WTA TECHNOLOGY MERGERS & ACQUISITIONS

MARKET VIEW – SEPTEMBER 2021

What makes an MSP attractive to a buyer?

In late September WTA Partners ran a webinar on Cloud Services M&A. In one of the five sessions given by four speakers, Jeffrey Jenner, who leads our Cloud Services practice, presented on "What makes an MSP attractive to an acquirer". This market view is very much based on that.

We first need to establish a common understanding of what an MSP is. There are many businesses claiming to be MSPs but many of these are VARs with only a small part of their business qualifying. What does it take to be accepted as a Cloud Services MSP and be valued as such rather than a VAR-plus? This primarily comes down to the level of Annual Recurring Revenue ("ARR") which itself will be a main driver of value. And to be classed as a proper MSP that should be 50% and preferably 60%. The higher the percentage the better. There is, however, a view that the very high weighting put on ARR has lessened because of the move to digital transformation increasing the importance of consultancy and professional services. Also important is the length of the contract with the customer: the longer the period the better too. Three year contract length is the standard and good but longer is even better.

So the possible first, and certainly one of the two most important attributes, is good ARR preferably from multiple revenue streams.

Sitting alongside ARR in importance and also a major driver of value is financial performance and with EBITDA performance having the highest weighting for that is a proxy for cash and cash generation which perhaps the key item of interest for acquirers. Well-run MSPs are achieving EBITDA margins of 15% so that is what to aim for. The best are achieving close to or at 25%. Those MSPs performing below 10% have work to do but some buyers will see that as an opportunity and an encouragement to acquire but will, of course, base valuation on the lower metric.

Consistency is important too as that shows sustainability. It is better to have a number of years of say 10% EBITDA performance than erratic performance over a similar period of time. Consistent, steady growth is best.

Revenue growth comes next. Top line growth is rated highly. Again the same consistently and sustainability points stated for EBITDA apply here too. Outstanding growth can be a definite wow factor as probably shown by the recent sale of Helecloud. From a beginning in 2016 it reached £13 million in 2021. Megabuyte estimates a valuation at five times revenue which would be an exceptional outlier achievement. Of course growth is not the only factor here but seems to have been important.

Revenue considerations leads us naturally to Customers. High revenue concentration is not attractive but a good spread of revenue across the customer base is as it de-risks the business. Worse still is a high level of customer churn as it indicates either poor delivery or out of date services. So to maximise attractiveness: deliver well and keep services relevant.

MSPs can add to their attraction by having customers with at least 50 seats for the larger number of seats the more complexity and complexity provides potential acquirers with greater opportunity to sell additional services.

Size does matter. The larger the turnover the more likely a higher EBITDA multiple is achieved. The bands tend to be revenue under £5 million, £5-10 million, £10-20 million and then larger.

Having a strong management team in place is good as it means the business is more likely to be sustainable and have good procedures. It is also attractive to a buyer as they may see opportunities for synergy savings.
If the business has both strong revenue growth and a strong management that may make it appealing for direct investment by Private Equity too which opens up additional possibilities for the existing shareholders.

Competition for staff is acute so culture is important. Happy and well qualified employees with good skillsets is a big positive. That means a high level of accreditations and a decent rating on Glassdoor.

There are many other items which can improve attractiveness such as having tax losses, good people to revenue ratios, specialisms, the private/public cloud mix, fixed asset spend, etc but those above are the most important to attract more the best suitors and, hence command a higher valuation.

So not every business will be able to tick all the boxes and ultimately each buyer will judge the business as a whole against their own reasons for acquiring but working on and improving the key drivers of value will certainly result in a better outcome for the shareholders and management.

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