%	25%
3 R&D % of Total Revenue	20.0%	17.0%	15.0%	14.0%	13.0%	10.0%
D&A % of Total Revenue	4.5%	4.5%	4.6%	4.7%	4.6%	4.6%
Other Operating Exp. % of Total Revenue	70.0%	62.0%	55.0%	49.0%	43.0%	35.0%
Interest Expense % of Total Revenue	0.3%	0.3%	0.3%	0.3%	0.3%	0.3%
Other Income % of Total Revenue	-	-	-	-	-	-
Effective Tax Rate	2.5%	2.5%	2.5%	2.5%	2.5%	2.5%

- 1**
 - COGS as a percentage of revenue is projected to decrease due to majority of COGS being fixed expenses
- 2**
 - Avalara is currently focusing on market penetration in international regions such as India and Brazil, which has led to large expenses from advertisements
 - SG&A has historically remained relatively flat at around \$300mm, however, it increased in 2021 as the company moved its focus to international expansion. We believe SG&A will stay consistent with 2021 levels, and its percentage of a revenue will decrease as a result in coming years
- 3**
 - Avalara’s R&D as a percentage of revenue is also projected to decrease as future software development will likely be driven by acquisitions rather than internal R&D