WHAT IS MY MSP COMPANY WORTH?

Arriving at Valuation

TEQUITY

Market Overview

The managed services market was valued at USD $185.98 billion in 2019, and it is expected to reach USD $356.24 billion by 2025, registering a CAGR of 11.5% during the forecast period of 2020-2025.

The market for managed services is going to be fueled by the increasing shortage of expertise as companies upgrade their infrastructure and systems more frequently. With the move to cloud-based solutions, many firms look to outside providers to manage the virtualization process and provide ongoing support.

Cybersecurity is an area of the market that is growing faster than others in the MSP space. A report published by insurance firm Hiscox in 2019 found almost 74% of organizations have a very novice infrastructure, while only 10% of the organizations in the world have the necessary infrastructure to deal with cyberthreats.

MSP Market Research

The overall MSP (managed IT services provider) market remains healthy and growing across North America and Europe, according to recent research.

IT Hygiene: Respondents were most comfortable offering and using antivirus (89%), firewalls (83%), data backup and recovery (81%), and endpoint security (75%).

Services Opportunities: On the services end, respondents were least comfortable with auditing and compliance management (53%), penetration testing (47%), and security system architecture (39%).

Automation: Respondents were least comfortable automating client onboarding (44%) with identity and access management in second place.

Growth Opportunities: The top three solutions MPSs were least comfortable with were biometrics, cloud access security brokers (CASBs), and digital rights management.

Source: Channele2e

MSP Market Challenges

- **MSP Customer Expansion & Retention:** In North America, MSPs pick up an average of four clients every three months while losing one in the same period. Top causes of customer loss included the company either went out of business (26% in North America and 16% in Europe) or were fired by the partner (25% in North America and 16% in Europe).

- **Business Hurdles:** North American MSPs claimed their biggest obstacles toward growth were sales (43%), lack of resources (42%), and marketing (26%).

- **Market Challenges:** The research identified several emerging challenges in the market — for both vendors and MSPs. For starters, the core RMM (remote monitoring and management) software market has matured in North America — meaning that most new sales are “rip and replace” engagements rather than organic MSP growth engagements.

- **Cyberthreats:** MSPs and their software suppliers remain prime targets for cyberattacks. Although the sector is strengthening its security practices, more steps are needed to ensure the MSP industry retains its credibility and avoids potential compliance regulations

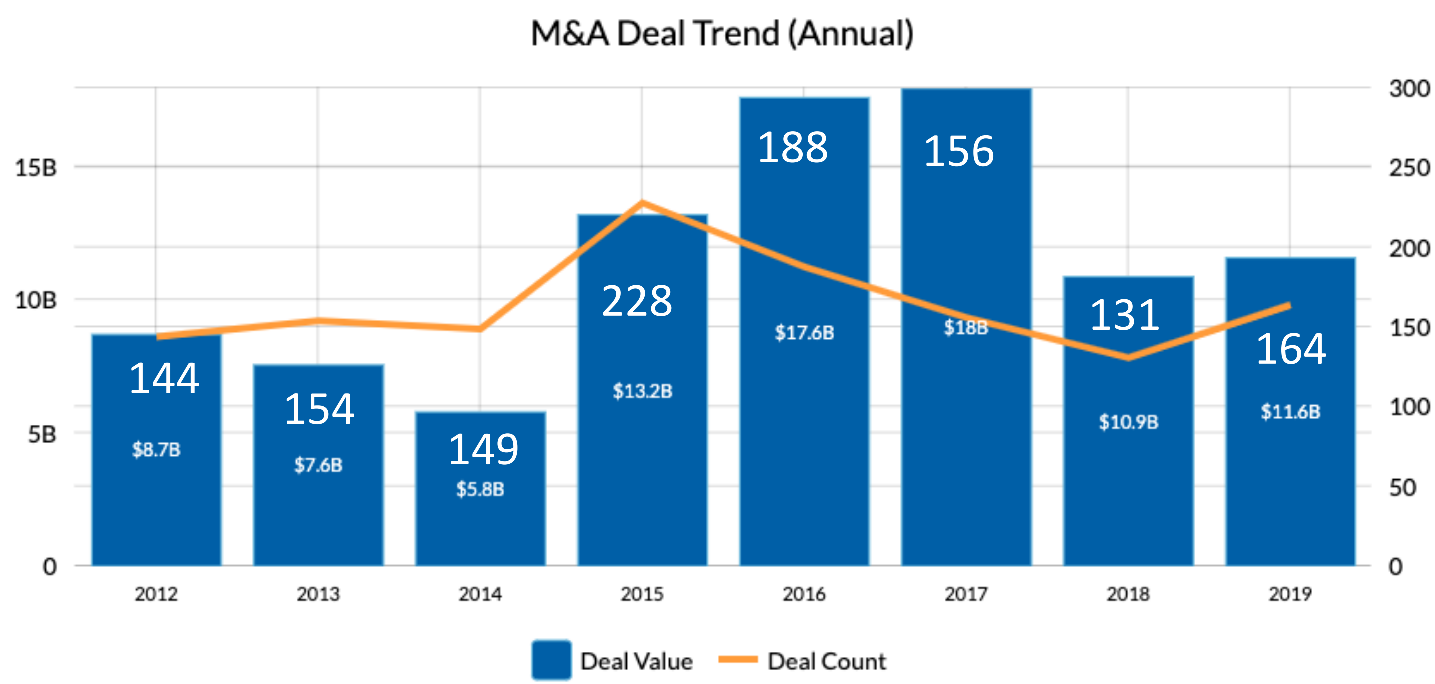
Source: Channele2e

M&A Trends in the MSP Market

THE MARKET

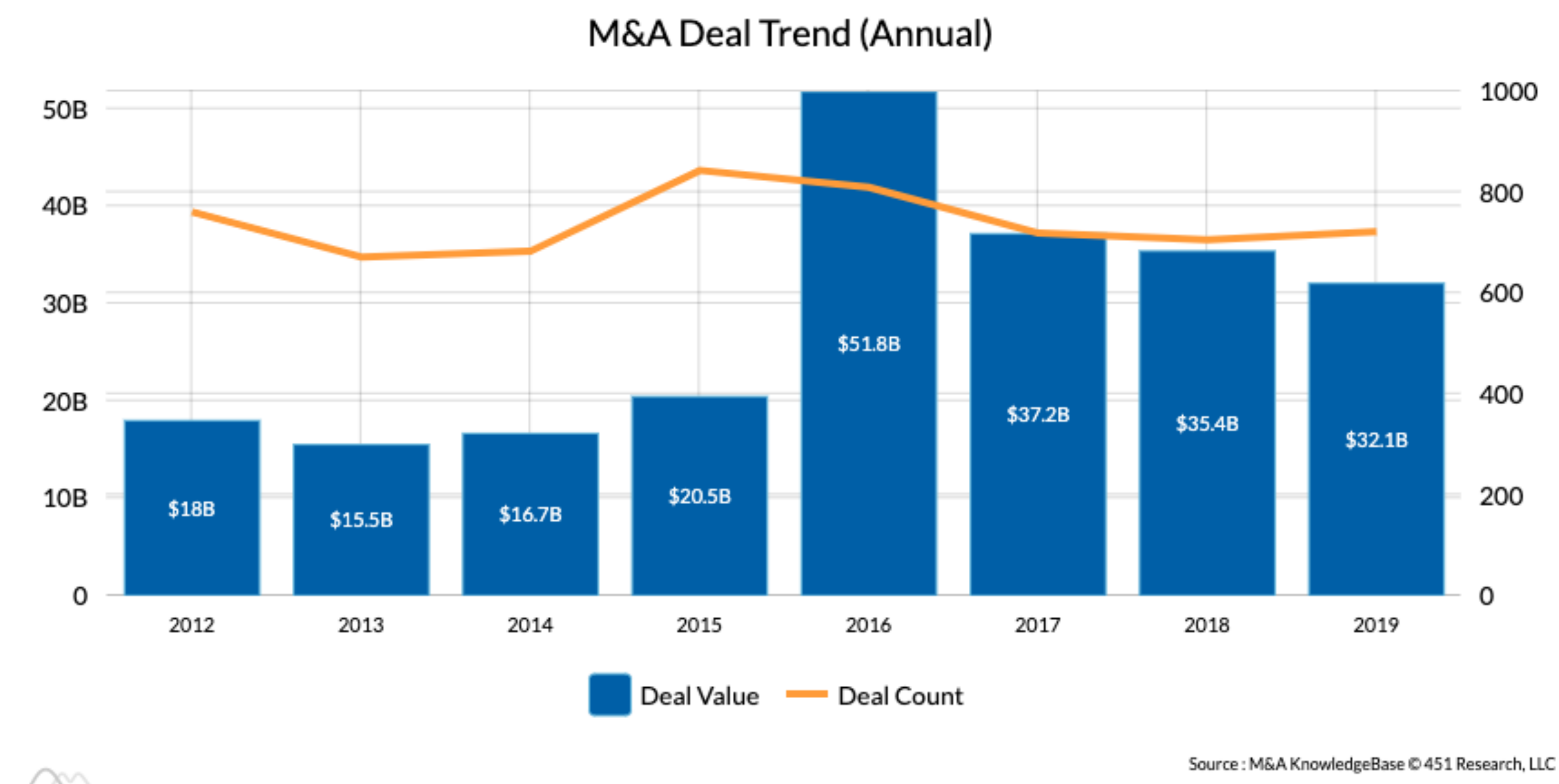
There has been a wave of transactions in the MSP market in the last few years. Many MSPs are contemplating whether the time is right to explore the sale of their firm to a larger strategic organization with the customers, market reach, and resources to help accelerate growth.

As part of this decision process, the big question is "what is my MSP company worth in today's market?"



Source : M&A KnowledgeBase © 451 Research, LLC

Broader MSP, IT, VAR M&A Trend



Transactions for MSPs, IT Services, and VAR firms globally

Valuation Enhancers

- Double digit top line YOY revenue growth
- Size: Bigger companies get better valuations (>$10m is good; >$15m is better)
- You have proprietary intellectual property (IP)
- You have self-service, proprietary cloud offerings
- High % of Recurring Revenue
- High % of Revenue from Managed Customers
- EBITDA is growing in a strong, predictable, consistent way each year; best-in-class MSPs generate > 15% EBITDA; top performers are > 20%
- Low Customer Churn
- Low Revenue Churn
- Majority of services are automated

- Geo focus or Vertical market specialization especially in highly regulated industries like finance and healthcare (depending on the buyer)
- Services pricing should be in line with the top 25% of market
- GAAP based financials
- Strong internal systems / projections tracked to actuals / KPIs monitored
- Working with an experienced M&A advisory firm running a fulsome process to ensure your opportunity is seen by a sufficient number of potential buyers
- Deal structured to include Earn-Out or other valuation lever
- And many more

Valuation Detractors

- Low or flat top line revenue growth YOY (MSPs with $6m-$15m revenue grew an average of 20.3% YOY in 2019)
- Revenue < $10m
- % of Recurring Revenue is < 50%
- % of Managed Customer Revenue < 80%
- High Customer Churn
- Low revenue per managed customer
- Low customer satisfaction score
- Significant % of revenue from hardware or 3rd party product sales
- Accounting isn't GAAP compliant

- EBITDA margins < 15%
- EBITDA < $1m
- Annual Revenue per Employee < $155
- Labor-intensive processes = hard to scale
- Weak or no internal systems = slows down rate of scale
- Being passive and waiting for one company to approach you – no leverage, no competitive offers
- Not running a process with an experienced M&A advisory firm
- And many more

Market Valuations

Valuations for MSPs typically range from 4x to 6x normalized EBITDA, with premium firms getting up to 8x and in a very few cases up to 10x

MSP Valuation Scorecard

Category	Criteria
Growth	% of Total Revenue growth and % of Recurring growth MSPs grew an average of 20.3% in 2019
EBITDA	Should be at least 10% 15% to 20% = higher value
Recurring Revenue	50%+ recurring revenue 80%+ of revenue from managed customers
Propriety IP	Does the company have truly proprietary IP that makes getting/onboarding/managing customers more efficient?
Product Revenue	What % of revenue is from products?
Retention	85%+ customer retention 90%+ revenue retention
Agreements	Length of terms / auto-renew?
Valuation	Multiple of trailing twelve months EBITDA based on above
Geography	Relevant market for existing company or a platform
Customer Concentration	Total revenue: less than 25% for top customer; less than 50% for top 5 Non-recurring revenue: less than 33% for top customer; less than 50% for top 5
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

EBITDA Valuation Approach

Most MSPs are valued between 4x and 6x normalized EBITDA based on EBITDA of 15% to 20%

Revenue	$10,000,000	
at 20% EBITDA	$2,000,000	
4x EBITDA	$8,000,000	or .8x Revenue
5x EBITDA	$10,000,000	or 1x Revenue
6x EBITDA	$12,000,000	or 1.2x Revenue

If growth is >20% and Recurring Revenue is >60%, more likely to receive a valuation at the top end of the range or possibly slightly higher

Revenue	$10,000,000	
at 15% EBITDA	$1,500,000	
4x EBITDA	$6,000,000	or .6x Revenue
5x EBITDA	$7,500,000	or .75x Revenue
6x EBITDA	$9,000,000	or .9x Revenue

Slightly less profitable will impact valuation to a degree.

Revenue	$10,000,000	
at 10% EBITDA	$1,000,000	
4x EBITDA	$4,000,000	or .4x Revenue
5x EBITDA	$5,000,000	or .5x Revenue
6x EBITDA	$6,000,000	or .6x Revenue

Lower profitability points to a valuation at 4x to 5x

Revenue Stream Valuation Approach

Buyers will value different streams of revenue higher or lower based on the quality of the revenue.

Metrics published by Channele2e:

VAR Revenue	.10 per $1 of Revenue
Break-fix hourly support	.45 per $1 of Revenue
IT Project / prof services	.63 per $1 of Revenue
True MSP revenue	1.27 per $1 of MSP Revenue

Using the same company with $10m in Revenue and 20% EBITDA:

EXAMPLE:			VALUE PER $1	VALUE	
Total Revenue	$10,000,000				
20% EBITDA	$2,000,000				
60% MSP Revenue	$6,000,000		1.27	$7,620,000	
20% IT Services	$2,000,000		0.63	$1,260,000	
Break-fix hourly	$1,000,000		0.45	$450,000	
VAR, HW revenue	$1,000,000		0.1	$100,000	
				$9,430,000	4.7x EBITDA
					.9x Revenue

To Consider

Are You Ready?	Understand your company's positioning and readiness for a transaction
Know Your Value	Get guidance on the range of your likely outcome in a transaction in today's market
Experienced Advisor	Work with an experienced advisory firm that knows your market and has a track record of strong transactions
Prepare Early	Put the measures in place today to maximize your outcome in a future event
Tax Advice	Get tax advice on whether an asset sale or a share sale is more beneficial
Financials	Ensure all financial records will stand up to scrutiny

TEQUITY

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