

2024 M&A Outlook

Navigating Evolving Market Dynamics



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Private Equity buyers led deal making in 2023, and are again positioned to lead acquisition activity in 2024 amid a slowing of deal volume, a higher bar for M&A, and several Platforms likely preparing for their own exit in the next year

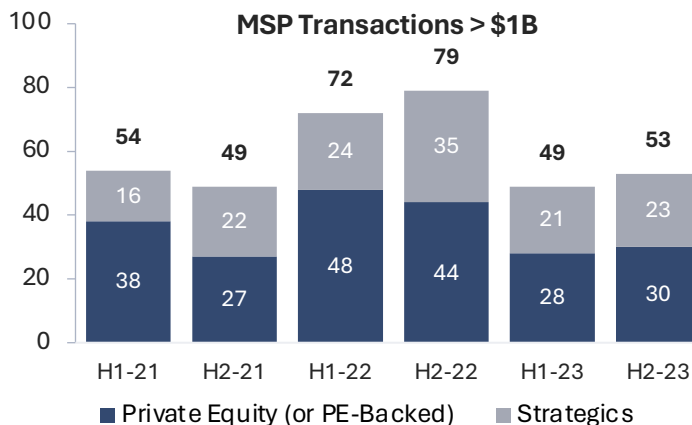
A LOOK BACK ON 2023 M&A TRENDS PROVIDES A HINT OF WHAT 2024 HAS IN STORE

Through 2023 and early 2024 demand for managed service provider (MSP) assets has remained robust amidst a rising interest rate environment, a limited supply of MSP assets coming to market, and increased scrutiny of potential acquisition opportunities from buyers.

Despite the slowdown of dealmaking last year, Private Equity (PE) buyers led all acquisition activity similar to 2022 and 2021. PE buyers accounted for 57% of all 2023 MSP acquisitions under \$1B in total enterprise value. In part the slowdown in deal making can be attributed to fewer assets coming to market restricting overall supply but also aiding overall MSP valuations.

Throughout the last twelve months there has been sustained demand for high-quality assets with strong underlying fundamentals and EBITDA greater than \$1.5M. However, starting in the last quarter of 2023, valuations and demand for assets with sub-\$1M EBITDA began to show signs of weakness unveiled by conservative offer spreads and quieter processes with less committed buyers.

In 2024, FOCUS expects the MSP M&A market to remain extremely competitive for platform investments and large add-ons across the country. In addition, valuations leveling off for smaller MSPs, longer diligence processes, and a transformational change among the MSP buyer pool to be amplified in 2024.



A RENEWED EMPHASIS ON KEY VALUATION METRICS AND MORE DILIGENCE IN 2024

The changing economic climate of 2023 brought more caution among both strategic and PE-buyers opting for more comprehensive diligence processes to thoroughly assess potential investments and mitigate risk. This is likely to continue in 2024 as buyers continue to exercise limited flexibility to overlook deficiencies to get a deal done. This approach, in combination with new challenges raising debt for businesses with shaky fundamentals has translated into longer and more intensive diligence processes.

Buyers are also spending more time validating critical valuation metrics (i.e., revenue mix, recurring revenue retention, true gross margin, etc.) although this can vary from buyer to buyer. **Understanding how their business measures up against key acquisition metrics will continue to be crucial for sellers** so

they can make informed decisions at each step of the transaction process. Last, and something unique to this year, 2024 will likely bring a wave of MSP platform exits compared to previous years. As each platform prepares for their own exit, new acquisitions will likely prioritize quality and ease of integration so to not negatively impact value so close to a liquidity event.

AN EVOLVING MARKET OF BUYERS AND WHAT IT MEANS FOR SELLERS

With a number of MSP platforms moving up market, this has opened the door for new first time MSP buyers to invest and build their own platform in a less crowded market. 2024 will likely see continued diversification of the buyer pool and the rise of new private equity entrants into the space.

From a seller's perspective, this creates a set of unique opportunities and challenges. As new buyers enter the MSP market for the first time, **this offers sellers the chance to invest early in a new platform** and potentially take on a meaningful position in the new executive team.

Conversely, as sellers engage these new buyers, they should remain attentive to effectively communicating their company's strategic positioning and what they are looking to accomplish through a transaction within the context of the buyers' own acquisition criteria.

Finding the alignment between seller and buyer is paramount to a successful transaction. When contemplating a transaction, sellers should take the necessary steps to address any buyers' concerns proactively while maintaining flexibility navigating the transaction process.

KEY VALUATION METRICS & BUYER CONSIDERATIONS

Revenue Mix (Recurring vs. Non-recurring)

Calculated as a company's percentage of recurring and non-recurring revenue, most buyers look for **50% recurring revenue** in acquisition targets.

Gross Recurring Revenue Retention

Amount of recurring revenue (expressed as a percentage) retained from one period to another. Buyers look for at least **90% gross recurring revenue retention**, but this varies on a case-by-case basis.

Customer Concentration

Limited customer concentration fosters a stable financial base for future growth. Buyers look to ensure that no customer makes up **more than 20% of total revenue**.

Gross Margin

Buyers look for **gross margin of 50% or greater** which indicates the company's ability to deliver services profitably. Buyers will likely drill into what is recorded in direct costs to ensure gross margin is accurate.

Organic Growth

Strong organic **revenue growth of 15% or greater** is attractive to potential buyers who seek businesses that can continue to earn market share in a competitive landscape.

Service Offering

Buyers are attracted to companies that can maintain a competitive edge by driving growth through **security services** that meet customers' evolving needs.

HOW FOCUS PARTNERS WITH MSPs TO DRIVE SUCCESSFUL OUTCOMES

FOCUS' MSP team works with clients to proactively define key elements of strategic positioning to address buyer considerations and collaboratively design a process to engage the market of active buyers. FOCUS' collective transaction experience and deep understanding of individual buyer criteria is at the foundation that empowers our team to drive successful outcomes on behalf of our clients.

Since 2020, FOCUS' MSP team has closed 26 M&A transactions valued at over \$563 million in aggregate transaction value. Of the 26 transactions, 12 represented the creation of a private equity back platform. A collection of select success stories from our experience can be found on the next page.

Select MSP Deal Success Stories

Acquisition Type	FOCUS Client Investment Banking MSP Team	Counterparty	Category	Strategic Rationale
Add-on		 	Sell-side	The ANP acquisition solidifies Coretelligent's position as a technology leader by expanding its expertise within the Microsoft stack, particularly by leveraging Azure for streamlined infrastructure management.
Platform	 	 	Sell-side	The merger of Groupe Access and MSP Corp will enable the new platform to provide unparalleled value to existing customers and drive innovation in the digital landscape.
Platform	 		Sell-side	New and existing clients will benefit from the combined expertise and resources of both companies, as well as a wider range of services and solutions.
Platform			Sell-side	The recapitalization positions Entech management to fund additional growth and scale as it continues to expand its regional presence in Florida.
Add-on		 	Buy-side	The acquisition provides Palindrome's clients with additional service capabilities and more resources, while allowing Cantey Tech to expand into Florida.
Add-on		 	Sell-side	The transaction offers Golden Tech the ability to offer new capabilities and more technical resources to service a growing client base in the mid-west.
Add-on		 	Sell-side	With the addition of Security7 Networks, Integriss expands its existing cybersecurity practice and capabilities to provide compliance and regulatory consulting for more clients.
Add-on		 	Sell-side	The combined entity is now able to deliver a wider range of services including New Charter's best-in-class cybersecurity offerings.
Add-on		 	Sell-side	Thrive now positions itself as a security-first MSP that delivers comprehensive managed services and unmatched expertise to drive secure digital transformation.
Platform			Sell-side	The ITS team brings decades of experience in managed IT services which, combined with additional investment for growth and acquisitions, will continue to drive ITS's national expansion.
Add-on		 	Sell-side	The acquisition generates enhanced capabilities to meet the evolving needs of clients for both organizations, including cybersecurity, IT strategy, digital transformation, and more.
Add-on		 	Sell-side	This acquisition expands The Purple Guys' presence in the Central U.S., providing clients in the region with access to an even broader portfolio of IT solutions.
Add-on		 	Buy-side	CMS will further add to General Informatics' expertise and resources while strengthening its geographic presence in Texas and opening a new market in Colorado.