IT & Tech-Enabled Services M&A Recap

FIRST QUARTER 2023

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Value scorecard driver: *understanding types of revenue*

EY Canada's Technology M&A team has developed a proprietary value scorecard where we look at relevant drivers that help assess value for IT and tech-enabled services businesses. Each quarter we look at a different value driver. In this quarter's thought leadership, we explore the nuances of the different types of revenue and their implications for value.

What do we mean by the nature of revenues?

IT and tech-enabled services comprise a broad range of businesses. This makes it challenging to discuss the nature of revenues for these businesses and its implications on value

However, there are several similarities in the nature of the revenue streams of these technology services businesses that allow for some helpful conclusions on the value of these individual revenue streams, as well as how these revenue streams interact in the context of the business to determine overall value.

Types of revenue for an IT and tech-enabled services business

In the context of this discussion, we are discussing revenue types in terms of their ability to recur. This is never black and white, but services revenue can be placed into three broad categories:

- Recurring revenue: Revenue generated from ongoing services that are contractually recurring in nature and not tied to a specific project and usually billed at predefined intervals. Examples include managed IT services, managed infrastructure services and maintenance contracts. Recurring revenue is typically more predictable and stable and, as a company scales, these services benefit from the existing operating leverage in the business and can become incrementally profitable.

- Re-occurring revenue: Revenue expected to occur at regular intervals with a level of certainty. This includes a wide range of professional services or product revenue related to a regular need of the customer and with a historical track record of repeating every year or few years.

- Project-based revenue: Revenue generated from providing a specific service or completing a particular project for a client. This type of revenue is typically one time/non-recurring and is earned during the duration of the project. Examples include one-time digital transformation or systems implementation contracts.

What does each of these mean for value?

Recurring revenue is a consistent income stream and can be used to forecast future growth with a high degree of certainty. This means business owners face fewer surprises and uncertainties when trying to grow and customers have a much higher switching cost. The recurring revenue comes at a much lower acquisition cost than winning a new customer and allows the business to plan for efficiencies around operating expenses, cost of delivery and other overheads.

When customers opt for a re-occurring revenue model, they have a higher lifetime value than those who make single purchases. However, as they are not governed by a contractually recurring contract, it is difficult to place the same level of certainty on future business from them. In addition, there is arguably more work to retain these customers and therefore additional costs.

On the other hand, project-based revenue is considered one-time in nature and the switching costs for a customer are low, unless these are critical or highly differentiated services. Relying solely on one-time revenues can make scaling difficult, meaning ideally these revenues should ideally be paired with other recurring or re-occurring services, to drive customer stickiness.

The key differentiator for each of the three revenue streams boils down to the stickiness of customer relationship. It is the predictability of the customer revenues and the ability to upsell that goes with it that can drive valuation premiums. Therefore, looking at the length of individual customer relationships – assessing the type and number of service offerings provided to them and positioning this in the overall context of the company's ability to drive customer stickiness – would be important to determine how valuable the revenue is to acquirers.

Balancing revenue streams for enhanced valuation

A typical technology services business will usually have a combination of revenue types. No matter the nature of the revenue, these often all sell to the same person of a customer organization. One-time project or product revenues can be very valuable if they can provide a wedge to sell a full suite of managed, recurring or re-occuring services into these organizations.

While technology service businesses should ultimately strive for recurring revenue, all revenue streams should be viewed in the context of their ability to aid the business model. This can create an overall valuation that is higher than the sum of the value of their individual parts.

Contact a member of our team if you're interested in learning more about our value scorecard along with other key parameters relevant to your business.

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Some of our
recent deals include:

BRIGHTWORKS

has been acquired by

believeco:

EY* acted as exclusive financial advisor to Brightworks Interactive Marketing Inc.

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WBM Technologies Inc.

has received an equity investment from

Westcap

EY* acted as the exclusive financial advisor to WBM Technologies Inc.

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SOROC

received an investment from

CenterGate CAPITAL

EY* acted as exclusive financial advisor to Soroc Technology Inc.

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Solutions
vistavu

has acquired

achieveit SOLUTIONS

EY* acted as the exclusive financial advisor to VistaVu Solutions Inc.

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abilis it

has divested its business intelligence solutions and services division to

Passerelle

EY* acted as exclusive financial advisor to Abilis Solutions Inc.

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EY advised on an acquisition that created one of the largest IT Services companies in Quebec.

EY* acted as exclusive financial advisor to **one of the parties**

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SIAPARTNERS

has acquired an interest in

R&G ADVISORY

EY* acted as the exclusive financial advisor to R&G Advisory Inc.

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DIGITCOM
EXPERIENCE clever TELECOM

has been acquired by

PINE HILL CAPITAL

EY* acted as exclusive financial advisor to Digitcom Telecommunications Canada Inc.

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Well.ca

has been acquired by

McKESSON Canada

EY* provide Transaction Advisory Services to Well.ca

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Video Series
Programmed for Success

EY's Technology M&A practice has recently launched a new video series, Programmed for Success

The 5-part series hosted by EY's Canadian Technology M&A Leader, Sid Nair interviews industry thought leaders from inside and outside of the firm. The series focuses on key considerations, risks and opportunities that should be considered prior to a sale of a technology business.

Programmed for Success Series

Watch along as Sid Nair explores the key considerations when selling your technology business with industry thought leaders.

Watch Episodes 1 - 5 →

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Q1 2023 Transactions[1]

Mar 29, 2023: Edge Centres Australia Pty Ltd. acquired **Hyson International Corp.,** a provider of data center infrastructure and hosting services to global clients, for an undisclosed value.

Mar 28, 2023: MosChip Technologies Limited (BSE: 532407) announced the acquisition of **Softnautics Inc.,** semiconductor and embedded AI solutions company with design expertise in systems software, FPGA, and VLSI IP development, for a transaction value of $17.2 million.

Mar 27, 2023: Transcat, Inc. (NasdaqGM:TRNS) acquired **TIC-MS, Inc.,** a precision metrology services and instrument calibration laboratory that offers fully accredited calibrations, inspections, and certifications, for a transaction value of $9.7 million.

Mar 22, 2023: K2 Partnering Solutions Ltd. acquired **Openlogix, LLC,** a technology consulting company, that offers digital transformation and software development services, for an undisclosed value.

Mar 17, 2023: Crypto Flow Technology Limited (SEHK: 8198) announced the acquisition of majority stake in **Your Choice Ever Best, Inc.,** operator of a crypto mining data center, for a transaction value of $4.6 million. The transaction represents an enterprise value of 7.5x revenue.

Mar 17, 2023: AD Solutions, Inc. acquired **Core Imaging USA,** a business solutions company that offers managed IT services, VOIP solutions, and document management services, for an undisclosed value.

Mar 16, 2023: Kyyba, Inc. announced the acquisition of **ViKi Technologies, LLC.,** a provider of technology and IT application services for healthcare and life sciences, financial, manufacturing, and insurance-auto and life markets, for an undisclosed value.

Mar 14, 2023: Parsons Corporation (NYSE: PSN) announced the acquisition of **IPKeys Power Partners, LLC,** which develops automated demand response (DR) resources and automated solutions for the electricity consumers, for a transaction value of $43.0 million.

Mar 10, 2023: Diploma PLC (LSE: DPLM) announced the acquisition of **Tennessee Industrial Electronics, LLC,** a distributor of aftermarket parts and repair services in the industrial automation end market, for an approximate transaction value of $92.0 million.

Feb 28, 2023: IP Pathways, LLC. acquired **Sophisticated Systems Inc.,** a provider of IT consulting services including business consulting and strategy, business continuity and disaster recovery planning, and project planning & management, for an undisclosed value.

Feb 22, 2023: Sonata Software (BSE: 532221) acquired **Quant Systems Inc.,** which engages in the development and deployment of software solutions and IT applications, for a transaction value of $160.0 million. The transaction represents an enterprise value of $4.3x revenue.

(1) Data sources: S&P Capital IQ, Mergermarket, Press Releases
*Deals indicated are Canadian deals
All currencies are in US$

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Q1 2023 Transactions(1)

Feb 22, 2023: cBEYONData LLC acquired **Summit2Sea Consulting, LLC,** an information technology and management consulting company that offers enterprise solution management and integration services to various government and commercial clients, for an undisclosed value.

Feb 15, 2023: Element 84, Inc. acquired **Azavea Inc.,** a provider of software engineering, data analytics, user experience design, big data processing, machine learning, and research and development services, for an undisclosed value.

Feb 09, 2023: New Charter Technologies, LLC, acquired **DS Tech, Inc**. a provider of IT professional consulting, cloud technology, business phone systems, network security, video surveillance, and disaster recovery services, for an undisclosed value.

Feb 07, 2023*: Hut 8 Mining Corp. (TSX: HUT) announced the acquisition of **U.S. Data Mining Group Inc.,** builder, and strategic operator of four Bitcoin mining centres through deploying next-generation software and hardware across the US, for a transaction value of $365.2 million.

Jan 30, 2023: Tahoe Network Infrastructure LLC acquired **E-Vergent.com, LLC**, which operates extensive fiber and fixed wireless networks in the communities south of Milwaukee and north of Chicago, for a transaction value of $11.2 million.

Jan 26, 2023: Encora Digital LLC acquired **Prime Technology Group, LLC,** a technology services company, that provides software solutions including IT service management, cloud storage, and workflow automation, for the insurance, financial services, and healthcare industries, for an undisclosed value.

Jan 18, 2023: Marlin Equity Partners and Altor Equity Partners, announced the acquisition of **Meltwater N.V.,** which offers solutions for media monitoring, social listening, consumer insights; and sales intelligence; social media publishing, social media engagement, social influencer marketing, and media database, for a transaction value of $686.7 million.

Jan 12, 2023: PacketFabric, Inc., acquired **Unitas Global LLC**, which deploys and manages cloud infrastructurea and cloud networking solutions and provides enterprise connectivity, remote monitoring and management services, for an undisclosed value.

Jan 11, 2023: APCT Inc., acquired **Advanced Circuits, Inc.,** a software-enabled designer and manufacturer of small-run, quick-turn and low volume production printed circuit boards, including multi-layer rigid and high-density interconnect (HDI) product, for a transaction value of $170.0 million.

Jan 11, 2023: Hexaware Technologies Limited (NSEI:HEXAWARE) acquired **High Point Solutions, Inc.,** an IT services and solutions provider, that supplies internetworking hardware products to Fortune 500 companies, for an undisclosed value.

Jan 10, 2023: Digital Intelligence Systems, LLC acquired **LinTech Global, Inc.,** a provider of software development and integration, data mining and analytics services, and IT infrastructure and support services, for an undisclosed value.
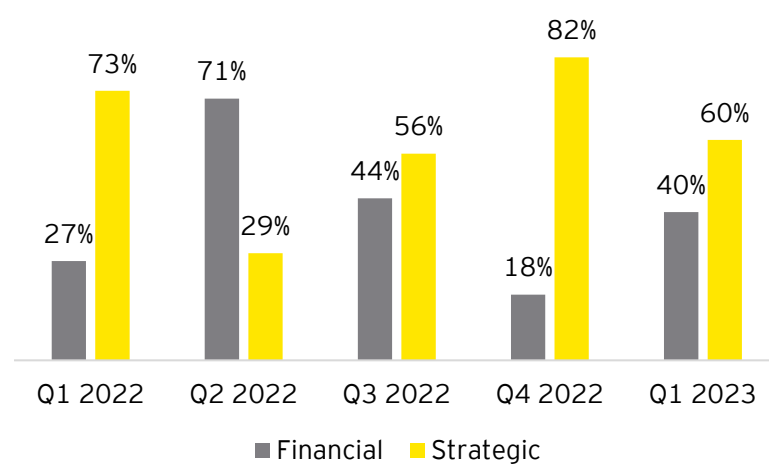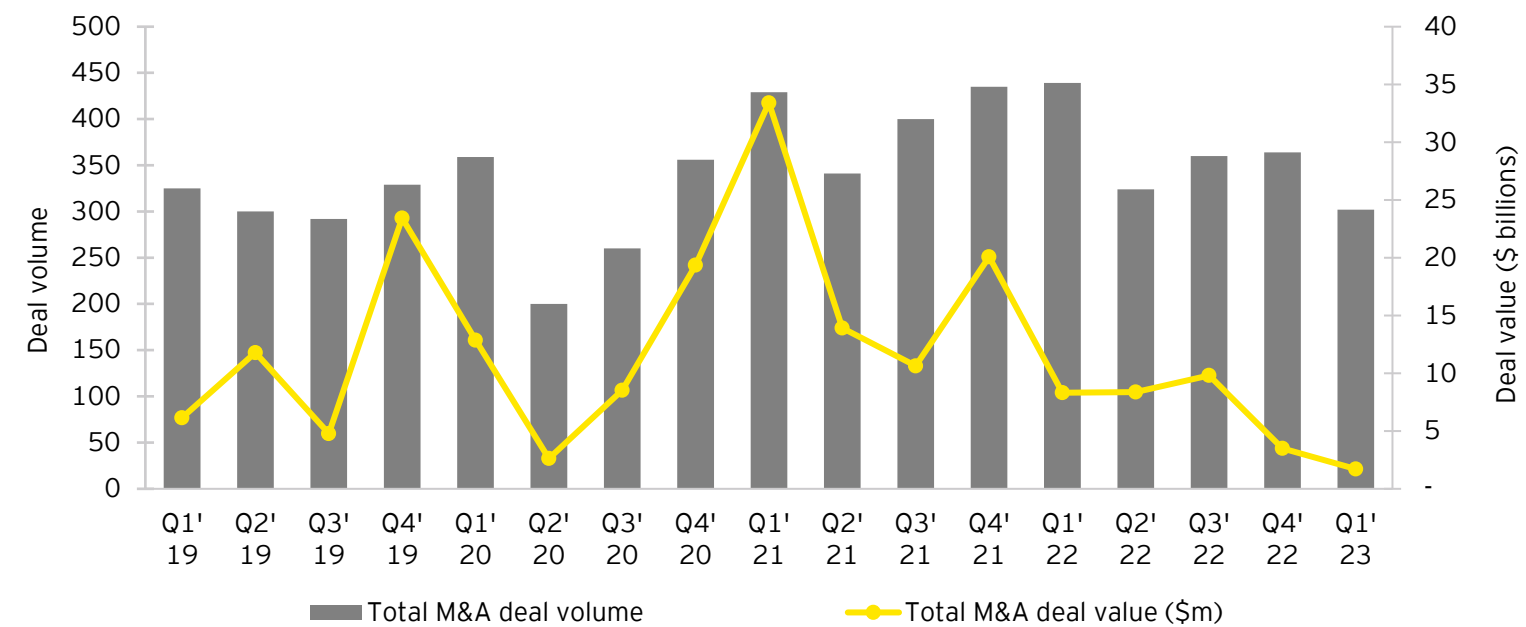
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Historical M&A
activity

Deal value by type of acquirer

- Financial
- Strategic

(Q1 2022: 27% / 73%; Q2 2022: 71% / 29%; Q3 2022: 44% / 56%; Q4 2022: 18% / 82%; Q1 2023: 40% / 60%)

Deal volume by type of acquirer

- Financial
- Strategic

(Q1 2022: 10.0% / 90.0%; Q2 2022: 9.6% / 90.4%; Q3 2022: 11.4% / 88.6%; Q4 2022: 11.3% / 88.7%; Q1 2023: 7.9% / 92.1%)
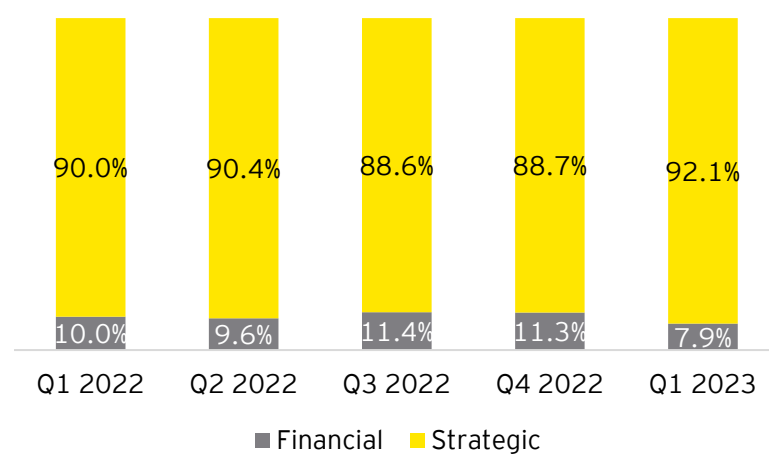
Both deal values and deal volumes have declined compared to Q1 2022 levels

- Total M&A deal volume
- Total M&A deal value ($m)

Public companies of IS&I category saw an increase in valuation in the first quarter of 2023, while other categories remained volatile

- CHS
- DPOS
- IS&I
- IT Cons
- TDV
- THSP
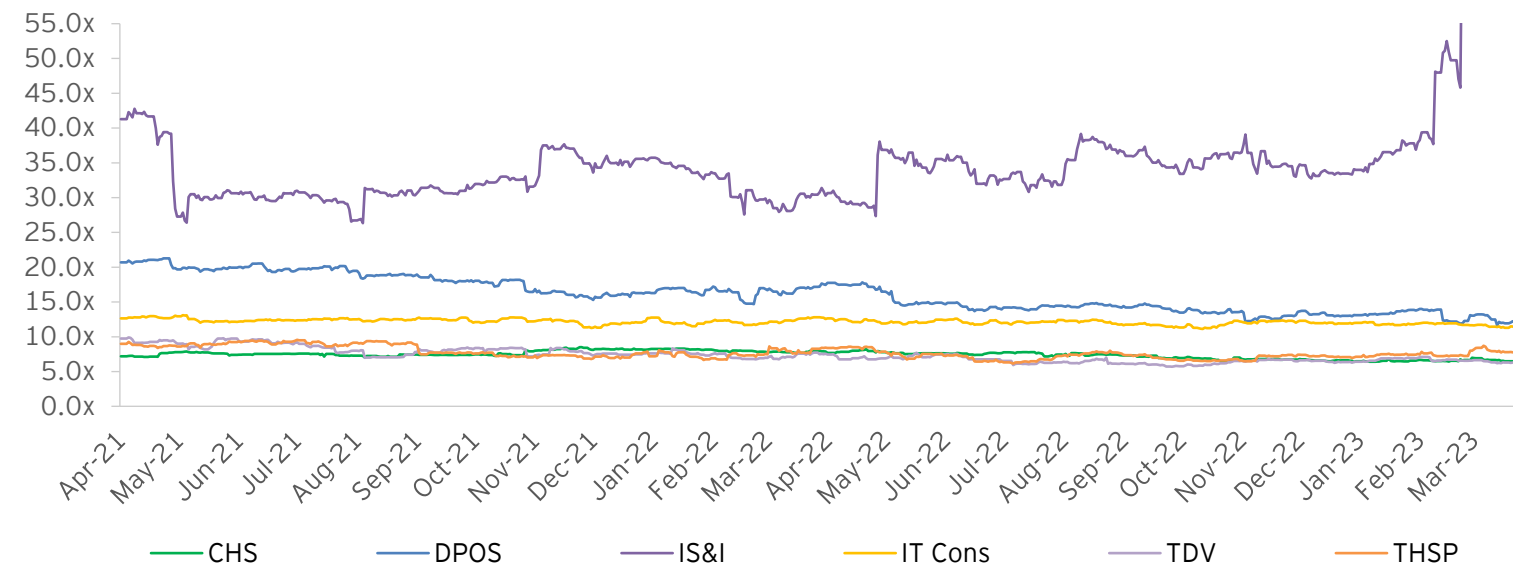
CHS - Communication and hosting services; DPS - Data processing and outsourced services; IS&I - Internet services and infrastructure; IT Cons - IT consulting and other services; TDV - Technology distributors and VARs; THSP - Technology hardware, storage and periherais.

Revenue transaction multiples are generally down compared to Q1 2022

Category	Multiple	Q1 2022
DPOS	1.1x	3.0x
IS&I	1.2x	1.5x
IT Cons	1.7x	2.0x
TDV	0.8x	
THSP	0.8x	2.5x
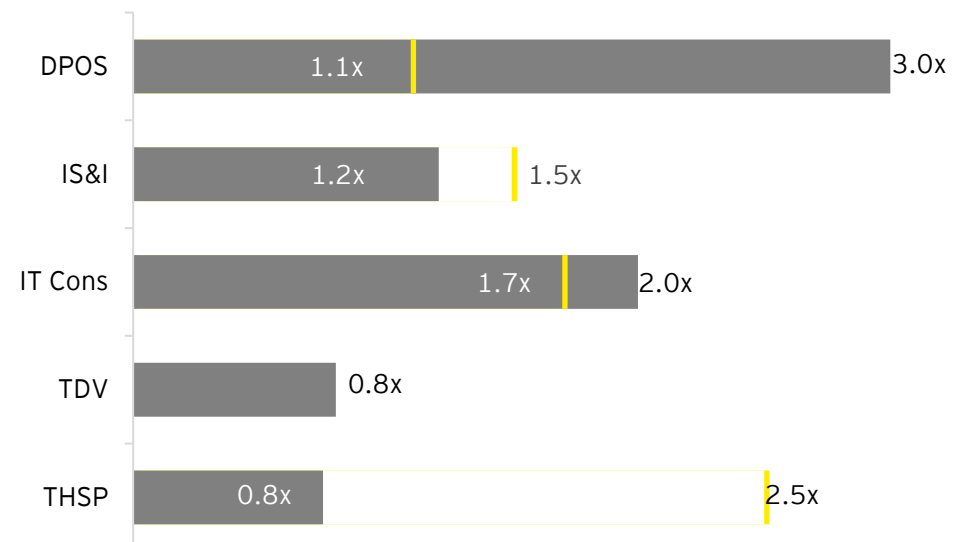
*Yellow line indicates Q1 2022 comparison

EBITDA transaction multiples remained volatile in Q1 2023

Category	Multiple	Q1 2022
DPOS	9.5x	17.1x
IS&I	19.9x	22.1x
IT Cons	6.2x	11.7x
THSP	5.3x	8.9x

*Grey line indicates Q1 2022 comparison

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