

MANAGED IT SERVICES M&A UPDATE | 2023 Q2 Review



STEADY QUARTER & OUTLOOK FOR MSP M&A

MSP and IT Services M&A during the second quarter of 2023 remained in line with volume seen the first three months of the year. 169 M&A transactions were closed in the MSP and IT Services sector during the second quarter in North America, just one fewer than in Q1. Of these transactions, there was an even split between buyer types, with ~49% being Financial / Private Equity buyers and ~51% being Strategic acquirers.

Private equity groups and strategic acquirers are still very active in their search for resilient Managed Service Providers who have continued to perform through the shaky macro environment. Buyers are constantly looking for MSP prospects that complement their current service offerings and enhance scalability and cost savings in order to position themselves for outsized growth in a potential economic rebound.

While there has been an overall reduction in M&A activity due to macroeconomic uncertainty since 2021, there are still ample opportunities for owners to take chips off of the table. Private equity groups and strategic acquirers in the space continue to deploy a playbook working to find healthy IT Services companies that they can acquire, integrate, and realize inorganic growth. The opportunity to expand and diversify their customer bases in market downturns, acquiring highly skilled and specialized IT services companies with strong customer bases, remains at the forefront for all investor types. Great businesses are still commanding great valuations.

MSP INVESTMENT GRADE ASSESSMENT OVERVIEW

Our desire to help owners prepare for an eventual exit has led to the formation of the Investment Grade Assessment. We've curated 90 of the most important questions we've heard buyers and investors ask to help owners benchmark the likelihood their company could receive an institutional investment, and whether they could expect a premium valuation.

This assessment is specifically catered to MSPs and IT Services businesses with questions weighted towards the most relevant industry KPIs and is designed to provide exceptional value in the short 20 minutes it takes to complete.

Link: <https://app.foundersib.com/auth/sign-up>

Free Discount Code: Q123ITS

Here's a brief video discussing it further: <https://vimeo.com/647794938>

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WORKING CAPITAL IN MSP TRANSACTIONS AND WHY IT MATTERS

By: Chris Weingartner, Managing Director

Working capital is a crucial financial metric that measures an MSP's ability to meet its short-term obligations and fund its daily operations. For any IT Services company, working capital plays a vital role in ensuring smooth service delivery, managing cash flow, and funding growth opportunities. When selling a company, it is fundamental for MSPs to understand how working capital gets reconciled and why it is important for both the buyer and seller to agree on how it is treated.

Importance of Working Capital for an IT Managed Services Company

Investopedia defines Working Capital as the difference between a company's current assets—such as cash, accounts receivable, and inventories of raw materials and finished goods—and its current liabilities, such as accounts payable and short-term debts. A balance sheet item, different business activities impact working capital differently. If you delay payment to vendors, your accounts payable will increase and working capital will decrease. If you collect from customers, your accounts receivable balance will go down while cash goes up. Working capital is a daily measure of the health of the business reflected in four primary ways:

1. **Cash Flow Management:** Working capital helps cover day-to-day operational expenses, such as payroll, rent, utilities, and supplier payments, ensuring that any MSP can function efficiently.
2. **Service Delivery:** Adequate working capital enables the company to invest in the necessary equipment, software, and personnel to provide quality services to clients.
3. **Growth and Expansion:** Positive working capital allows MSPs the opportunity to pursue growth initiatives, such as acquiring new clients, expanding service offerings, or investing in research and development.
4. **Business Stability:** Sufficient working capital acts as a buffer against unexpected expenses, economic downturns, or client payment delays, ensuring the company remains financially stable.

Working Capital Reconciliation in a Company Sale

When selling an IT Managed Services company, the working capital position of the business at the time of the transaction becomes an essential consideration. Here's how working capital is typically reconciled during a sale:

1. **Definition of Working Capital:** Both the buyer and the seller need to agree on the definition of working capital, including which current assets and liabilities are included and excluded. Typically cash and debt are excluded from a transaction, as the seller gets the benefit of cash that was generated pre-sale but is expected to pay off all debt as a condition of closing. In addition, oftentimes MSPs may not be including all items correctly in working capital, missing assets such as prepaid expenses (insurance, rent, etc.), or liabilities such as accrued PTO or prepaid revenue (deferred revenue). This definition is often outlined in the purchase agreement and a major business negotiation point.
2. **Calculation of Working Capital Target:** The parties determine the typical or "normalized" level of working capital required to operate the business. This is typically based on historical averages or industry benchmarks. Most often we see MSPs measured against the trailing twelve-month or trailing six-month averages used to set the target working capital that is expected to be on the balance sheet at closing.

WORKING CAPITAL IN MSP TRANSACTIONS AND WHY IT MATTERS

By: [Chris Weingartner](#), Managing Director

- 3. Adjustments to Purchase Price:** At closing, the MSP and its advisors are expected to deliver an accurate estimate of the working capital as of the day the deal closes. If the estimated working capital at the time of the sale is higher or lower than the working capital target, adjustments to the purchase price may be made to reflect the difference. These adjustments can be dollar-for-dollar or subject to negotiation based on predetermined formulas at the time of closing. If the seller delivers working capital above the target, the purchase price is adjusted upwards. If less working capital is delivered, the purchase price is adjusted downwards.
- 4. Post-Closing Adjustments:** Within 30 – 90 days of the transaction close, a final determination of the working capital at close is made as actual, accurate account balances are determined. If there are further discrepancies between the estimated working capital and the actual working capital at closing, additional adjustments to the purchase price are made to reflect the changes. Oftentimes there is a short-term escrow set in place to ensure that if the calculation results in a true-up from the seller to the buyer is required, those funds have been set aside to properly cover that liability. If there is an amount due to the seller from the buyer, the seller will receive the full escrow plus the additional amount owed.

For an overly simplistic analogy, think of working capital as the tires, brake pads, level of gas, and wiper fluid on a car for sale. If you are interested in purchasing the car, there is an expectation that you'll be able to drive it off the dealer's lot without immediately having to go replace or repair one of the items above. If that isn't the case, and you know you need a new transmission, you'd be willing to pay less for the vehicle, knowing that additional expenditure was required to get it in good working order..

Working capital reconciliation ensures that the buyer pays a fair price for the business based on its financial health and ensures that the seller receives appropriate compensation for the working capital tied up in the company. A good advisor will help ensure that the target is appropriately set with the right accounts being excluded and included, as well as validate that the adjustments and level of escrow are accurate and fair. If you are an IT Services business or MSP thinking about undertaking a transaction, we're happy to hop on a call to discuss working capital's importance in a deal further and answer any questions you have. Please don't hesitate to reach out to Chris Weingartner (cweingartner@foundersib.com), Founders' Managing Director who covers the MSP sector.

Founders' Latest Transaction



Founders is pleased to announce that Evergreen Services Group ("Evergreen") has acquired Western Computer, a leading Microsoft Gold Cloud partner and reseller of Microsoft Dynamics 365, CRM, and ERP systems. Western Computer follows Evergreen's acquisition of 70 software and services companies since 2017. Western Computer was exclusively advised by principals of Founders Advisors LLC in this transaction.

[View Press Release](#)

UPCOMING EVENTS



Webinar - Trends in MSP M&A with Evergreen Services Group

On September 19th at 2:00p ET, we will be hosting a webinar with Ramsey Sahyoun, Co-Founder and M&A Partner of Evergreen Services Group. During the 45-minute session, we'll explore trends in the merger and acquisition environment for IT Services groups. Content will be focused on what drives enterprise value and makes a company an attractive acquisition target with Q&A to follow.

We recently had the privilege of working with [ESG on the sale of Western Computer](#), and know they are a founder-focused group that is working to build something special in the ecosystem. Since launching in 2017, they have completed nearly 40, publicized transactions in the IT Services space. We hope you can join us by registering through the link below for this quick session that should add value and provide unique market insight direct from one of the industry's most reputable buyers.

Evergreen Services Group is a family of leading managed services and software companies operated by world-class leadership teams. Evergreen partners with owners of services and software businesses to provide operational assistance and capital in support of growth and exceptional service delivery. Evergreen differentiates itself by providing a permanent home for businesses that care deeply about their customers and employees. For more Evergreen Services Group news and information, visit www.evergreensg.com.

To register in advance for the Trends in MSP M&A with Evergreen Services Group webinar, please access this [registration link](#).

Silicon Y'all – Technology Summit 2023



From October 2nd – 4th 2023, Founders will host its ninth annual Technology Summit. Attendees engage in meaningful discussions about growth, value, and current industry trends in a relaxed, Southern hospitality focused forum. The conference is an invaluable opportunity to connect with industry peers and professionals focused on recurring revenue-based businesses. We are very excited for this year's summit and are currently curating our invitation list for 2023.

You can find more information at SiliconYall.com. We have a few spots remaining, and if you're interested and able to attend, please sign up for the waitlist and email cweingartner@foundersib.com expressing interest.

MSP / IT SERVICES INSIGHTS

Insights

[The Entrepreneur's Dilemma – Selling When Things are Going Well](#)

The best time to sell your business is when it is healthy and growing, but many owners aren't interested in pursuing an exit when things are going well. As an owner, how should you think about this paradox?



[Preparing Your MSP for a Transaction](#)

When considering a sell of our business, there are several critical areas to consider ahead of a transaction. What are the preparations you can take to ensure you get competitive bids for your MSP?



[The Customer Isn't Always Right – When to Fire a Challenging Client](#)

What are the situations where it might be better to fire or not sign up a client? Doing so can sometimes be necessary to protect your company's profitability and culture.



[Questions Every MSP Owner Should Ask Their M&A Advisor](#)

Ahead of hiring representation, owners should do their research on the M&A advisors in consideration. What are the questions you should ask these groups before selection?



[What Is and Why Does Working Capital Matter in MSP Transactions?](#)

Working capital becomes an essential consideration in MSP transactions. What are the reasons for its importance when selling your business?



[Five Factors \(Other Than Profitability\) That Drive MSP Valuation](#)

Five major factors can impact an MSP's valuation. As an owner, how should you think about these factors when planning on the front end for a successful exit?



[Private Equity is Emailing & Calling My MSP Non-Stop – What Do I Do?](#)

You and your business are constantly getting inbound interest from private equity groups. What are the best ways to handle the inquiries received?



[Valuing IT Services and Managed Service Providers](#)

While there is no simple algorithm for valuing business, there are certain metrics that command premium valuations. How should owners think about their current performance compared to these metrics?



[Strong Year & Outlook for MSP M&A](#)

Timing is a significant factor when considering a sell of your business. What is the outlook for MSP M&A for 2023?



[Hot M&A Market For Managed IT Services](#)

Certain trends are seen in M&A markets that affect deal volume in the sector. What were the trends affecting Managed IT Services in March 2022?

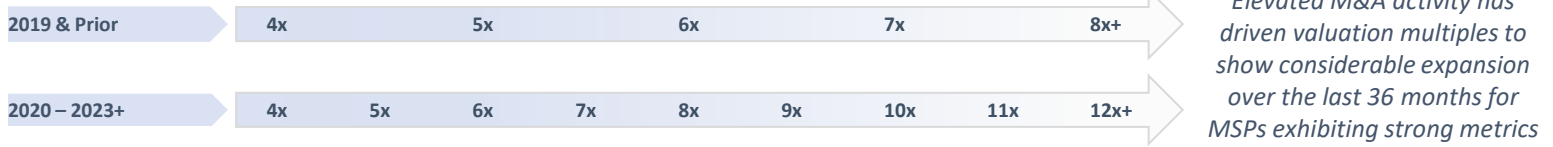


VALUATION DRIVERS IN MANAGED IT SERVICES

Founders Managed IT Services Valuation Scorecard

Founders' MSP Valuation Scorecard isolates the most critical quantitative and qualitative factors driving valuation multiples

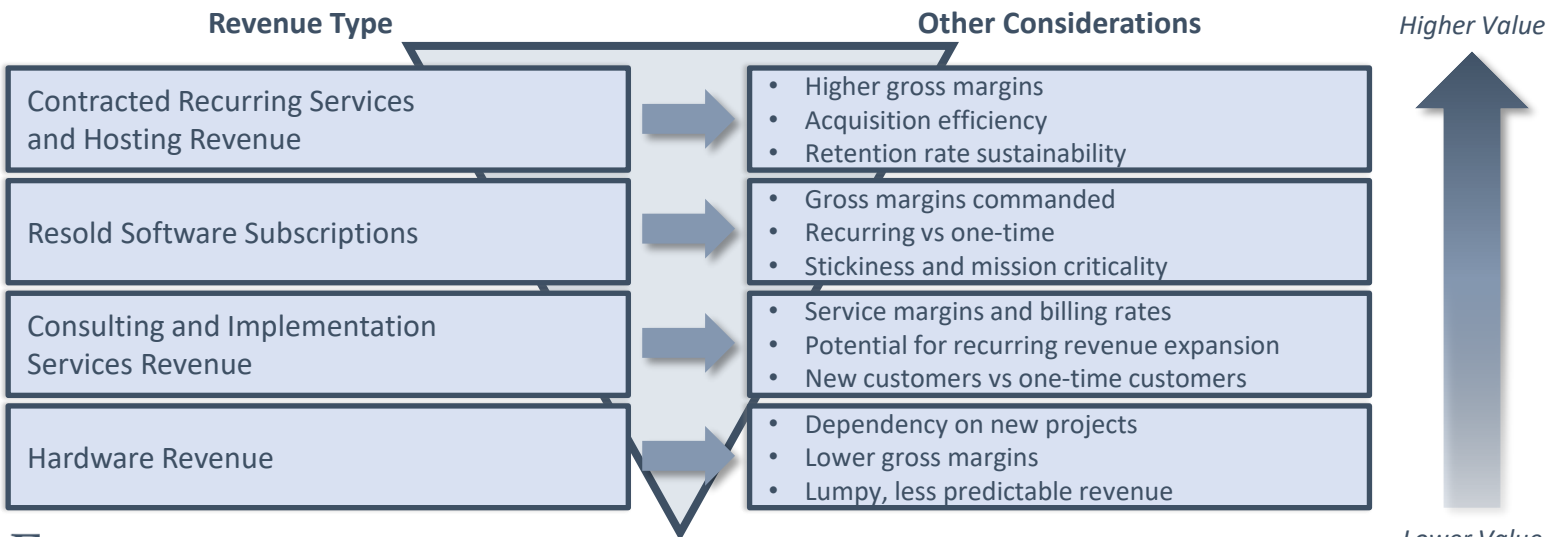
Enterprise Value / EBITDA Ranges Observed



Quantitative Factors			
Financial Preparedness	Consistent reporting; ability to analyze at the customer level; GAAP; proof of cash → quality of earnings + full audit is likely with investors		
Growth	< 10%	> 30%	It is important to monitor recurring growth separately from total revenue growth
Size (Total Revenue)	< \$15M	> \$15M	>\$15M is rare, and that scale would be highly differentiated in the fragmented sector
EBITDA Margin	< 10%	> 20%	If <10%, should exhibit extraordinary marketing-driven investment and growth
Recurring Revenue	< 50%	> 80%	80%+ of revenue should come from managed customers rather than project / one-time
Retention	< 85%	> 95%	85%+ Customer Retention & 90%+ Net Retention are key benchmarks to track to
Gross Margins	<35%	>50%	Fully burdened gross margins for employee costs; measure margin by revenue stream
Agreements	< 12 Months	> 24 Months	What is the average length of managed services terms and do clients auto-renew?
Customer Concentration	> 20% for Top Customer	< 50% for Top 5 Customers	Mitigate the risk of one customer leaving and materially impacting business
Qualitative Factors			
Process Efficiencies	Does the company have efficient customer onboarding and strategy for managing their SLAs? Make onboarding and managing customers extremely efficient		
Data Integrity	Quality and quantity of non-financial data tracked, including pipeline, backlog, sales & marketing efficiency, delivery and operational metrics		
True Managed Solution	Extending services beyond a base-level reseller of solutions. Investors place premium on expertise such as an internally managed SOC or NOC, industry knowledge that enables customer success within a sector, and other sticky managed service capabilities		
Geography Considerations	Room to run in primary and secondary geographies served; ability to remotely serve customers		
Other Considerations	Quality of team, seller trustworthiness, pricing, operations metrics, predictability of MRR, ability to do M&A, end markets served, EBITDA to free cash flow conversion; quality of internal records and financial statements		

Revenue Stream Impact on Valuation for Managed IT Services

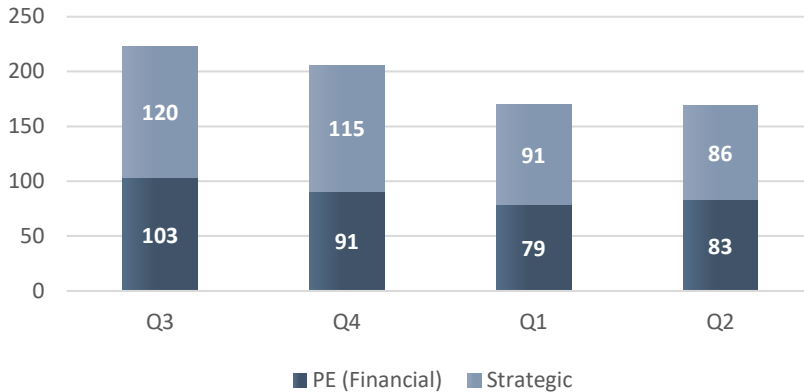
Revenue composition remains a critical driver of valuation for managed IT service providers; the below visual displays how the investor community views varying streams of revenue in terms of value and considerations influencing ultimate viewpoints



KEY BUYER ACTIVITY

Steadiness in MSP & IT Services M&A with Balance Between Financial and Strategic Transactions

MSP & IT Services LTM M&A Activity (United States)



Rollup Strategy Proliferation

- Private equity has zeroed in on the MSP landscape, with a proliferation of “rollup” strategies
- Rollup strategies entail acquiring a “platform” investment to plant their flag, followed by a series of acquisitions billed “add-ons”
- Through acquiring additional entities, MSPs can expand the breadth of services provided to customers while leveraging operational efficiencies and best practices from their new partners

Select MSP Rollups Driving Add-On Activity in the Last 24 Months

Platform (PE Sponsor)



(Alpine Investors)



(A&M Capital)



(Baymark Partners)



(Quad-C Management)



(Source Capital and Centerfield Capital Partners)



{Charlesbank Capital Partners and GTCR}



(Tiger Infrastructure Partners)

Recent Add-ons



Direct it.



outsOURCE IT SOLUTIONS GROUP



SCW IT SERVICES



GADELLNET



NEOLORE NETWORKS INC.

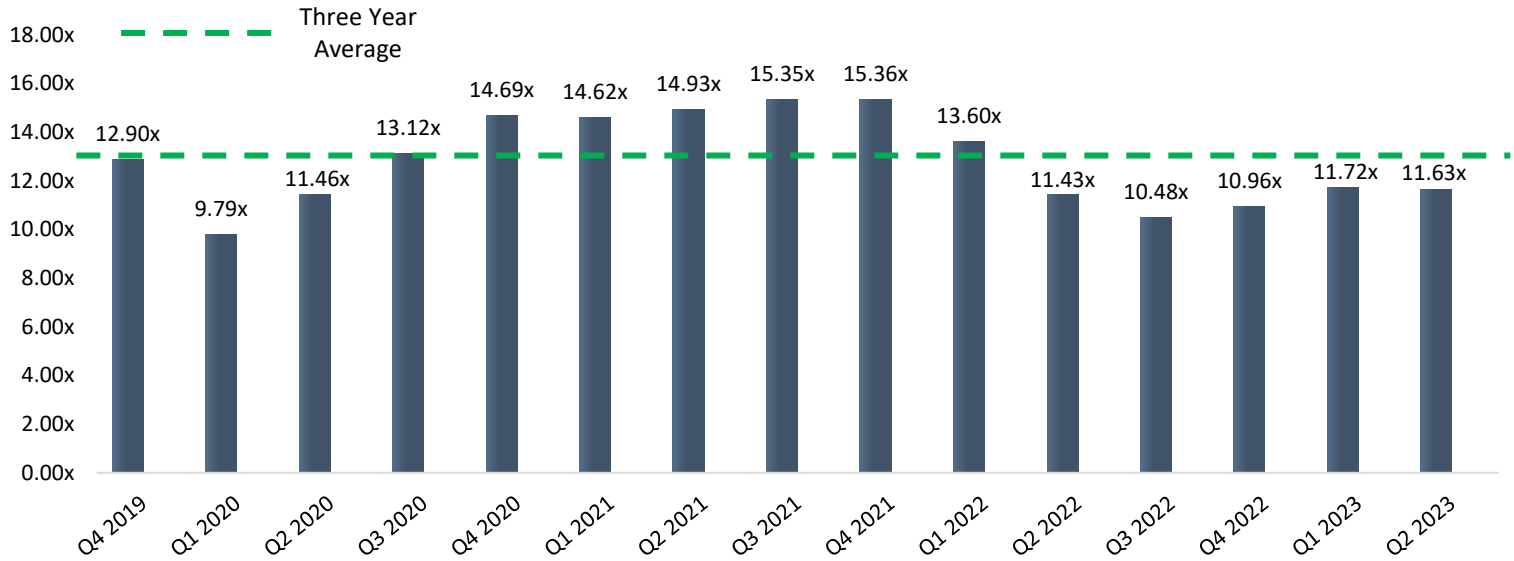


AltaVista Technology



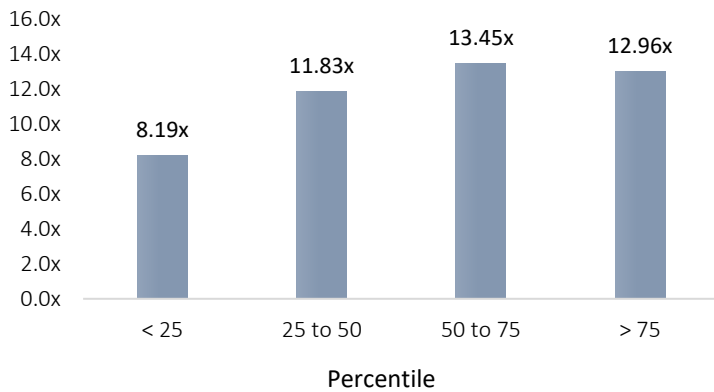
2023 Q2 PUBLIC METRICS OVERVIEW

Public EV/LTM EBITDA Multiples



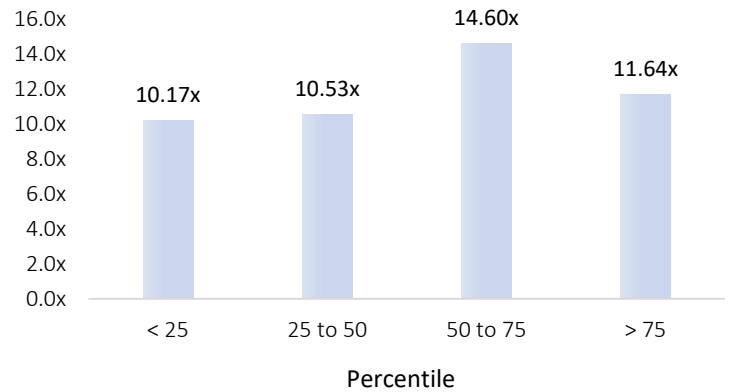
Revenue Growth

Revenue Growth Percentile vs. EV/LTM Revenue

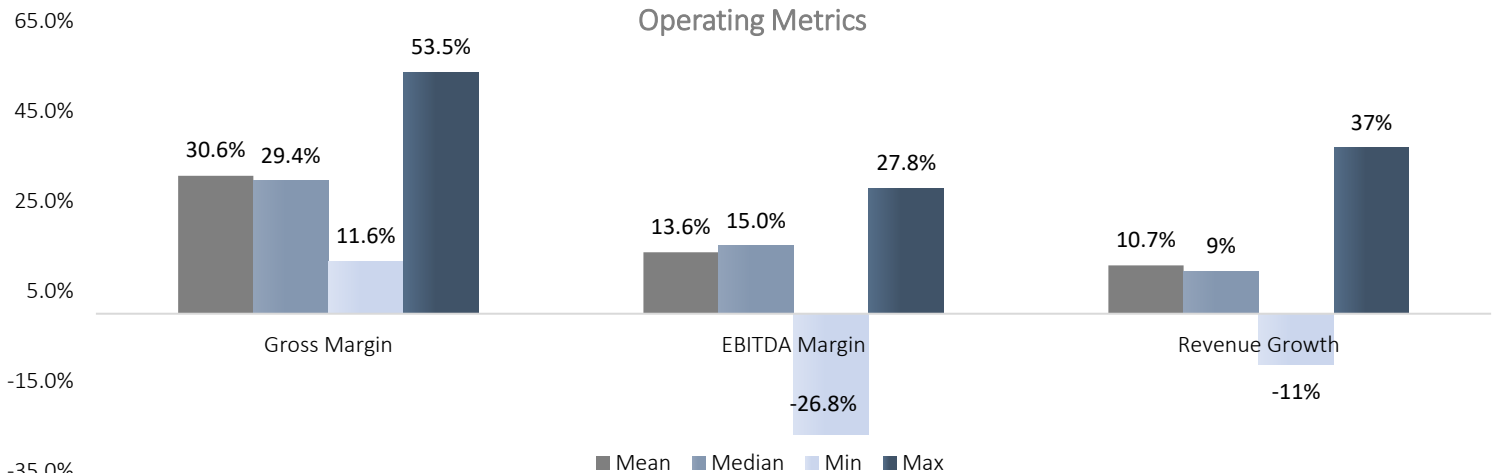


Margins

Gross Margin Percentile vs. EV/LTM Revenue



Operating Metrics



PUBLIC VALUATION & GROWTH METRICS

Name	% of 52 Week High	EV	LTM Financials					Enterprise Value Multiples	
			Revenue	EBITDA	Revenue Growth	Gross Margin	EBITDA Margin	LTM Revenue	LTM EBITDA (An. Norm.)
Accenture	94%	189,937	63,550	10,310	7%	32%	16%	3.0x	17.8x
Capgemini	91%	36,044	23,126	3,233	21%	27%	14%	1.6x	10.0x
CGI Group	99%	26,684	10,326	1,977	10%	21%	19%	2.6x	13.0x
Cognizant Technology Solutions	92%	32,154	19,414	3,526	3%	36%	18%	1.7x	9.2x
Consolidated Communications	51%	2,611	1,167	325	-7%	54%	28%	2.2x	7.5x
DXC Technology	84%	9,460	14,430	917	-11%	22%	6%	0.7x	3.8x
ePlus	94%	1,582	2,068	186	14%	25%	9%	0.8x	8.0x
Fujitsu General	72%	2,438	2,741	166	31%	23%	6%	0.9x	12.9x
Gamma Communication	92%	1,298	597	113	8%	51%	19%	2.2x	9.6x
Genpact	77%	8,070	4,392	648	6%	35%	15%	1.8x	9.7x
HCL Technologies	99%	37,273	12,635	2,987	18%	44%	24%	3.0x	12.5x
Infosys	79%	66,035	18,212	4,458	12%	30%	24%	3.6x	14.8x
Insight Enterprises	99%	5,207	10,104	466	2%	16%	5%	0.5x	10.6x
Leidos	80%	17,389	14,601	1,406	5%	14%	10%	1.2x	11.7x
Nomura Research Institute	85%	16,867	5,113	1,159	13%	35%	23%	3.3x	14.6x
NTT Data	85%	38,012	25,780	3,934	37%	26%	15%	1.5x	9.6x
Rackspace Technology	37%	4,298	3,106	(831)	2%	26%	-27%	1.4x	8.0x
Science Applications Int.	95%	8,141	7,736	681	3%	12%	9%	1.1x	11.8x
Softcat	94%	3,451	1,238	171	29%	35%	14%	3.4x	19.8x
Softchoice	69%	924	914	60	2%	35%	7%	1.0x	11.0x
Tata Consultancy Services	93%	142,502	28,078	7,405	18%	47%	26%	5.1x	19.4x
Wipro	84%	23,211	11,269	2,170	14%	29%	19%	2.1x	10.3x

Statistics

Min	924	597	(831)	-11%	12%	-27%	0.5x	3.8x
Median	13,164	10,215	1,038	9%	29%	15%	1.7x	10.8x
Mean	30,618	12,754	2,067	11%	31%	14%	2.0x	11.6x
Max	189,937	63,550	10,310	37%	54%	28%	5.1x	19.8x

SELECT MSP & IT SERVICES Q2 TRANSACTIONS

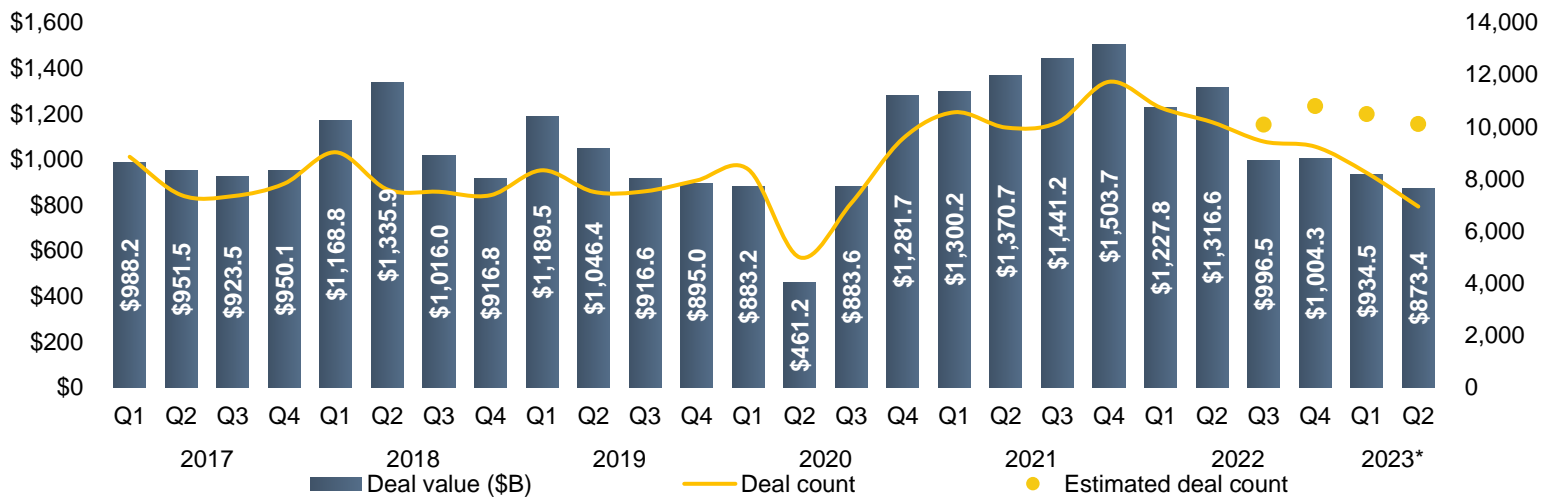
Notable Transactions

  <p>The company was acquired by CDW (NAS: CDW) for an undisclosed amount on June 6, 2023. The acquisition provides additional capabilities to the CDW Public Sector Cloud Services Practice.</p>	  <p>The company was acquired by AST, via its financial sponsors Recognize Partners and Maranon Capital, through an LBO on May 8, 2023 for an undisclosed amount. The acquisition expands the breadth of AST's capabilities as a solutions provider of the Oracle and adjacent cloud ecosystems for enterprises.</p>	  <p>The company was acquired by Modern Networks, via its financial sponsor Horizon Capital, through an LBO on June 8, 2023 for an undisclosed amount. The acquisition provides Modern Networks with a stronger presence in the southwest portion of the UK.</p>	  <p>The company, a subsidiary of Eatel, was acquired by DartPoints, via its financial sponsor Astra Capital through an LBO on May 2, 2023 for an undisclosed amount. The acquisition allows DartPoints to better serve the needs of customers and end-users in mid-size edge markets.</p>
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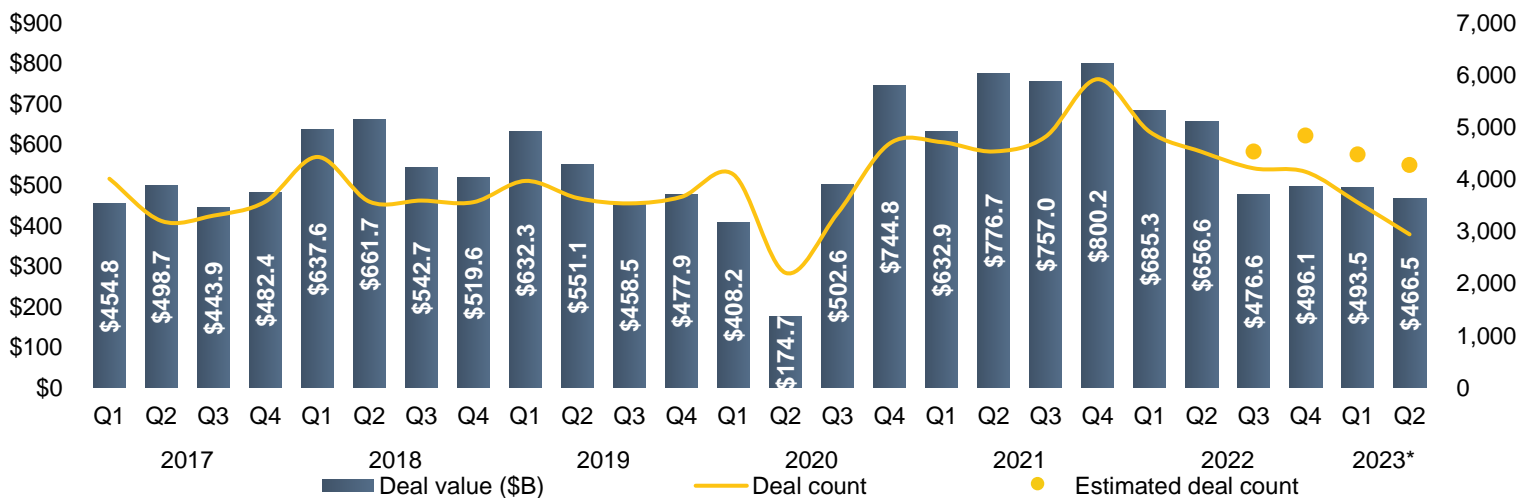
Date	Target	Buyer	Purchase Price	Revenue	EBITDA	EV / Revenue	EV / EBITDA
Jun-23			N/A	N/A	N/A	N/A	N/A
Jun-23			N/A	N/A	N/A	N/A	N/A
May-23			N/A	N/A	N/A	N/A	N/A
May-23			N/A	N/A	N/A	N/A	N/A
May-23			N/A	N/A	N/A	N/A	N/A
May-23			\$34.8	N/A	N/A	N/A	N/A
May-23			N/A	N/A	N/A	N/A	N/A
May-23			\$100.0	N/A	N/A	N/A	N/A
Apr-23			N/A	N/A	N/A	N/A	N/A
Apr-23			N/A	N/A	N/A	N/A	N/A

GLOBAL & NORTH AMERICAN M&A ACTIVITY

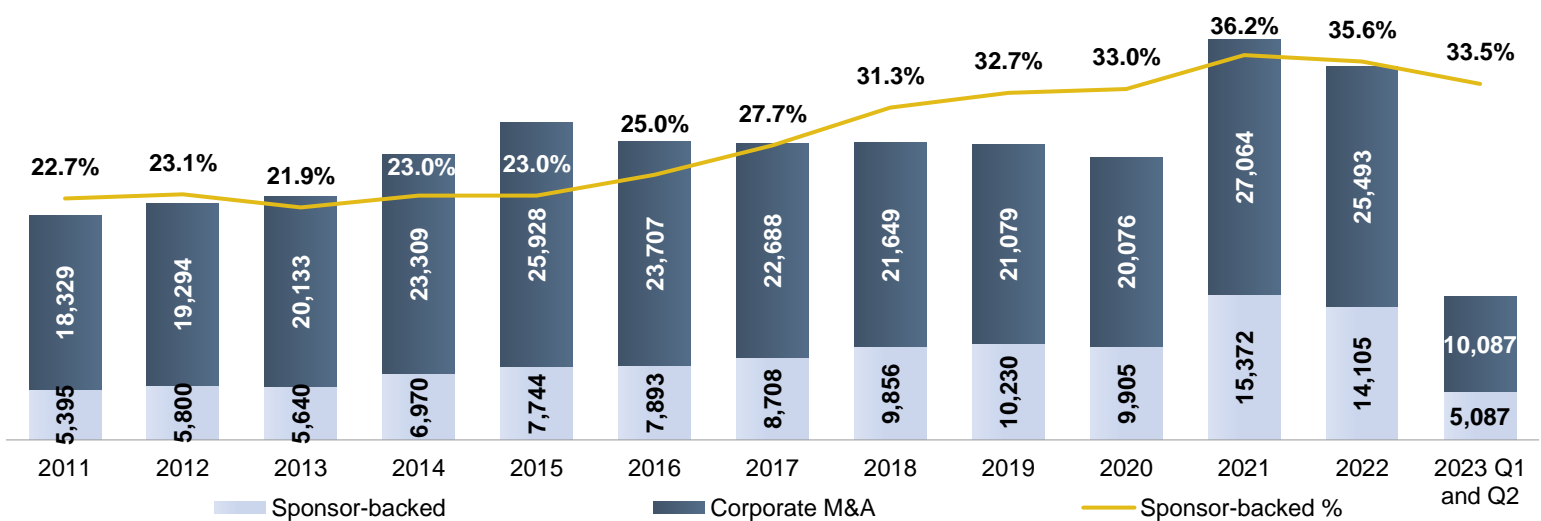
Global M&A Activity By Quarter



North American M&A Activity By Quarter



Global M&A By Type

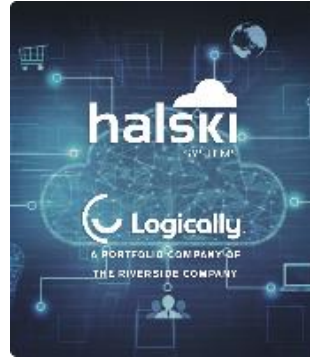


SELECT FOUNDERS TECHNOLOGY TRANSACTIONS



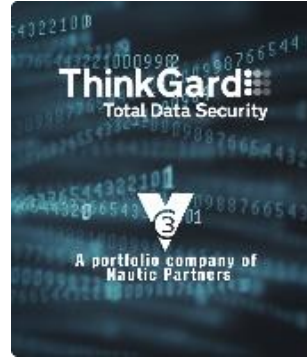
Microsoft Dynamics
System Integrator

[Press Release](#)



Managed Security and
IT Services

[Case Study](#)



Cybersecurity and
Technology Risk
Management

[Press Release](#)



Managed IT Services
and Cloud Security



API Platform as a
Service

[Press Release](#)



Transactional Email
Delivery Platform

[Press Release](#)



Data and Software to
Law Enforcement
Agencies

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Business Process
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Workflow Platform

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Platform

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Management Platform

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FOUNDERS ADVISORS

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