LUMA digital marketing summit

STATE of DIGITAL MARKETING 2023

LUMA is pleased to present its 2023 State of Digital Marketing report.

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AGENDA

- PREAMBLE
- MARKETS
- MARTECH TRENDS
- ARTIFICIAL INTELLIGENCE

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PREAMBLE

A few overarching observations and some news before we delve into specific trends and market discussion.

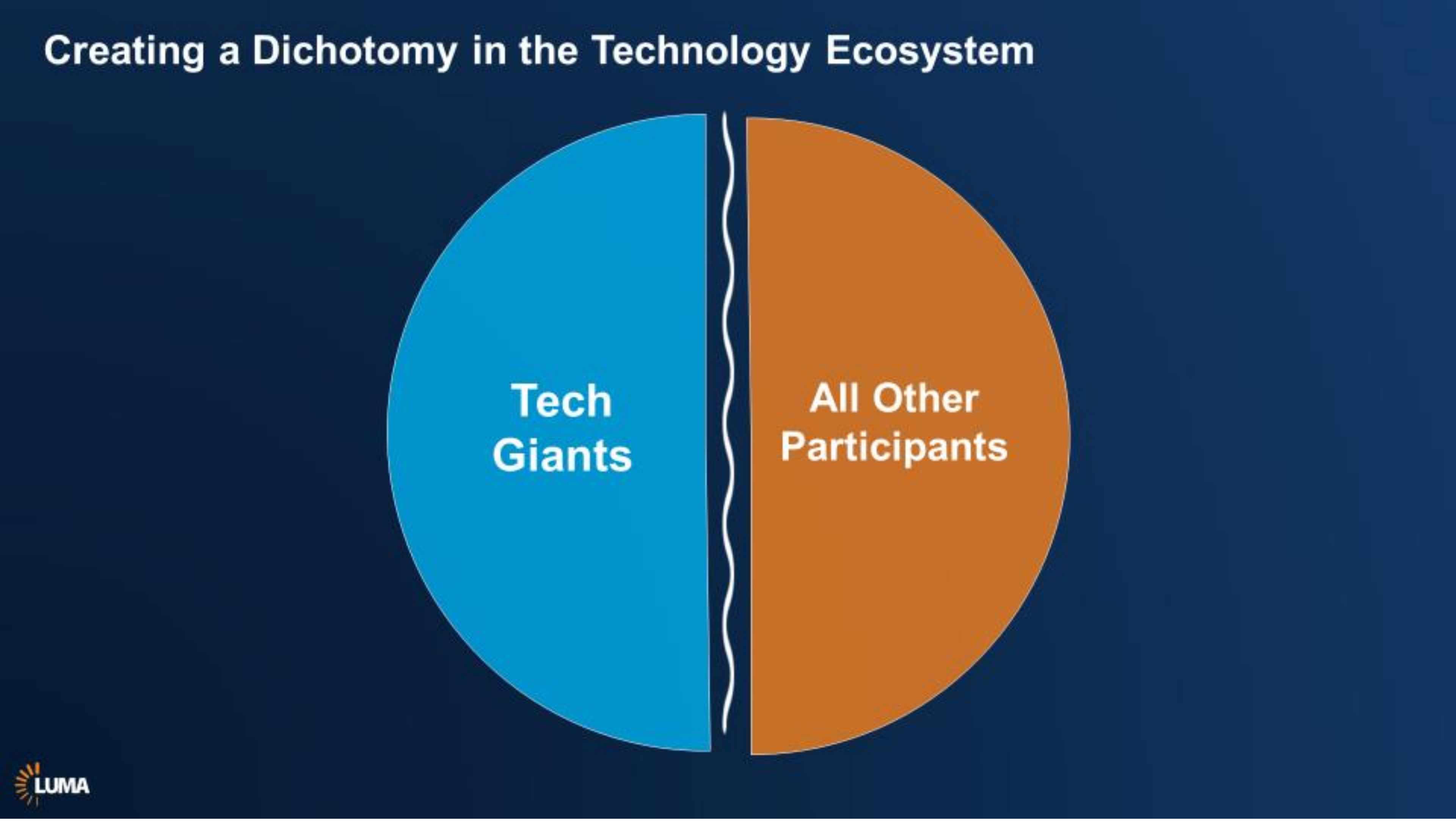
There is a pervasive air of uncertainty in the markets deriving from three areas:

Macro – There are two major conflicts occurring in Ukraine and Israel and a general sense of heightened global tensions. We have mixed signals with respect to the economy, and there is some worry about what's to come in terms of a recession or a soft landing.

Industry – The industry continues to grapple with data signal loss and its long-term implications.

A.I. – This is a positive change, but a disruptive change, nonetheless. It has the potential to completely rewrite the rulebook in terms of creating software and content, and more generally how we conduct business at large.

By many parameters, including GDP growth, inflation and market performance, we are in a better place than we were in 2022. These metrics stand in contrast to general market sentiment and consumer confidence, which tends to lean negative. It’s feelings over facts.



Current market dynamics have fostered a dichotomy in the technology ecosystem between the Tech Giants and everyone else.

Big Turmoil in Big Tech?

2022 DMS

Google

amazon

Microsoft

Meta

3 themes:

1. **Major Business Model Changes**
2. **Rising Competition (media, cloud, data)**
3. **Increasing Government Scrutiny (privacy, antitrust)**

Last year we talked about "Big Turmoil in Big Tech" with respect to major business model changes, rising competition, and increased government security…

Big Turmoil in Big Tech?

	2022 Turmoil
	(27%)
Google	(39%)
amazon	(50%)
Microsoft	(29%)
Meta	(64%)

Source: FactSet, Market Data as of November 7, 2023.

… a look at trading performance in 2022 will confirm there was indeed a lot of turmoil for Big Tech…

Big Turmoil in Big Tech?

	2022 Turmoil	2023 Strength
	(27%)	+40%
Google	(39%)	+48%
amazon	(50%)	+70%
Microsoft	(29%)	+50%
Meta	(64%)	+165%

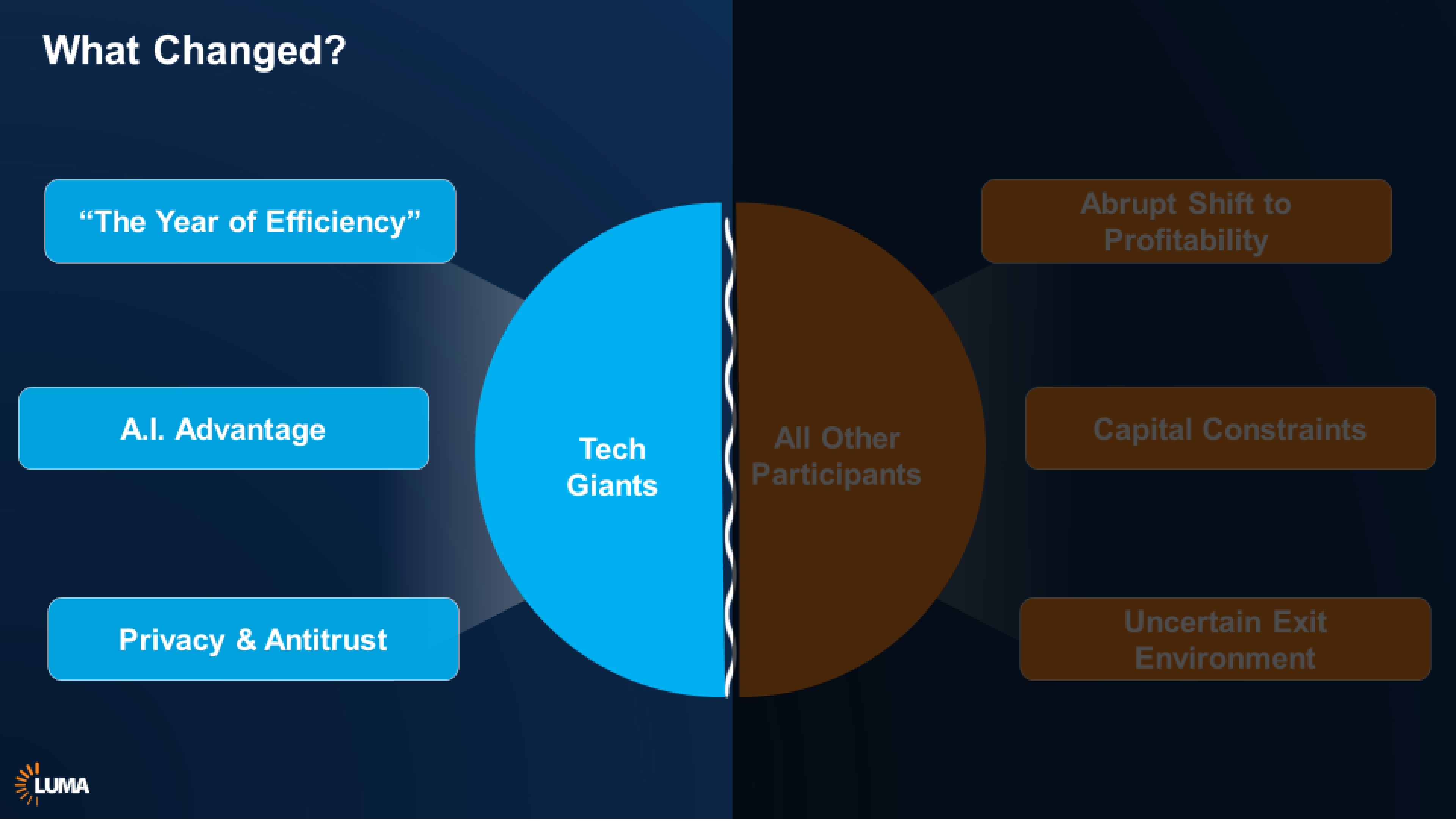
Source: FactSet, Market Data as of November 7, 2023.

…But move forward a year, and you'll see that 2023 YTD has proved to be a strong year for Big Tech Companies…

And It's Not Just Consumer Tech

	2022 Turmoil	2023 Strength
	(27%)	+40%
Google	(39%)	+48%
amazon	(50%)	+70%
Microsoft	(29%)	+50%
Meta	(64%)	+165%
Adobe	(41%)	+74%
ORACLE	(6%)	+33%
salesforce	(48%)	+60%

… And its not just Consumer Tech that's performing well – Marketing Clouds and large software companies more broadly have performed extremely well.



So, what changed? We suggest three things – "The Year of Efficiency", A.I. Advantage, and Privacy & Antitrust.

Shift to the "The Year of Efficiency"


TECH · TECH INDUSTRY

FORTUNE

Mark Zuckerberg calls this the 'Year of Efficiency': Now Amazon and Google are falling in line with talk of 'streamlining' costs and slowing hiring

BY TRISTAN BOVE
February 3, 2023 at 1:15 PM EST

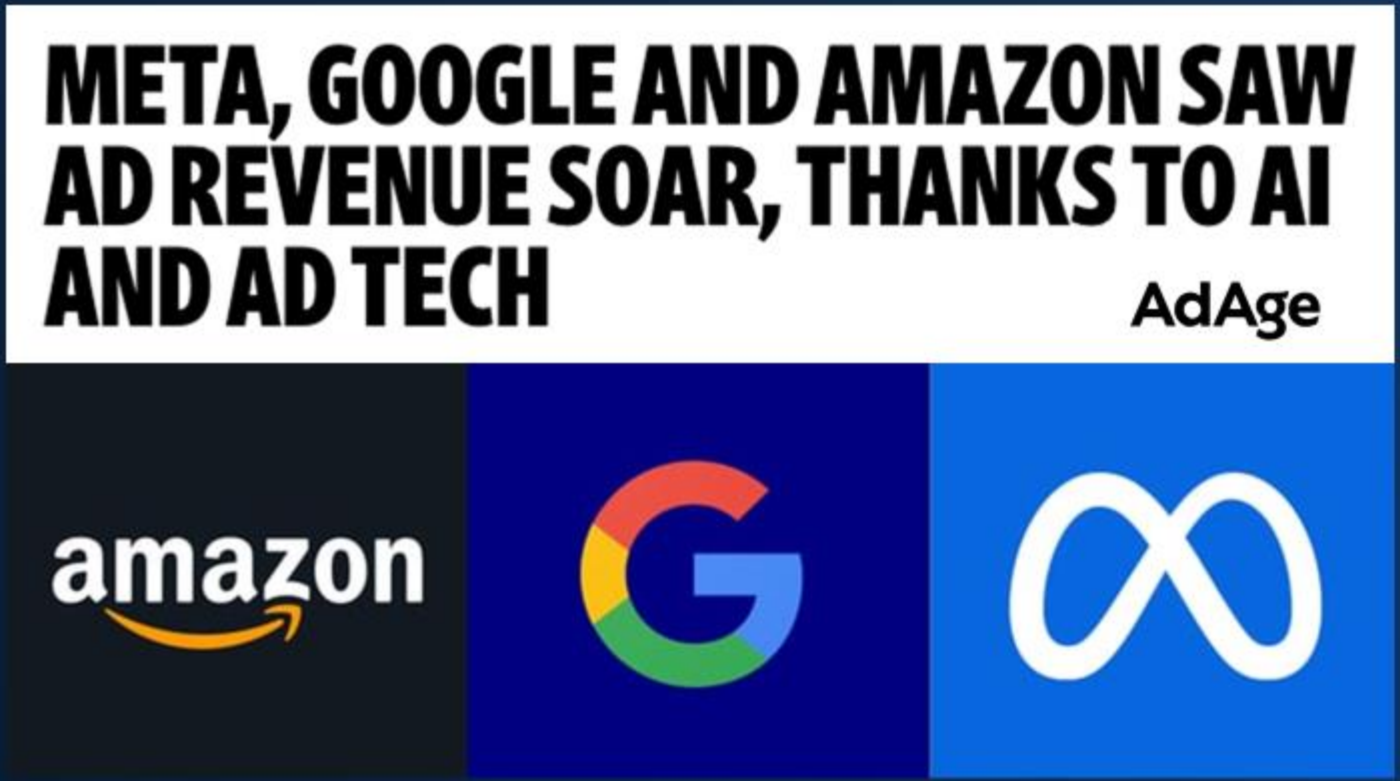
EBITDA Margin (%)

	Q3 2022	Q3 2023	Change
Meta	39.6%	59.0%	+19.4%
amazon	14.4%	20.4%	+6.0%
Microsoft	48.5%	54.5%	+6.0%
Google	37.9%	40.3%	+2.4%

LUMA **Source:** Company filings & Releases. FactSet. EBITDA is defined by Broker consensus.

The shift to "The Year of Efficiency" was a bonanza for Big Tech companies with large payrolls. These firms are so large that slowing hiring or RIFs materially changed economics and drove EBITDA margins.

And Then Came Q3 2023



Q3 Earnings saw tremendous revenue lift on the back of the Triopoly's advertising businesses fueled by A.I. solutions, beating expectations and driving market performance.

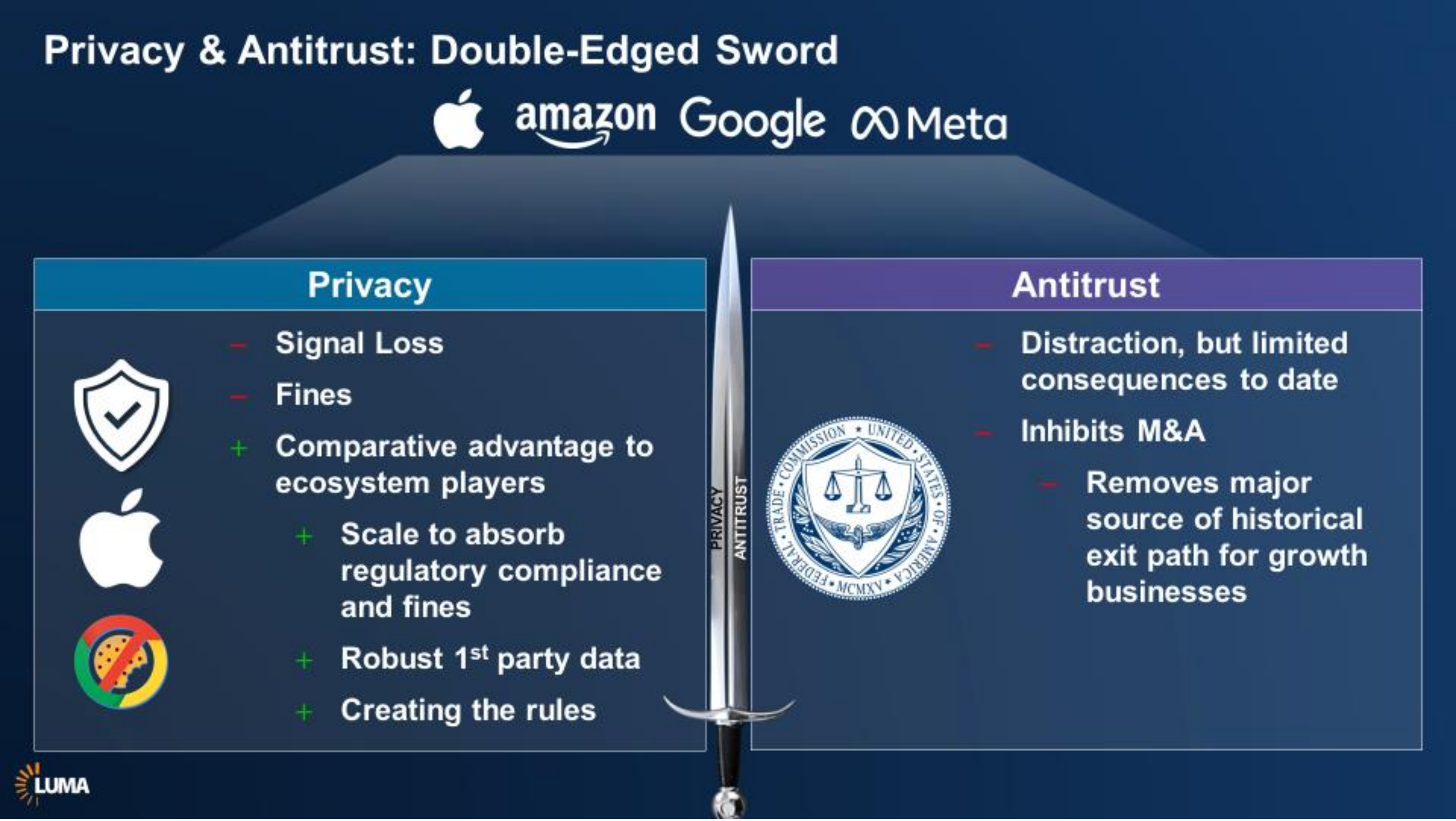
Scale as a Comparative Advantage in A.I. Race

	Build	Partner	Buy
amazon	alexa, Olympus AI	ANTHROP\C	10
	"Apple GPT"		32
Google	Bard, DUET AI	AI21labs, ANTHROP\C, cohere, Meta AI, runway	21
Microsoft	Microsoft 365 Copilot	OpenAI	18
Meta	Meta AI, LLaMA by Meta	Microsoft Azure	17
X	GROK		0
Adobe	SENSEI	NVIDIA	0
ORACLE	ORACLE AI	cohere, NVIDIA	2
salesforce		Google	1

Source: Company Filings & Releases. CB Insights. Buy column represents acquisitions since 2010. **Note:** List is not exhaustive of full A.I. capabilities.

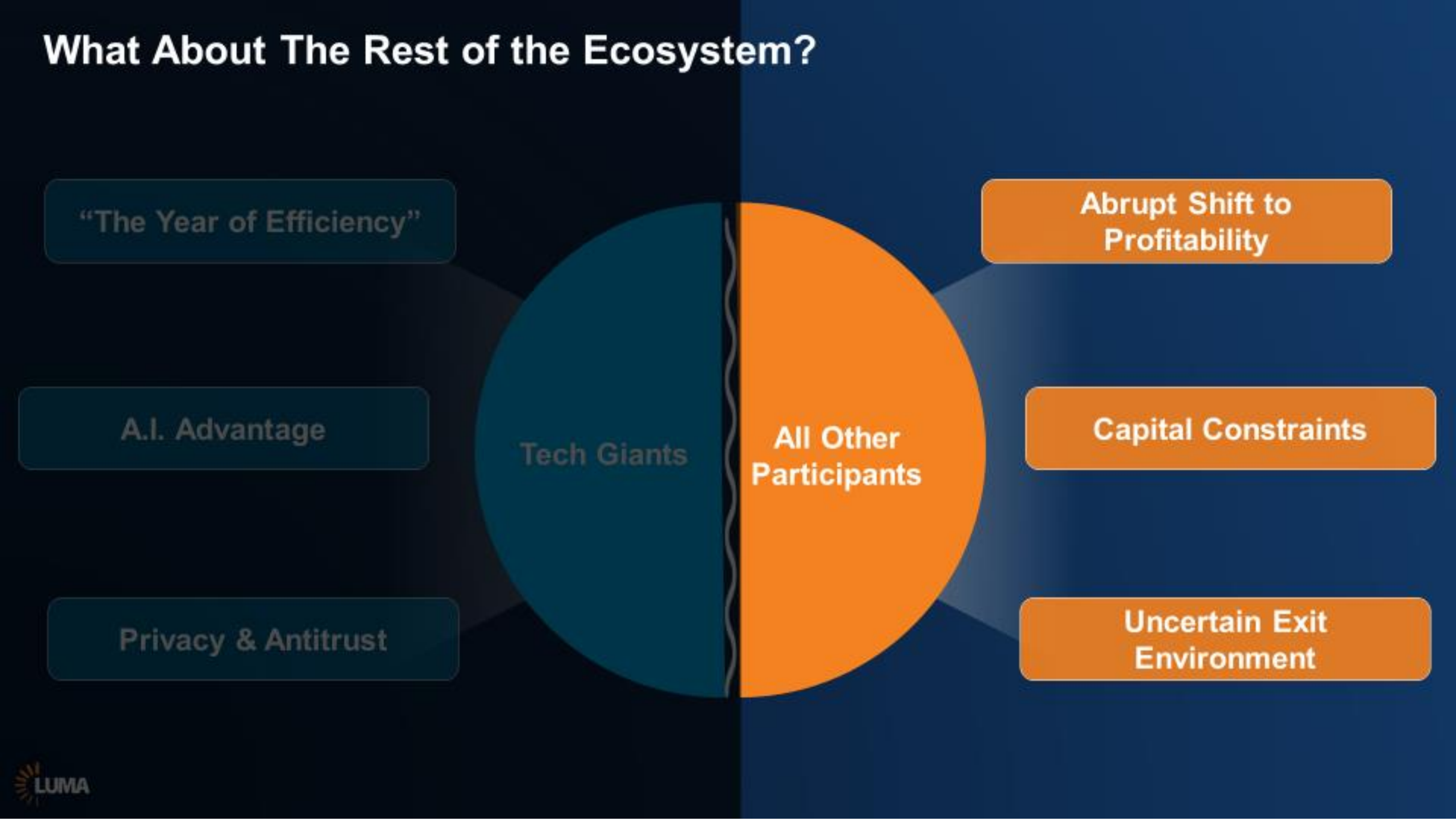
A key ingredient of that success in the A.I. race is scale as a comparative advantage. The largest players are pursuing opportunities across all fronts – building A.I. solutions organically, investing in strategic partnerships, and buying companies.

These investments are meant to position these large tech companies for what promises to be one of the most consequential technology trends in the last generation.



It's important to remember that privacy & antitrust are like two edges of a sword – they work contra to one another. With respect to privacy; signal loss has an implication to the broader ecosystem doesn't impact the Tech Giants to the same degree. In part, they help make the rules and have huge swathes of 1P data.

Antitrust has held them back from doing deals and that hurts the ecosystem in terms of exit opportunities.



The rest of the ecosystem is now left to contend with an interesting set of dynamics.

Path to Profitability Harder For Less Mature Companies

Median EBITDA Margins (%)

	Q1 2022	Q2 2023	Change
Tech Giants	47.2%	49.8%	+2.6%
MarTech (LUMA.M)	(0.8%)	10.0%	+11.1%

Source: Company Filings & Releases, Financial data as of latest available. Note: EBITDA Margin % represents the cohort median.

The abrupt shift to profitability is not easy for less mature and less scaled businesses such as those in the LUMA.M. Tech Giants were already highly profitable, and only had to make incremental changes. Meanwhile, the broader set of MarTech companies had to make a step function jump from unprofitable to profitable, a change that would cost them growth.

This is a complete reimagining of the economics, and to that end, these companies, which are younger and on the cusp of profitability, deserve credit for the tremendous strides that they've taken.

The harsher financing ecosystem has meant that we’re seeing an accelerated number of failures on the startup side – probably not unexpected in turbulent markets like this.

Uncertain Exit Environment

Public Markets

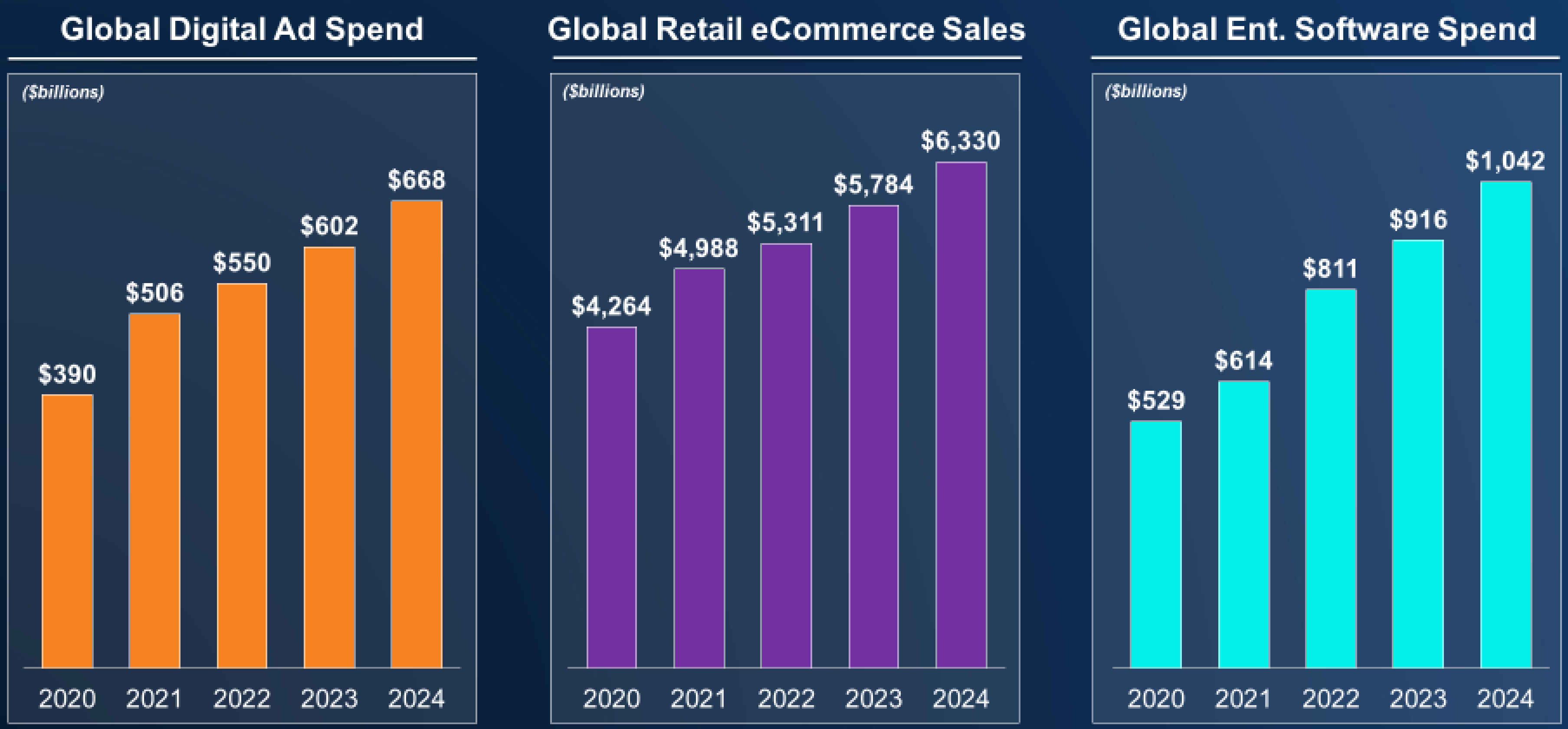
Only 3 Scaled Tech IPOs in 2023

M&A

"The Digital Media & Marketing ecosystem has experienced **~12 months of a muted M&A environment with lower volumes and fewer scaled deals** compared to the highs that followed the pandemic and lasted through 3Q 2022."

The uncertain exit environment is evident in the lack of recent scaled IPOs – only 3 in 2023, which also all only happed in Q3. The slow IPO market is coinciding with a significant and sustained lull in M&A activity.

The Case For Optimism in Marketing Technology



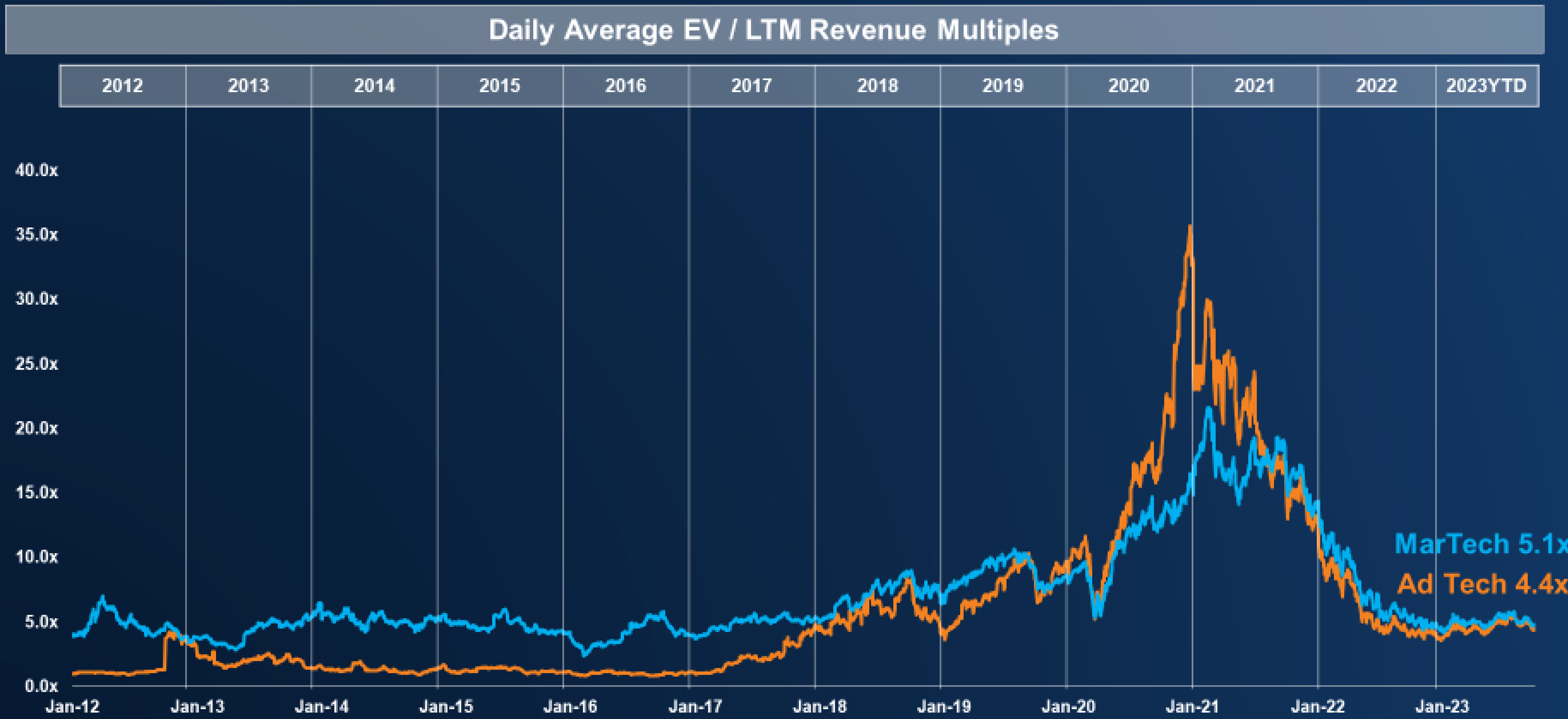
Source: eMarketer (latest available as of Oct 2023), Gartner (Oct 2023).

While there are certainly a number of challenges for the broader MarTech ecosystem, there also remains a strong case for optimism.

While “feelings” are bogged down by uncertainty in the funding and exit environment, the “facts” around the underlying fundamentals driving MarTech are strong – Digital Ad Spend, eCommerce Sales, and Enterprise Software spend all continue to grow.


MARKETS
LUMA

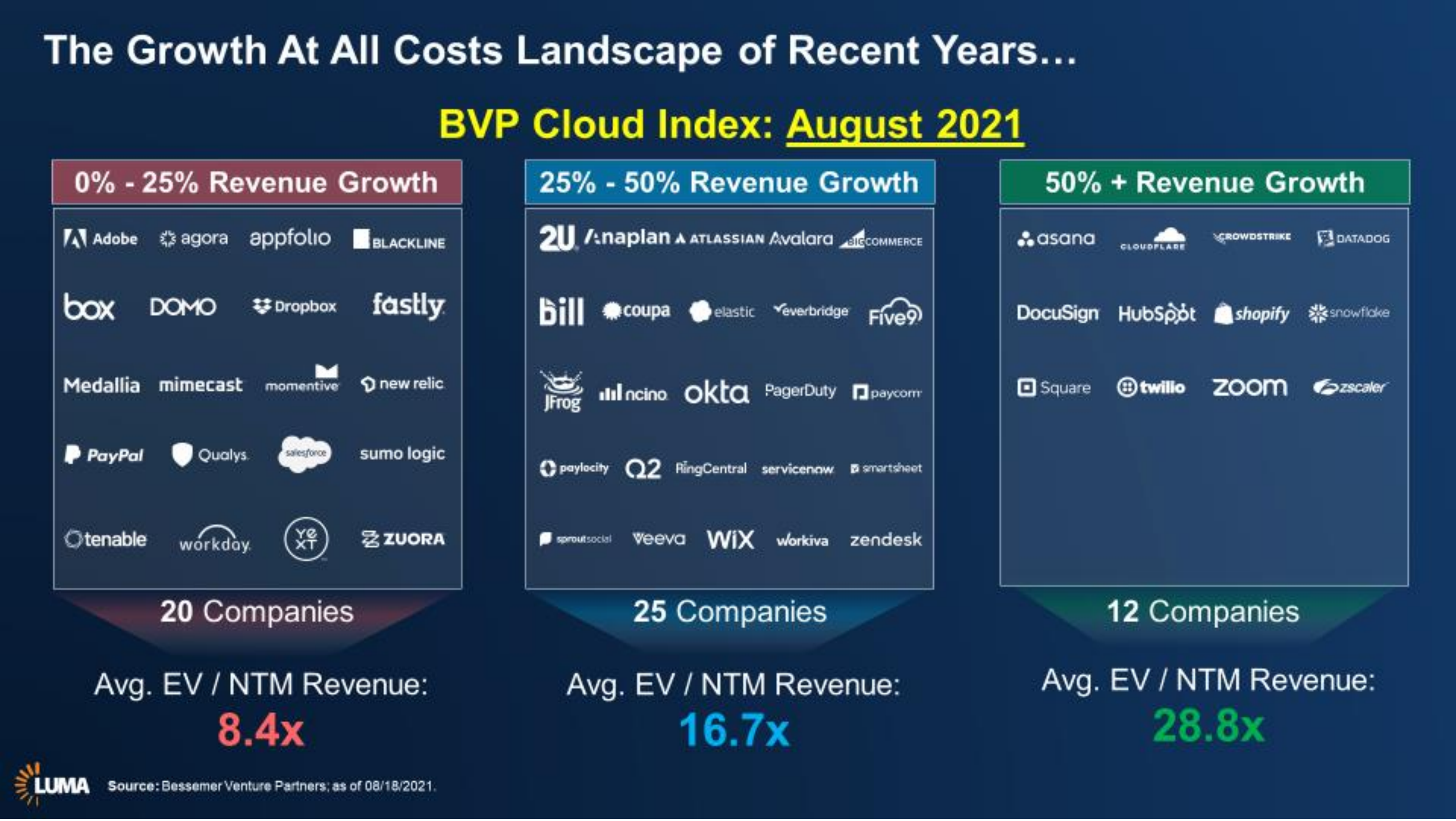
Ad Tech & MarTech Multiples Have Reverted to the Mean



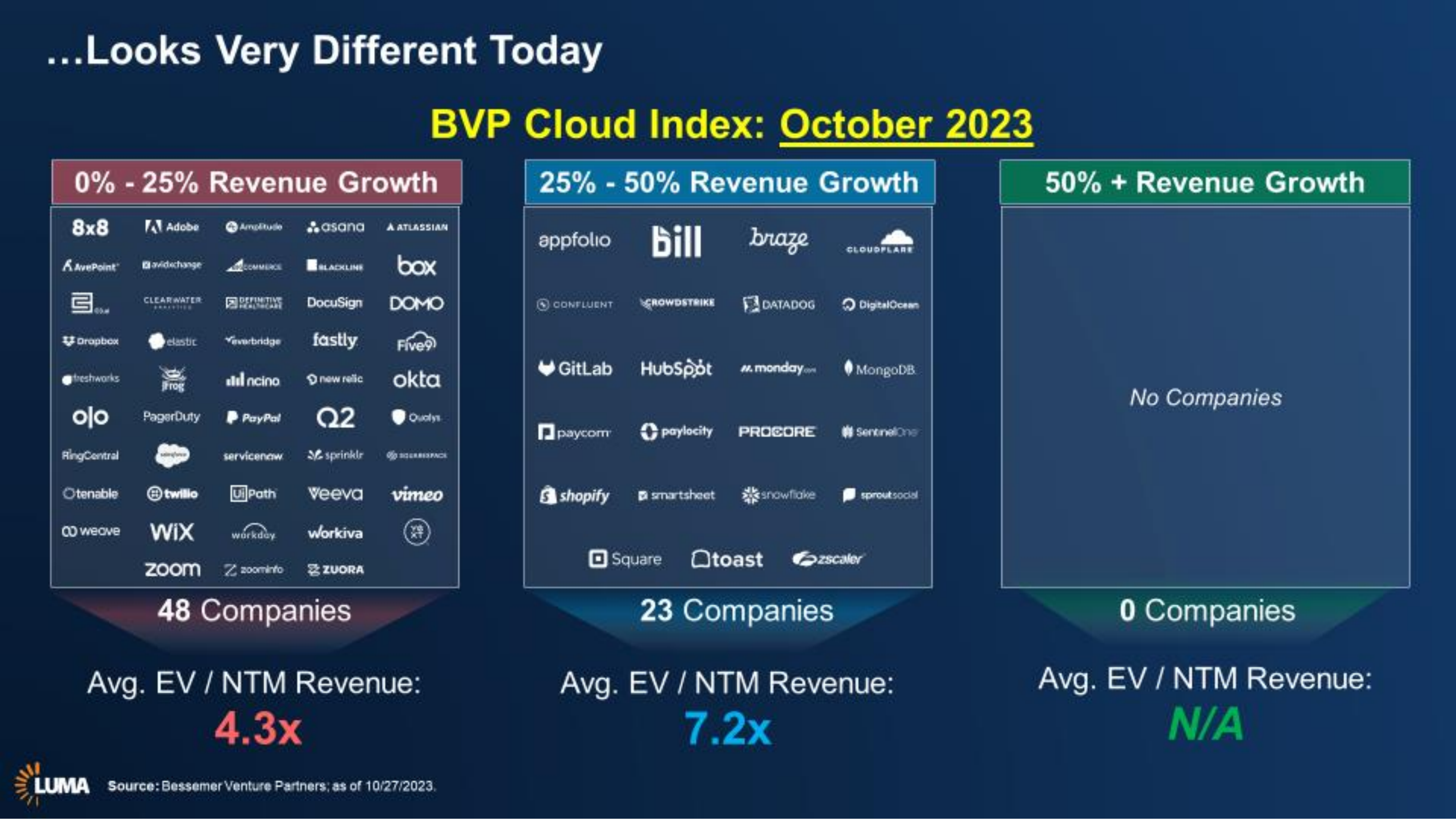
LUMA **Source:** LUMA Analysis, Company filings & Releases, FactSet. **Note:** Represents GAAP Revenue for MarTech cohort and "Net Revenue" for Ad Tech Cohort. Net Revenue methodology and definitions vary by company. The cohorts contemplated are an evolving set of companies that include but are not limited to those within LUMA.A and LUMA.M indices. As of 09/30/2023.

It's no surprise that feelings have been on the decline given the significant drop in valuations that began in 2022. However, it's critical to take a longer-term perspective on the markets. When looking at Ad Tech and MarTech valuations over the last 10 years, you see that the declines of the last 18 months were actually a reversion to the historical averages – roughly 4.0 - 5.0x net revenue.

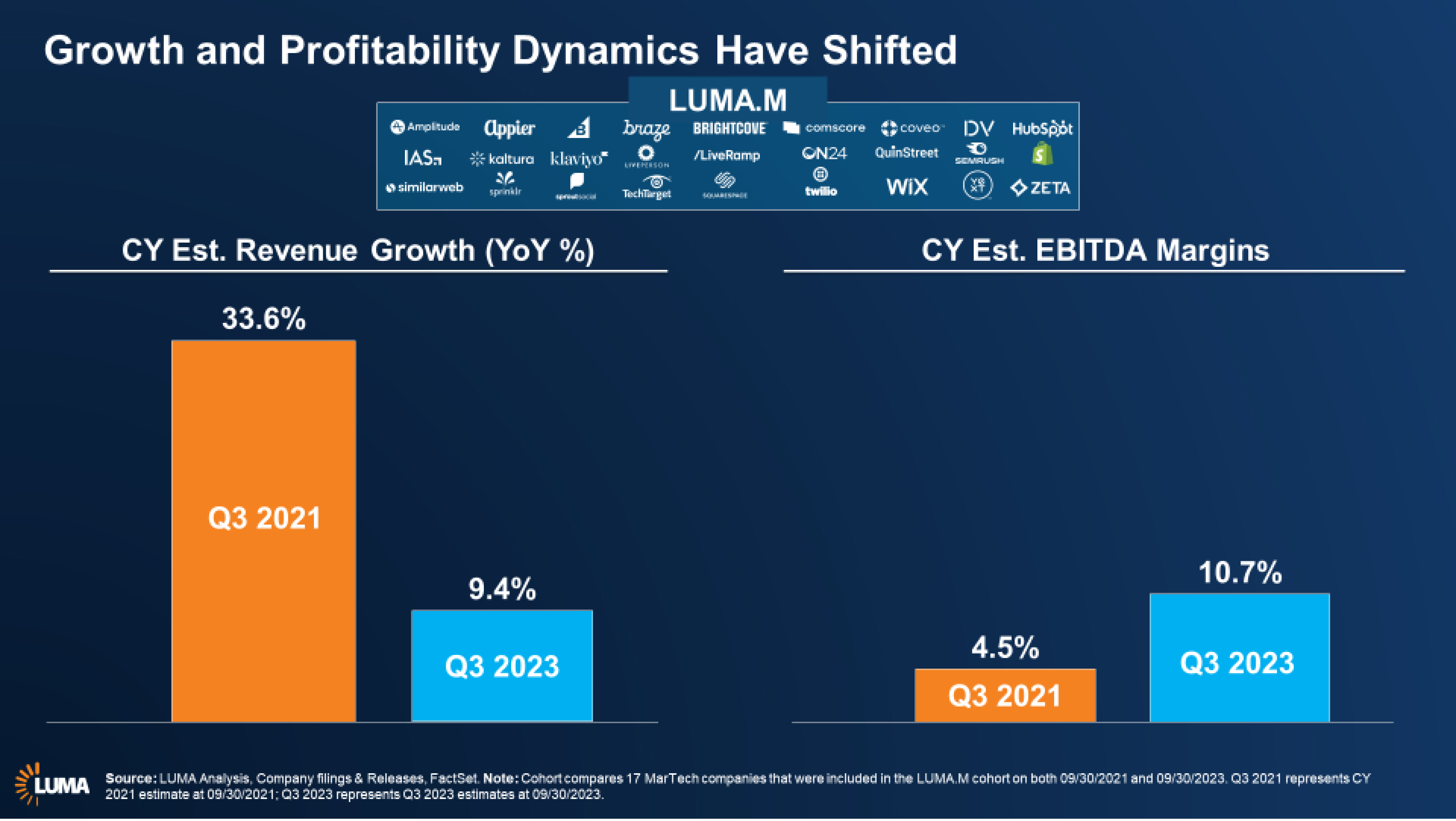
What's also important to consider is that the downward movement in valuations hasn't persisted. Instead, we've begun to find stabilization at these historical averages, with revenue multiples holding relatively tight in the public markets over the last 6 – 7 quarters.



In order to frame where the market is today, it's helpful to understand how trading and operating performance has shifted. Back in August 2021, we were in a period of "growth at all costs", as growth was by far the most important valuation metric for software businesses. Looking at the BVP Cloud Index from that time, you will notice that the different growth cohorts resulted in significant jumps in valuation, with the fastest growing companies rewarded with exorbitant valuations – nearly 30x FORWARD revenue (a high EBITDA multiple today).



Fast forward to today and it is a very different picture. First, the growth metrics have changed dramatically, with over 80% of the cloud businesses now in the bottom growth cohort vs. 1/3rd in 2021 and none left in the top cohort. These changes in growth profiles have come with significant changes in valuations, as the average NTM Revenue multiples have effectively cut in half for each cohort.



As valuation dynamics have changed, so too have companies' underlying metrics. In 2021, the companies in LUMA's MarTech Index (LUMA.M) grew over 30% on average and had average EBITDA margins were in the single-digits with many companies actually in the red.

As longer sales cycles and pressure on renewals have compressed growth, these companies have had to lean on the operating leverage in their businesses and have effectively managed the transition to higher EBITDA margins. Impressively, as a cohort the LUMA.M companies managed to more than double margins even as growth dropped by over 70%.

So, what does this all mean? Well, if Meta only had to focus on a "Year of Efficiency", the broader software ecosystem is headed for a new *ERA* focused on efficiency. As highlighted by industry leaders, such as Jason Lemkin and ICONIQ Growth, the current growth and capital landscapes are not short-term anomalies and therefore software companies need to reprioritize for efficient, profitable growth over the long term.

All three tech IPOs this year – Arm, Instacart, and Klaviyo – were emblematic of this trend, as all three showed strong efficiency metrics and made the shift to profitability before IPO, something only 22% of software companies did in 2021.

Klaviyo is a Primary Example of Efficient Growth

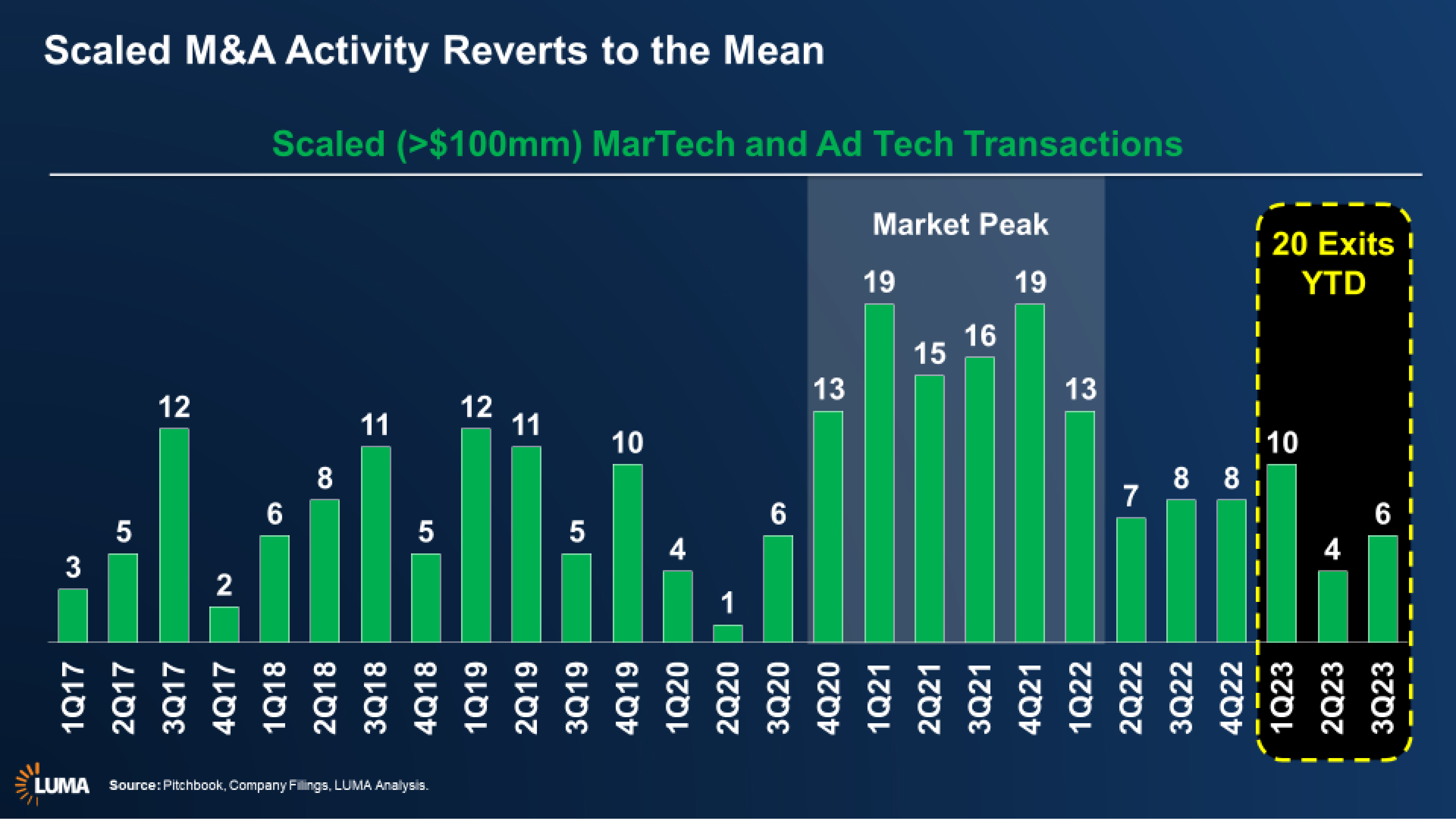
ICONIQ	$200M – IPO Companies	klaviyo
YoY ARR Growth	40%	48%
Net $ Retention	110%	119%
Rule of 40	30%	60%
Net Magic Number	0.6x	1.0x
ARR per FTE	$220K	$454k

11.1x ARR Multiple

LUMA **Source:** Company Filings. FactSet (Market Data as of 11/8/2023).

Klaviyo is particularly important to highlight, as it's both the only MarTech company to have gone public in 2023 and is a perfect example of "efficient growth". In the ICONIQ Report, they introduce a framework for evaluating a company's overall growth and efficiency. They called these metrics the "Enterprise Five".

Impressively, Klaviyo sits above the median metrics across all five categories for companies of the same size / stage. This top-tier efficient growth performance allows it to command a premium ~11x ARR multiple, well above the median for the MarTech cohort, though still significantly below multiples of the '20-'21 era.



Despite a global slowdown in M&A activity over the last 18 months, M&A remains the primary source of exits across the MarTech and Ad Tech ecosystems. There have only been three scaled tech IPOs this year (only one in MarTech or Ad Tech) yet there have been 20 scaled MarTech and Ad Tech exits in the first three quarters of 2023, with more to come in the last quarter.

While this activity may seem light compared to the surge of M&A activity in 2020 and 2021, the pace reflects the typical spotty, scaled M&A environment that has existed in these ecosystems for some time.

The Historical MarTech Buyer Universe

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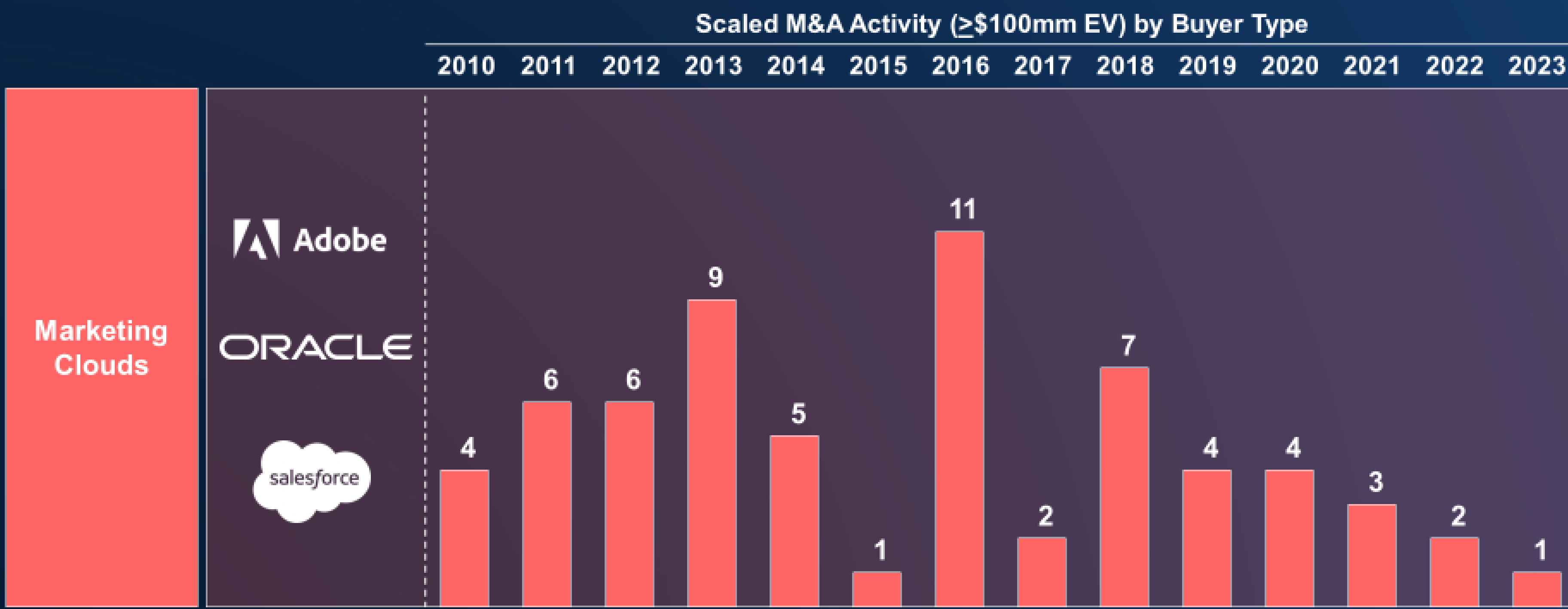
If M&A is the primary source off exits for MarTech, then it's critical to assess who the buyers are. In 2019, we talked about this expanding buyer universe of MarTech, which added the Digital Giants and Brands, following the continued activity from Marketing Clouds and Private Equity.

Today, the picture is quite different. While Private Equity remains the most active buyer in MarTech, the other categories of strategic buyers have limited their activity. Digital Giants are largely on the sideline due to anti-trust concerns, Brands have never been consistent, and the Marketing clouds have slowed considerably.

In Recent Years Marketing Clouds Have Slowed Down M&A Activity



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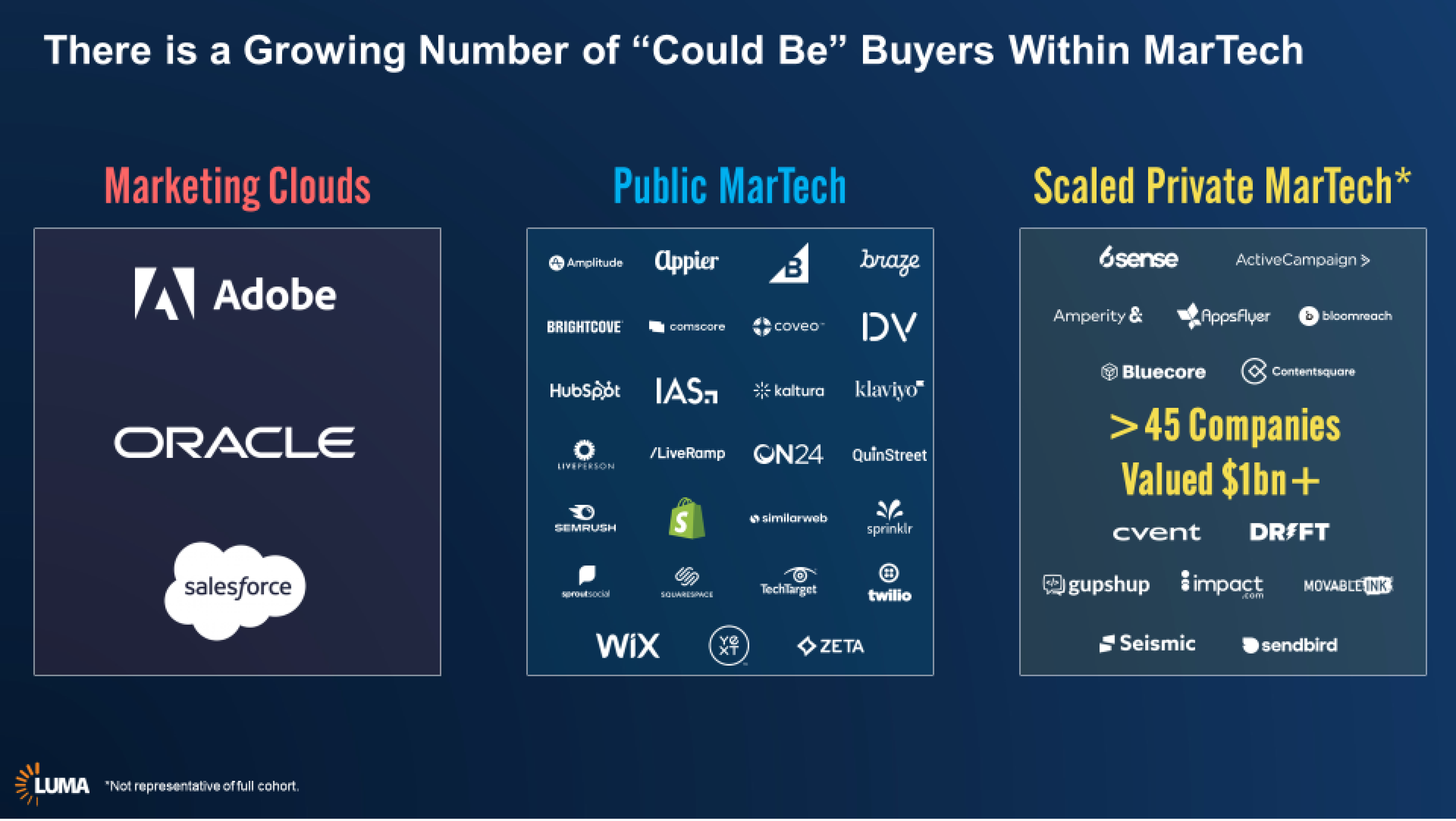
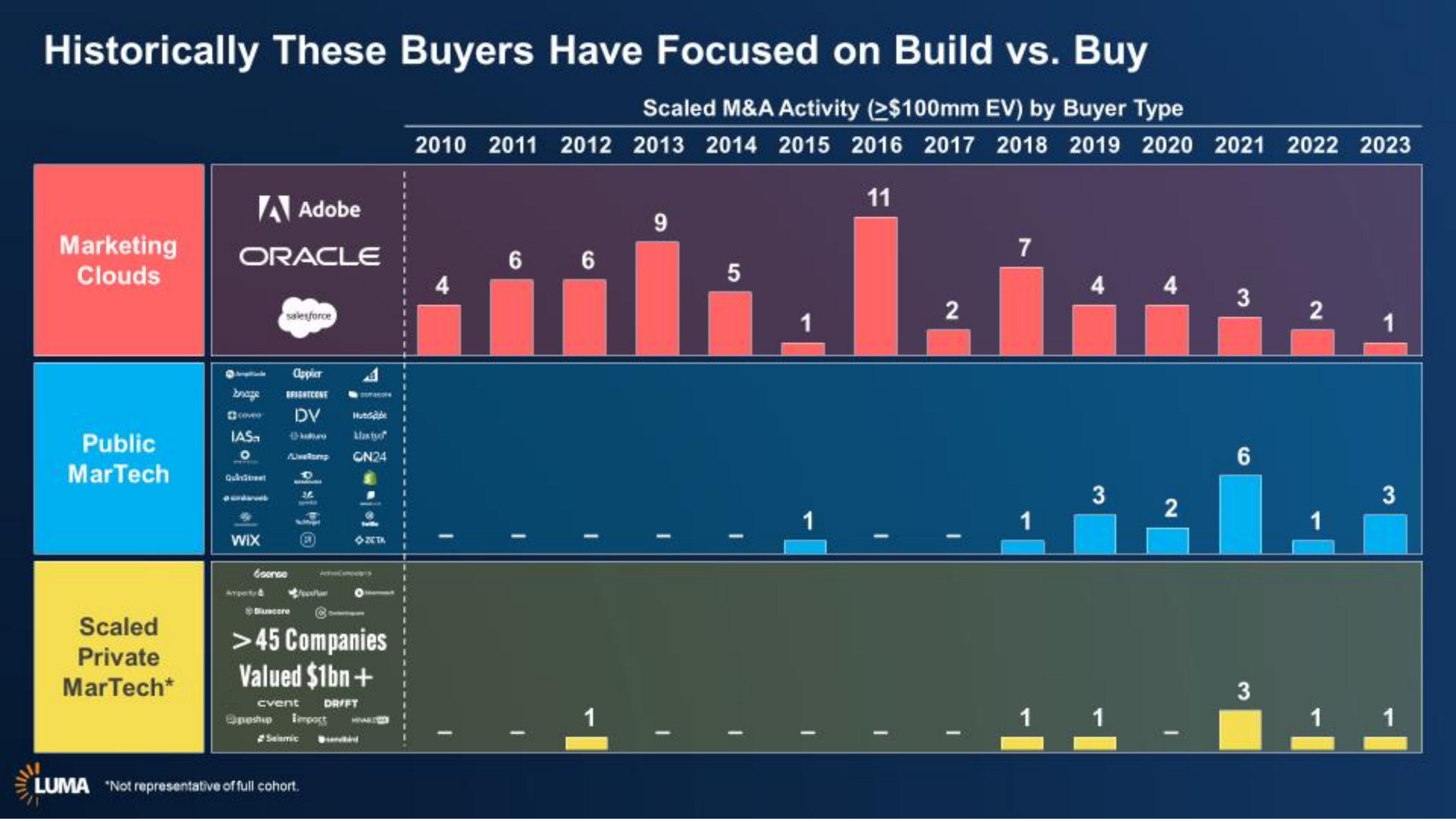
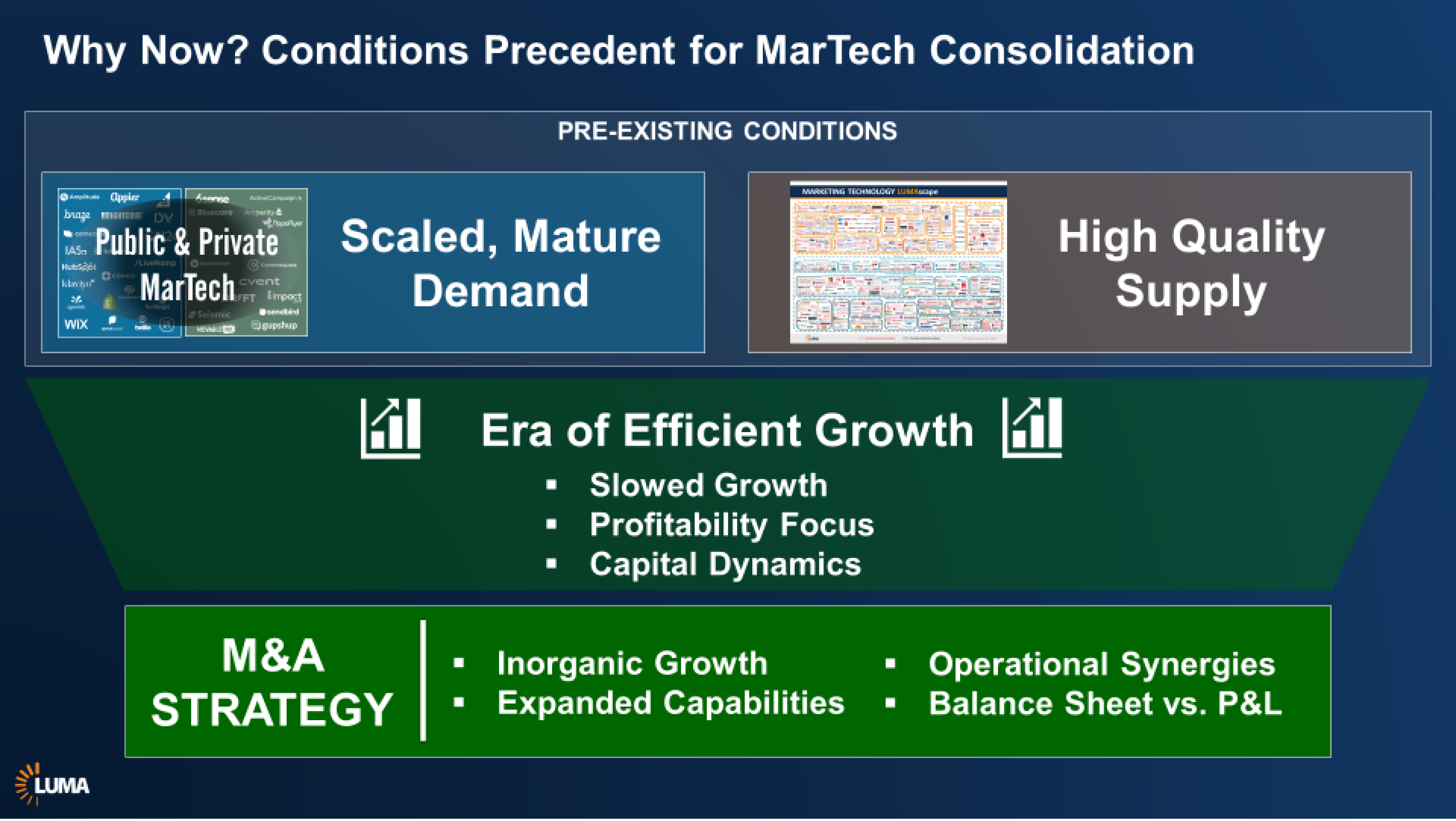
Over the last few years, the Marketing Clouds have slowed down the number of scaled M&A transactions they pursued, and not just within MarTech. Instead of executing a range of mid-scale transactions (sub $1 billion), these platforms have focused on larger, transformative deals since 2020 (e.g. Salesforce / Slack and Adobe / Figma).



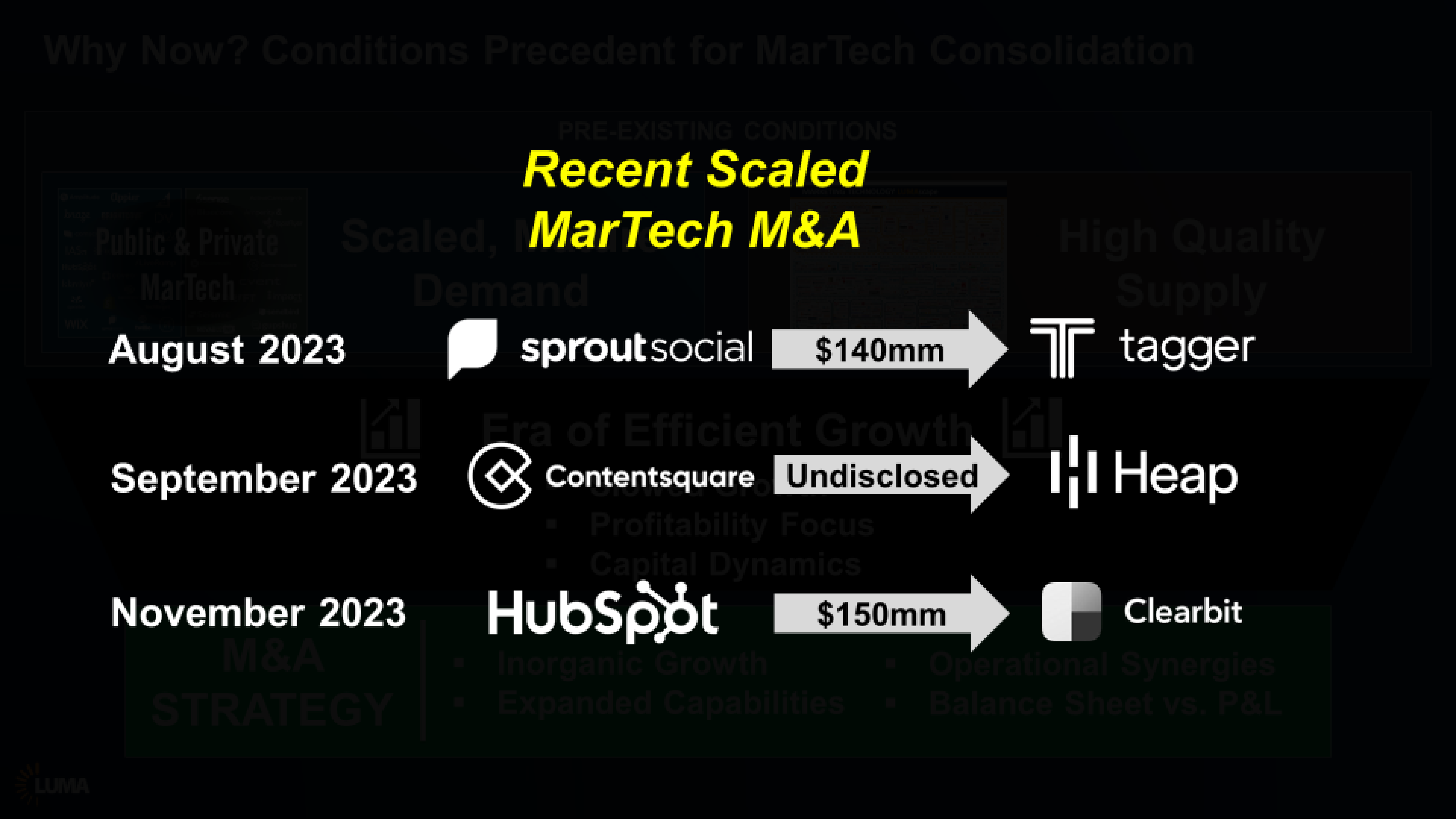
As the prior strategic buyers move to the sidelines, we believe there's a sizeable and growing cohort of likely strategic buyers from within the MarTech ecosystem. Specifically, we expect more buying activity to come from the ~75 public and scaled private (>$1bn valuation) MarTech companies. Collectively these companies represent nearly $250 billion in valuation and have over $25 billion of cash on hand or capital raised in the last 3 years.



Historically, these cohorts of Public MarTech and Scaled Private MarTech have not focused on M&A as a growth lever, preferring to focus on building vs. buying. Over the last 10+ years, this has been a reasonable strategy given robust access to capital and limited focus on the bottom-line. Companies could constantly expand hiring, investing off their P&L to drive further growth…but we're no longer in that era.



For any M&A to take place, you must start with a combination of scaled, mature demand and high-quality supply. While these conditions have been in ample supply in MarTech for some time, it's the new conditions tied to the "Era of Efficient Growth" that will spur further M&A from these cohorts. Slower organic growth, a focus on profitability and changing capital dynamics are impacting both how strategics plan to expand and the openness of growth companies to consider consolidation. Given these dynamics, M&A is a natural strategic lever, allowing strategics to expand growth and capabilities, invest off their balance sheets vs. P&Ls, and maintain margin integrity through scale and operational synergies.



It’s easy for bankers to call for more M&A, but the trend of MarTech consolidation has already begun. Just in the last few months we’ve seen scaled M&A activity from Sprout Social, Contentsquare, and HubSpot; and for each of these three it’s been their biggest transaction to date.

MARTECH TRENDS

Key Trends Across the MarTech Ecosystem

- Data & Identity
- Commerce
- Omni-Channel Experience
- Evolving MarTech Stack

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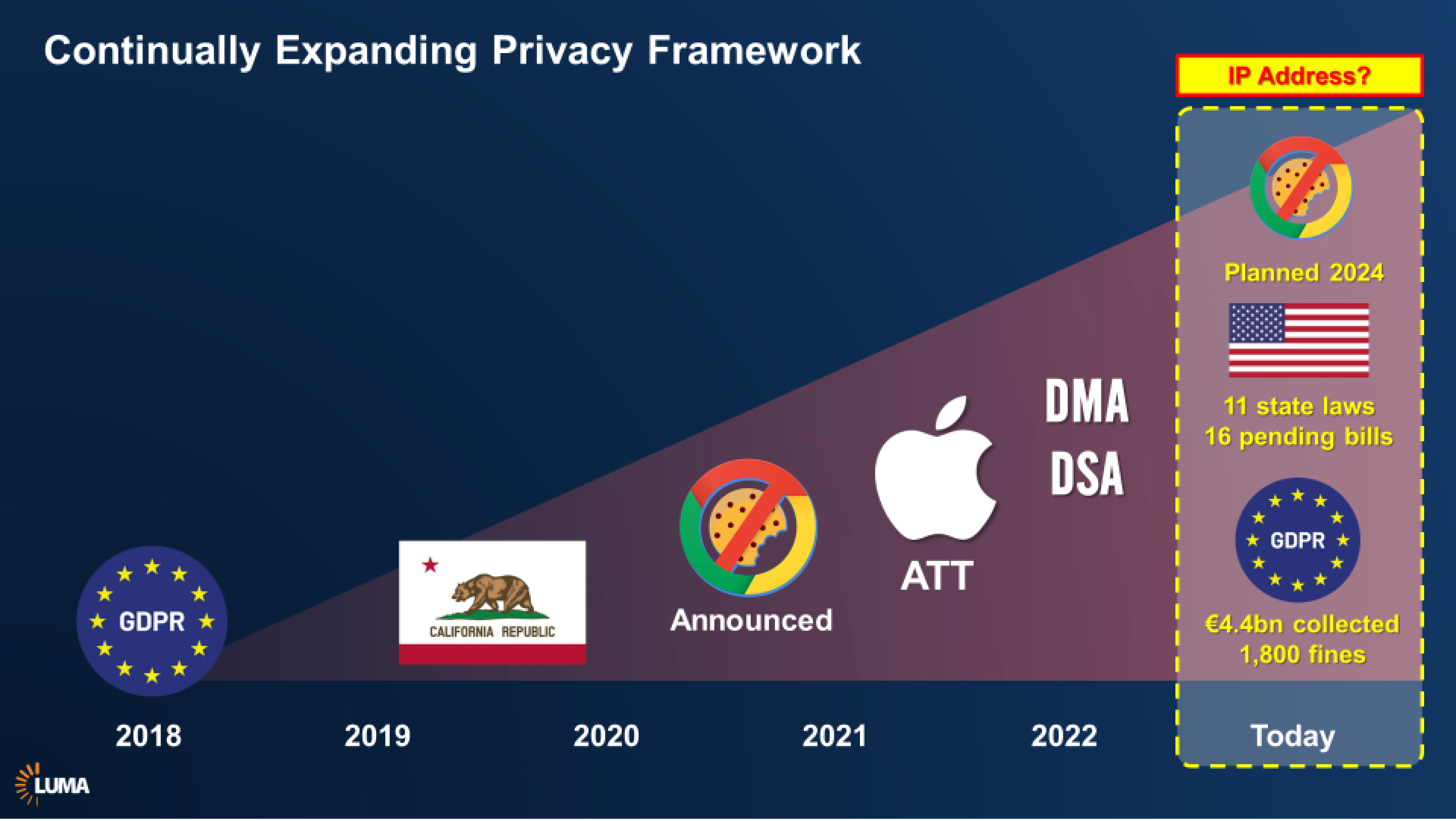
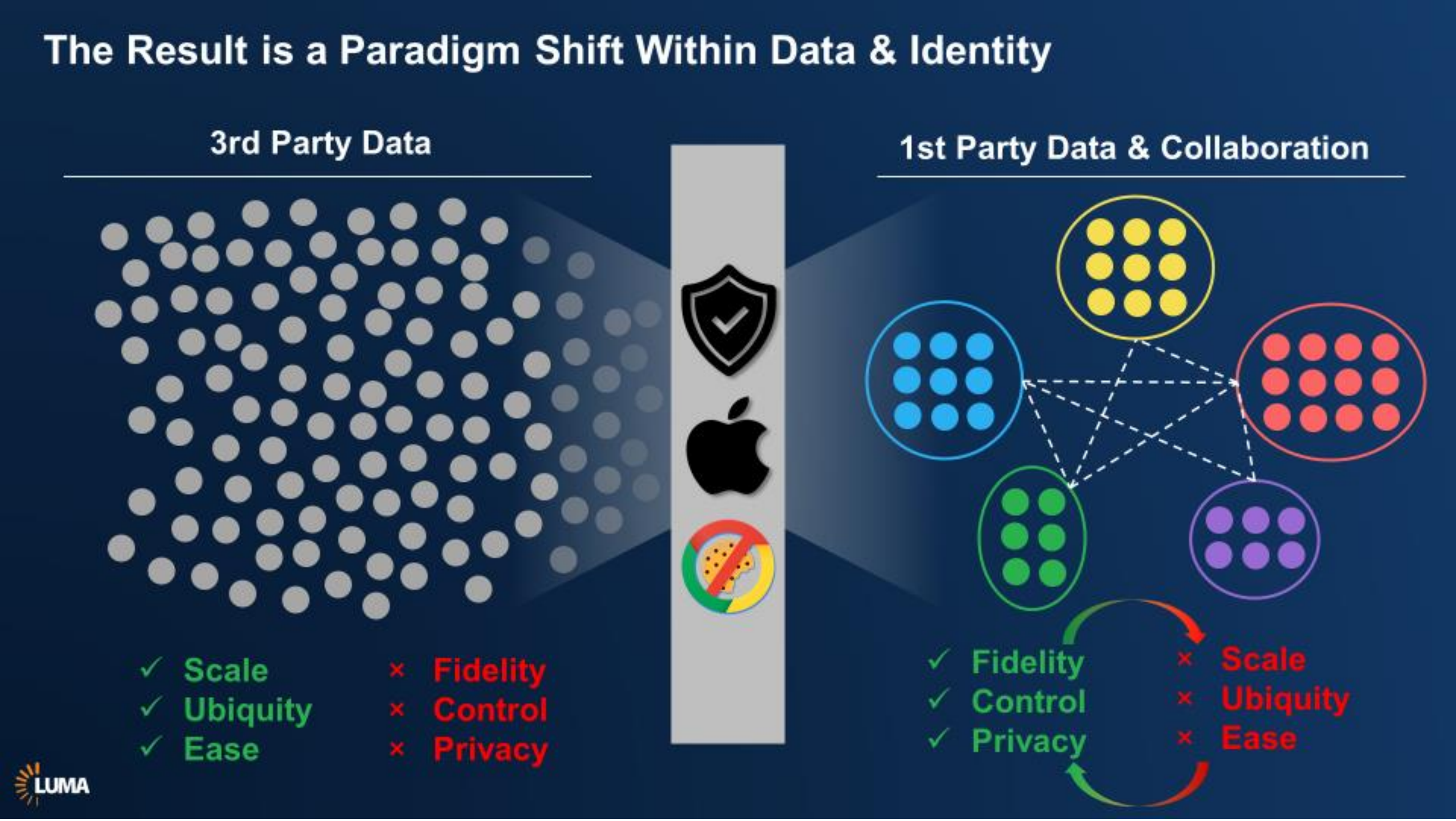
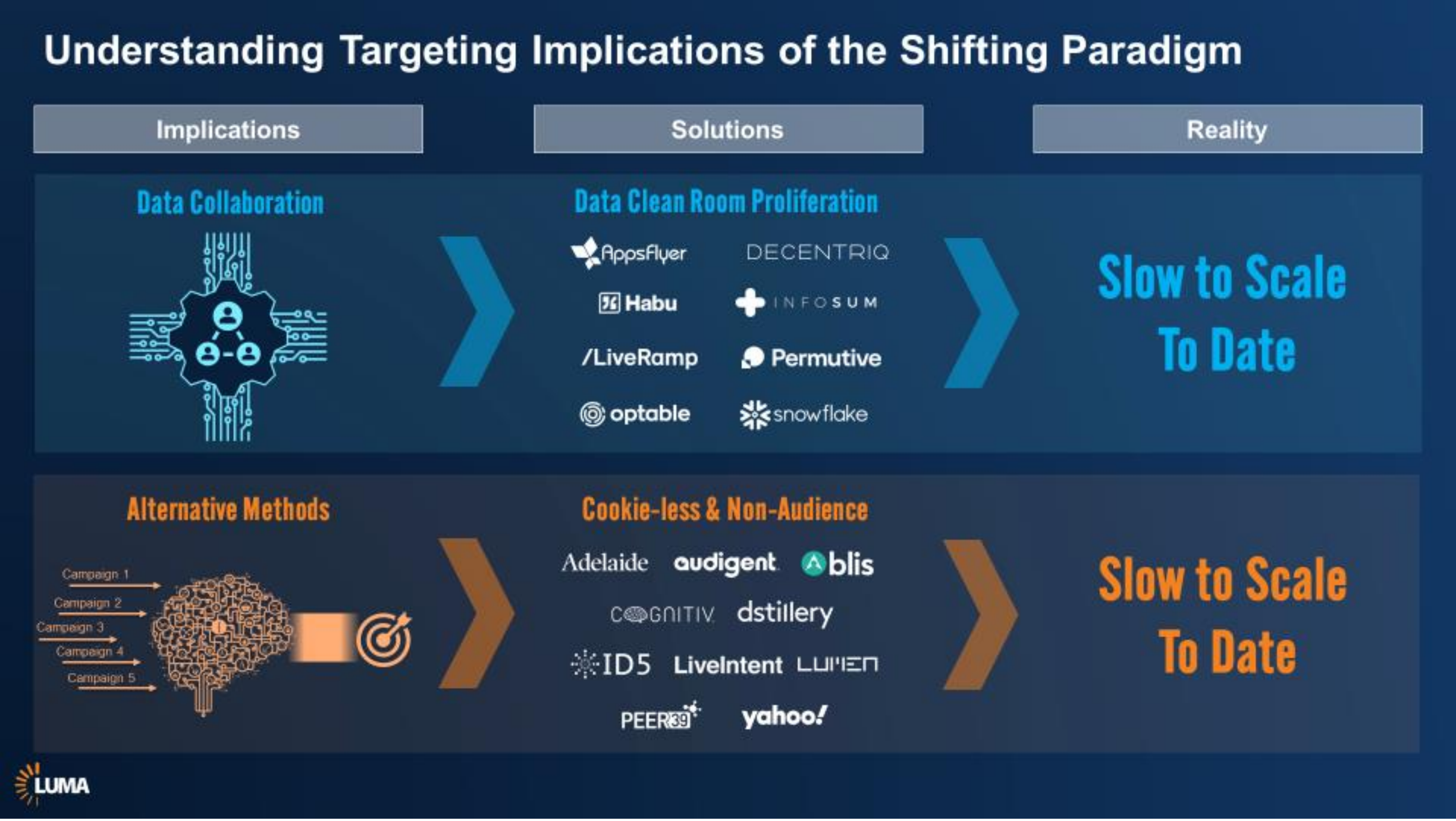


As has been clear for the past 5 years, the privacy landscape is an evolving one. We saw the start of this in Europe with GDPR in 2018 tackling the issue of consumer's privacy, what signals can be shared and what consents need to be obtained for said signals to be tracked. We've also seen legislation in the US, at least at the state level. More impactful, perhaps, has been the response of the tech platforms, namely Google and Apple with respect to their deprecation of signal. The privacy landscape is not static, and with the ramp up and enforcement of new laws like the "Delete Act" passed in California in October, there are significant implications to how, at least on the advertising side of MarTech, some signal can be used. We've recently seen hints that IP addresses are next, and we can only assume the train will continue moving in this direction.



These forces have pushed in a paradigm shift from a 3P-centric world to a 1P data-collaboration world.

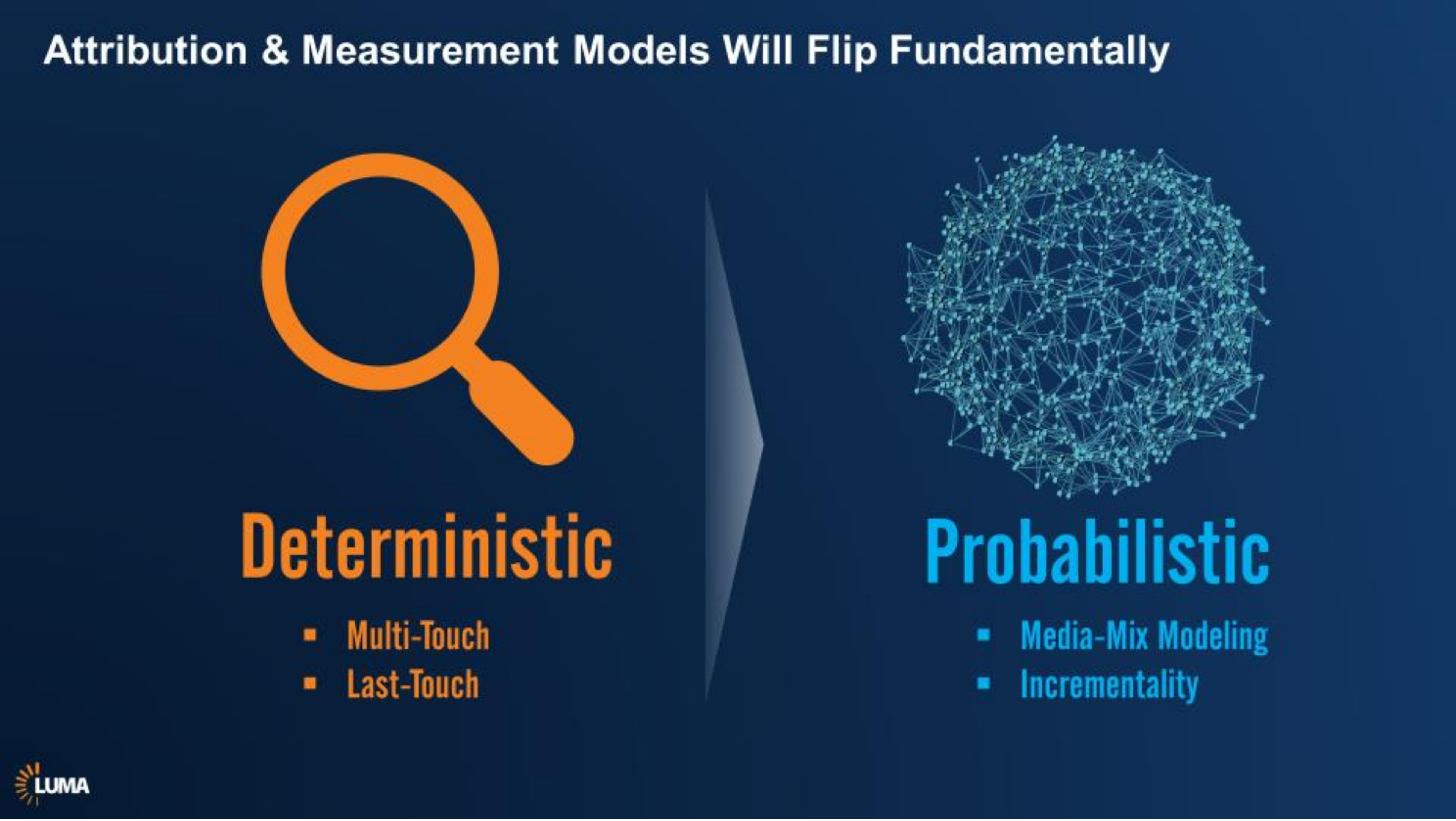
In the 3P world, Scale, Ubiquity and Ease were key strengths to that paradigm, while the lack of Fidelity, Control and Privacy were noteworthy drawbacks. In this new 1P paradigm, these strengths and drawbacks are flipped.



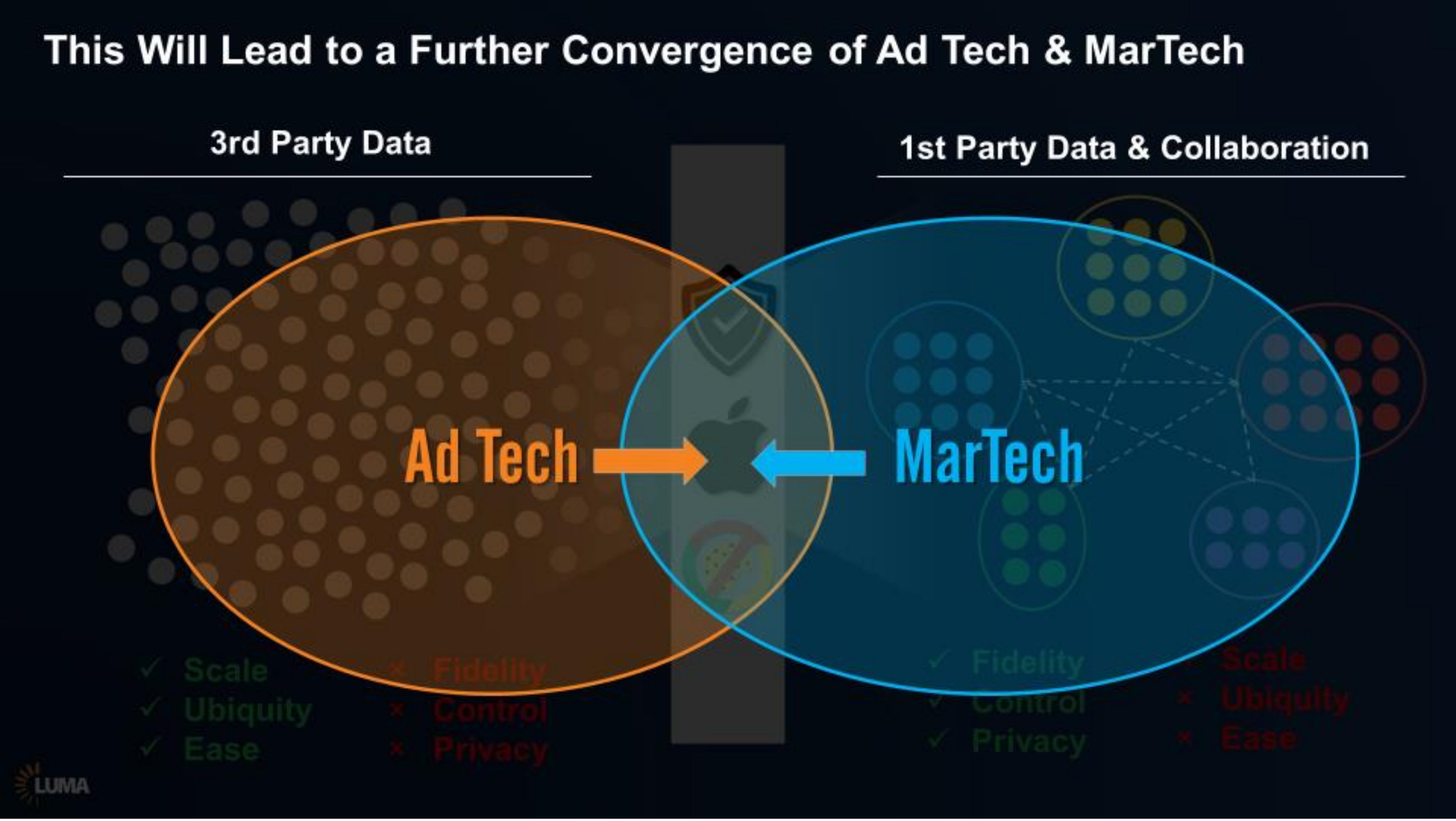
As a result of this paradigm shift, we've seen responses for future targeting opportunities that we're grouping into two categories. First is the need for data collaboration, which is being addressed by the proliferation of Data Clean Room and other solutions. Second is the need for alternative targeting methods, which has given rise to cookie-less and non-audience solutions.

While many companies are testing, both these categories have been slow to scale to date.

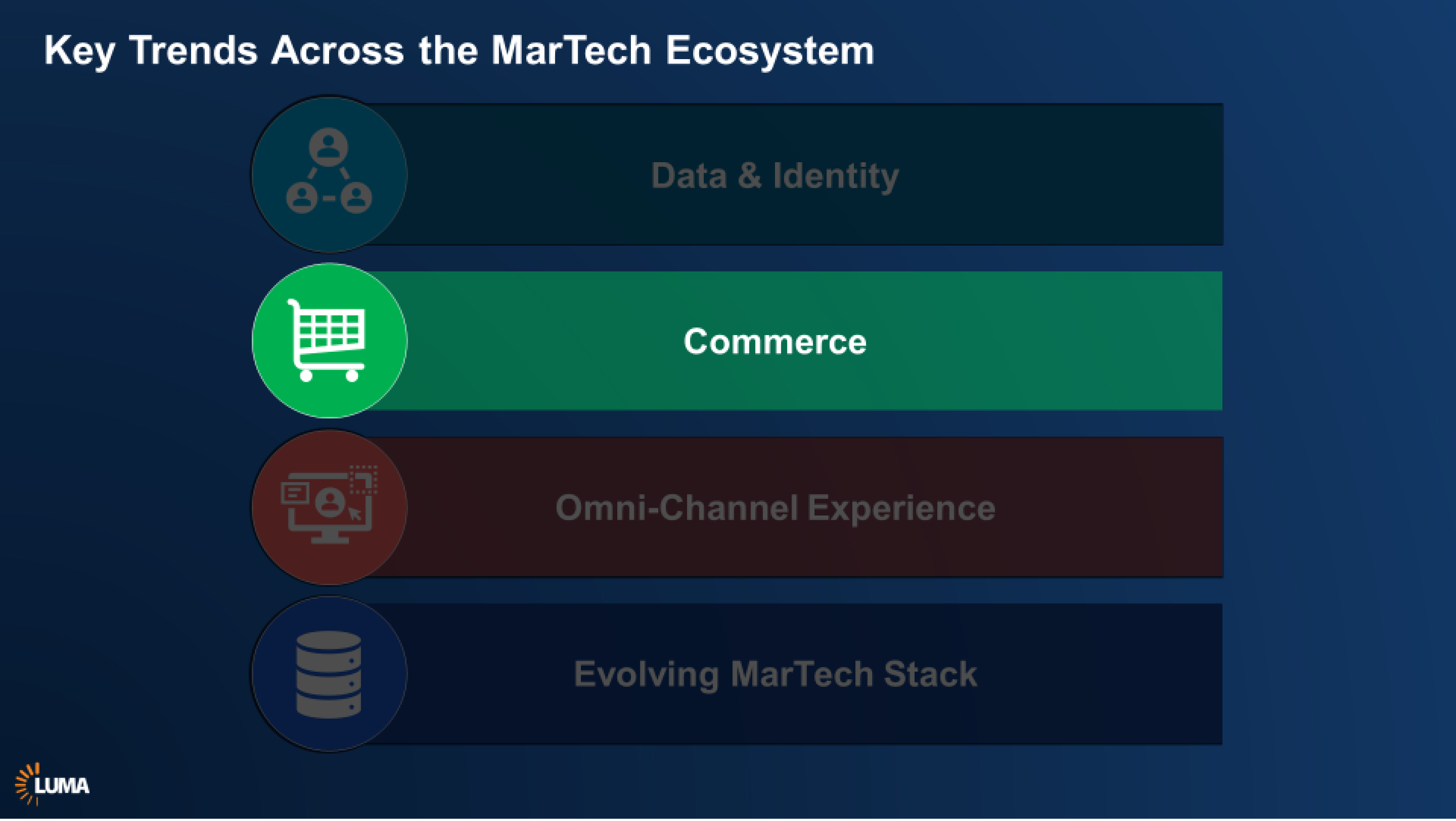
By slow to scale today, we mean while many are testing these alternative solutions, most are waiting for full scale implementation until cookie deprecation is actually upon us. If we learned anything from GDPR, it's that the advertising industry waits until the 11th hour to act. So long as cookies are still available, this shift will be slow.



The other implication of the paradigm shift is within Attribution and Measurement, and the need to move from deterministic measurement methods to probabilistic – or algorithmic – models.



Note that within the parameters of our previously discussed framework and paradigm shift, Ad Tech traditionally relied on 3P data, while the DNA of MarTech has always been 1P. Going forward, we are likely to see further convergence in the worlds of Ad Tech & MarTech.


Key Trends Across the MarTech Ecosystem
Data & Identity
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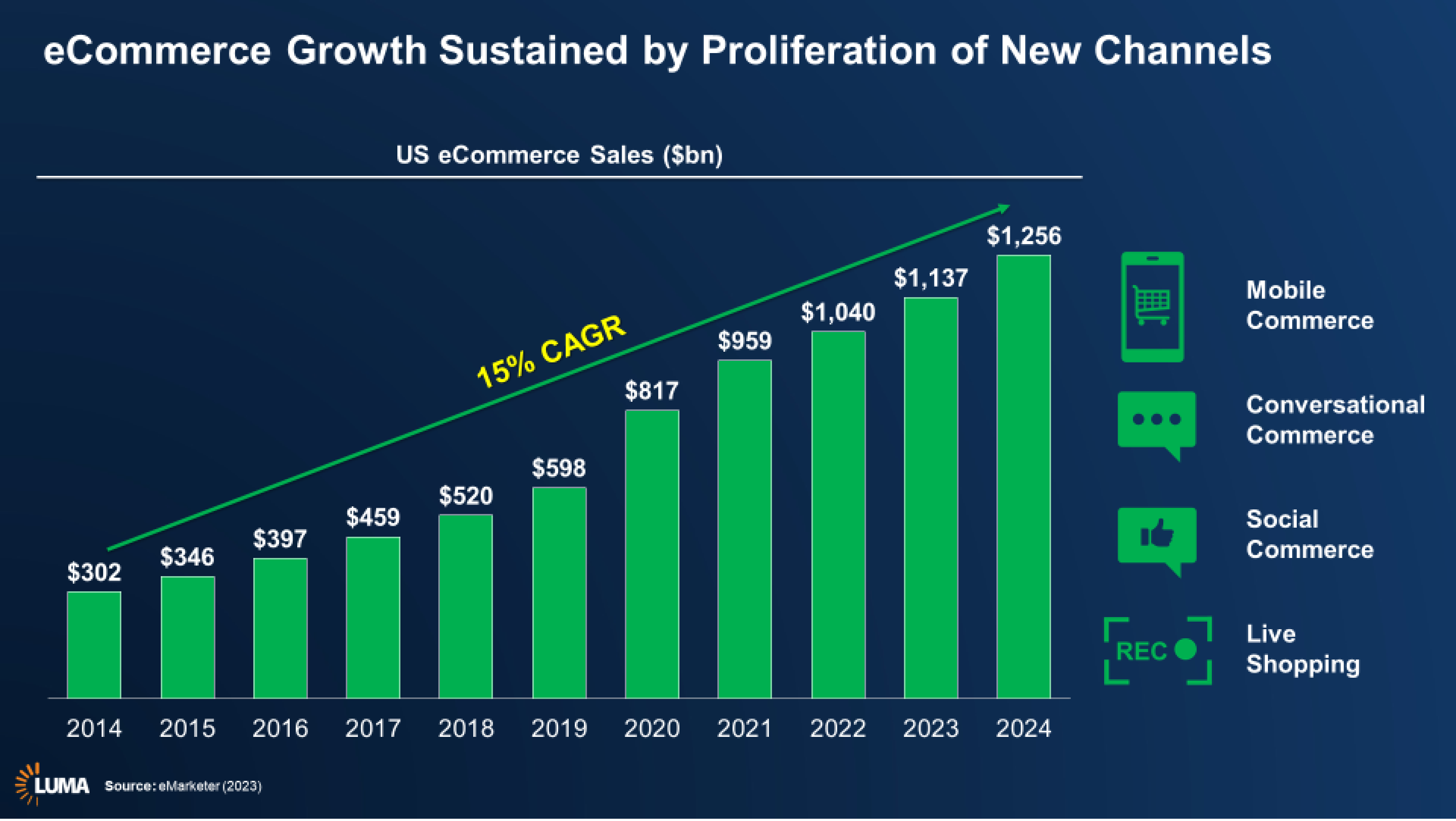
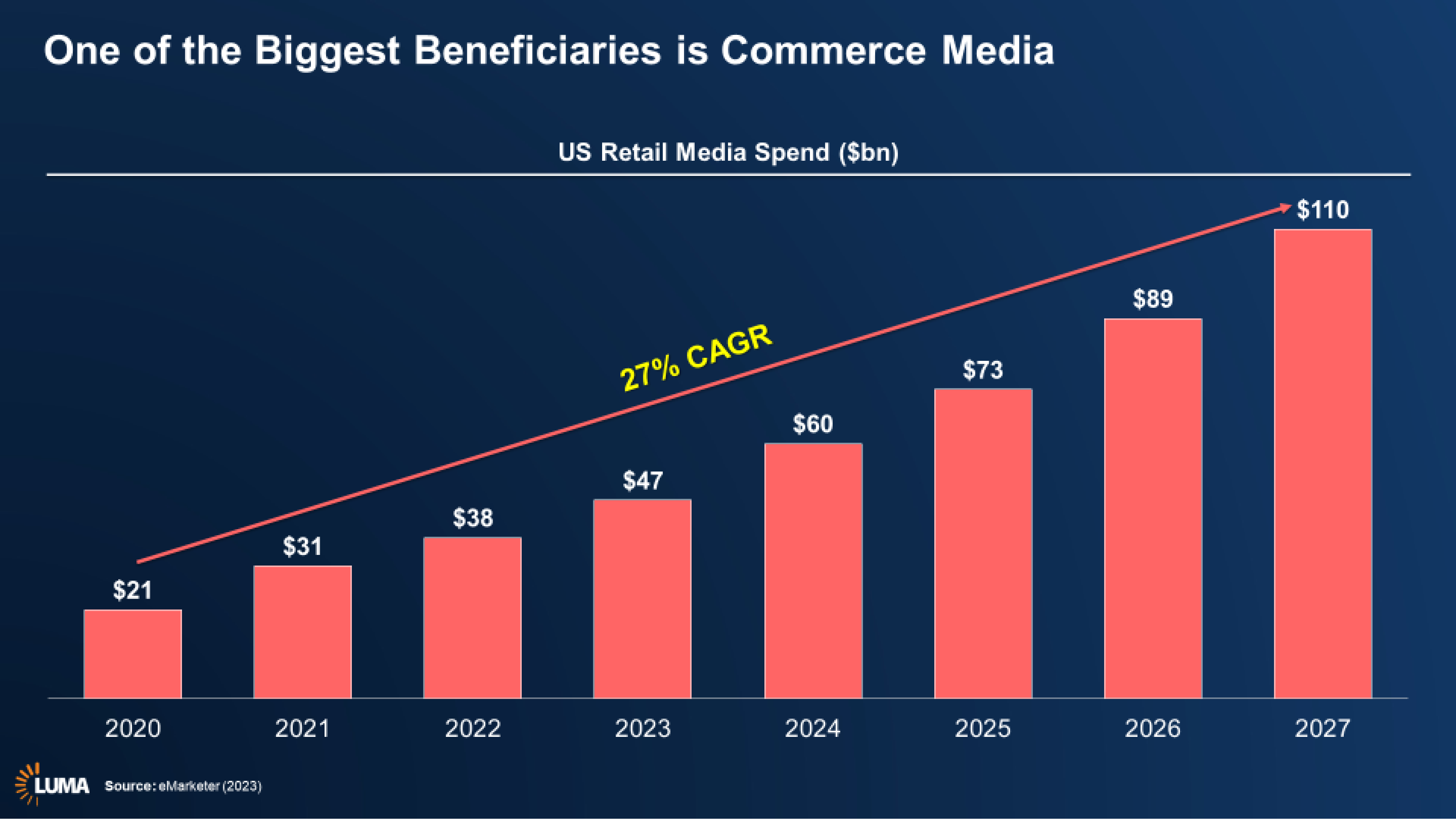
LUMA

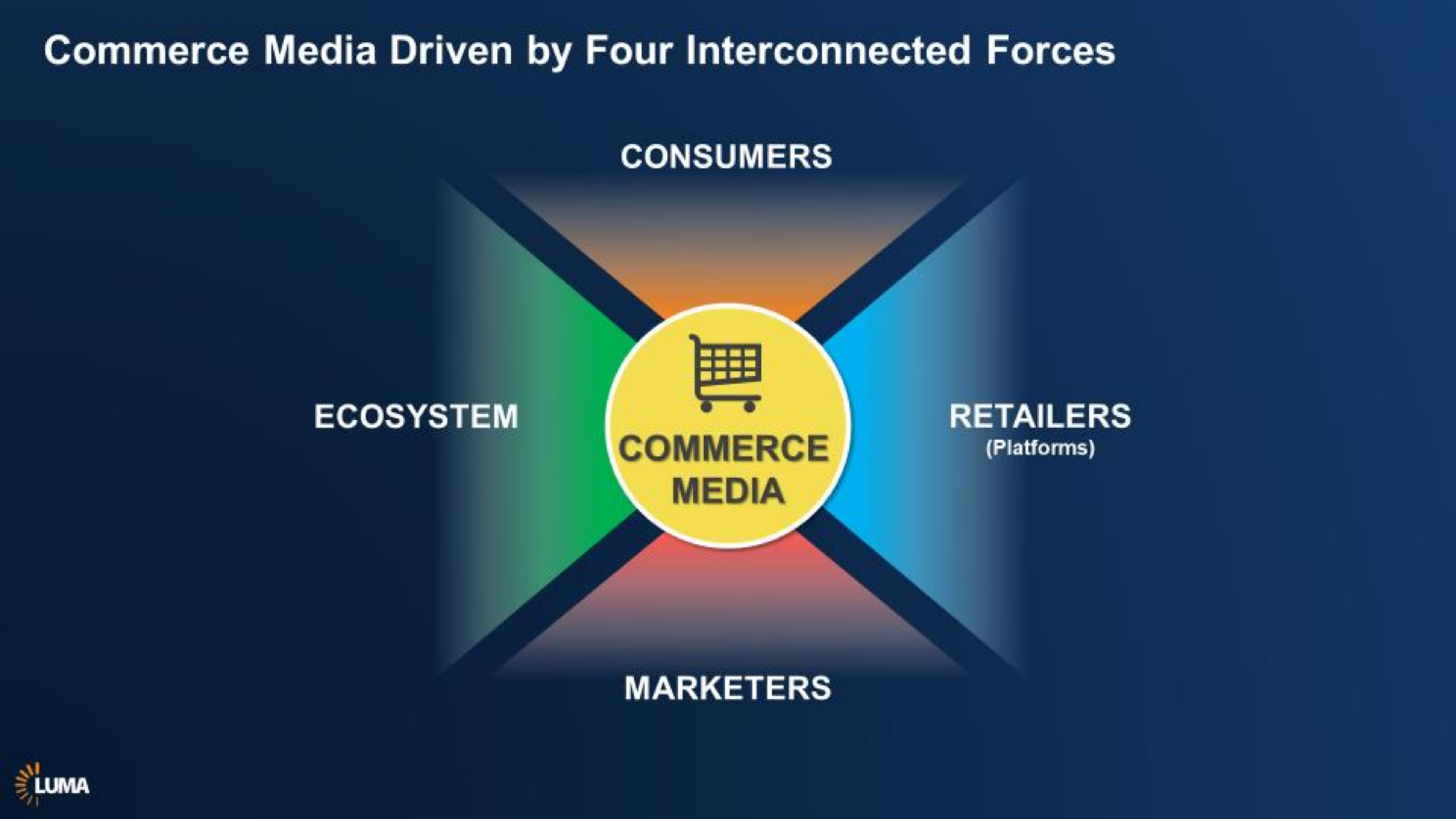


eCommerce continues to be a massive driver of growth in the economy, reaching over $1 trillion in US consumer spend over the last year. While pull forward during COVID did not create an exponential shift towards ecommerce, it did create a step function from which the ecosystem has continued its strong growth.

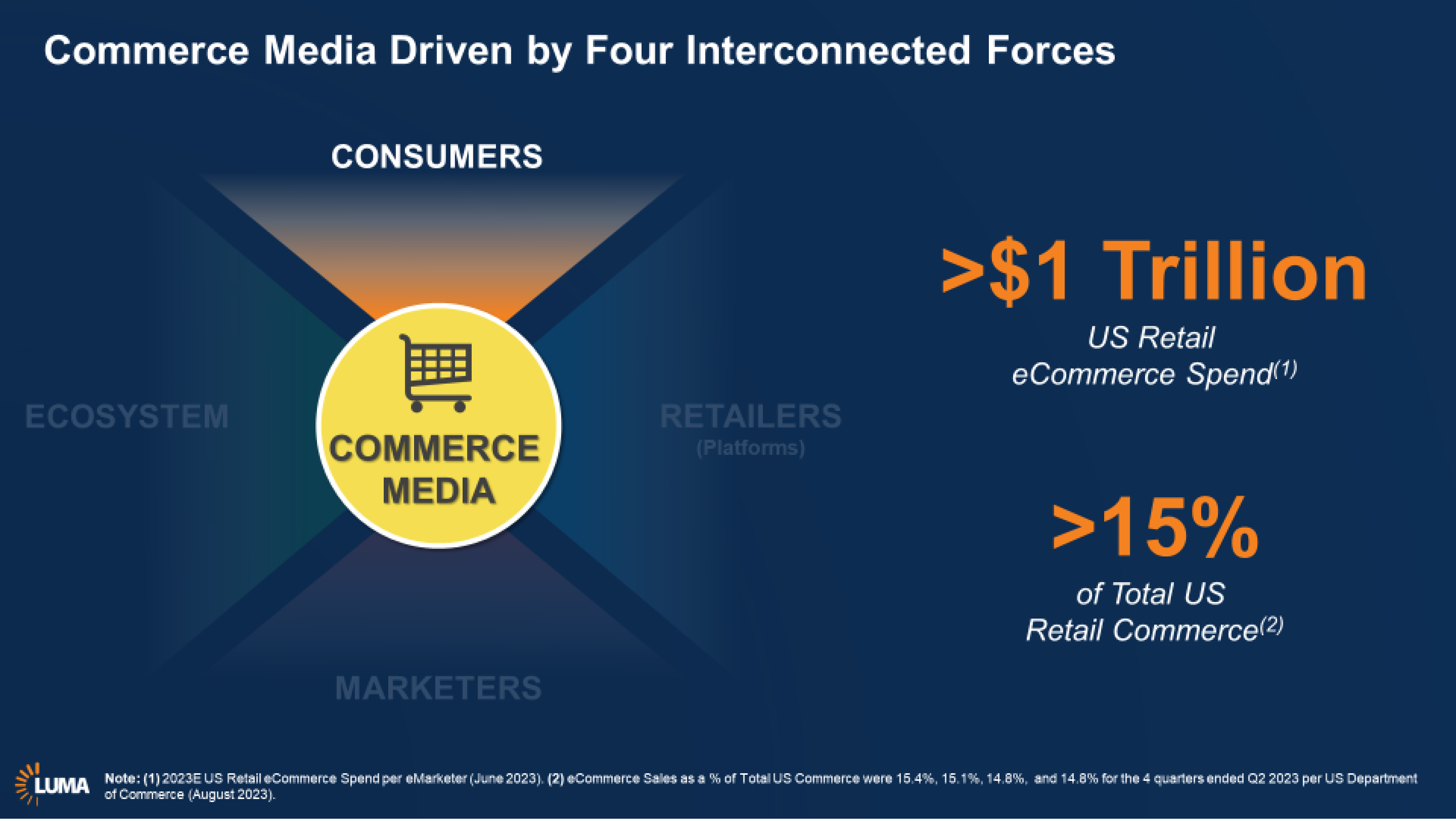
In recent years, this growth has been supported by the continued adoption of new ecommerce channels from consumers. These include, but are not limited to – Mobile Commerce, Conversational Commerce, Social Commerce, and Live Shopping.



With the rise of eCommerce has come the meteoric rise of Retail Media. This dynamic sector is expected to drive more than $60 billion in US ad spend next year alone and has garnered significant attention over the last few years.

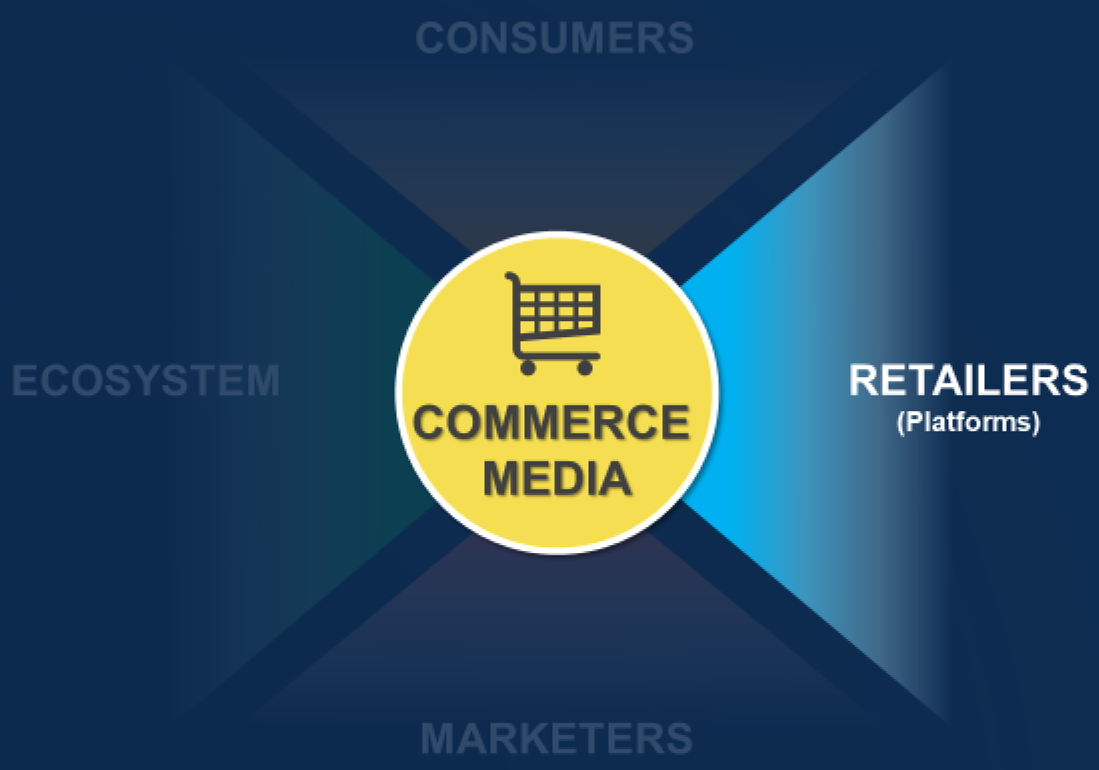


The growth of this sector has been driven by a wide variety of factors, but ultimately we see the key pillars coming from four interconnected forces – Consumers, Retailers, Marketers, and the Ecosystem at large.



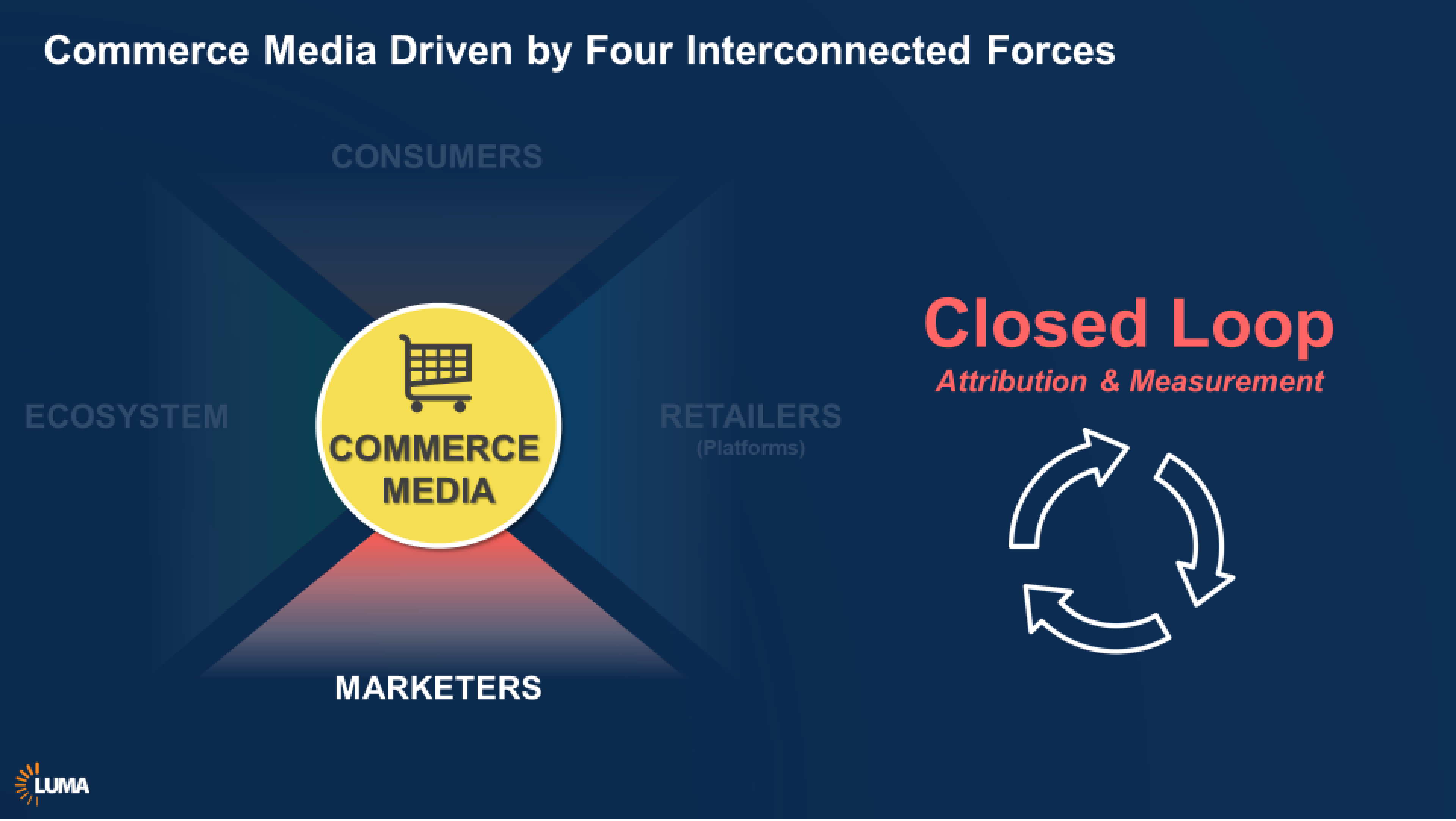
Consumers: as we noted, retail eCommerce spend will be over $1 trillion in the US in 2023. This represents over 15% of all Retail Commerce in the country and highlights the continued adoption of digital from US consumers, creating the digital engagement necessary to drive scaled advertising opportunities.

Commerce Media Driven by Four Interconnected Forces



- **A** Improves Customer Experience
- **B** Leverages Existing Assets
- **C** Improves Conversion
- **D** Way Higher Margins

Retailers: After seeing the incredible success of Amazon in retail media, many retailers have jumped into the opportunity, as it both creates new revenue / profits and aligns well across other critical business needs.

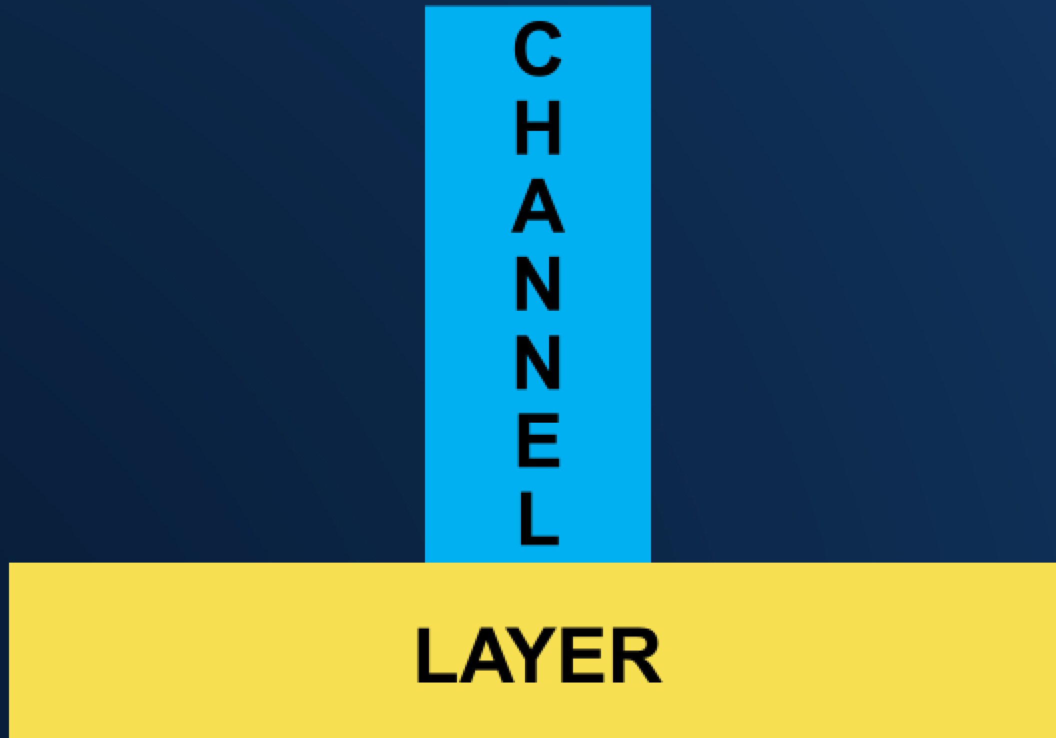


Marketers: For Marketers the excitement around commerce media really comes down to "Closed Loop Attribution". Marketers have continually sought to tie advertising spend to real-world results, and what better way to do this than to tie it directly to retail outcomes.

Commerce Media Driven by Four Interconnected Forces

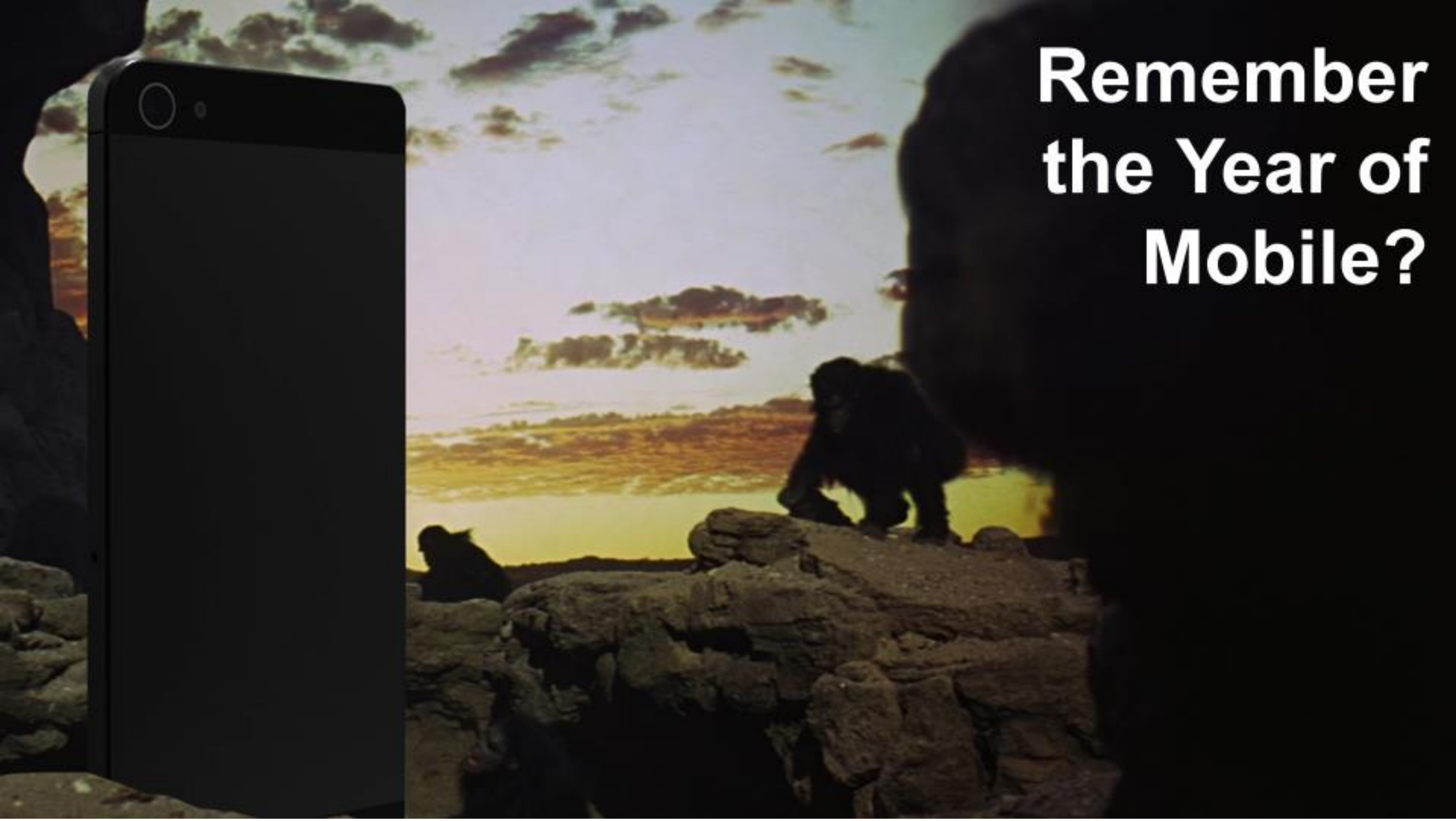
Ecosystem: The draw of closed-loop attribution has only become more important as the rest of the digital ecosystem deals with continued data deprecation from both platform and regulatory changes. This is drawing more spend to platforms that can provide performance driven advertising, as well as opening opportunities for Commerce Media businesses to take their data off-platform.

Commerce Media is Both a Channel AND a Layer

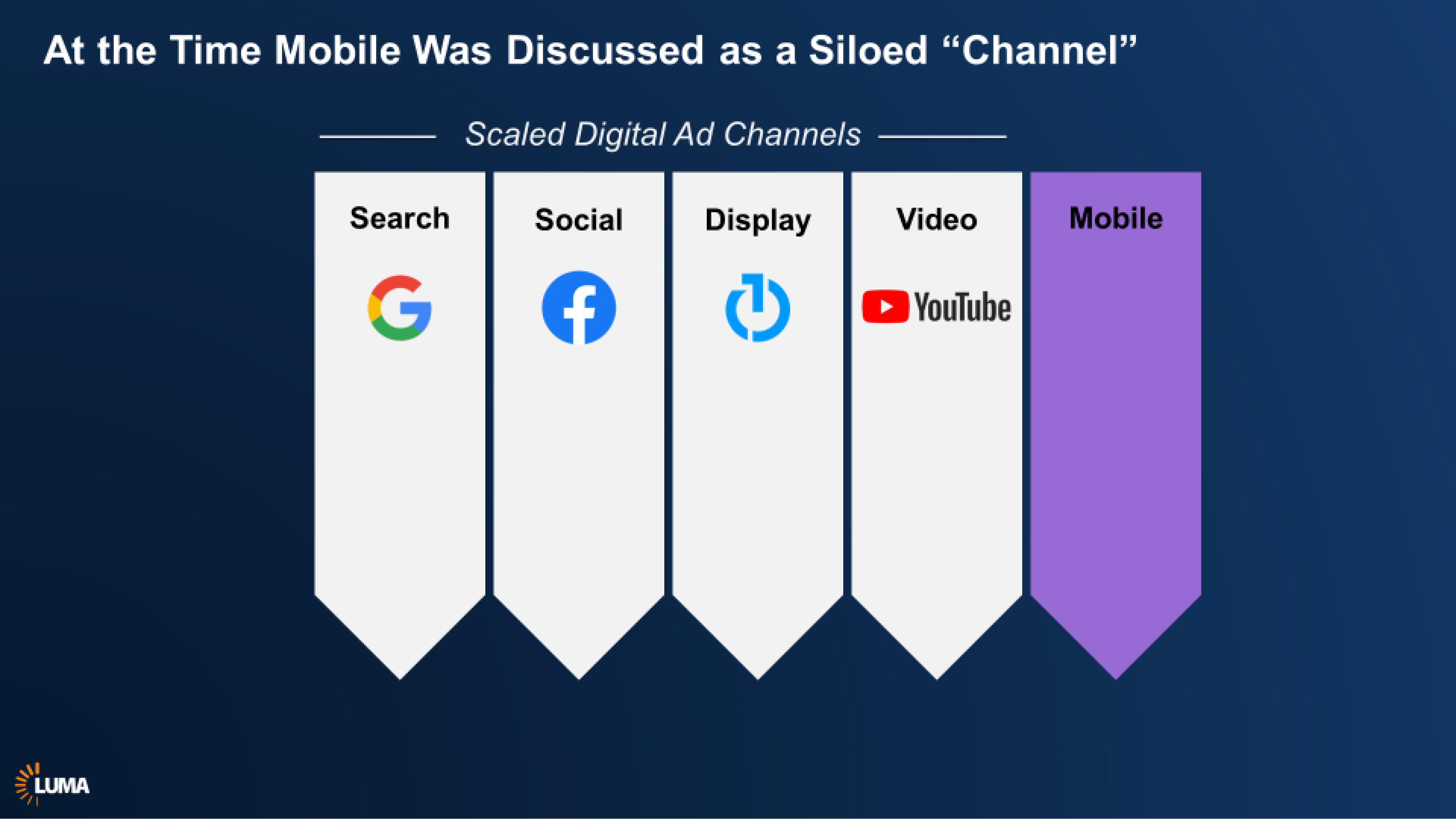


As Commerce Media heads towards a $100bn market opportunity it has drawn a lot of interest and excitement from the advertising ecosystem, but it also comes with considerable confusion and complexity. New non-retail platforms continue to launch “retail media” offerings and commerce companies continue to launch partnerships with outside media properties. So what is Commerce Media?

We believe the key to this is that Commerce Media is not simply a new advertising channel, it’s both a Channel and a Layer on the existing digital advertising ecosystem…and it’s not the first time we’ve seen this.

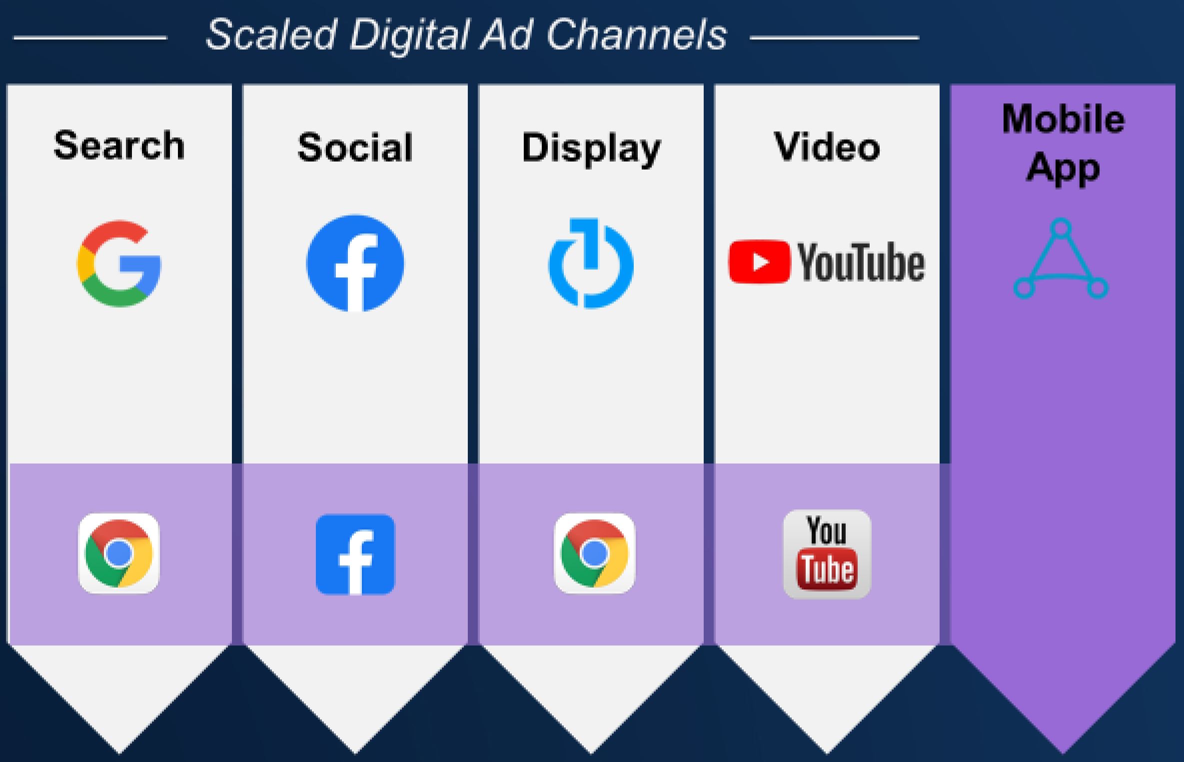


The “Year of Mobile” was an approximately 5-year span from about 2010-2015 when everyone was calling for the next year to be the year that the mobile advertising channel took off.

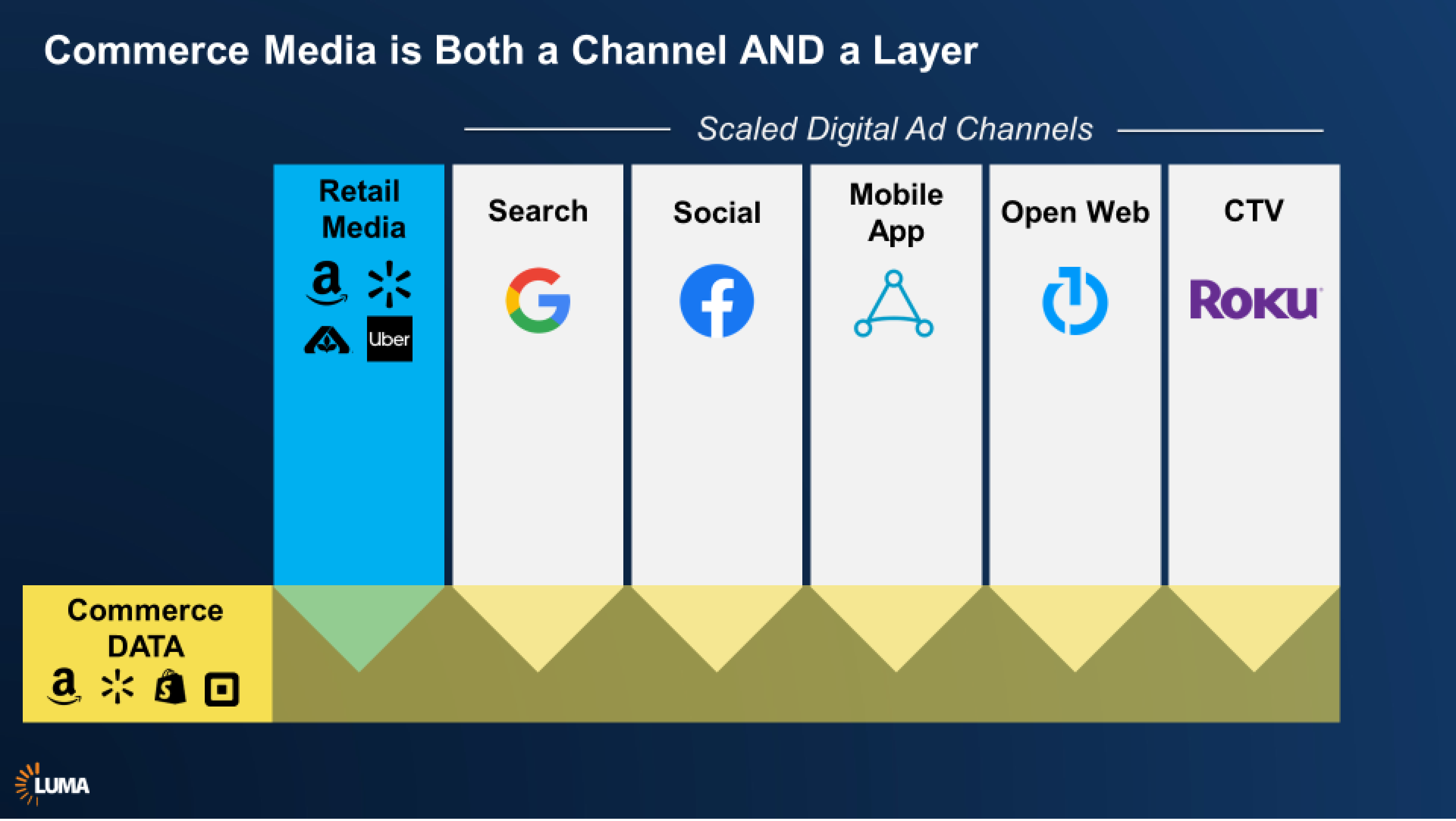


In the 2010-2015 period, Mobile was often thought about as a new advertising channel that would sit alongside other digital channels such as Search, Social, Display, and Video.

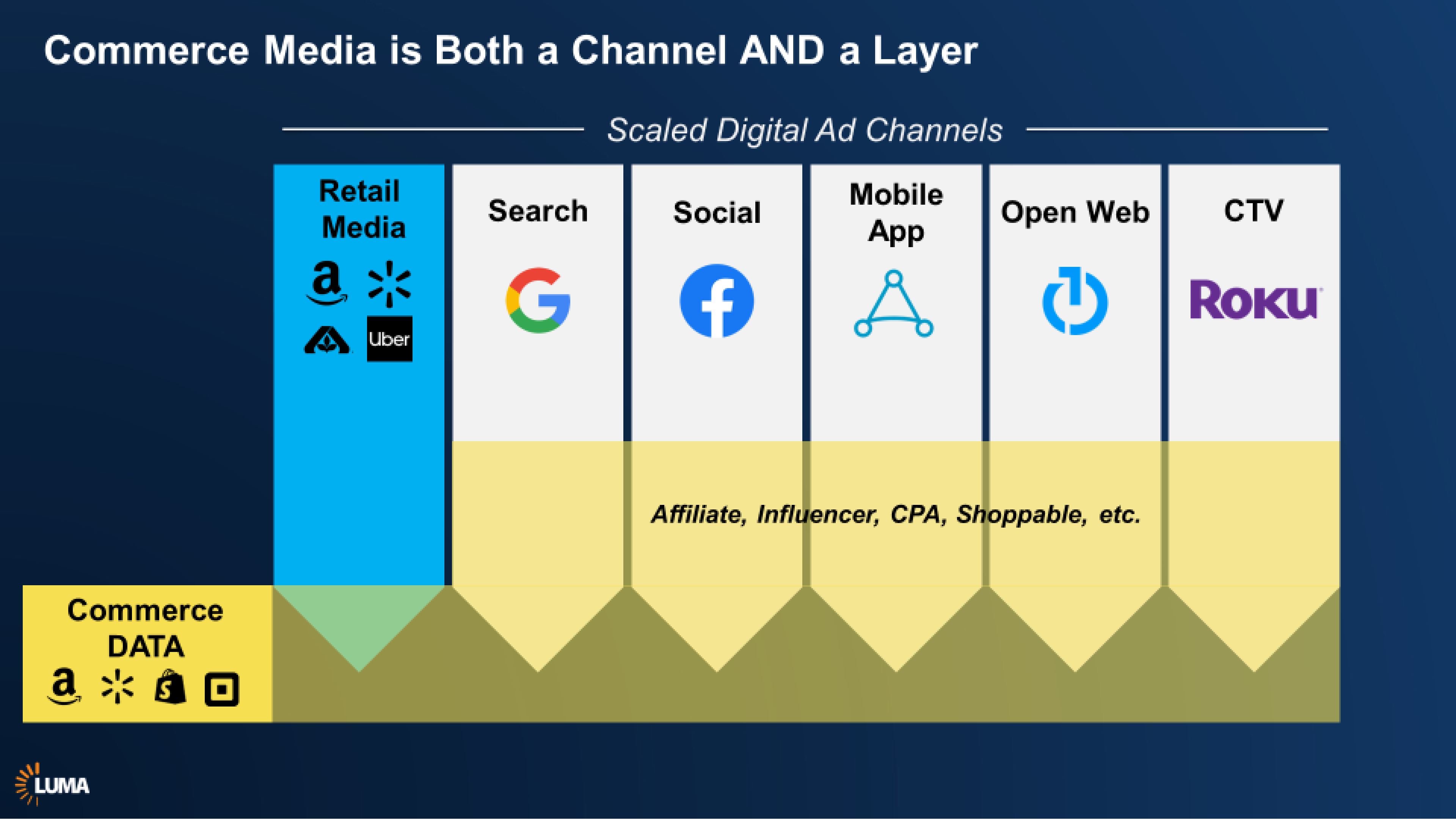
But For Most Marketers, It Was Actually a Layer



However, for most marketers, Mobile wasn't really a new channel, it was a layer on top of the existing digital advertising channels. Marketers didn't plan mobile-search and desktop-search as separate and discrete channels, rather they needed to plan search across mobile and desktop.

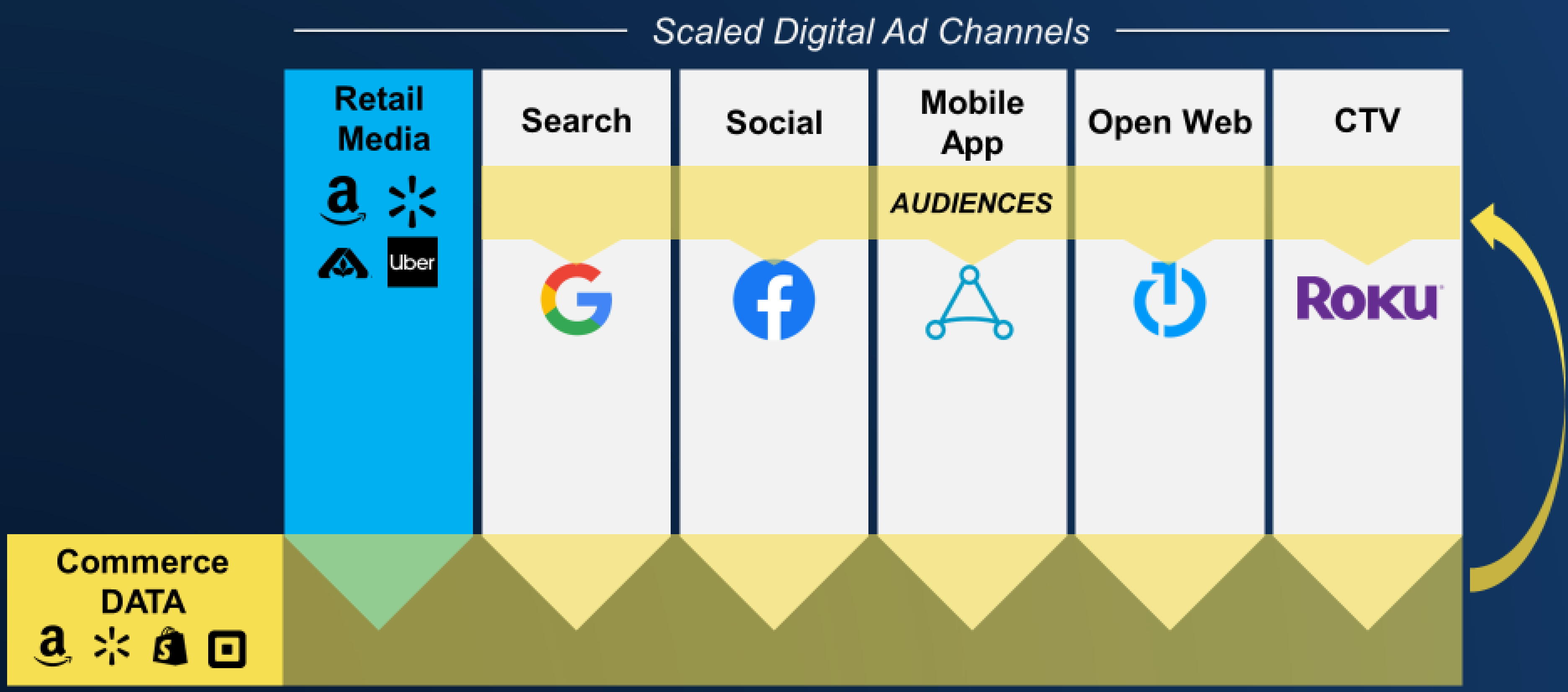


The same is true in Commerce Media. The Retail Media component is certainly a new channel, as there are new sources of inventory with unique customer engagements and advertising strategies. But Commerce Media exists in a much broader capacity, which includes leveraging commerce data and ultimately using these signals to tie media purchases to commerce outcomes.



This isn't entirely new. The performance marketing ecosystem has long focused on tying media purchases to commerce outcomes. Just consider the affiliate ecosystem, influencer marketing, general Cost Per Acquisition ads, and shoppable media formats, all of these are forms of "Commerce Media". In today's ecosystem these opportunities are only expanding as consumers lean further into new commerce formats (e.g. social commerce) and as commerce platforms become more active participants in leveraging their data and growing these formats.

Commerce Media is Both a Channel AND a Layer



In addition to the bottom-of-the-funnel media purchases, one of the biggest opportunities in Commerce Media is the expansion towards upper funnel media purchases. Rather than only using commerce signals to confirm outcomes, commerce platforms (retailers & intermediaries) are leveraging their data to create new audiences to inform media purchases across the digital landscape. In an ecosystem dealing with data deprecation, this creates a massive opportunity and is one of the primary reasons there is so much promise around Commerce Media more broadly.

Key Trends Across the MarTech Ecosystem

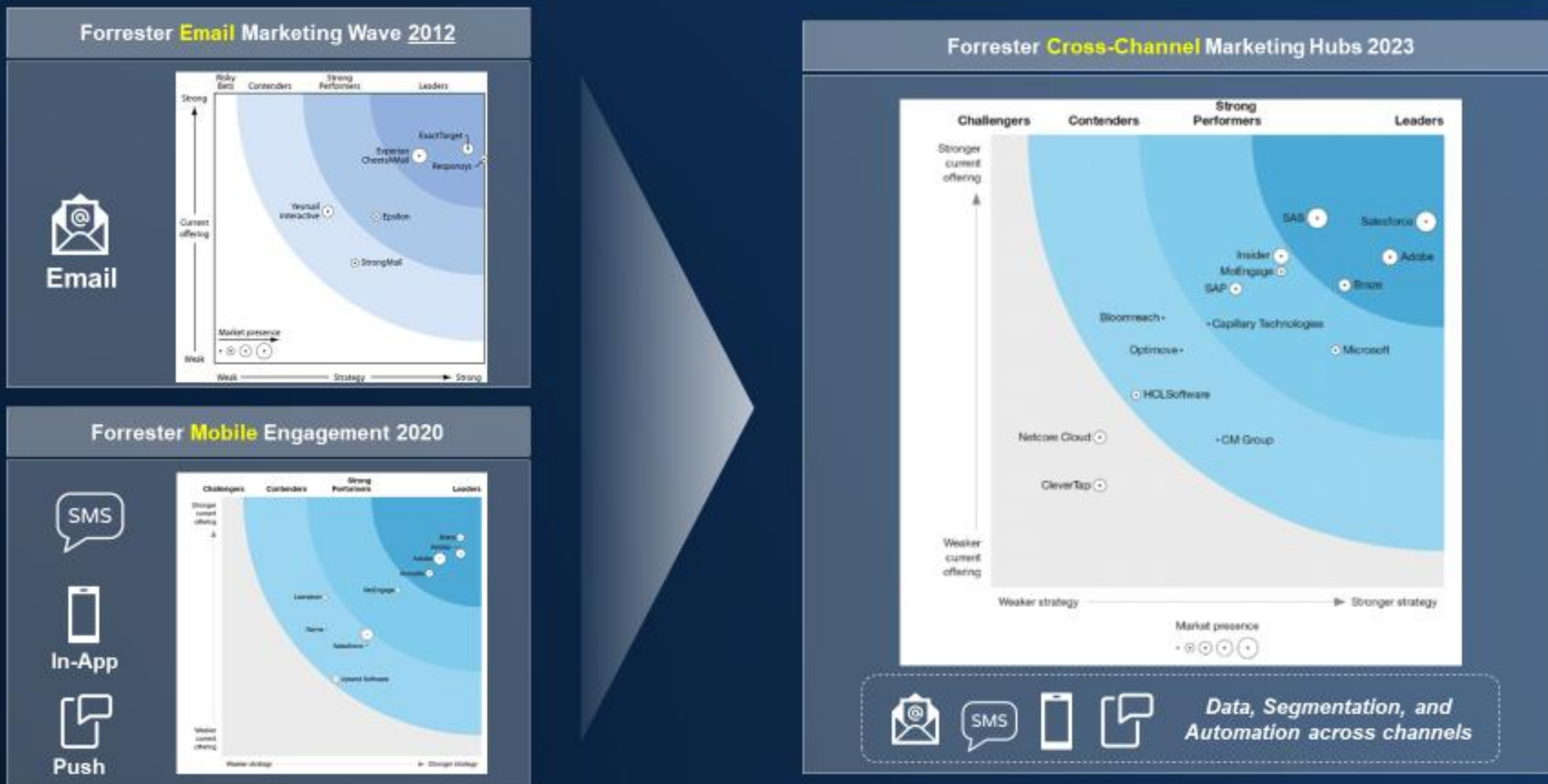
Data & Identity

Commerce

Omni-Channel Experience

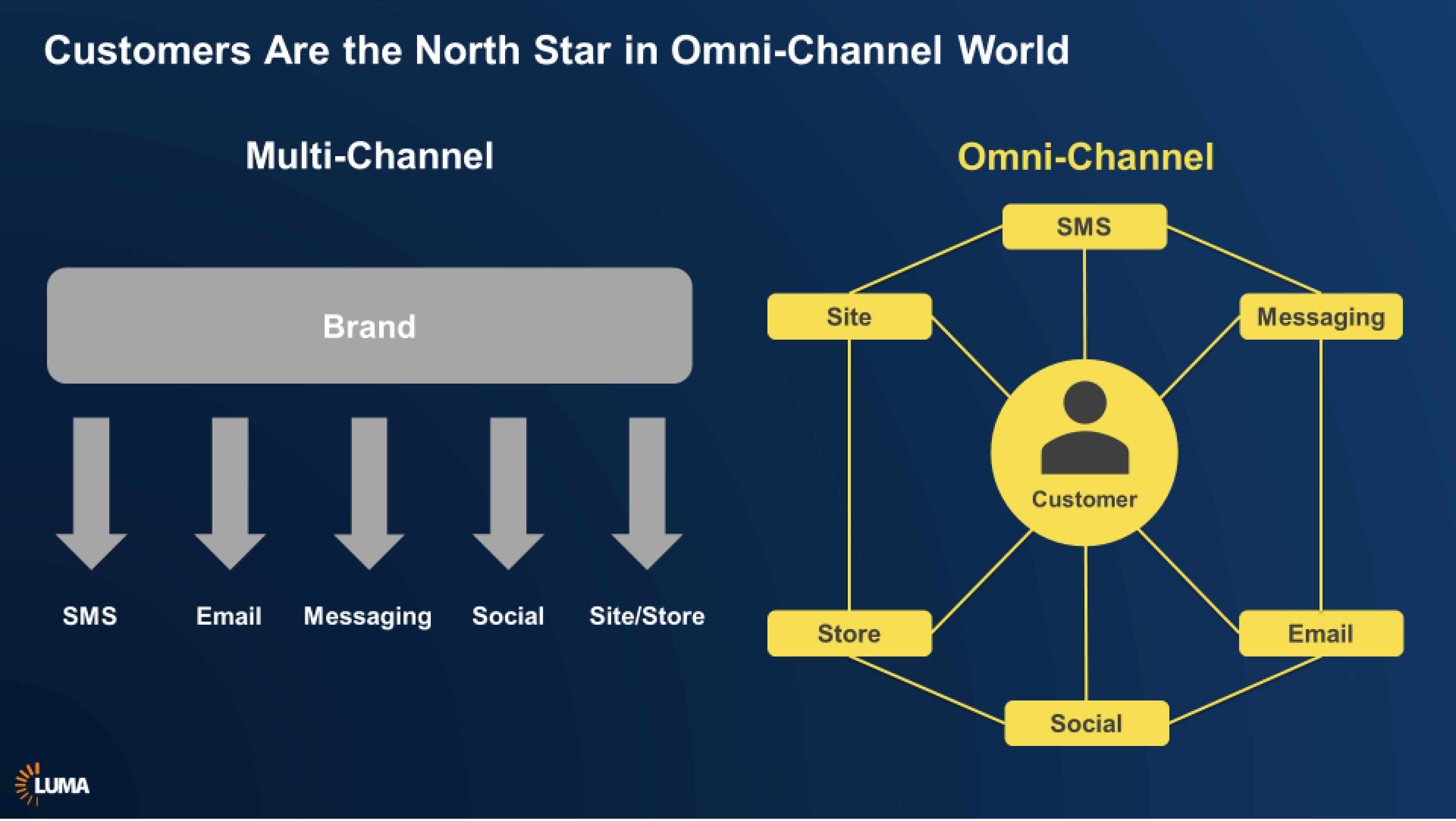
Evolving MarTech Stack

We've Moved From Silos to Multi-Channel to Omni-Channel

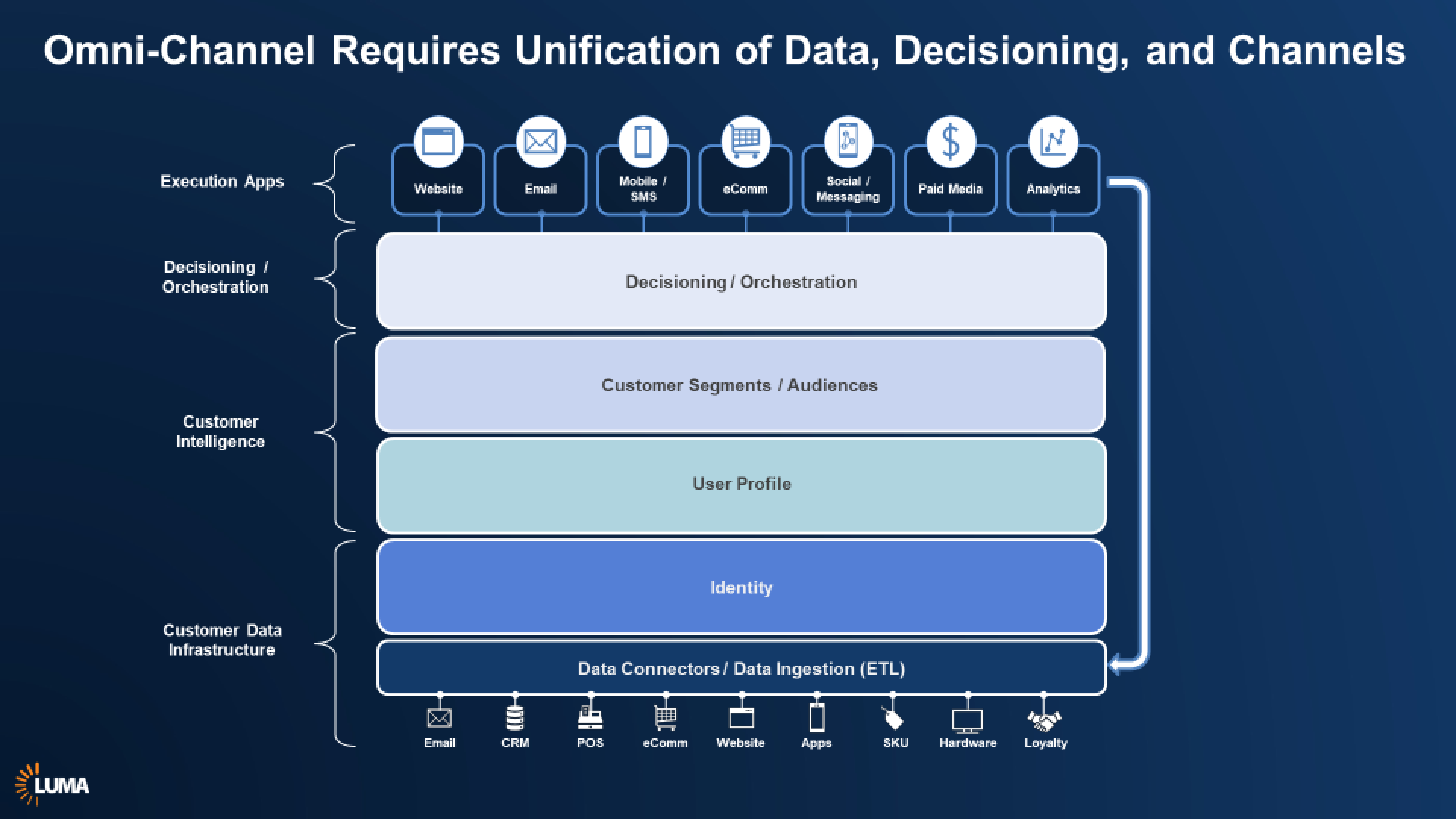


Over the last 10+ years, the digital marketing ecosystem has been on an evolution towards managing omni-channel customer experiences. Businesses that began in discrete marketing channels (email, SMS, app messaging, etc.) and were non-competitive are increasingly bumping into each other around the promise of unifying key customer touchpoints.

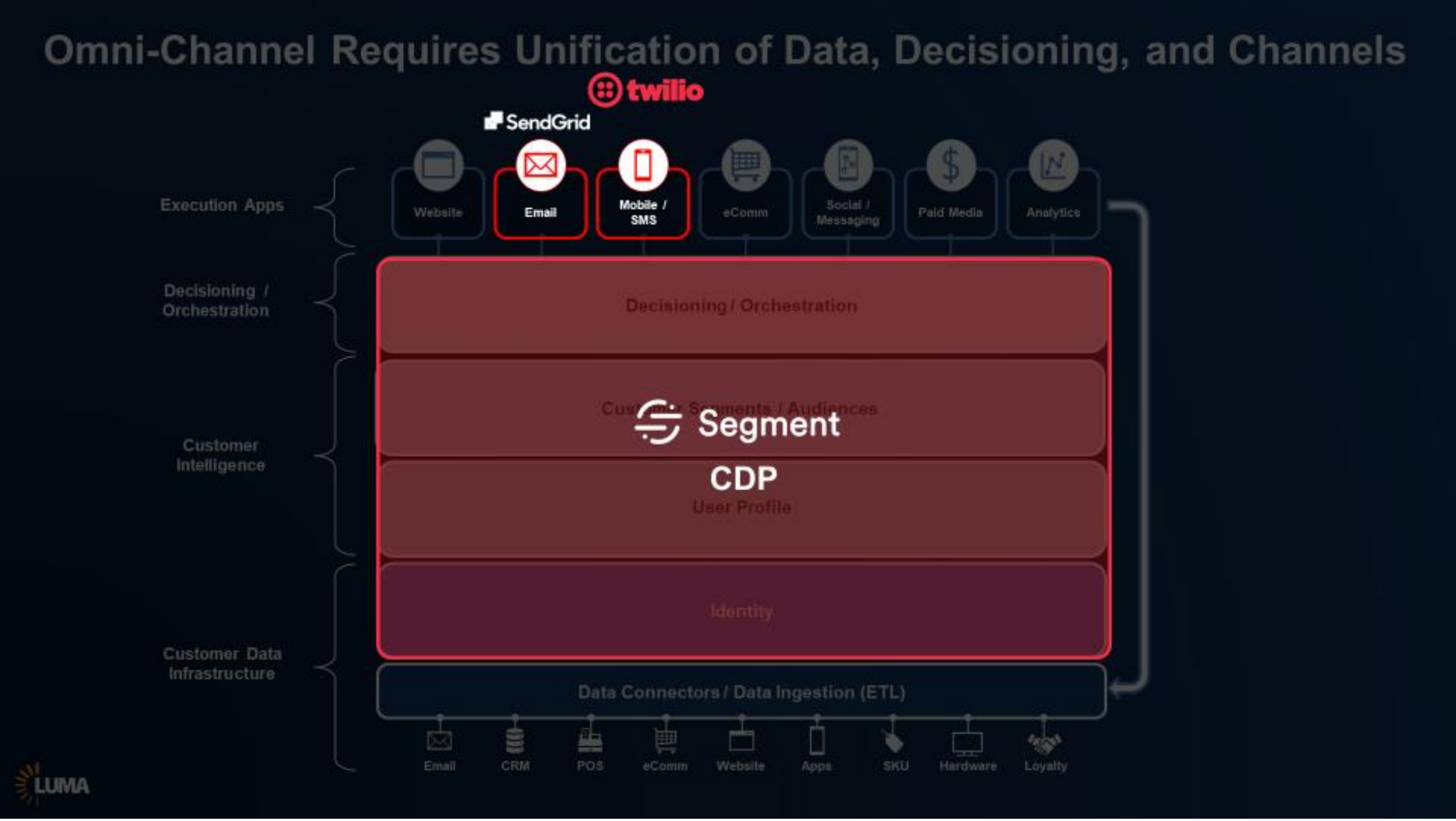
In fact, if you were to go and look at the different marketing taglines of companies that came from very different places – eCommerce, SMS, email, and mobile messaging – they are now starting to sound suspiciously similar.



As these companies move to unifying around omni-channel, they're shifting from thinking about marketing automation with a brand-first approach (managing brand messaging across a variety of channels) and are shifting to orchestration and engagement methods with customers at the center (unifying personalized messaging across all channels).



This drive towards omni-channel optimization is really what's led to the growth of CDPs and the evolution of how companies are interacting with customers across channels. Pictured above is a chart we've often used to contextualize CDP capabilities. CDPs of different varieties have sat in the middle – managing aspects of identity, user profiling, customer segmentation and decisioning to optimize communications across all channels. Lately, we've noticed many companies focused on the omni-channel customer experience have started to expand across the top layer on different execution touchpoints, as well as down into the stack to own more of the decisioning themselves.



Twilio, a leader in SMS marketing infrastructure, used M&A to expand capabilities over the last few years, acquiring SendGrid to move into email infrastructure and acquiring Segment to capture a full CDP / identity infrastructure layer.

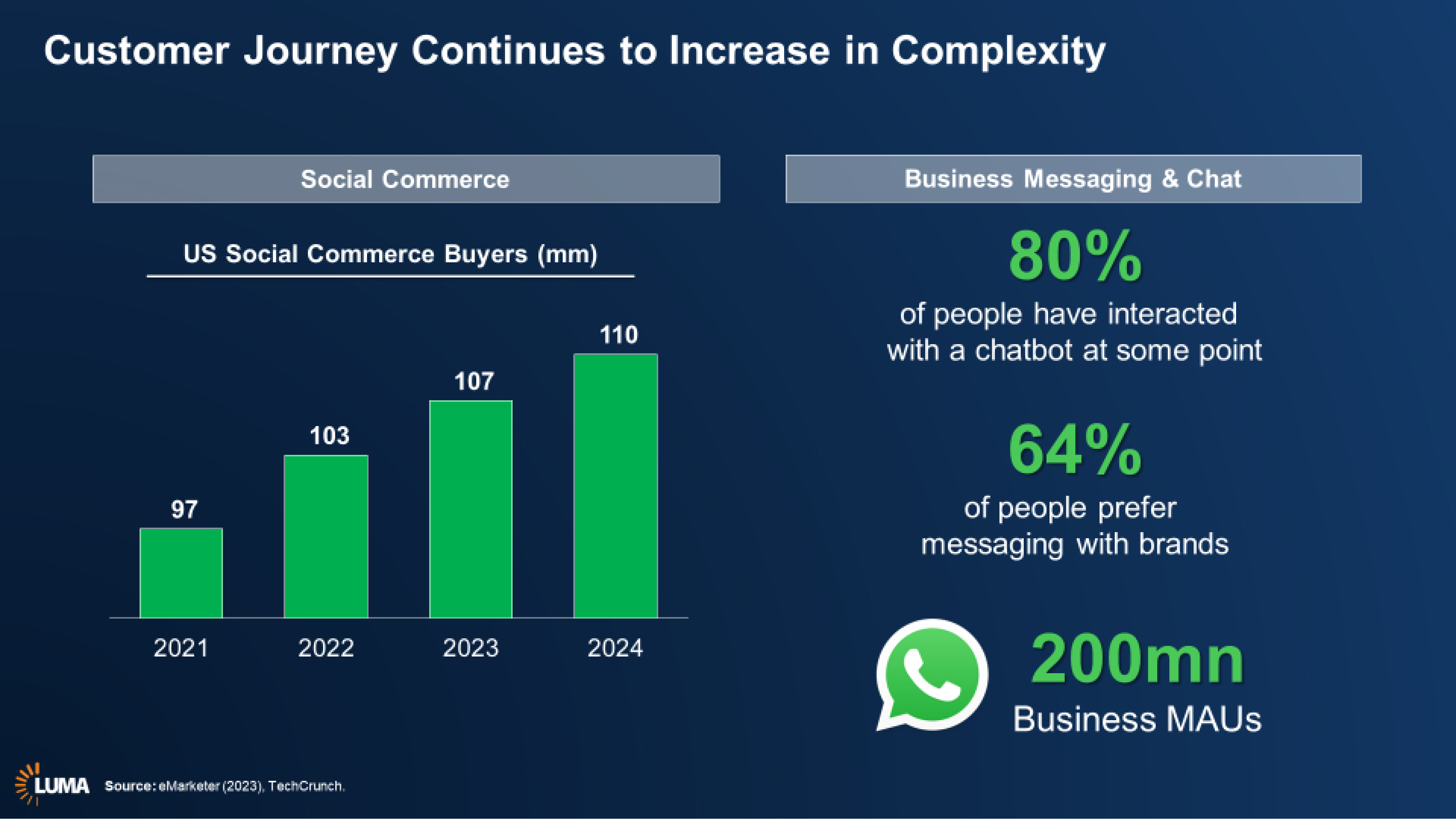
Omni-Channel Requires Unification of Data, Decisioning, and Channels

Bloomreach started in search optimization for eCommerce sites and has expanded across omni-channel touchpoints – adding mobile / SMS, email, paid media, and overall site optimization. They then acquired Exponea, a CDP, moving deeper into owning the full decisioning and orchestration layer.

Omni-Channel Requires Unification of Data, Decisioning, and Channels

Klaviyo started with email, expanded into mobile / SMS, and most recently built their own CDP allowing them to drive further into the data part of the stack.

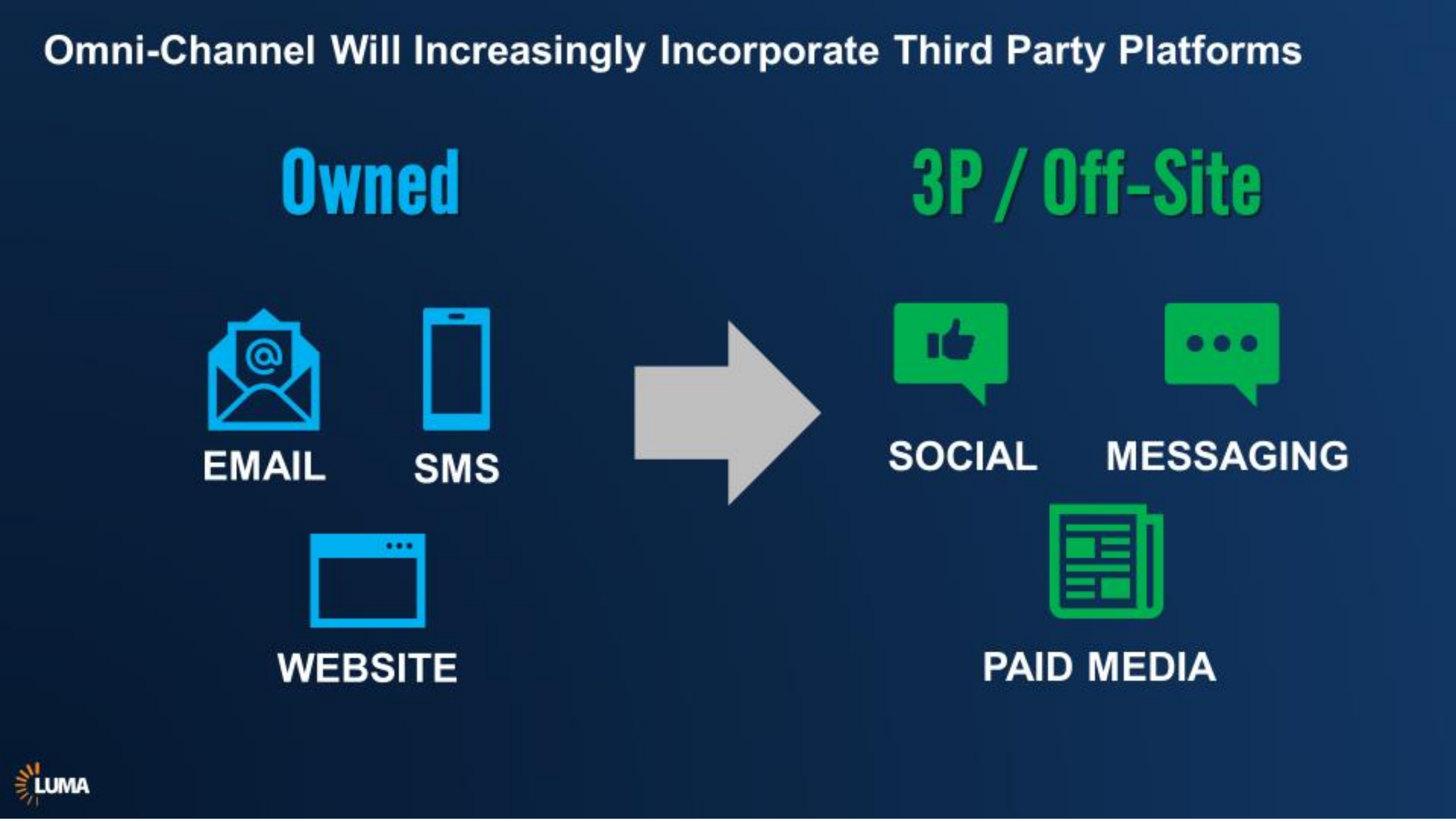
Ultimately, all these companies are finding opportunities to expand across multiple customer touchpoints, and as they do, need to start moving further into the data stack in order to own the full orchestration.



Even as platforms expand across exiting customer channels, the customer journey is growing more fragmented and complex. Social commerce has been a major focus of large platforms over the last year, with TikTok launching Shop and Amazon making significant partnerships with platforms like Meta, Snap, and Pinterest. This is leading to over 100mm social commerce buyers in the US this year.

We've also seen a rise in conversational commerce and overall business to consumer messaging. While onsite chatbots have been growing for some time, the rise of conversational AI has brought more comfort to consumers messaging with businesses and opens opportunities to chat wherever consumers are.

In fact, in their latest earnings announcement, Meta noted that business messaging is going to be the next major pillar of its business.



What's interesting to see here is that while much of the existing omni-channel experience management has happened within marketers owned channels – Email, SMS, push, website, etc. – these new interactions and transactions are happening on 3rd party channels – social, messaging apps, etc. This will add complexity to managing the omni-channel experience and require further expansion from the existing platforms.

Key Trends Across the MarTech Ecosystem

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Omni-Channel Experience

Evolving MarTech Stack

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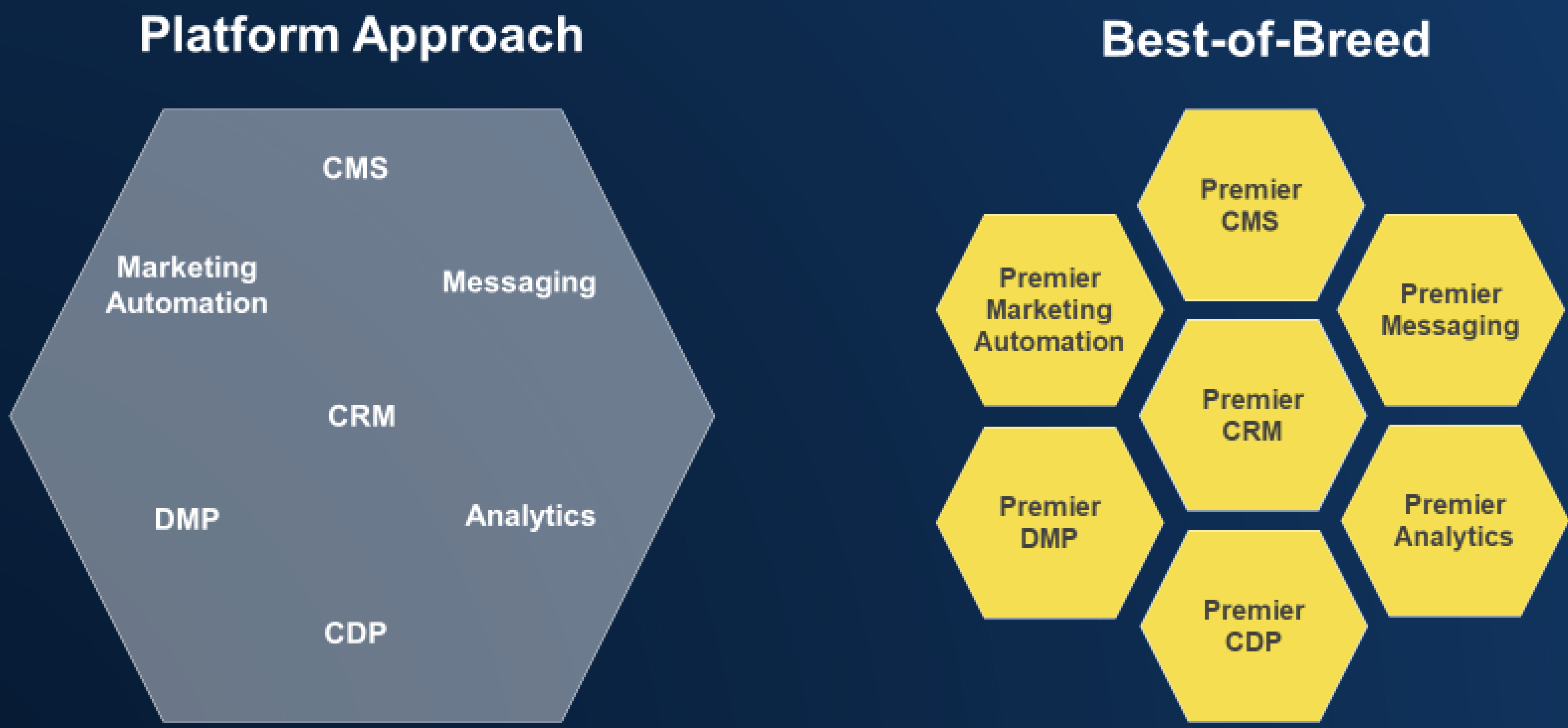
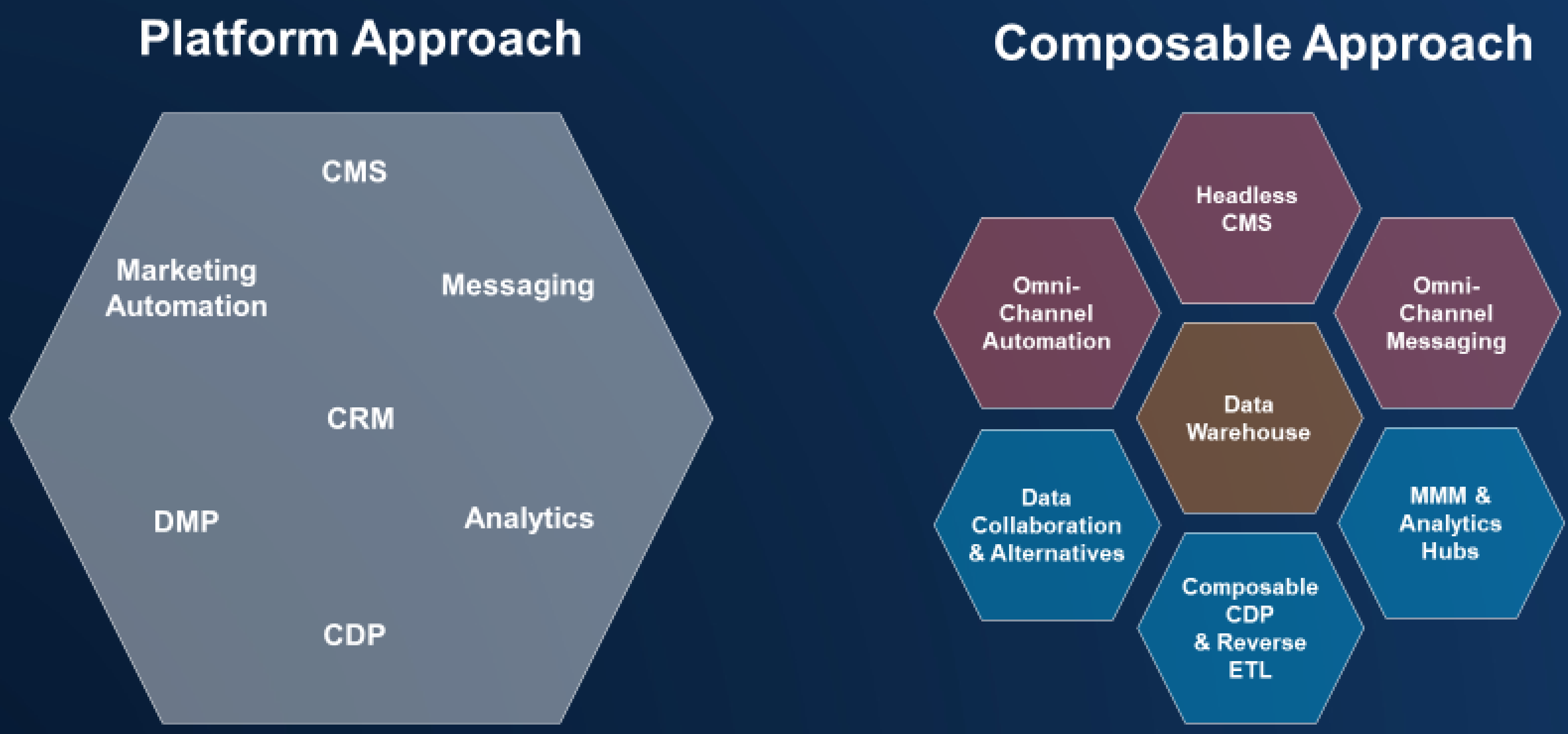
Push and Pull Between Platforms and “Best-of-Breed” in MarTech Stack

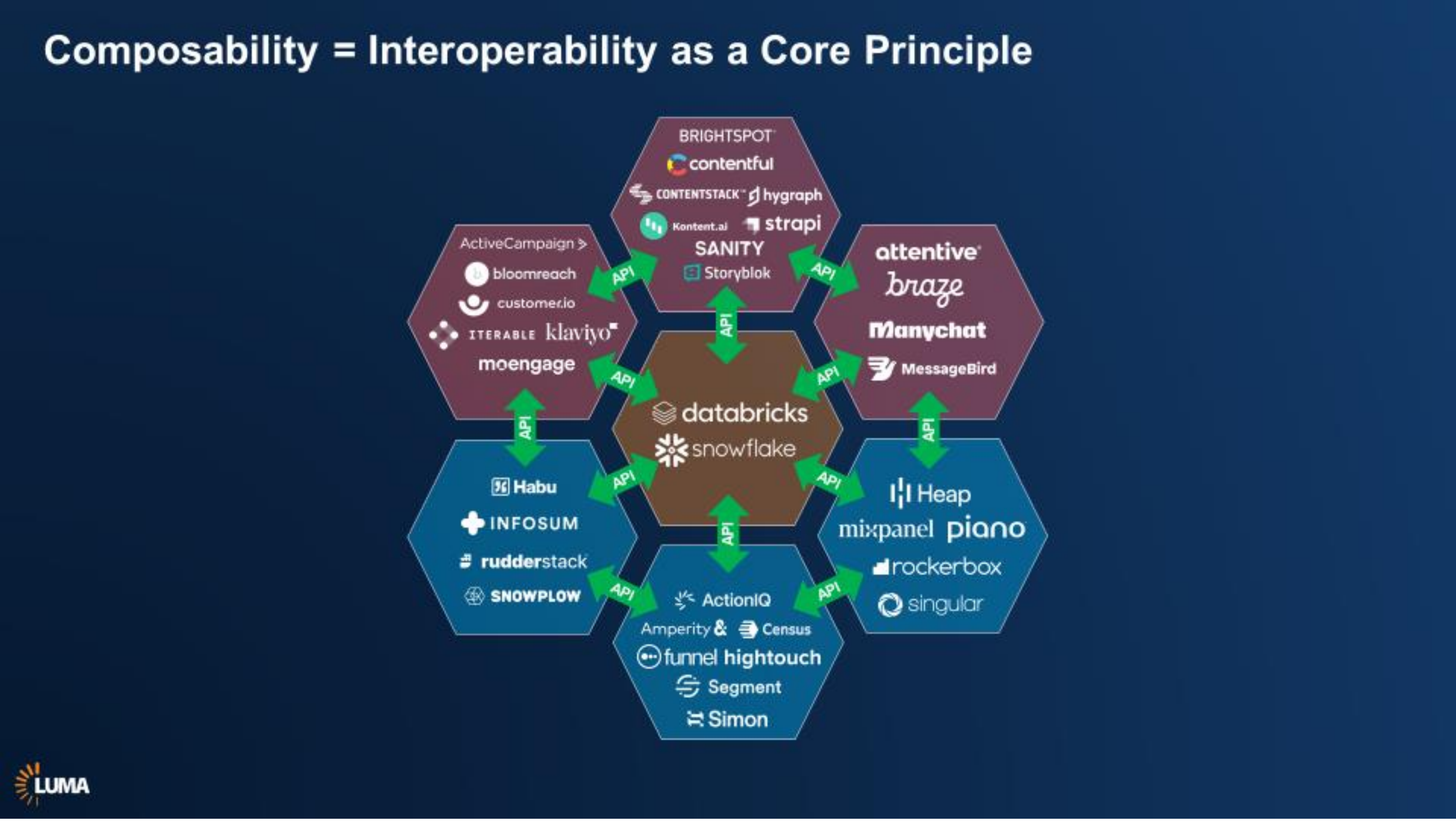


As the MarTech ecosystem has evolved, there has long been a push and pull between between the notion of a full MarTech suite (e.g. the MarTech clouds) and a “best-of-breed” approach. While large platforms have continued to grow and found significant success from organic and inorganic capability expansion (see prior section as an example), they’ve also needed to play nice in the sandbox, as marketers have continued to lean heavily on “best-of-breed” capabilities, building robust, customized MarTech stacks. This has meant that ecosystem integration is important, even for the largest platforms.

“Best-of-Breed” Shifting Towards Composable MarTech Stacks

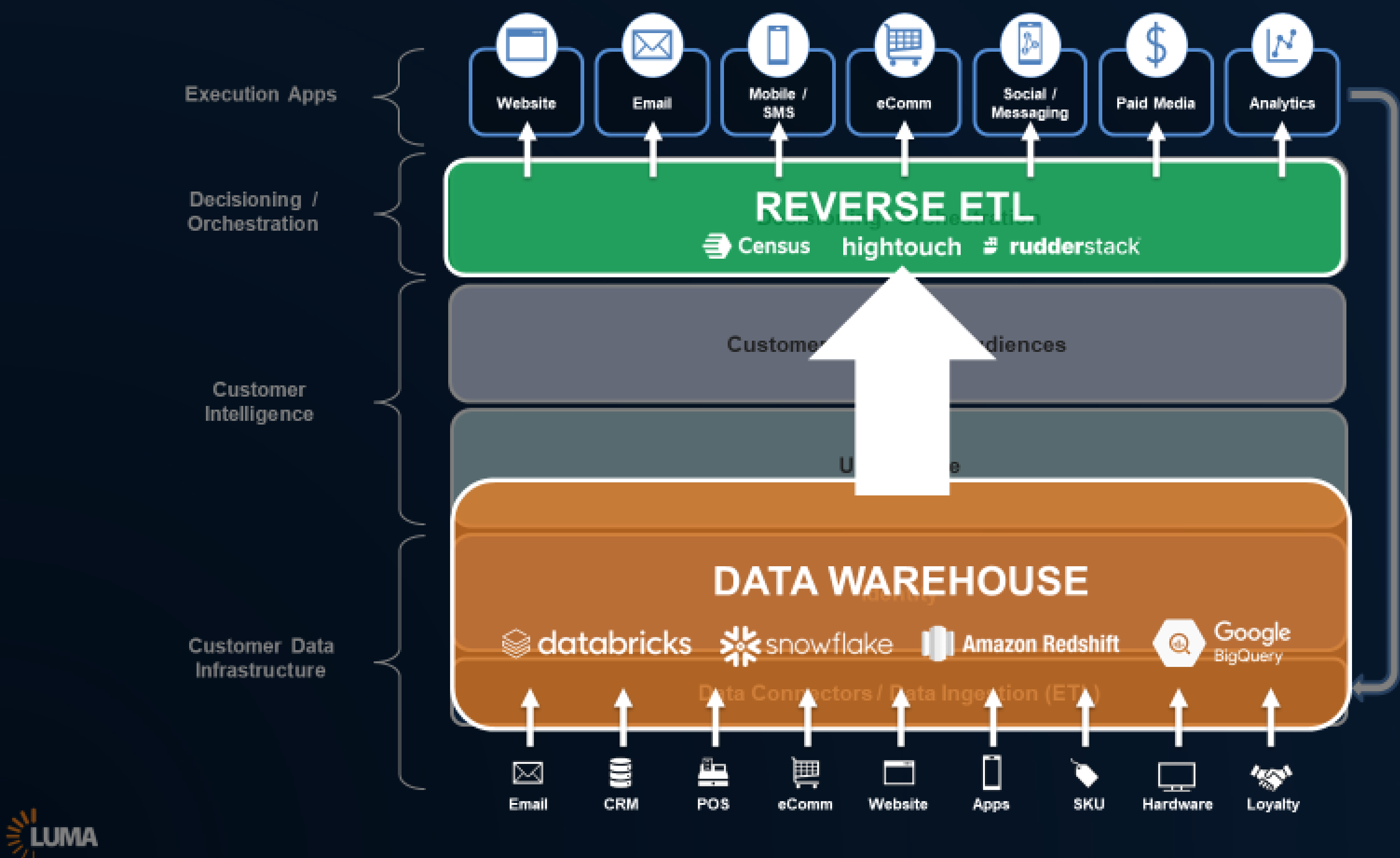


But that cobbling together of various MarTech capabilities has been a massive challenge. These integrations took time and if they did not operate smoothly, marketers could lose the value they sought from a more customized stack. In response to these challenges, we’ve seen a shift in the landscape from one focused simply on “best-of-breed” to one focused on composability of capabilities. The focus is no longer just about which platform is the best for a given channel, but which platform is the best for integrating into the platforms a marketer is already using.

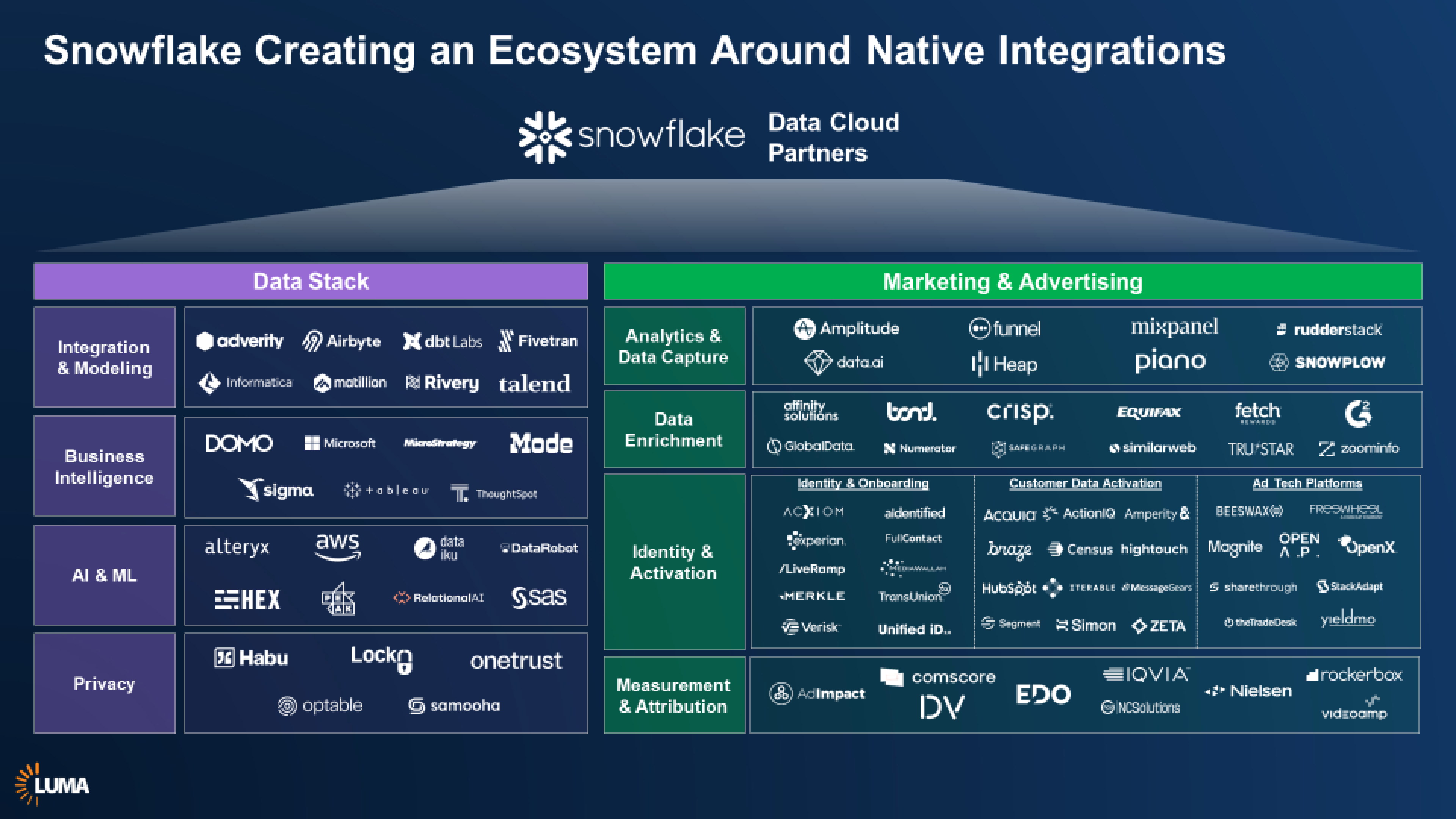


Ultimately, what we boil composability down to is this notion of interoperability at the core. These systems all need to be working together and rather than put that on the marketing / IT organizations or hold up buying decisions, the ecosystem is looking to remove that burden from the start. For this reason, the second thing you'll often see on a MarTech vendor's site, after they describe their capabilities, are the details on their partner ecosystem because they're all coming in with pre-built, native integrations.

Rise of Reverse ETL Platforms Demonstrates Composability



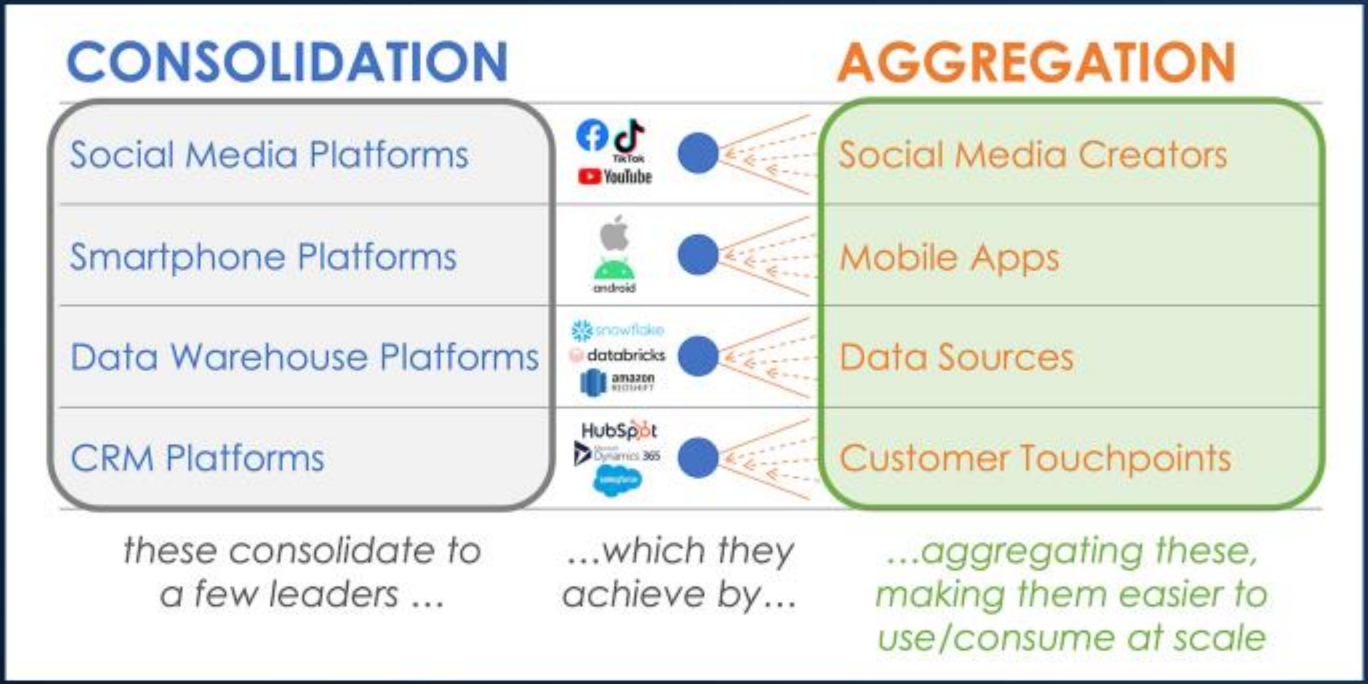
We’ve noticed some channels having an outsized impact on this, and the data warehouse is a prime example. The notion of reverse ETL and the composable CDP is all built on the fact that rather than having your data stored in multiple places and moving the data around, you’re able keep it in the core data warehouse infrastructure and run the decisioning from there. The reverse ETL comes to interact with that data and brings the decisioning to the execution channels.



This is not just for the CDP capability though. Lately, Snowflake has been heavily focused on building out a full ecosystem around native integrations into its central data warehouse. These partnerships span across data, marketing and advertising partners, all looking to make it easier for Snowflake's data customers to more easily action on their data. Ideally this creates a mutually beneficial relationship whereby Snowflake has more data processed on its platform (how it drives revenue) and the partners have an easier path to acquiring and retaining customers by simplifying the discovery and usability of their capabilities.

Aggregation Theory Applied to MarTech Stack

chiefmartec



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Ultimately, what this is doing is bringing the notion of Ben Thompson's Aggregation Theory into the MarTech stack, as detailed by Scott Brinker in a recent ChiefMartec blog post. As he discusses in the piece, we have never seen a real consolidation of MarTech companies / capabilities given the draw towards "best-of-breed", but increasingly we are seeing points of aggregation, where certain platforms become the focal point for accessing and discovering the broader swath of capabilities. Much like YouTube aggregates video creators and consumers, platforms such as Snowflake could aggregate Marketers' data and MarTech vendors.

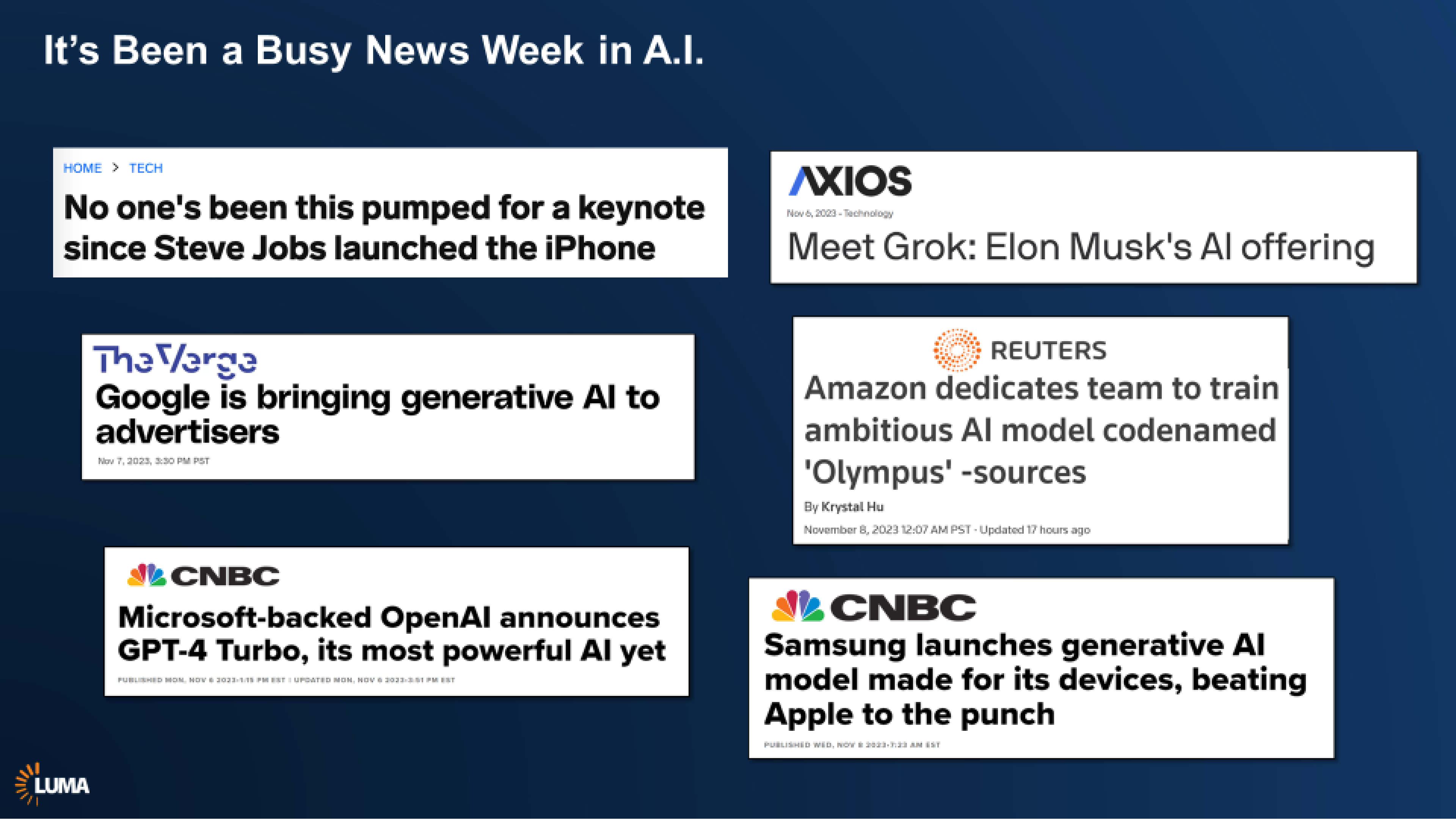
Ecosystems of Technology Generate Flywheel Effects

The powerful thing about aggregation theory is that it creates incredible flywheel effects for the anchor companies sitting in the middle. We've certainly seen this take form in the consumer ecosystem, but we're now seeing multiple B2B platforms move in this direction, creating ecosystems around them that improve utility for their customers while solidifying their critical position in the stack.

Snowflake is clearly doing this in the data ecosystem, but it can also be seen in eCommerce with Shopify, as well in media with TheTradeDesk's launch of Kokai earlier year, allowing other ad tech / data vendors to build on top of its DSP platform as a focal point for executing advertising spend.

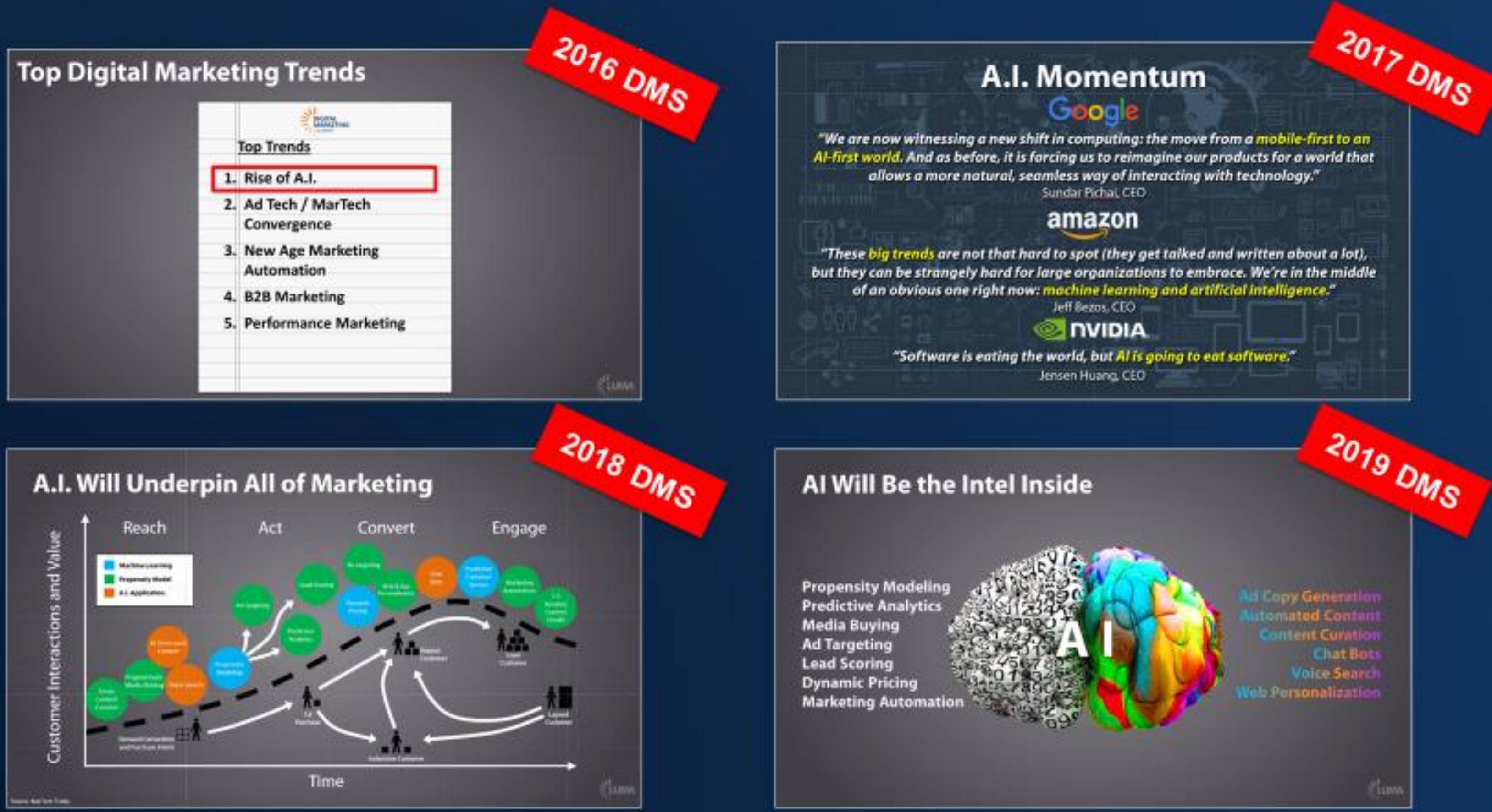
ARTIFICIAL INTELLIGENCE

A.I. is the topic of the day. It seems impossible to escape the Artificial Intelligence conversation. Technology loves “Shiny New Things”, and this is as “Shiny” as it gets. However, in this case we believe the hype is warranted.



Just in this last few weeks, there were several noteworthy announcements in A.I. and some particularly significant ones about automation. Many of the infrastructure and foundational platform dynamics that we discussed in the last section appear to be forming and taking place in A.I.

A.I. Has Been On Our Agenda for A While



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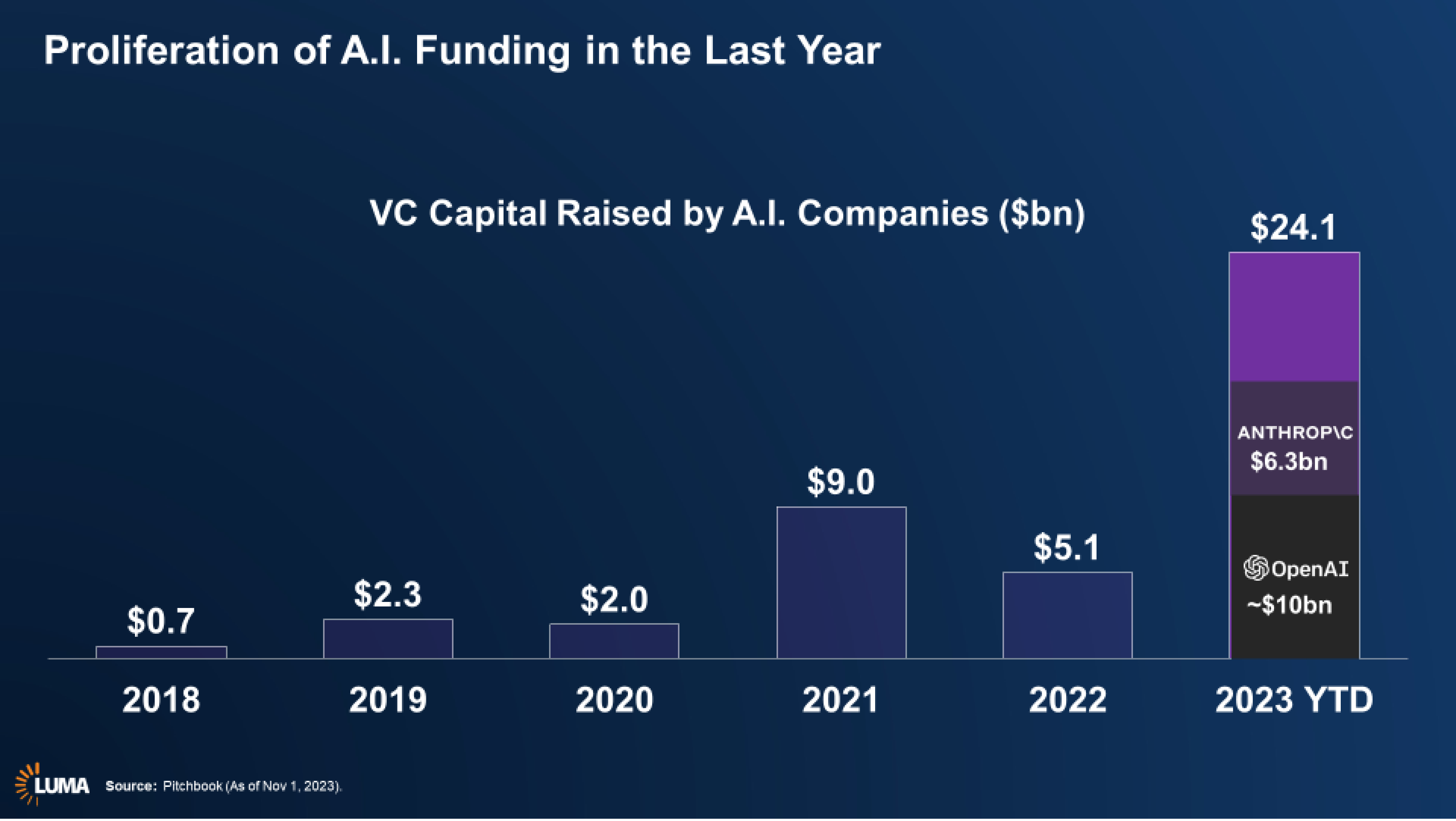
Of course, A.I. isn't new, it's not a phenomenon that began on November 30th, 2022 with the release of ChatGPT. Since 2016, we talked about the rise of A.I., it's momentum and growth, and the "left-brain" and "right-brain" use-cases across marketing.



Since the launch of ChatGPT and the focus on generative A.I., we have seen a spike in venture funding to the sector though – over $24bn year-to-date in 2023. The valuations and sums of money raised by individual companies have been robust.

A.I. Frenzy Has Led to Soaring Private Market Valuations

	Capital Raised ($bn)	Valuation ($bn)
OpenAI	$11.3	~$80
ANTHROP\C	$7.2	~$25

15 A.I. Unicorns Birthed in Q3 2023

Adept
AI21labs
character.ai
CoreWeave
cohere
DeepL
Helsing
imbue
quantexa
Light Years Beyond
replit
runway
Synthesia
Typeface
ZHIPU·AI

 Source: Crunchbase, PitchBook, TechCrunch. As of November 1, 2023.

In Q3 alone, 15 new A.I. unicorns were birthed. We note a tremendous amount of attention, hype and financing at very high valuations.

A.I. Frenzy Has Also Fueled the Public Markets

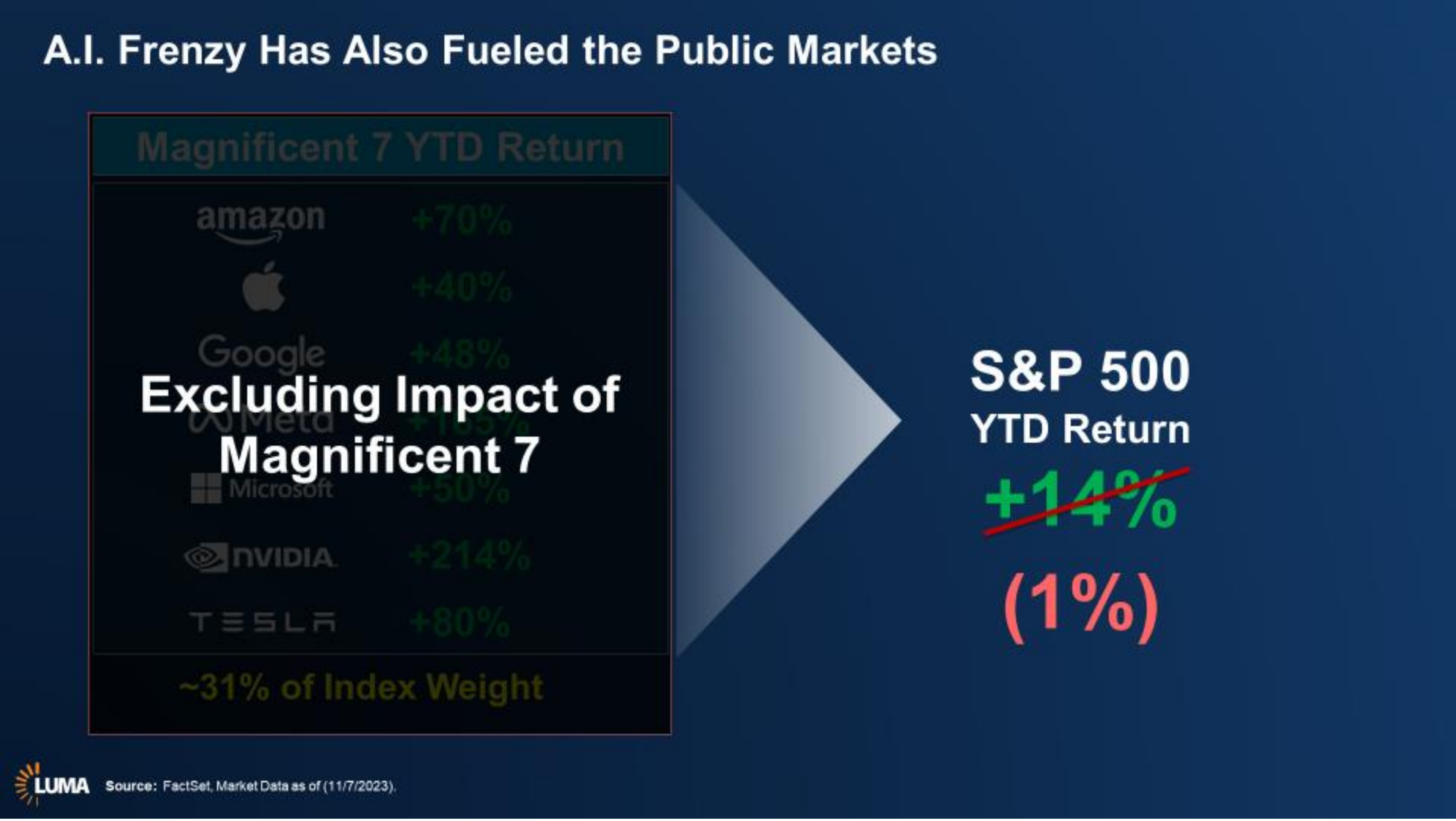
Magnificent 7 YTD Return	
amazon	+70%
Apple	+40%
Google	+48%
Meta	+165%
Microsoft	+50%
NVIDIA	+214%
TESLA	+80%

~31% of Index Weight

S&P 500
YTD Return
+14%

Source: FactSet, Market Data as of (11/7/2023).

The so-called Magnificent 7, which account for ~31% of the weight of the S&P 500 index have delivered phenomenal returns, driving a 14% gain in the overall market in 2023 YTD. All of this is on the back of narratives closely tied to A.I. for each of these companies.

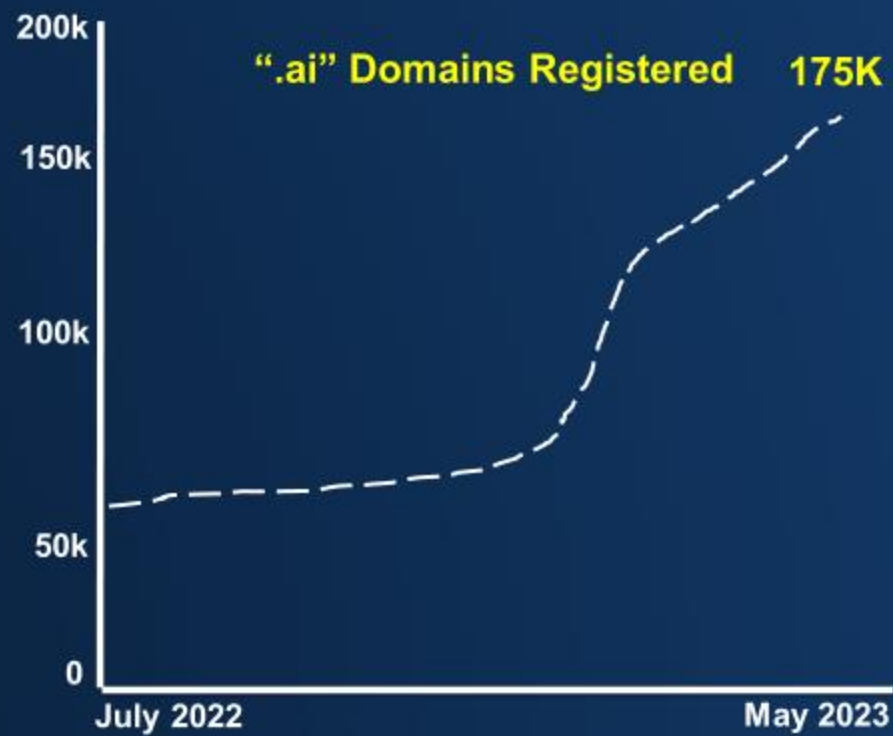


Without the Magnificent 7, the market is actually down.

With the A.I. Opportunity, Comes the A.I. Hype

2017

2023



LUMA **Source:** Axios (May 2023).

At LUMA, we're big believers in A.I. being a game-changer. That said, there is a lot of hype, and as Mark Hurd suggests – much of it can be nonsense. It seems many are trying to position themselves as an A.I. company, just look at the rise in ".ai" domain registrations.

Years ago, we talked about A.I. being more of a tool, the "intel inside". If you're using A.I. to do whatever it was you were doing before, you're not an A.I company per se. So, if you're a media optimization company that decides to implement A.I., you aren't an A.I. company, you're a media optimization company that uses A.I.

A.I. Raises a Variety of Concerns

- Data Security
- Human Safety
- Copyright Infringement
- Availability of Training Data
- Regulation
- Misinformation
- Model Bias
- IP Challenges
- Anti-Competitive

A lot of concerns have been raised with respect to A.I. The good news is that unlike other major platform developments, the industry seems set on a conscious approach to understand the consequences of this new paradigm as it is being built.

Scale as a Comparative Advantage in A.I. Race

	Build	Partner	Buy
amazon	alexa, Olympus AI	ANTHROP\C	10
Apple	"Apple GPT"		32
Google	Bard, DUET AI	AI21labs, ANTHROP\C, cohere, Meta AI, runway	21
Microsoft	Microsoft 365 Copilot	OpenAI	18
Meta	Meta AI, LLaMA by Meta	Microsoft Azure	17
X	GROK		0
Adobe	SENSEI	NVIDIA	0
ORACLE	ORACLE AI	cohere, NVIDIA	2
salesforce		Google	1

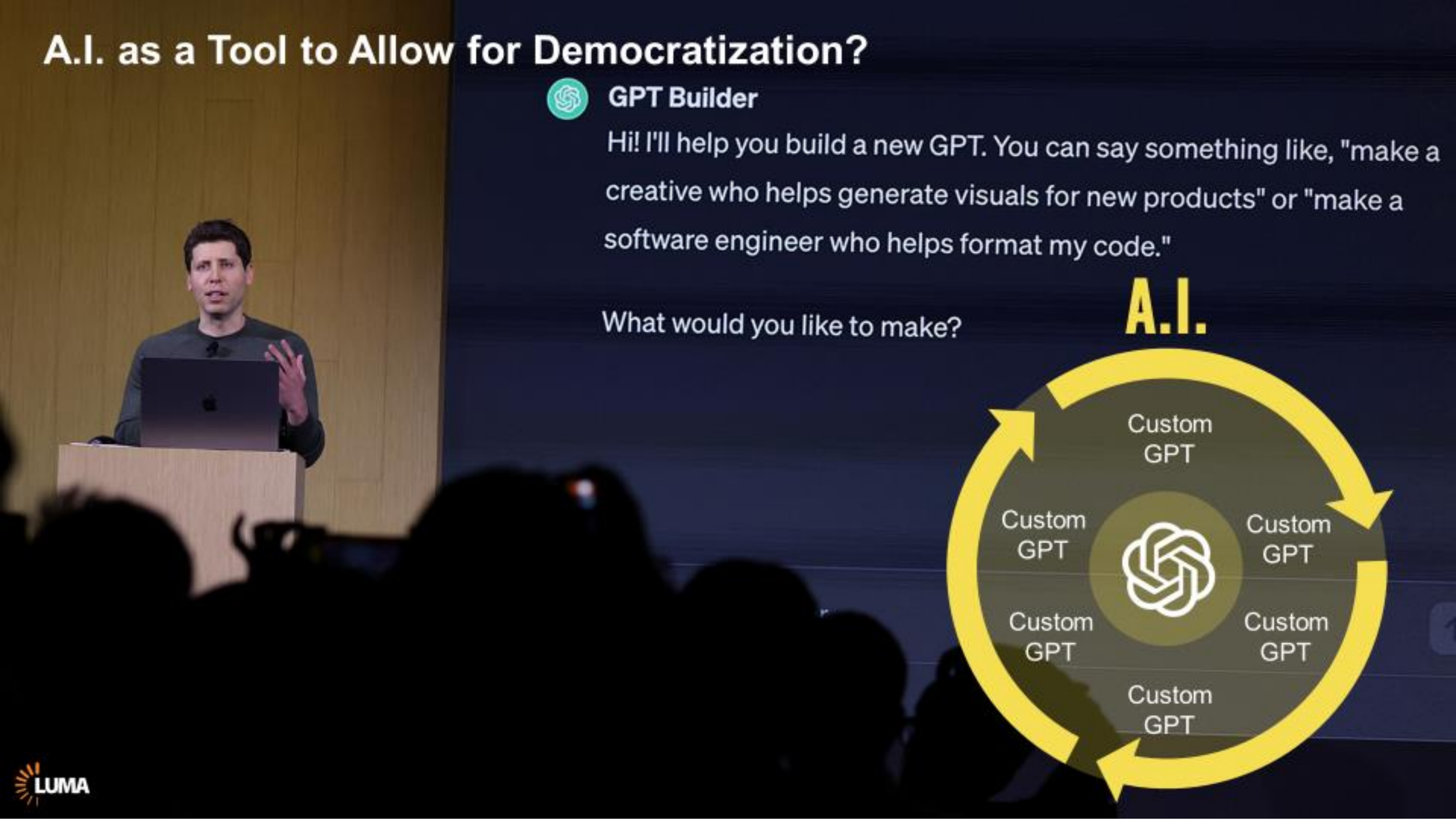
LUMA **Source:** Company Filings & Releases. CB Insights. Buy column represents acquisitions since 2010. **Note:** List is not exhaustive of full A.I. capabilities.

One concern is the notion of unfair advantages in this race. Is scale going to give the large players that we referenced earlier, whether they're building, acquiring, or investing, an unfair advantage vis-a-vis the rest of the ecosystem?

Is A.I. Shaping Up to Be Winner-Take-Most?

Is A.I. shaping up to be a “Winner-Take-Most” scenario?...

A.I. as a Tool to Allow for Democratization?



OR, will this be democratized with platforms that put instant software creation into the hands of every participant in the ecosystem, as suggested at OpenAI's recent developer event?

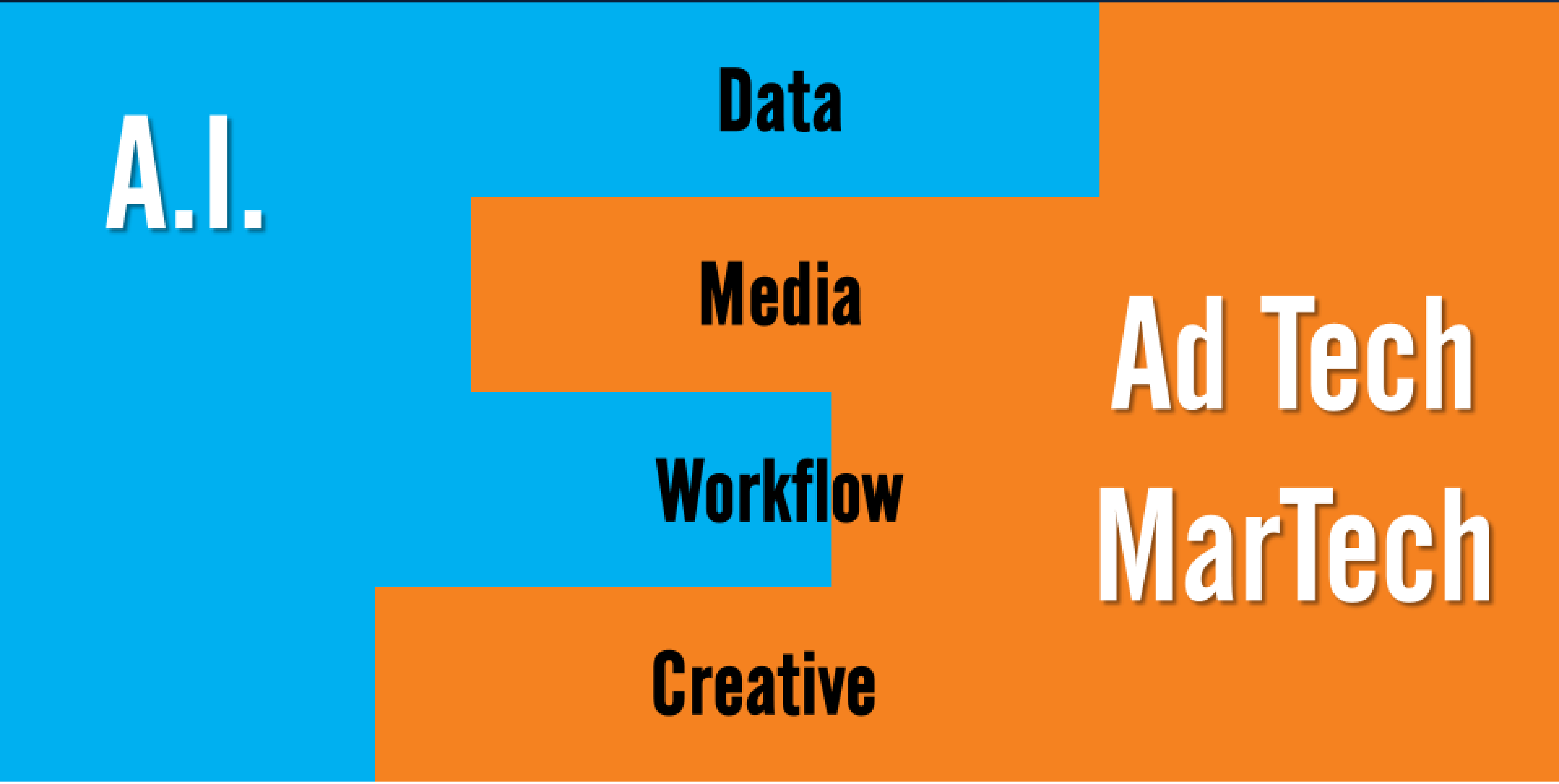
Expect A.I. Regulations and Oversight to Evolve

- Regulation
- Data Security
- IP Challenges
- Copyright

The executive order announced last week addresses a lot of parameters, alluding to the consciousness of trying to do it right this time.

Though we do worry about overreach and the question of how to regulate something if there is such a significant unknown in what the products and services are going to be. Given its nascent stage, could regulation set US companies back competitively and create regulatory capture that favors the big tech early movers?

A.I., Ad Tech & MarTech: Made For Each Other



A.I., Ad Tech & MarTech were made for each other. A.I. is powerful software, but what it needs is fuel – massive data sets. The largest and most robust data sets in the world happen to be in Ad Tech & MarTech. The A.I. opportunity has a variety of applications across data, media, workflow and creative optimization.

We look forward to seeing how this technology is going to be used to leverage business models across our digital media and marketing ecosystem.

LUMA

Strategic Advice for the Digital Age

We welcome your feedback on all the above. Whether it’s industry trends, marketplace dynamics or to discuss a specific company situation, don’t hesitate to reach out. Ping us directly, or generally at info@lumapartners.com