

Extra Crunch

Private equity is ready to take MSP consolidation to the next level

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The outlook for managed services providers (MSPs) remains positive, as increasing complexity and security concerns — driven by the work-from-anywhere environment and high-profile hacking incidents — have moved IT management from being a cost center to a core strategic priority for the C-suite.

A key driver of the growth of such providers is the fact that the requisite skills needed to manage and secure complex IT environments are in high demand, making it difficult for many businesses to develop and maintain internal IT teams that are up to the task.

As a result, an increasing number of companies will continue to outsource some, or all, of their IT management to highly skilled managed service providers. Some industry insiders estimate that only 30%-40% of the managed services market has been penetrated, so there is a huge gap that MSPs can fill.

Private equity investors have taken notice of these tailwinds and many are highly interested in investing in the sector, which will fuel the currently ongoing consolidation.

MSPs have all the ingredients that private equity loves — a strong demand trend, low risk of obsolescence, a “sticky” service that attracts long-term customers and high recurring revenues, strong cash flow margins and a relatively “asset-light” business. In addition, with approximately 40,000 MSPs in the U.S. [as of 2019],

Select PE-Owned MSPs

MSP	PE Firm	Description
Abacus Group	WestView Capital Partners	Vertically focused MSP - leading provider of managed IT solutions focused on the financial services and asset management sectors
AccountabilIT	WestView Capital Partners	SMB and SME focused MSP - leading provider of managed IT services with offices in Arizona, Arkansas and India
Ascend Technologies	M/C Partners	SMB focused MSP - prominent Midwest IT solution provider
Centre Technologies	Main Street Capital Corporation	SMB focused MSP - full-service IT consulting and managed services provider headquartered in Texas
Convergence Networks/Grade A	Riverside Partners	SMB focused MSP - leading provider of managed IT services with locations in Northern US and Southern Canada
Corsica Technologies	Inverness Graham	SMB focused MSP - leading provider of managed IT and advanced cybersecurity services with locations in the Mid-Atlantic, Midwest, Southeast and Mountain region
Dynamic Quest	Spire Capital	SMB and SME focused MSP - leading provider of managed services with offices in the Southeast and the Philippines
Eze Castle Integration	H.I.G. Capital	Vertically focused MSP - global provider of end-to-end technology solutions to financial and professional services industries
Ntiva	Southfield Capital	SMB focused MSP - leading provider of managed IT services with offices across the East Coast and Midwest
Thrive	Court Square and M/C Partners	SMB and SME focused MSP - leading provider of outsourced managed IT services with locations throughout New England, the Mid-Atlantic, Chicago and San Francisco

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A selection of private equity-owned MSPs.

the industry remains very fragmented, leaving massive opportunities for private equity players to build large companies via acquisitions.

Many private equity firms are already invested in the sector. Cowen tracks approximately 50 private equity-owned MSPs, many of which have already acquired other MSPs. The table above shows a few such private equity-backed MSPs that are expected to be catalysts for continued consolidation in the sector. Most of these firms have already completed multiple acquisitions.

In the consolidation now underway, firms often are scooping up MSPs with EBITDA ranging from \$3 million to \$10 million and are growing them organically and through add-on deals. However, larger private equity firms are starting to enter the fray to build major regional or specialty MSP players.

Below are some recent examples of larger private equity firms buying MSPs that were originally acquired and built up by smaller private equity firms:

- Thrive, which originally partnered with private

equity firm M/C Partners (which is investing a \$350 million fund), completed a recapitalization with Court Square Capital (\$2.7 billion fund).

- VC3, which originally partnered with WestView Capital Partners (\$700 million fund), was sold to Nautic Partners (\$1.5 billion fund).
- New Era Technologies, which originally partnered with Gemini Investors (\$64 million fund), completed a recapitalization with Sentinel Capital Partners (\$2.2 billion fund).
- InterVision, which originally partnered with Huron Capital Partners (\$550 million fund), completed a recapitalization transaction with MidOcean Partners (\$1.2 billion fund).

Despite the white-hot interest in the sector against the backdrop of surging M&A activity, MSPs can’t just rest on their laurels and expect to be bought at a top valuation. Private equity firms are most interested in companies that can show rapid growth, good profitability, a strong management team, and, crucially, a high share of revenues that are recurring, with 75% emerging as a bench-

mark for leading players. The most desirable MSPs will be those who also have deep expertise in hot areas such as cloud services and security.

MSPs that check the boxes for private equity firms in terms of scale and business characteristics can be valued at over 10 times trailing EBITDA, with industry leading firms garnering EBITDA multiples in the midteens or higher.

As with all industries, as consolidation goes on, demand for MSP acquisitions will fade. But we appear to be a long way from that point. Recent sales processes have attracted as many as 30-40 private equity bidders, and these firms are looking over their shoulder, as interest in MSP acquisitions rises among other buyers such as value-added resellers, systems integrators, IT consultants, telecom firms, hosting companies and

infrastructure providers.

In other words, it's a great time for MSP owners to cash in, if that's their plan. For those seeking to grow and capitalize on the post-pandemic trends, they will need to continually make strategic decisions that keep them at the cutting edge of cloud and security services while preparing for sharper competition in the months and years ahead.