

# Information Technology Services



## Inside This Issue

- **Despite macro headwinds, M&A volumes in the IT Services sector increased in 2022, fueled by 4.2% and 7.9% forecasted global spending growth on information technology services in 2022 and 2023<sup>(1)</sup>, respectively.** The total number of transactions continued its multiple-year growth trajectory with 1,458 acquisitions reported, a new annual record.
- **The market environment remains receptive to M&A in IT Services in 2023 despite a downtick in activity in Q4 2022.** Underlying fundamentals and secular trends remain positive, which will continue to drive investment in the sector and long-term strength, albeit with a likelihood of reduced valuations in the near-term.
- **At \$400 billion, IT Outsourcing remains the largest segment of the global IT Services market<sup>(2)</sup>, accounting for 35% of the total,** and within it, Application Outsourcing and Web Hosting services continue to be the fastest growing subsegments. This trend is expected to continue as digital transformations across industries create complexities that are more efficiently addressed through outsourced vendors.
- **Companies able to demonstrate vertical expertise and the ability to cross-sell recurring services into an existing client base** continue to attract premium valuations within the sector.
- **The further build-out and establishment of IT infrastructure and applications globally will continue to drive increased demand for IT Services** as companies grow the number of technology applications within their businesses and invest in automation.

Sources: (1) Gartner, (2) Statista

Year-end 2022 Report

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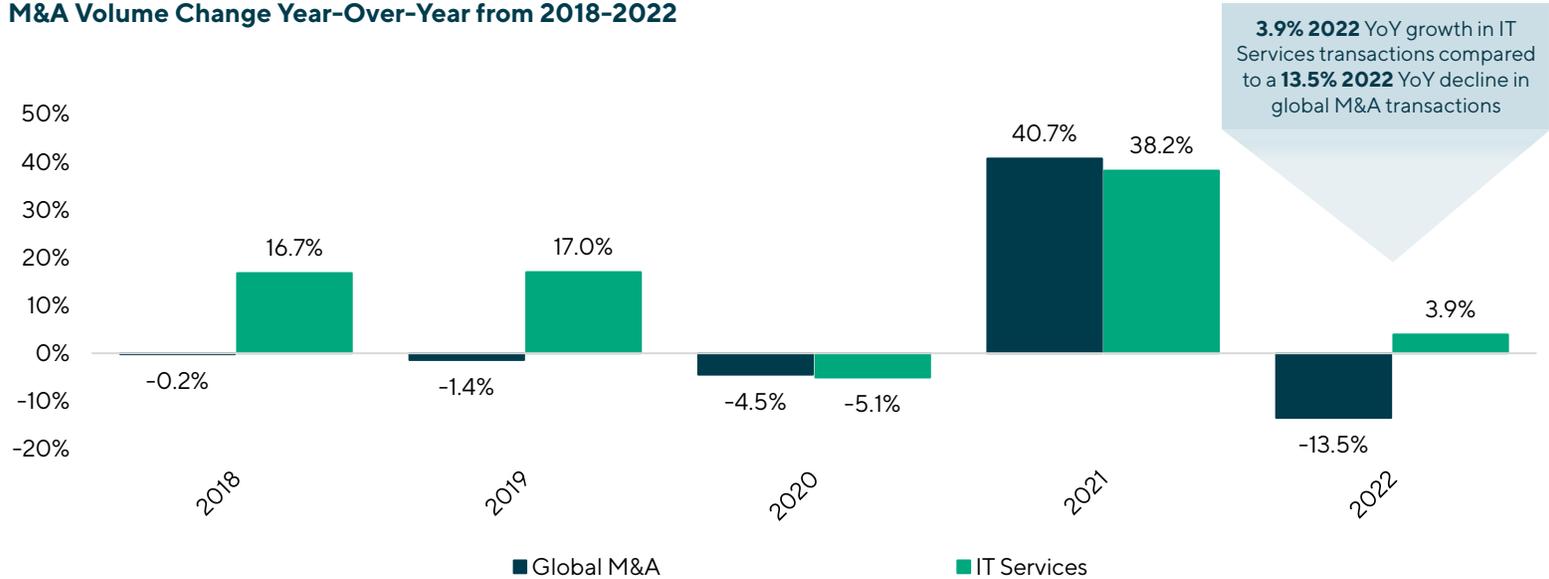
# 2022 Information Technology (IT) Services M&A Activity

## M&A Activity in the Sector Remains Strong Compared to Broader Market

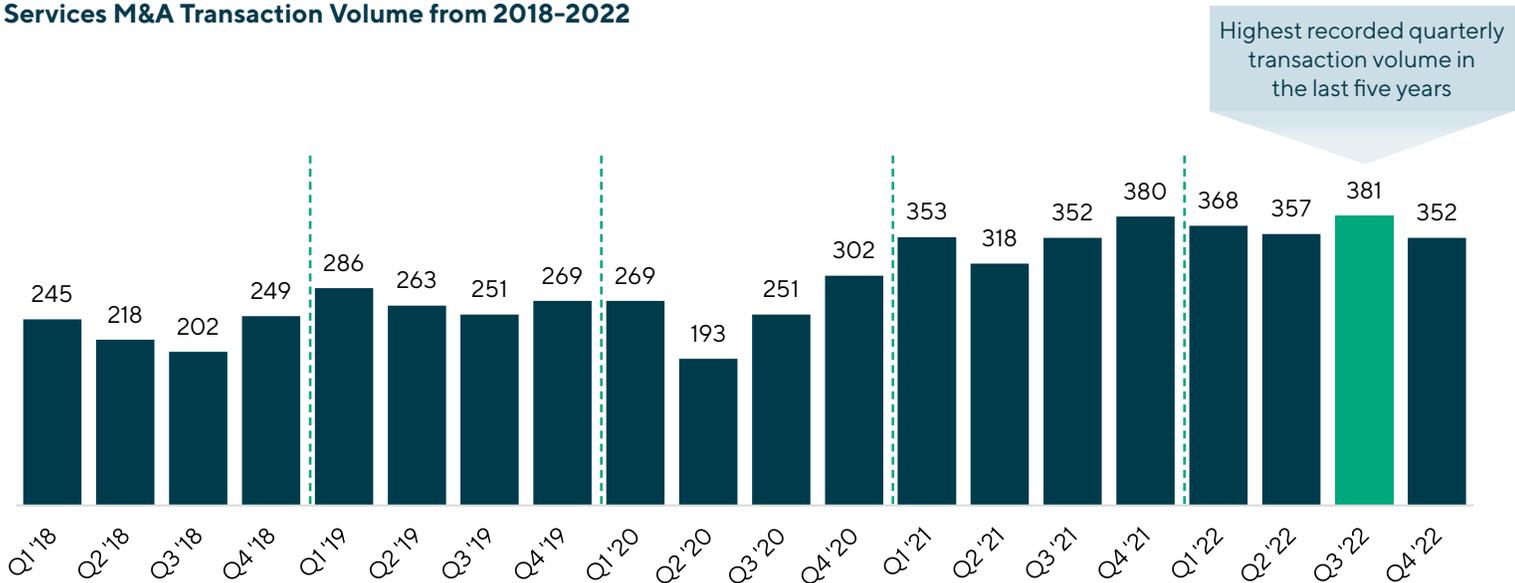
- Mergers and acquisitions (M&A) volumes in the IT Services sector in 2022 hit another high as transaction volume for the year totaled 1,458, compared to 1,403 in 2021
- Sector resiliency is well demonstrated by the ~4% growth in sector M&A volumes during 2022 versus total global M&A volumes that declined ~14%
- Strategic acquisitions for vertical-specific expertise, expertise within key vendor ecosystems, geographic coverage and capability expansions within a fragmented IT Services sector drove sustained M&A volume
- In addition to strong secular trends, IT Services businesses also represent attractive investment opportunities during periods of economic uncertainty as many exhibit recurring and / or reoccurring revenue coupled with strong growth and margins
- 352 transactions occurred in the sector in Q4 2022, down ~8% from Q4 2021, reflecting a market-wide slowdown in M&A activity; however, the demand for acquisitions remains strong relative to the broader M&A market, which experienced a 35% decline in transaction volume over the same period

**IT Services deals to continue to come to market and successfully execute, although, there has been an observed higher scrutiny on the sustainability of growth seen to date in 2023**

### M&A Volume Change Year-Over-Year from 2018-2022



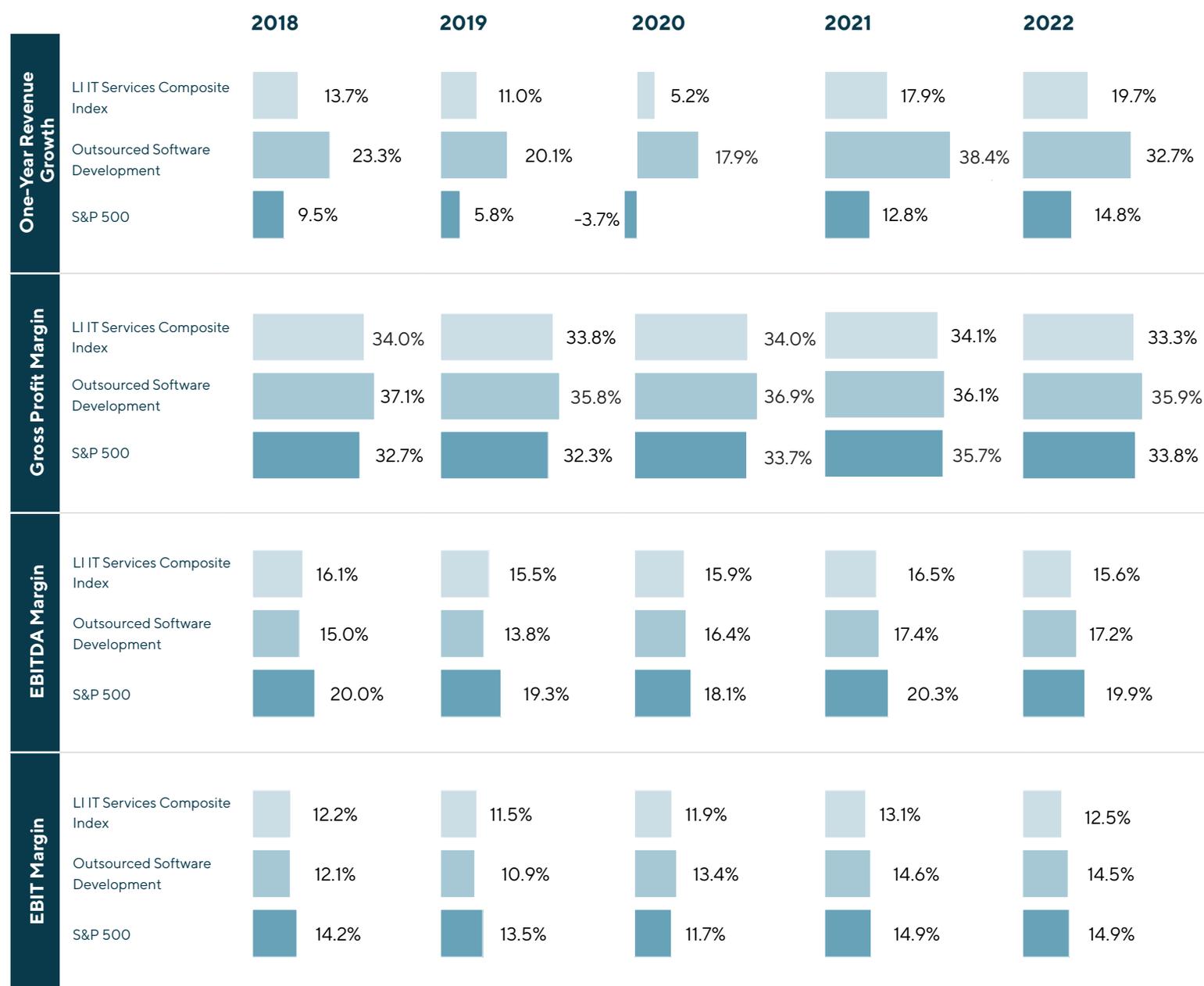
### IT Services M&A Transaction Volume from 2018-2022



Sources: S&P Capital IQ, Mergermarket, Pitchbook and Proprietary Information  
 Note: Considers closed and reported transactions on S&P Capital IQ

# Sustained Financial Performance of Companies within the Sector Against a Backdrop of Public Market Volatility

- Despite a growing number of negative macroeconomic headwinds in 2022, secular tailwinds resulted in the IT Services sector continuing its multi-year trend of gross profit margins above 30% and saw revenue growth rates increase to almost 20%, showing strong resilience compared to the S&P 500, even accounting for wage inflation
- In response to rising costs and wage inflation, IT Services companies are pivoting business models to more recurring services or vertical specialization for better revenue growth and profitability opportunities
  - 50% of channel respondents to a recent CompTIA industry survey cited this as a reason for pivoting business models
- The Outsourced Software Development subsector continues to stand out as a particularly bright spot within the sector, generating robust valuations even after a significant valuation adjustment during 2022 as companies within the space offer very high growth rates and revenue visibility, while maintaining positive margins and cash flows typically associated with IT Services models
- Value-Added Resellers (VARs) that implement or resell IT hardware have suffered from widely publicized supply chain disruptions and chip shortages but have observed a gradual improvement in these issues throughout 2022 and into 2023



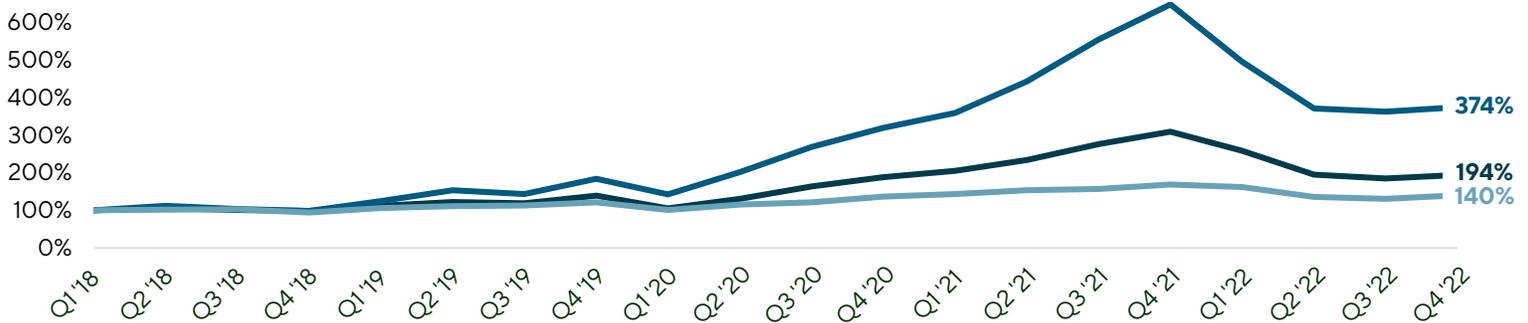
Source: S&P Capital IQ

Note: The "LI IT Services Composite Index" is comprised of public companies operating within one of Lincoln's tracked subsectors: North American & European Systems Integrators, North American & European Value-Added Resellers, Offshore IT Services, North American & European IT Managed Services and Outsourced Software Development

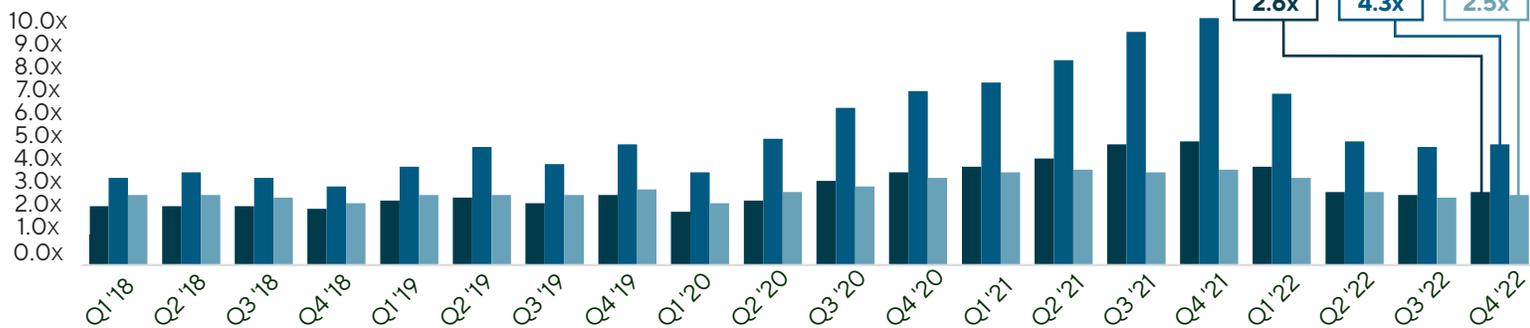
# 2022 IT Services Public Company Trading Performance Versus the Broader Market

- Following the economy-wide lows as a result of COVID-19 lockdowns at the end of Q1 2020, Lincoln's IT Services Composite Index sustained steady growth through 2021 and outperformed the S&P 500 throughout 2022, as companies within the sector continue to take advantage of favorable industry tailwinds accelerating mass digitalization and investments in IT infrastructure
- Though down significantly from 2021 highs, the Outsourced Software Development subsector has still outperformed the broader market by a significant margin over the last 3-5 years, benefiting from growing industry-specific software needs with niche capabilities and ongoing digital transformation across industries
- In Q4 2021, both the IT Services Composite Index and the Outsourced Software Development Index reached peak valuations, but over the course of 2022, these valuations have returned to pre-COVID levels with Enterprise Value / Revenue multiples at 2.6x and 4.3x respectively in Q4 2022
- Outsourced Software Development has consistently traded at a premium to the S&P 500 over the last five years, and this premium widened significantly in 2020-2021; however, in H2 2022 the differential returned to similar levels observed pre-COVID. In contrast, the broader IT Services Composite Index was trading at a discount to the S&P 500 in 2018-2019 (on an EV / Revenue multiple basis), but this dynamic flipped in H2 2020 and the IT Services Composite Index has been trading at a premium since that time

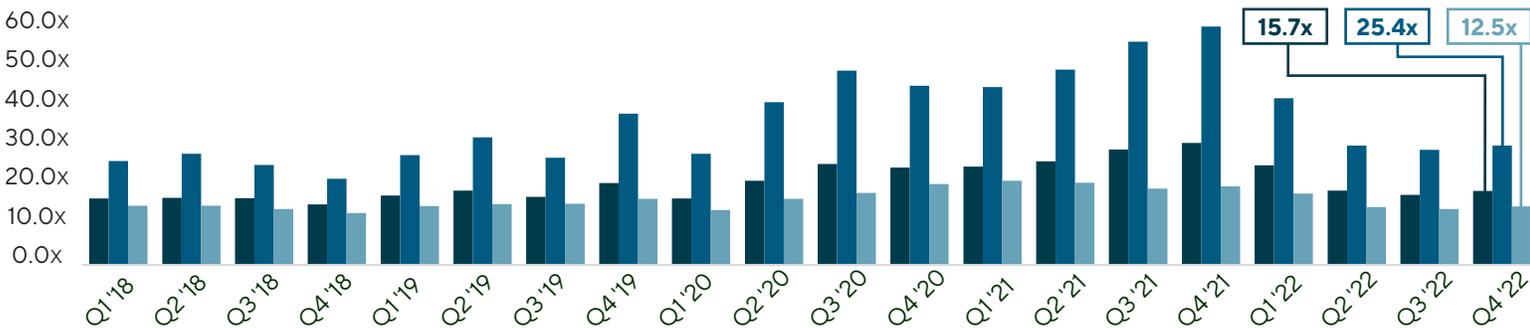
## Enterprise Value Indexed to January 2018



## Enterprise Value / LTM Revenue Valuation Multiples



## Enterprise Value / LTM EBITDA Valuation Multiples



### Legend

- LI IT Services Composite Index
- LI Composite Outsourced Software Development Index
- S&P 500

Source: S&P Capital IQ, Proprietary Information

Note: The "LI IT Services Composite Index" is comprised of public companies operating within one of Lincoln's tracked subsectors: North American & European Systems Integrators, North American & European Value-Added Resellers, Offshore IT Services, North American & European IT Managed Services and Outsourced Software Development

# Looking at 2022 and Beyond: Deal Momentum and Valuations to Sustain for Service Companies within the Digital Transformation Value Chain

## Observed Trends Amongst Sector Acquisition Activity

### Software Consultants and Implementers are In High Demand by Strategic and Financial Buyers

- Companies with heavily invested IT infrastructure are now more focused on digitalization (e.g., data & analytics, artificial intelligence (AI), process automation and rapid cloud migration) and require increasing levels of specialized, outsourced capabilities to meet their needs; this has prompted large systems integrators and consultancies to accelerate M&A activity to fill talent gaps within industries
- As public valuations for outsourced software development companies in 2022 and 2023 have moderated, financial sponsors are on a more even playing field in competing for private acquisitions in the space
- Though these types of more project-based companies are more difficult to leverage than Managed Service Providers (MSPs), they benefit from strong projected growth in key software ecosystems

### Scaled MSPs Appear to be a Favored Target of Private Equity (70%+ Recurring Revenue)

- Vertically focused models have been more successful than pure SMB generalists: Financial Services, Legal, Life Sciences, SLED, etc. due to the ability to service a more homogenous IT stack
- MSPs with increasingly digital “front ends” and strong domain expertise, especially in data and cybersecurity and vertical-specific regulatory compliance, show higher levels of client retention and growth

### Private Equity is Not Expected to Slow Down as a Contributor of IT Services Platform Acquisition Activity

- Private equity (PE) firms have raised larger funds over the last two years and are keen to deploy dry powder in digital services as customers signal that they will continue to invest regardless of economic conditions, in contrast with other professional services
- Given high M&A multiples for MSPs, some financial sponsors are trying to buy more traditional VARs at lower multiples and evolve the business models toward a predominance of managed services
  - A fragmented market landscape and breadth of pre- and post-sale service offerings to expand into has enabled many successful PE platforms to transition business models within a relatively short time frame, resulting in multiple expansion during hold periods

*Customers are also more tech-savvy, so the bar is higher for what they expect from providers. If basic security is all you offer as an MSP today, for example, it may no longer cut it as data breach-nervous customers seek an expert with more sophisticated skills. The same goes for improving other tech, sales and marketing skills, or pursuing a business model that more aligns with how today's customers prefer to engage in the digital economy. So, if this means blowing up that finely optimized managed services stack you've been working on since 2018, so be it.*

**– CompTIA IT Industry Outlook 2023**

Source: S&P Capital IQ, Mergermarket, Pitchbook and Proprietary Information  
Note: Considers closed and reported transactions on S&P Capital IQ

## Select Attractive Attributes of M&A Targets in the IT Services Sector

- Service providers specializing in key ecosystems (e.g., Adobe, Coupa, Microsoft Dynamics, Oracle, Salesforce, SAP, ServiceNow, Snowflake, Workday, etc.), typically coupled with cloud services relationships and solutions (e.g., AWS, Azure, Google Cloud, etc.)
  - Those paired with strong internal cybersecurity and data analytics capabilities often garner additional premium
- Software Consultants and Systems Integrators with a demonstrated ability to leverage initial implementation engagements into Application Managed Services relationships
- MSPs with an offering that takes responsibility for management of all or key portions of clients' tech stacks vs. providing very narrow functions (e.g., help desk, break-fix, etc.)
- Consultants with deep expertise in specific functional areas (e.g., Customer Experience, Supply Chain, HR, Finance) and demonstrated C-suite relationships

## Top IT Services Acquirers by Number of Transactions (2018-2022)

| Strategic Acquirers                                     |     |
|---|-----|
| <b>Accenture</b> (NYSE: ACN)   Systems Integrator       | 71  |
| <b>Deloitte</b> (Private)   Systems Integrator          | 37  |
| <b>NTT Data</b> (TSE: 9613)   Systems Integrator        | 20  |
| <b>Cognizant</b> (NasdaqGS: CTSI)   Systems Integrator  | 16  |
| <b>Ernst &amp; Young</b> (Private)   Systems Integrator | 13  |
| <b>Top 5 Total</b>                                      | 157 |

| Financial Sponsor-Backed Acquirers                        |    |
|---|----|
| <b>Thrive Operations</b> (Court Square)   MSP             | 13 |
| <b>Executech Utah</b> (Alpine Investors)   MSP            | 12 |
| <b>Claranet</b> (Tikehau Capital)   MSP                   | 11 |
| <b>Fellowmind Company</b> (FSN Capital Partners)   MSP    | 10 |
| <b>Meriplex Communications</b> (Vitruvian Partners)   MSP | 10 |
| <b>Top 5 Total</b>  | 56 |

# IT Services Subsector M&A Snapshot: Strategic Acquisitions of Channel Partners

| Closed | Target                           | Business Description  | Acquirer  |
|--------|----------------------------------|---|---|
| Dec.   | Utegration                       | Full-service consulting and solutions provider specializing in SAP technology and SAP-certified products for the energy and utilities sectors. Expands Cognizant's SAP capabilities to the energy and utilities sectors through its 350-person team that services over 50 North America-based clients.  |    |
| Nov.   | Aspirent                         | Specializes in strategic consulting, cloud development and project management services related to data and analytics for clients in the consumer goods, industrial products, communications and healthcare industries. Its 230-person team strengthens capabilities in key data partner ecosystems, including Azure, AWS, Databricks and Snowflake. |    |
| Sep.   | Insurance Team of 4impact        | 50-person team specializing in Guidewire solutions for the insurance industry in Australia. It offers a full range of services from strategy to implementation, enhancements, integrations, maintenance and support. Deloitte continues to add insurance sector capabilities and strengthen its presence in the Asia Pacific region.                |    |
| Aug.   | Natuvion Group                   | SAP Data Transformation Partner providing companies with support in the relocation of business-critical data and processes to modern IT platforms and systems. Expands cloud migration capabilities with SAP S/4HANA transformation projects in Germany, Austria, Switzerland, Slovakia, the United States and Australia.                           |    |
| Aug.   | Nubik                            | North American multi-cloud digital transformation specialist in Salesforce, FinancialForce and Rootstock Cloud ERP. Provides leading solutions in manufacturing and distribution, high technology and professional services. Expands Deloitte Canada's Salesforce capabilities and middle market digital transformation service offerings.          |    |
| Jul.   | Solvera Solutions                | Digital transformation consulting and managed services provider with capabilities across ServiceNow, Microsoft and SAP with a strong presence in Western Canada. Enhances Accenture's regional presence, expands current offerings in Microsoft Modern Workplace and Microsoft Power Platform and grows its capabilities in SAP S/4HANA.            |  |
| Jun.   | Business Services & Technologies | Bulgarian provider of Managed Cloud Services, Software Development and Application Management Services. It specializes in guiding digital transformation processes through SAP. Its managed services are for SAP solutions such as Ariba, S/4HANA and SuccessFactors. NTT DATA adds increased scalability in its "global shoring approach."         |  |
| Apr.   | Entrago                          | ServiceNow elite partner providing advisory, consulting and delivery services in Australia. It primarily serves the healthcare sector, as well as government and financial services sectors. Adds 21 team members with ServiceNow expertise in the healthcare sector to Deloitte Consulting's Enterprise Technology and Performance Group.          |  |

## Lincoln's Recent IT Services Transactions

|   |  |  |   |  |   |   |   |
|---|--|--|---|--|---|---|---|
| <p><b>Dunedin</b></p> <p>has sold</p> <p><b>red</b></p> <p>to</p> <p><b>AEA</b></p> <p>Sell-Side</p> <p></p> | <p><b>C.I.V.C.</b></p> <p>has sold</p> <p><b>COMPUTER AIDED TECHNOLOGY</b></p> <p>to</p> <p><b>goengineer</b></p> <p>a portfolio company of</p> <p><b>GOENGINEER</b></p> <p>Sell-Side</p> <p></p> | <p><b>webworks</b></p> <p>Marketing for Online Shops</p> <p>has been sold to</p> <p><b>Customer Collective</b></p> <p>a portfolio company of</p> <p><b>DOWN2 EARTH CAPITAL</b></p> <p>SPONSORED BY COMMERCE BANK</p> <p>Sell-Side</p> <p></p> | <p>Founder, private shareholder and</p> <p><b>LEAD EQUITIES</b></p> <p>have sold</p> <p><b>SOLO.COM</b></p> <p>to</p> <p><b>HOUSE OF HR</b></p> <p>a portfolio company of</p> <p><b>naxicap</b></p> <p>Sell-Side</p> <p></p> | <p><b>Blue.cloud</b></p> <p>has sold a majority stake to</p> <p><b>HUDSON HILL CAPITAL</b></p> <p>Sell-Side</p> <p></p> | <p>Private shareholders of</p> <p><b>Intermate.Group</b></p> <p>have partnered with</p> <p><b>ECM</b></p> <p>Sell-Side</p> <p></p> | <p><b>OPERATIONAL Solutions</b></p> <p>has sold a minority stake to</p> <p><b>BGF</b></p> <p>Sell-Side</p> <p></p> | <p><b>Circle.</b></p> <p>has been sold to</p> <p><b>arrow</b></p> <p>a portfolio company of</p> <p><b>MML</b></p> <p>Sell-Side</p> <p></p> |
|---|--|--|---|--|---|---|---|

Source: S&P Capital IQ, Mergermarket, Pitchbook, Company Press Releases and Proprietary Information



## Lincoln's Business Services Group is Committed to Serving Our Clients

We are immersed in the constantly evolving, rapidly growing service-based economy. Our breadth of transactional, operational and technical experience enables us to intuitively communicate the underlying dynamics in key subsectors and generate excellent outcomes based on our clients' individual needs.

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Valuations & Opinions

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