IT & Tech-Enabled Services M&A Recap

SECOND QUARTER 2024

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Value scorecard driver: contribution margin

EY Canada's Technology M&A team has developed a proprietary value scorecard through which 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 contribution margin and its implications for value.

What is contribution margin?

Contribution margin is a financial metric that plays a crucial role in the strategic planning and decision-making processes, particularly in the IT and tech-enabled services sector. It measures the amount of revenue from the sale of a product or service that exceeds the variable costs associated with producing it. This residual revenue is what contributes to covering the company's fixed costs and, once they are covered, to generating profit.

It has particular relevance when evaluating IT and tech-enabled services companies because, as these businesses grow, they often provide a suite of different services that sit on top of an underlying fixed cost infrastructure. To understand the unique value of the services – both individually and combined – it is useful to understand how they each contribute versus their variable costs. Since most IT services companies have people costs as the main variable cost, looking at contribution margin is a simple way to look at how profits can be scaled.

What does a higher margin mean and how does it affect a company's worth?

Contribution margins are a useful proxy when considering the value of a single service or group of services a company offers, because some IT services can become highly commoditized, such as professional services and staff augmentation. This means there is little contribution, making it harder to scale without taking on a significant amount of people, which comes with a more sizable, fixed cost infrastructure.

Higher contribution margins might mean the service is more differentiated – e.g., industry-specific solutions or on-trend offerings – mission critical – e.g., cybersecurity services – or less directly tied to variable costs, e.g., managed services models. When a tech-enabled service has a high contribution margin compared to its "pure play" services equivalent, it demonstrates that the use of technology is truly differentiated.

The implications of the contribution margin on a company's value are significant. A high contribution margin can signal to investors that the company has a scalable business model or true differentiation. It can also indicate that the company has pricing power and a competitive advantage in the market. As a value driver, we think of contribution margin as a key screening component. Investors will always dig into the nuances of contribution margin, but it is often used as one of the main gauges for initial interest.

What should you watch out for? Remember, it's about how the contribution margins of different service lines work together.

To increase the contribution margin, companies can employ several strategies. One approach is to increase prices, which can be effective if the product or service is unique or highly valued by customers. However, this strategy requires careful consideration of market demand and competitor pricing to avoid losing customers. Another strategy is to reduce variable costs by finding more efficient methods of production or negotiating better terms with contractors or suppliers. We have seen companies use accelerators in certain industries or certain automations – increasingly using AI – to build a more differentiated offering that can command higher margins.

It's very important to consider that a low-contribution margin service line does not mean it is not worthwhile. For example, sometimes having a low margin value-added reseller business unit can be a crucial wedge to reach customers who can then be sold valuable managed services. It also might serve as a large-volume play that covers your fixed costs and allows for more dynamic and profitable services to flow directly to the bottom line.

Some sectors like government want to work with just a few vendors, meaning that you may need lower-margin services to be able to compete for your customer base. The key should be maximizing the contribution margin of each service and to have a coherent strategy on how each service contributes to the whole.

Final thoughts.

In conclusion, the contribution margin is a critical financial indicator for companies in the IT and tech-enabled services sector. It provides insight into how much revenue is contributing to covering fixed costs and generating profit. A high contribution margin can enhance a company's value by demonstrating scalability and potential for high returns. To increase their margin, companies can adjust pricing, reduce variable costs, focus on high-margin products and innovate to stay competitive. Companies should look to grow the margin of each service, but equally consider the strategic worth of each service line to the overall business strategy.

We actively work with companies to build an equity story around their service offering that will resonate with investors. Further, we can analyze and effectively present the contribution margin, so investors can evaluate in respect to potential future acquisitions. Please reach out if you would like to discuss how we can help you. Let's work together to showcase the true value of your business.

Some of our recent deals include:

MANNARINO

has been acquired by

SCALIAN

EY* acted as exclusive financial advisor to Mannarino Systems & Software Inc.

*Ernst and Young Orenda Corporate Finance Inc.
*Ernst & Young LLP.

Provider of collaboration software and solutions for the life sciences industry

has been acquired by

A financial sponsor-backed provider of services for the life sciences industry

EY* acted as the exclusive financial advisor to the seller

*Ernst and Young Orenda Corporate Finance Inc.

BRIGHTWORKS

has been acquired by

believeco:

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

*Ernst & Young Orenda Corporate Finance Inc.

WBM Technologies Inc.

has received an equity investment from

Westcap

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

*Ernst and Young Orenda Corporate Finance Inc.

SOROC

received an investment from

CenterGate CAPITAL

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

*Ernst and Young Orenda Corporate Finance Inc.

Solutions vistavu

has acquired

achieveit SOLUTIONS

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

* Ernst & Young Orenda Corporate Finance 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.

*Ernst and Young Orenda Corporate Finance Inc.

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

*Ernst & Young Orenda Corporate Finance Inc.

SIAPARTNERS

has acquired an interest in

RG ADVISORY

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

*Ernst & Young Orenda Corporate Finance Inc.

DIGITCOM EXPERIENCE clever TELECOM

has been acquired by

PINE HILL CAPITAL

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

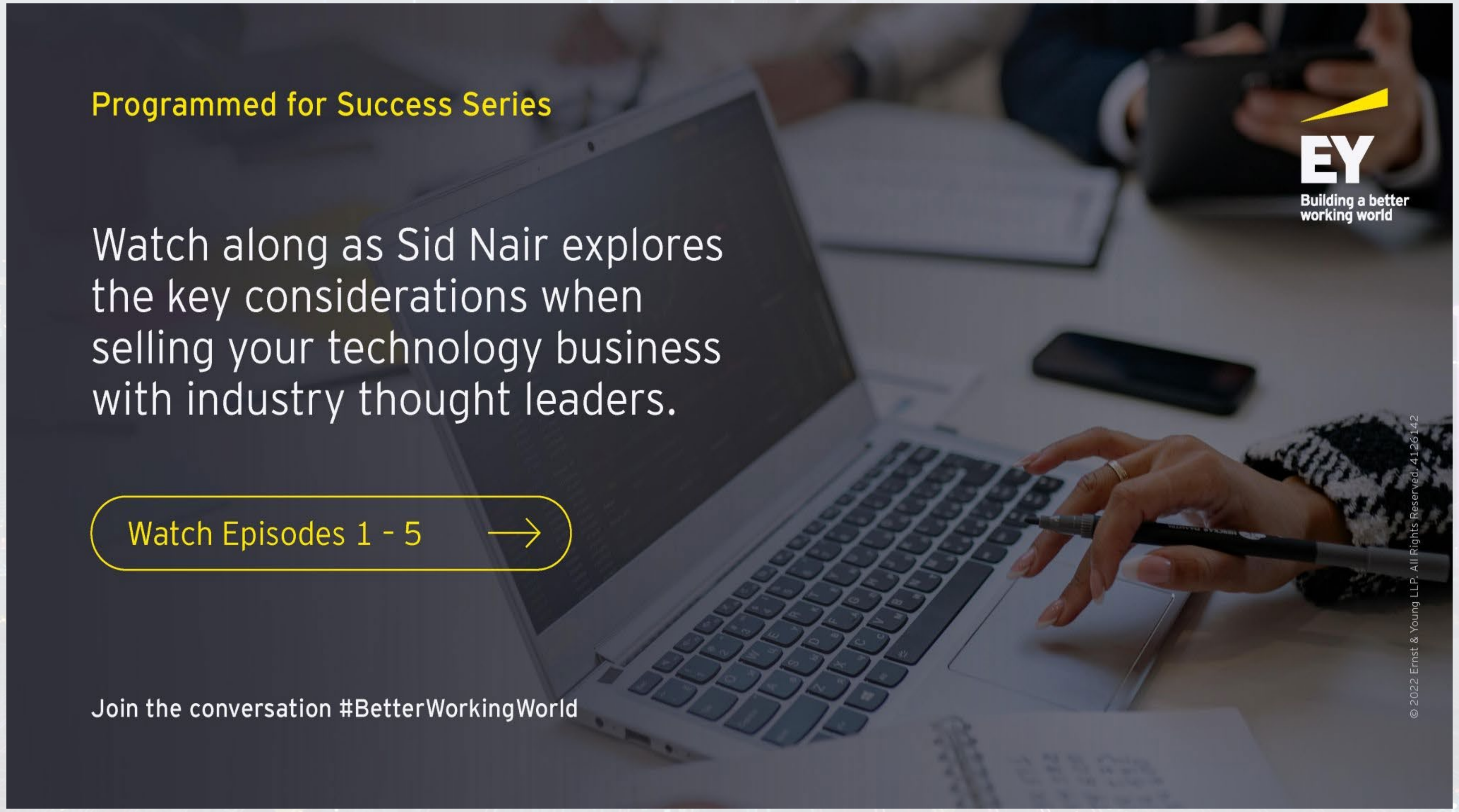
*Ernst & Young Orenda Corporate Finance Inc.

Deals closed in Q2 2024

Our 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.



Select Q2 2024 transactions

Announced Date	Target	Target HQ	Target Description	Buyer	Buyer HQ
Jun 27, 2024	Altimetrik Corp.	🇺🇸	Leading data and digital engineering solutions company which offer transformative solutions in digital enablement, championing precision in data and digital engineering ▸ Deal Value: undisclosed	TPG Inc.	🇺🇸
Jun 27, 2024	DKBinnovative	🇺🇸	Leading provider of cybersecurity and managed IT services to thousands of businesses across the US ▸ Deal Value: undisclosed	Lyra Technology Group	🇺🇸
Jun 27, 2024	HWN, Inc.	🇺🇸	Technology services business assets of HWN, Inc., which comprises of technology services ▸ Deal Value: $11.2 million	INNO4 LLC	🇺🇸
Jun 24, 2024	Quality Uptime Services	🇺🇸	Provider of customized preventive and emergency service programs for mission-critical data centers and other facilities ▸ Deal Value: $119.0 million	ABM Industries Inc. (NYSE: ABM)	🇺🇸
Jun 20, 2024	Nuspire, LLC	🇺🇸	Provider of managed security services, managed & endpoint detection and response, and consulting solutions ▸ Deal Value: undisclosed	PDI Technologies	🇺🇸
Jun 19, 2024	eStruxture Data Centers Inc.	🇨🇦	Canadian data center provider with various locations, which offers colocation, bandwidth, security, and support services ▸ Deal Value: $1.3 billion	Fengate Asset Management	🇺🇸
Jun 10, 2024	Belcan LLC	🇺🇸	Global supplier of Engineering Research & Development services to the aerospace, defence/govt., automotive, & industrial markets ▸ Deal Value: $1.3 billion ▸ EV / Revenue: 10.0x	Cognizant (NASDAQ: CTSH)	🇺🇸
Jun 10, 2024	Rome Research	🇺🇸	Provider of various IT consulting services including systems administration, assurance, programming, and IT/technical training ▸ Deal Value: $7.0 million	NexTech Solutions	🇺🇸
Jun 04, 2024	Inline Computer Support	🇨🇦	Comprehensive technology solution provider, which provides managed services, cloud computing, and network security services ▸ Deal Value: Undisclosed	Innovation Networks	🇨🇦

Data sources: S&P Capital IQ, Mergermarket, Press Releases
All currencies are in US$

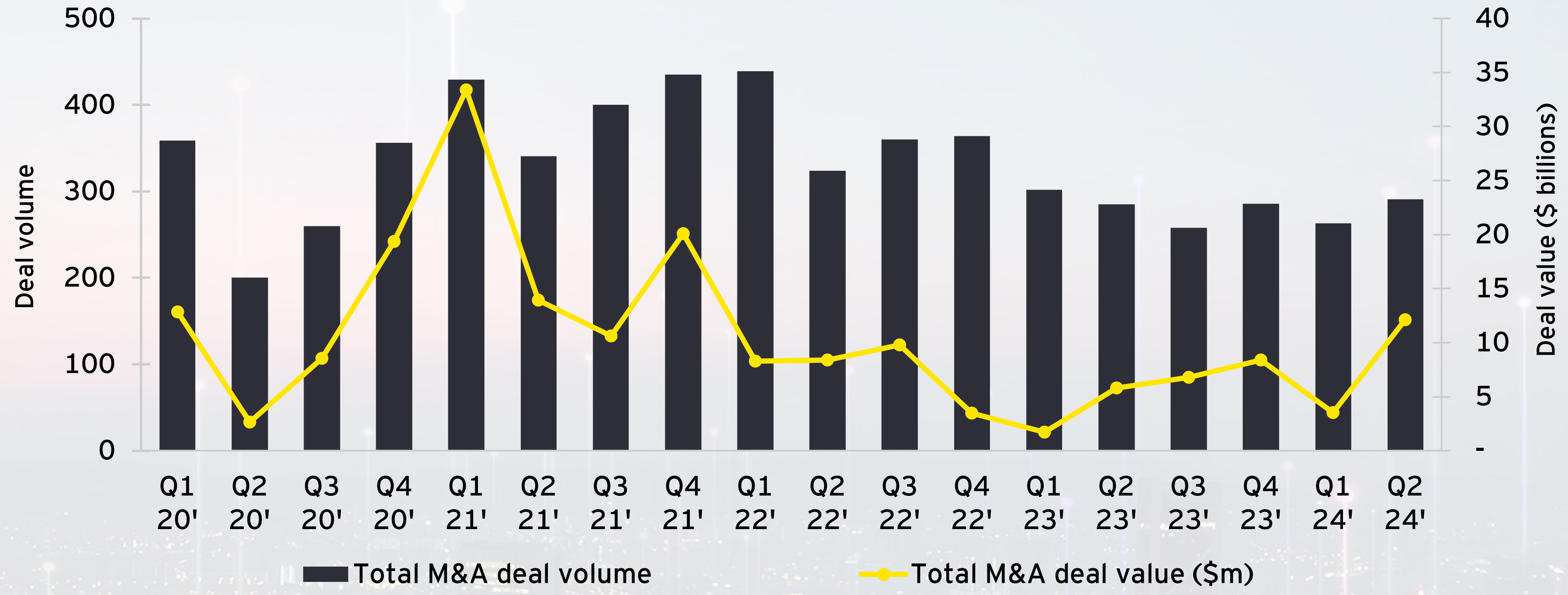
Select Q2 2024 transactions (cont'd.)

Announced Date	Target	Target HQ	Target Description	Buyer	Buyer HQ
May 15, 2024	TSR Inc.	🇺🇸	Leading provider of information technology staffing solutions ► Deal Value: $29.0 million ► EV / Revenue: 0.2x; EV / EBITDA: 7.8x	Vienna Parent Corporation	🇺🇸
May 07, 2024	Vumetric, Inc.	🇨🇦	Leading cybersecurity provider specializing in advanced penetration testing designed to identify cyber vulnerabilities ► Deal Value: undisclosed	TELUS Corporation (TSX:T)	🇨🇦
May 05, 2024	Perficient, Inc.	🇺🇸	A global digital consultancy transforming the leading enterprises and biggest brands ► Deal Value: $3.0 billion ► EV / Revenue: 3.3x; EV / EBITDA: 18.5x	EQT Private Capital Asia	🇭🇰
May 03, 2024	Diamond Technologies, Inc.	🇺🇸	Premier provider of customized solutions for data collection, automation, and industrial communications ► Deal Value: $12.3 million	Beacon EmbeddedWorks	🇺🇸
May 03, 2024	Innovapost Inc.	🇨🇦	Provider of information technology, information system, and business solution services ► Deal Value: undisclosed	Deloitte Canada LLP	🇨🇦
May 01, 2024	Barcoding, Inc.	🇺🇸	A supply chain automation, and innovation company that helps organization be more efficient, accurate, and connected ► Deal Value: $92.0 million ► EV / Revenue: 0.8x; EV / EBITDA: 11.9x	DecisionPoint Systems, Inc.	🇺🇸
May 01, 2024	Info Center, Inc.	🇺🇸	A pure-play ServiceNow "Elite" partner, providing strategy, professional and managed services ► Deal Value: $371.3 million	Insight Enterprises (NASDAQ: NSIT)	🇺🇸
Apr 11, 2024	Ipseity Security Inc.	🇨🇦	Leading Identity and Access Management (IAM) company, which provides identity, cloud security, and managed services ► Deal Value: undisclosed	Cyderes, LLC	🇺🇸
Apr 02, 2024	Presidio, Inc	🇺🇸	Provider of IT and digital solutions which offers a full suite of solutions from data & analytics, cloud services, and cybersecurity ► Deal Value: $4.0 billion	Clayton Dubilier & Rice	🇺🇸

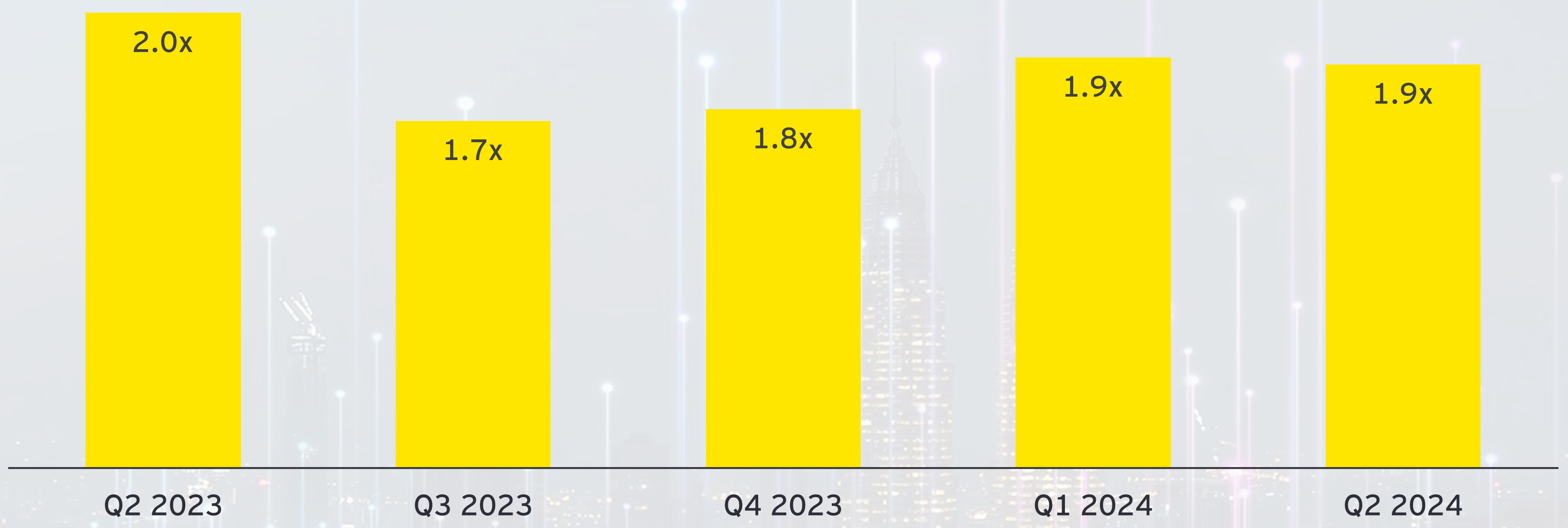
Data sources: S&P Capital IQ, Mergermarket, Press Releases
All currencies are in US$

Historical M&A activity

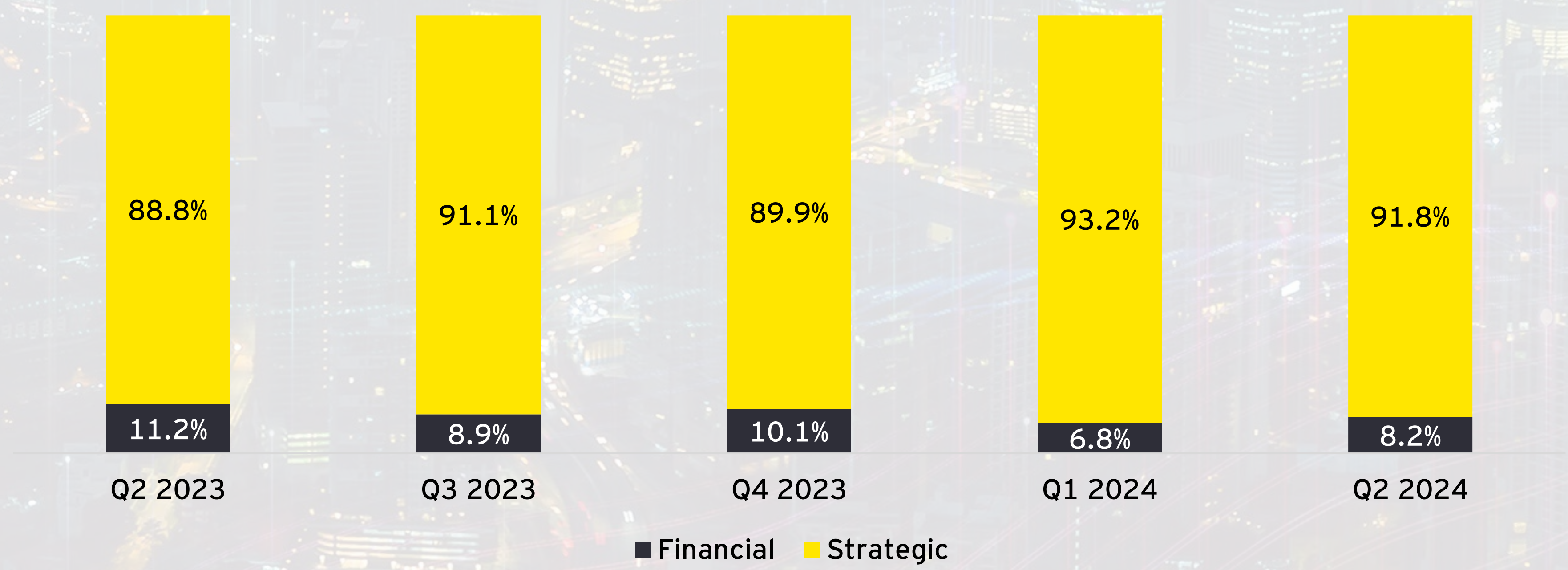
Both deal value and volumes[1] slowly picking up in comparison to previous four quarters



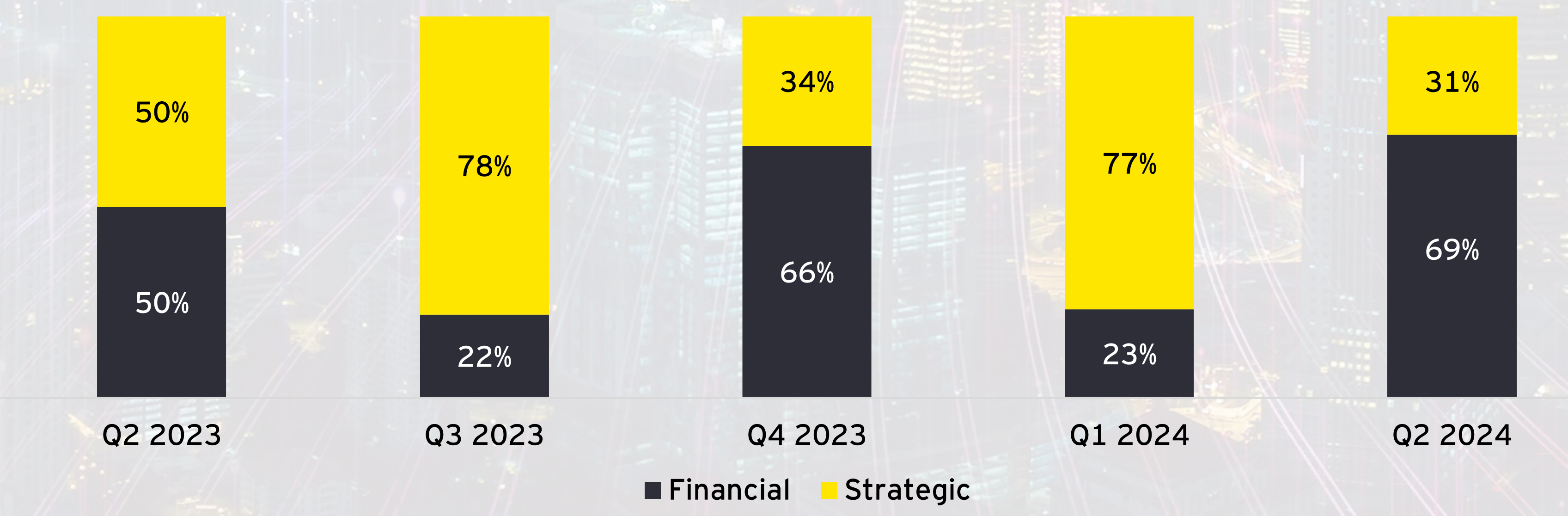
EV/revenue transaction multiples in 2024 witnessed growth driven by improving market outlook



Deal volume[1] by type of acquirer



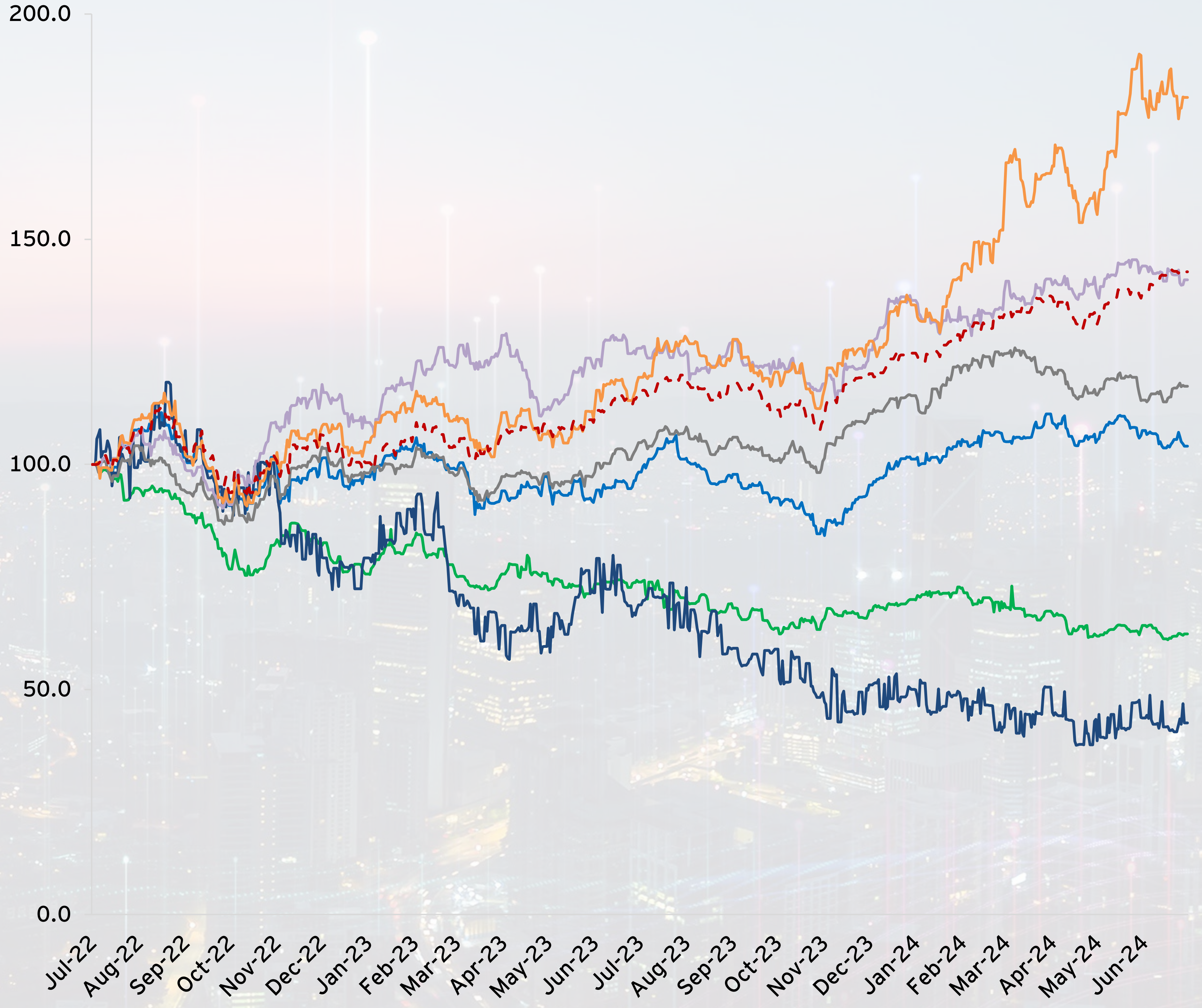
Deal value by type of acquirer



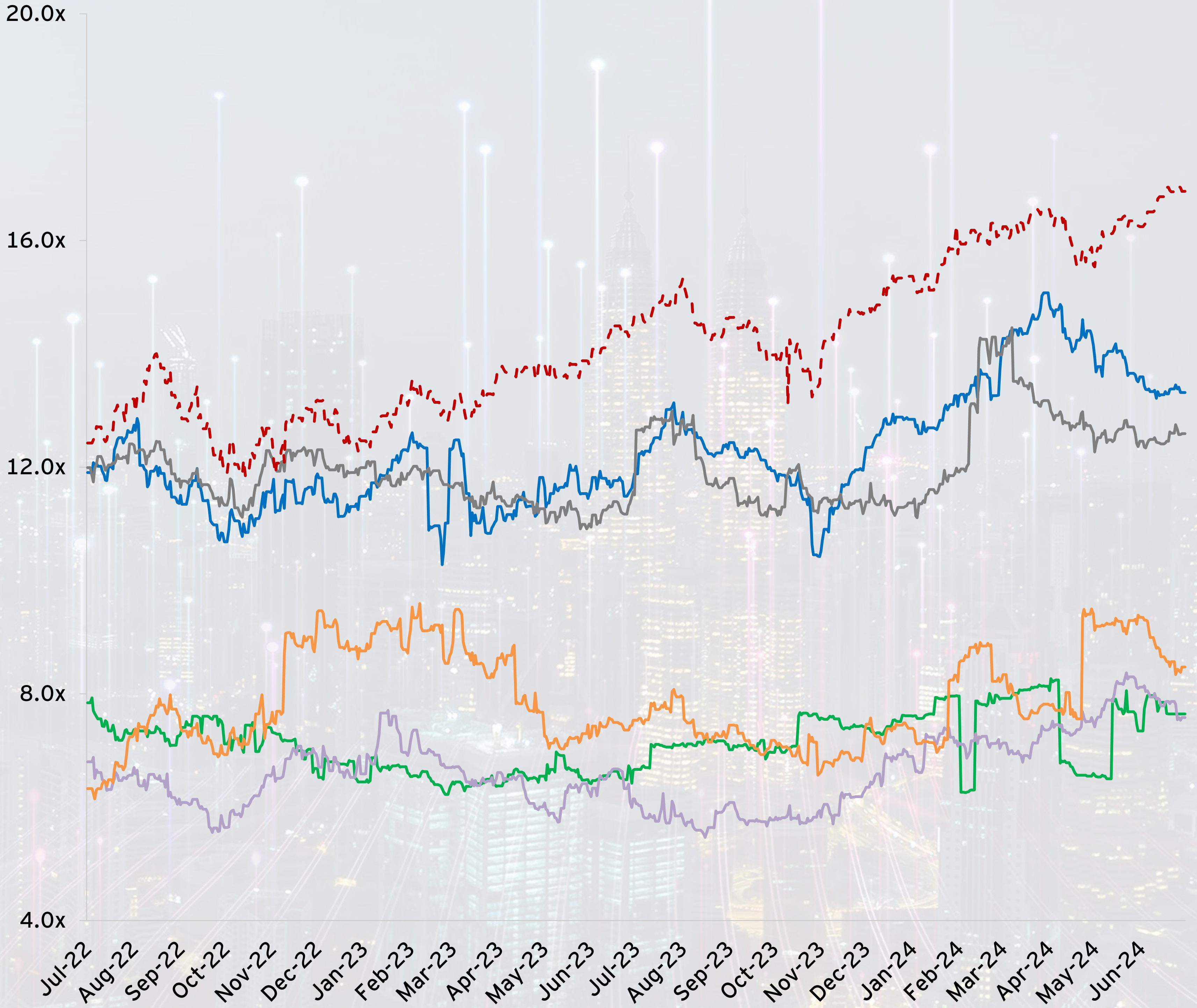
1. Includes deals (#) with undisclosed deal values
Source: S&P Capital IQ and Mergermarket

Public market performance

S&P 500 outperformed most of the categories in last 8 quarters; Tech hardware & storage businesses thrives on AI-related compute & storage demand [(1), (2)]



Services focused IT consulting and outsourcing businesses are trading (EV/EBITDA) at a significant premium[(1), (3)]



Communication and hosting services | Data processing and outsourced services | Internet services and infrastructure | IT consulting & other services | Technology distributors and VARs | Technology hardware, storage and peripherals | S&P 500

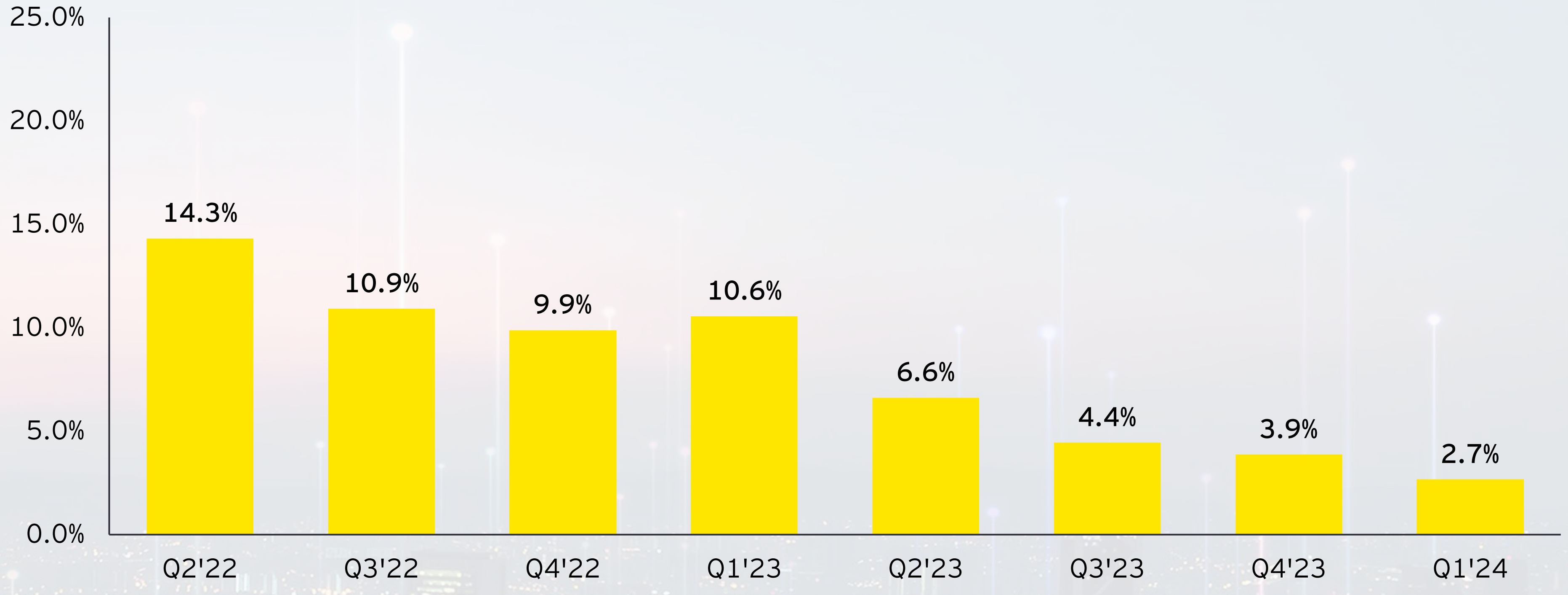
1. *Communication & hosting services: (NYSE:VZ, NYSE:T, TSX:BCE, TSX:T, NasdaqGS:ATNI, NasdaqGS:CNSL, OTCPK:LICT); Data processing and outsourced services: (NasdaqGS:ADP, NYSE:FIS, NYSE:FI, NasdaqGS:JKHY, NYSE:BKI, NasdaqGS:EEFT, NasdaqGS:CNDT, NYSE:EVTC, TSX:ISV); Internet services and infrastructure: (TSXV:MTLO, NasdaqGS:BCOV, NasdaqGS:EGIO, NasdaqCM:TCX, NasdaqGS:INAP); IT consulting & other services: (NYSE:LDOS, NYSE:BAH, NYSE:CACI, TSX:CGY, NYSE:SAIC, NYSE:RAMP, NYSE:IBM, NSEI:TCS, NYSE:ACN, NasdaqGS:CTSH, TSX:GIB.A, NYSE:DXC, ENXTPA:CAP; Technology distributors and VARs: (NYSE:ARW, NYSE:SNX, NasdaqGS:AVT, NasdaqGS:RELL, NasdaqGS:NSIT, NasdaqGS:PLUS, NasdaqGS:SCSC, NasdaqCM:AEY, OTCPK:EACO, NasdaqGM:CLMB, OTCPK:SPRS); Technology hardware, storage and peripherals: (NYSE:DELL, NYSE:HPQ, NYSE:HPE, NASDAQ:XRX, NYSE:PSTG, NYSE:NCR, NasdaqGS:PLXS, NYSE:BHE, TSX:CLS, NasdaqGS:SSYS, NYSE:MEI, NasdaqGM:ALOT, TSX:BYL, TSX:FTG)*
2. *Reflects average values within segments*
3. *Reflects median values within segments; IS&S segment companies all report negative earnings and hence excluded from the chart*

Source: S&P Capital IQ

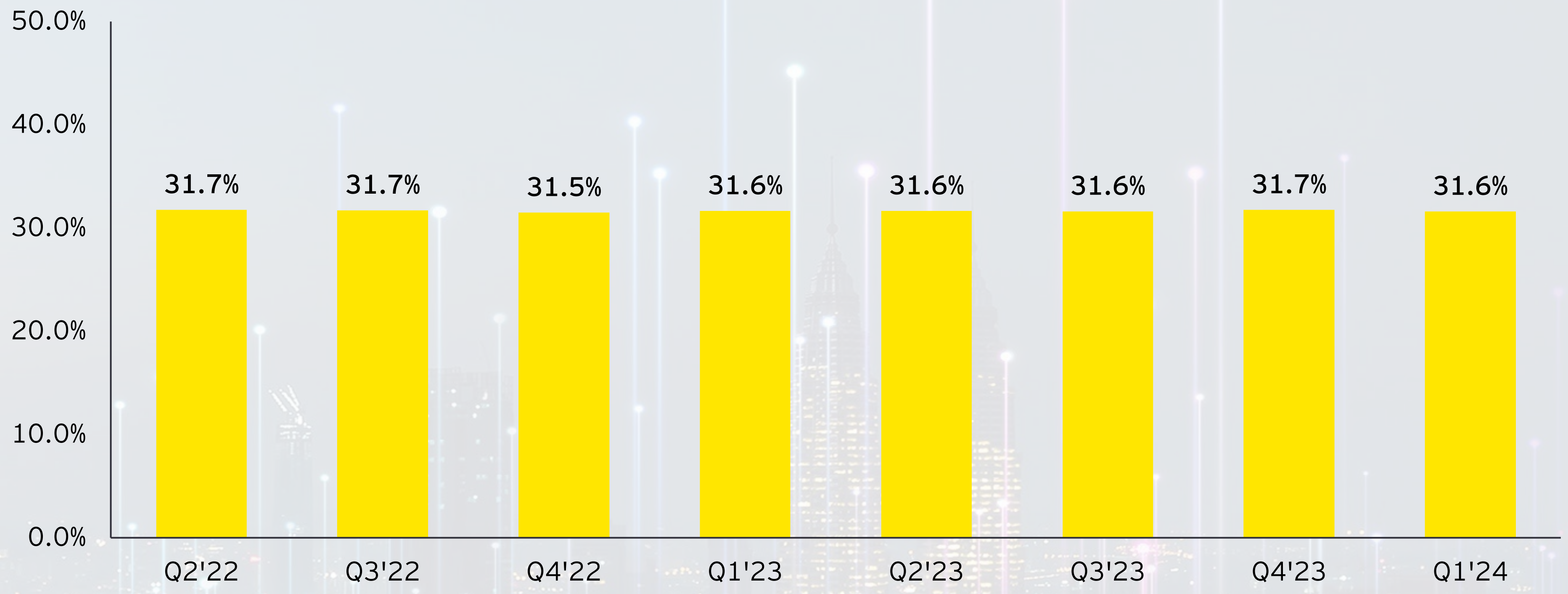
Public market performance (cont'd.)

Q-o-Q financial performance of Top IT Consulting companies(1), (2)

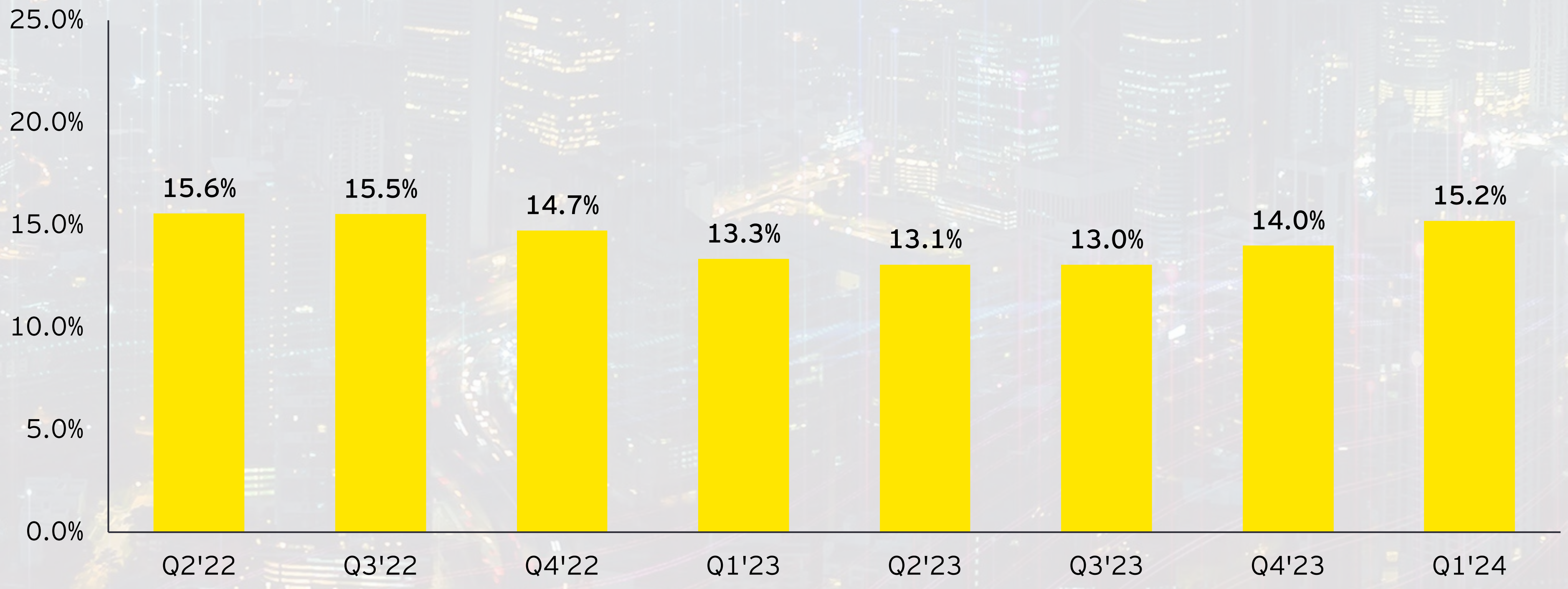
LTM Revenue Growth (%)



LTM Gross Margin (%)



LTM EBITDA Margin (%)



- Slowdown in demand for new digital projects and discretionary spend have led to decline in revenue growth in the recent quarters
- Organizations have scaled back on IT budgets, postponing or cancelling projects, thereby dampening the demand for technology products and services
- Industry giants including Accenture and Cognizant have recently announced a downward adjustment in its full-year revenue projection for FY25
- Interestingly, EBITDA margins witnessing slight improvements driven by downsizing and cost cuts in the recent quarters to accommodate dampened demand

1. Include NYSE:ACN, NSEI:TCS, NYSE:IBM, ENXTPA:CAP, NasdaqGS: CTSH, TSX:GIB.A,NYSE:BAH, NYSE:EAPM, NYSE:CACI, NYSE:KD, NYSE:DXC; Q2 2024 financials were not disclosed for most of the companies at the time of building this report
2. LTM denotes last twelve months; data represents mean values
Data sources: S&P Capital IQ

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