# How new Covid-19 realities impact ICT sector M&A

Economic disruption and business growth challenges are among the Covid-19 comms industry headlines, and a primary area of interest is the pandemic's effect on the ICT sector's M&A market.

Here, our panel of experts assess the most important M&A impacts and trends, how they will shape up, and the implications for ICT business leaders and all elements of the M&A model.

It is clear that Covid-19 M&A considerations will impact long-term strategies on where to invest and what constitutes a sustainable operating model, while financial backers and acquirers will become more focused and cautious. As we head closer towards the post-Covid-19 lockdown era, many existing M&A trends will persist. But our expert panel expects a short-term downturn in deal activity and a return to market strength over the longer term...

**Dan Freed, Partner, YFM Equity Partners**
The ICT sector has the potential to be one of the more resilient segments and should bounce back quickly. In the immediate days and weeks after the Covid-19 crisis hit, private equity and banks have on the whole been focused on their existing portfolio of investee companies and borrowers. The sector does not appear to have been as badly hit as others so I have not seen a pull back over and above the general more cautious approach that would be expected at a time like this. We're continuing to see new opportunities and resilient sectors such as comms will be attractive areas to invest.

**Marcus Allchurch, Partner, Acuity Advisors**
I have spoken to numerous ICT clients and contacts over the last month, and to over 30 of the private equity houses which have been active providing growth capital into the sector. The overwhelming sentiment from a business perspective is positive: In the short-term ICT players are providing a lot of the tools to enable companies, schools etc to operate remotely and there has been a huge push to make that happen. Longer term, discussions are already starting to take place where companies are engaging with their customers to work out what more robust, sustainable solutions ought to be implemented. The key risk for most ICT companies comes from the sectors they are ultimately exposed to.

**Paul Billingham, Director, Knight Corporate Finance**
ICT businesses will have to be patient when looking for funding and investment over the next six months as institutions focus on existing portfolios, and wait to see the longer-term impact of the economic shock. The majority of high street banks are solely focused on supporting the Government CBILS at the moment and are not considering new opportunities outside of that. We have seen almost all high street banks and some private equity houses pause on new funding and investment opportunities, but challenger banks and some private equity houses are still open for business to resilient and key business sectors, and ICT is in that category.

**• Acquirers and investors will be more attuned to how a business may cope under certain future scenarios, such as Covid-19, as well as base their decisions on a company's past performance. Furthermore, the bar for due diligence is rising with a broader set of factors for growth MSPs to consider...**

**Dan Freed, Partner, YFM Equity Partners**
Investment criteria for funders are unlikely to change significantly due to the coronavirus pandemic, but there will be an even sharper focus on the robustness and sustainability of companies to withstand the impact of such events. Businesses with high recurring revenues and a good spread of customers across defensible sectors, for example, should continue to be attractive investment opportunities. Also, those that support changes to the way we work, such

as home working, virtual meetings, online consultations, and the accelerated use of data to allow businesses to be more agile, should be well placed.

**Paul Billingham, Director, Knight Corporate Finance**
Moving forward there will be more focus from investors on what sectors an ICT provider's customers are from, as anyone with a high level of exposure to hospitality and non-food retail, for example, are going to see a number of customers struggle to recover from the crisis. On the other hand, any provider with more of a focus on public sector, financial services and education will be far better placed.

**Marcus Allchurch, Partner, Acuity Advisors**
The coronavirus pandemic will change the criteria in identifying and partnering with ICT firms looking to raise investment in the future insofar as buyers and investors will be even more focused on the quality of the business. What does that mean? The ability to grow organically, the relevance of the proposition, how recurring is the revenue, how cash generative is the business, and defining the upsides to accelerate growth. Failure to measure up on these criteria will almost certainly lead to an impact on interest and value.

**Ryan Sorby, Principal, Boost&Co**
The criteria for acquisition targets should focus on two key metrics during this time, outside the more traditional diligence metrics, which together will stand businesses in good stead to survive this crisis and then thrive. These are balance sheet strength (retained earnings, surplus cash, minimal historic shareholder withdrawals) and a track record of managing and reducing costs where possible (strategy, agility, speed of decision making and implementation). Working capital will be a key challenge during the pandemic and beyond. If Government schemes – furloughing in particular – are delayed, then customer payments will slow down or in some cases cease as businesses fail. This knock-on effect will hit companies hard, emphasising the need for a strong balance sheet to absorb this.

**• The difficulty of sustainably growing an ICT provider business could be the biggest strategic challenge they face. Our experts offer advice on how to tackle those challenges and opportunities...**

**Paul Billingham, Director, Knight Corporate Finance**
For resellers looking to scale-up, the biggest challenge post Covid-19 will be having the confidence to understand that the impact is short-term and that their business is resilient to the economic shock. There will undoubtedly be opportunities as customers put in place far better home working and video conferencing plans in readiness for a potential crisis like this occurring again.

**Marcus Allchurch, Partner, Acuity Advisors**
The key challenge will be finding and securing deal pipeline. We all know that this sector has been very active from a consolidation perspective for 15 years now, but with evermore private equity backed platforms looking to buy smaller bolt-ons we see a real ramp in demand which isn't really offset by a similar ramp in supply. I do not believe that access to capital will be a challenge for this sector, nor that scale up opportunities will be negatively impacted over the longer term. If anything, good businesses will do better and potentially see higher valuations.

**Dan Freed, Partner, YFM Equity Partners**
While uncertainty and the rapidly changing landscape have had some impact on scale-up opportunities in the short-term, the longer term fundamentals for the sector should be sound. Scalable business models which ride the wave of long term trends, for example AI or driving efficiencies, should be well placed when the economy rebounds. The quality of the management team and business plan are key considerations for investors and will drive appetites to pursue investment opportunities. Features such as recurring revenue, earnings visibility, scalability and

exposure to robust customers and end markets are attributes that will increase the chances of a successful round. ICT providers must demonstrate a strong organic growth plan and the potential to accelerate this through inorganic growth should also be attractive.

**• While fundamental M&A factors stand the test of time, acquirers and investors are evolving their approaches to M&A within the ICT provider sector, and are becoming focused on key metrics from a more cautious and different vantage point...**

**Marcus Allchurch, Partner, Acuity Advisors**
Preparing for a sale or investment is like training for a sports match, and so often the difference between a good process and a bad one comes down to the basics. Prove you can grow organically, maximise your proportion of revenues which can be called genuinely recurring, invest in having a highly relevant proposition, make sure it's generating an appropriate level of cash, and articulate convincingly where the upsides will come from. It's important where possible to have data supporting all this, and it may be helpful to ensure your narrative around downside protection (for example, the ability to withstand Covid-19 and similar unexpected disasters) is well thought through.

**Paul Billingham, Director, Knight Corporate Finance**
Resellers with a high level of recurring revenue and are less reliant on project work to achieve profitability will be viewed positively, as well as those focused on sectors that continue to perform well despite the current economic crisis. Businesses that have been prudent with cash and demonstrated that they can plan and re-forecast effectively during the downturn will also stand a much better chance of securing funding and investment.

**Ryan Sorby, Principal, Boost&Co**
In the short-term, I expect to see a slowdown as lenders wait for more certainty of performance through the crisis. I don't think that raising investment will be affected in the long-term. The appetite is still there for the sector and in fact, this may increase when the pandemic is over, if the initial performance and resilience continues through Q2. Scale provides protection and comfort during times like these. Our research shows that owner-managers, who had previously considered an exit but hadn't progressed the idea, are actively looking at consolidators to either 'join' their larger group or to facilitate an exit.

**• Beyond Covid-19: Here we explore the reasons why M&A is set to accelerate, overcome disruption and aid growth challenges...**

**Dan Freed, Partner, YFM Equity Partners**
For ICT providers with scaling-up on their mind, the opportunities and challenges will probably not be dissimilar to the pre-Covid 19 era but with even greater emphasis on the ability to be agile and responsive to customer needs and having a highly scalable proposition. ICT providers that can demonstrate resilience through a period of challenge and change should emerge with strong prospects. I am optimistic that there will be good investment opportunities in the sector in the near to mid-term. Covid-19 has highlighted communications businesses as critical suppliers to many public and private sector organisations with the huge increase in working from home driving calls, videoconferencing and broadband usage. Times of change will also drive consolidation opportunities so I would expect to see M&A activity in the sector where well capitalised businesses can accelerate their strategic plans through acquisition. We're continuing to see new opportunities and resilient sectors such as comms will be attractive areas to invest.

**Ryan Sorby, Principal, Boost&Co**
There is an increased awareness of how important ICT is, not only as businesses evolve and improve efficiencies in general, but when there is a change to the norm – another black swan event – ICT has proven itself to be invaluable in keeping businesses functioning. The crisis will increase demand because additional places of work are now needed as part of business

continuity planning. Security requirements will expand as access points to business data increase and need sufficient protection. General ICT consultancy should also expand as businesses seek health checks on their systems to make sure they are prepared for the future.

**Marcus Allchurch, Partner, Acuity Advisors**
From an M&A perspective, we are seeing a few important themes, including lots of conversations about ramping up buy-and-build strategies, especially where companies see a gap in their portfolio around unified comms, cloud services or remote working. Generally, investors are talking about a 'flight to quality' which means that while good deals will get done – potentially at higher values – lower quality businesses may struggle to get interest. Bigger deals, which are dependent on debt funding to fully maximise value, are reportedly being put on hold for the time being. As the sector will no doubt prove resilient especially compared to others, we anticipate more interest in comms and ICT M&A. When the dust settles, there will be more focus than ever before on homes and businesses having the right infrastructure, the right solutions and the right security to enable people to live and work wherever they are. That presents a massive opportunity for the sector.

**Paul Billingham, Director, Knight Corporate Finance**
The sector is highly resilient and has proven to be a critical part of the UK and world economy, so we do not doubt that there will continue to be an abundance of M&A and investment opportunities in the mid-term. Knight has seen two transactions complete since the Government lockdown and we still have several transactions progressing. We do not see any long-term impact on the numerous scale-up opportunities, but the timing of business plans will be affected and are likely to be delayed by six to 12 months as the we get to fully understand the longer-term impact of the crisis. The sector has proven itself to be key to the effective operation of home working and the economy in general, and this is likely to be reflected in continued support and appetite from funders.

**Key M&A trends and trajectories to consider**

• Covid-19 disruption will place more pressure on some ICT providers to adapt to new realities, such as the shift to cloud and recurring revenues, or face an existential crisis.
• M&A-related investor activity will focus more on areas with long-term sustainability.
• Businesses operating in less robust sectors such as hospitality are urged to find growth in new more robust markets and reassess their operating model.
• Acquirers and investors will be more attuned to how a business may cope under certain future scenarios, such as Covid-19, as well as base their decisions on the past performance of a company.
• The bar for due diligence is rising with a wider set of factors taken into account.
• Acquirers and investors are evolving their approaches to M&A with far more emphasis placed on familiar priorities as well as new ones.
• The trends in M&A that have been caused by Covid-19 are likely to decrease the choices for acquirers as certain markets such as hospitality and retail may now be deemed a long-term risk.
• Acquirers and investors will effectively raise their game, become more strategic in their decision making and more selective with a longer-term outlook.

**Implications for ICT providers**
The trends highlighted in this report have significant implications for the future success of the M&A value creation cycle, with greater scrutiny applied to ICT providers seeking to exit or secure funding. This requires ICT provider business leaders to assess and perhaps rethink their long-term strategy through a post-Covid-19 lens, and bring a fresh look at the sustainability of their approaches to target markets, diligence and processes. For example, there are a number of reasons to believe that increased competition in more robust sectors will be an aberration stimulated by Covid-19 factors, as the intrinsic value of a firm operating in the Government sector, for example, versus hospitality, will be increased.