



Digital Transformation Services (DTxS)

Ready for the next wave

February 2023

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ICON Corporate Finance is pleased to present our Digital Transformation Services (DTxS) report. This is the first in our series on DTxS M&A and Financing activity, and the tailwinds that are shaping the sector

Deal activity remained elevated in 2021 and 2022, as Digital Transformation initiatives led to strategic and financial buyers pursuing capabilities across the services sector. Ongoing interest in sub-sectors like strategy & design, customer experience, AI & data services, and cloud engineering bodes well for continued sector consolidation into 2023. A few key takeaways:

- 1 Digital Transformation is now a C-suite priority, with the focus shifting to overall business transformation rather than just technology adoption
- 2 Strong deal activity a response to the key challenges facing enterprises - rising cloud costs, cyber vulnerability, the proliferation of data, and the renewed focus on cost cutting
- 3 Sector M&A volume in 2022 rose 22% over 2020 levels, illustrating the strength of the M&A market despite public market headwinds. Average M&A multiples held up in 2022, at significantly higher levels than before Covid
- 4 Led by strategics, acquisition activity has evolved through multiple waves - from pre-Covid focus on IT modernisation, to digital optimisation during Covid; and finally to the focus in the past year on fully integrated digital business models
- 5 Strategics also cut across traditional services boundaries with their acquisitions as they look for opportunities to move up the value chain
- 6 Private Equity continues its Managed Services platform build, whilst extending reach into categories like security, governance & compliance, cloud, and data

Mapping Digital Transformation Services

Defining Digital Transformation

Business and technology innovation strategy with the goal of aligning around a digital culture; investments in new approaches to remain relevant for customers

Types of Digital Transformation

Customer Experience Transformation

Digital Operating Model Development

Cloud Enablement

Business Process Automation

Data Enhancement

ICON's DTxS sectors*

Consulting

- Application Development
- Application Partner Ecosystem
- Vertical & Horizontal Providers

IT Services

- System Integrators
- Application & Cloud Managed Services
- Managed Security & Compliance
- Value Added Resellers

Cloud, Data & Automation

- Cloud Partner Ecosystem
- Data & Analytics
- Hyperautomation Services

* Services companies typically span across a number of these sub-sectors

Where things stand *today*

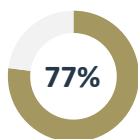
2022 was a pivotal year for Digital Transformation in the enterprise

- What started in 2020 as a survival-response to Covid has morphed into an exercise in building foundations critical for long-term Transformation success
- More complex and long-term initiatives are now back on strategic radars as digital models become an intrinsic part of the new normal

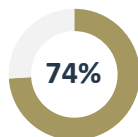
Strong demand for Transformation bringing Tech Services firmly into focus

- With ever-increasing demand for implementation services – consultancies, software vendors, IT services players, and PE investors are continuing to scour the highly fragmented services market for acquisition-based growth
- The uncertain economic climate has meant that strategic and financial buyers are focused on sectors with repeat revenue elements; case in point is Private Equity interest in the managed services sector, which will remain strong into 2023

When it comes to implementing Digital Transformation...



Organisations are now accelerating and/or scaling up Digital Transformation efforts

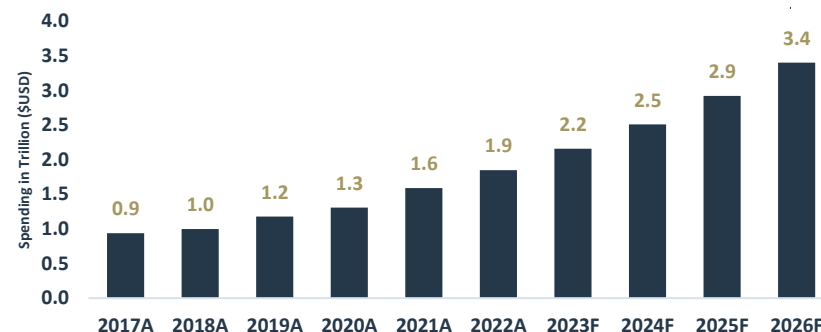


Organisations noted Digital Transformation as their top technology initiative in 2022



Organisations permanently altered their strategies having implemented digital initiatives during the pandemic

Digital Transformation Technology & Services spend forecast to accelerate



DTxS deals reached new heights post Covid



*2021 onwards includes M&A and PE Financing deals for Europe and North America

Highly conducive Transformation environment

Digital Transformation is a C-suite priority

- Digital Transformation is now mainstream – the piecemeal approach to technology adoption and utilisation is firmly in the rear-view mirror
- Most forward thinking companies view it now as ‘business transformation’, rather than tech adoption – the strategic and operational advantages of digital incumbents is compelling

Started from Customer Experience (CX), now expanding to innovation across the Enterprise

- Transformation now involves business strategy transformation, operations realignment, people change management and importantly, creating a flexible technology core
- The pace of tech change is accelerating – platform shifts like mobile in 2007-2008, Cloud in 2010-2012, and AI/ML in 2018-2020 are happening faster – Transformation essential for companies to adapt

Market leaders will be ‘bionic companies’

- Technology is about doing more with less; yet to achieve potential it needs combining with talent
- As coined by BCG, leading companies must become ‘bionic’ versions of themselves, whereby powerful technology and human capabilities are combined to create the most long-term value

“Github Copilot has dramatically increased my coding (capability)....it writes ~80% of my code, ~80% accuracy. I don’t even really code, I prompt & edit.” Andrej Karpathy, Founding member, Tesla Autopilot

\$ 3.4tn

Global Digital
Transformation
spend by 2025

17.4%

Forecast CAGR
2020-26

62%

Leaders saying
Digital
Transformation is
priority in 2023

57%

Organisations
choosing ‘buy’ or
‘buy & build’
strategies

**Talent
Retention**

No.1 risk in 2023
identified by Digital
Transformation
executives

DTxS activity – solving key challenges across the Enterprise ^(1/2)

Cloud costs much higher than anticipated

“Cloud has resulted in higher-than-expected costs for 73% of users” – Aptum

Implications for deal activity

- Cloud solution providers will continue to be in demand as strategic acquirers target cloud consulting & execution capabilities
- Increased complexity across cloud infrastructure, and a highly fragmented market with regional cloud solutions players, implies the focus of deals will be smaller-sized specialist acquisitions

ICON perspective

- In recent years, most companies accelerated their plans to implement the cloud. However, many are now being confronted with higher costs and operational challenges
- Save for cloud-native organisations, most organisations are being forced into multi-cloud and hybrid cloud setups

Heightened corporate vulnerability to cyber attacks

*“Cyber-attacks will become uninsurable”
– Mario Greco, CEO, Zurich Insurance*

- Buyers showcase a willingness to consolidate specialist security services expertise, with middle market deals driven by PE add-ons and strategic capability building
- MSPs will extend offerings to ‘cybersecurity managed services’ through M&A as end-clients rely on services businesses to implement and monitor security protocols

- Spending on cybersecurity is expected to expand much faster than overall tech spend, and is now the top-spend category for senior executives
- With large parts of customer-facing functions within enterprises now digitally enabled, cybersecurity is a boardroom issue

Source(s): Aptum survey of IT professionals in US, UK and Canada; Canalys Cybersecurity forecast 2023; Red Hat 2023 Global Tech Outlook

DTxS activity – solving key challenges across the Enterprise (2/2)

Exponential proliferation of structured and unstructured data

Implications for deal activity

- AI and Data focused Services firms will partner with hyperautomation SaaS platforms as a path to build scale; whilst complementing those with selective data capability acquisitions
- Strategic acquirors could also seek to build a vertical-specific bouquet of specialised skills and platforms; more broadly they will use automation to reduce workload and augment human skill sets

ICON perspective

- Data is no longer siloed within departments, and is being requisitioned for use across the enterprise for decision making
- Massive data volumes offer promise but are not useful in isolation. The rise of hyperautomation technologies (including RPA, Low/No-code tools, iBPMS platforms, & AI) will help supercharge data-driven decision making alongside core process automation

Renewed focus on cost mitigation – tech talent remains in high demand

- Creation of one-stop shop services providers that can holistically deliver cloud, security, IT consulting, networking and communication solutions will drive leading Services players to scale across the services chain
- Increased openness from clients to outsource product development & design services will continue to drive IT Services & Consultants to strengthen capabilities in these sub-sectors

- One of the key reasons behind the failure of many Digital Transformation initiatives has been the shortage of talent in critical roles, including cloud architects, cybersecurity and full-stack developers
- Significant rise in the cost of tech talent post pandemic, has led to clients working with a reduced number of third-party providers to rationalise spend

DTxS acquisitions evolved through multiple M&A waves

Wave I: IT modernisation

- Focus on acquiring digital commerce, advertising, CX & design capabilities, in addition to core system integration and outsourcing expertise
- Modernising the enterprise IT stack is the principal driver

Wave II: Digital optimisation

- Cloud enablement, data & analytics, and digital engineering are front-and-centre of activity
- Blurring of lines between traditional consultants and IT services, which has seen the Big 4 making a big push through acquisitions in digital capabilities

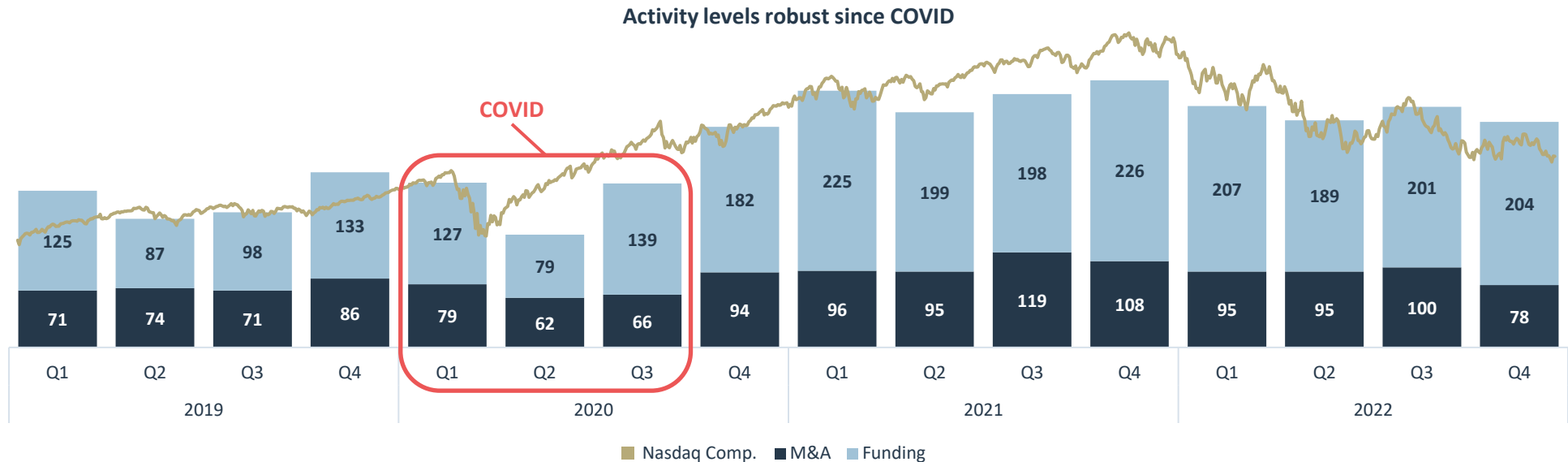
Wave III: Digitally-enabled business

- Automation and AI becoming ubiquitous across the enterprise, with cloud/data remaining key themes
- Hybrid business models in conjunction with old economy as clients embark on building digital organisations

Key: Buyer ➡ Target



Elevated deal activity mirrors the high level of interest in DTxS



Takeaways

- M&A activity remained resilient early in 2022 continuing on from the strong uptick seen in 2021. Tightening market conditions put a lid on activity in Q3 and Q4'22; albeit they remain above pre-Covid levels
- Private Equity has doubled down since Covid continuing their buy-and-build spree from 2021 in a few key sub-sectors, particularly Managed Services
- Strategics focused activity in 2022 on acquiring next-gen offerings in end-to-end transformation services, multi-cloud capabilities, and data analytics

\$ 145bn

Aggregate M&A deal value
2022 (disclosed)

22%

Volume vs.
2020

120%

Median Deal
Size vs. 2020

\$ 24bn

Raised in PE financing rounds
2022 (disclosed)

52%

Volume vs.
2020

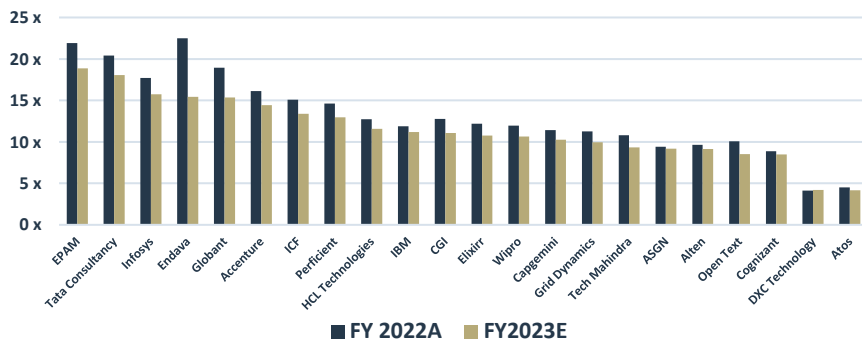
91%

Agg. Value vs.
2020

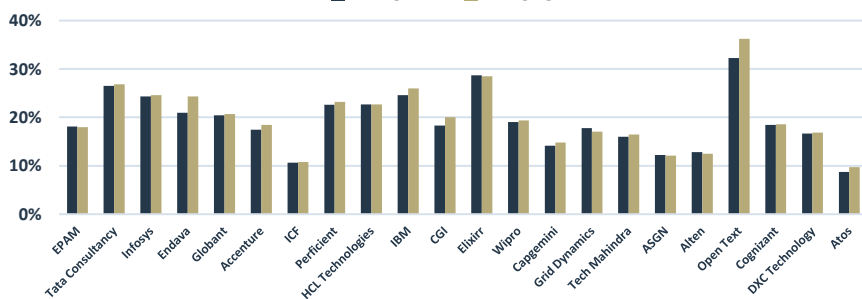
M&A multiples remain strong despite choppy public markets

Public market multiples retreated in 2022...

EV/EBITDA



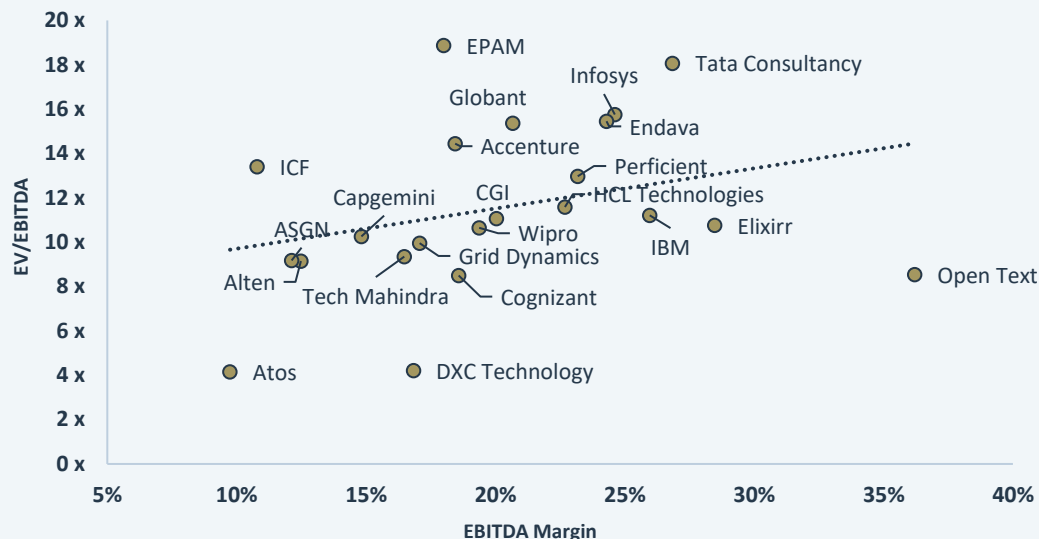
EBITDA Margin



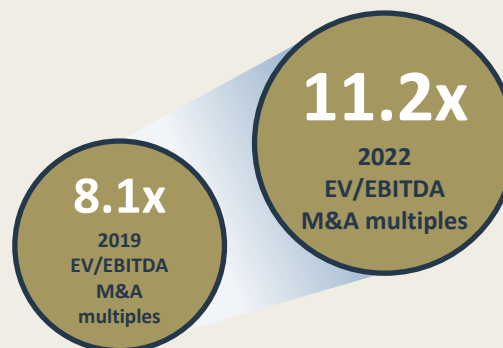
Takeaways

- Valuations across listed consulting and services companies, declined in 2022 along with the broader tech sector; albeit the rate of decline was more measured
- In the private markets, competition for quality assets together with acquirors' desire to adhere to longer-term strategic initiatives has meant that deal multiples have remained comparable to 2021
- This is particularly true for assets within strategy & design, customer experience, data services, and cloud engineering

...but Strategics will add capabilities to drive margins & ultimately valuations



M&A multiples remain healthy



Sectors commanding premium valuations:

- Digital Strategy & Design
- Managed Security
- Customer Experience
- Data Services
- Cloud Engineering

Strategics crossing traditional boundaries

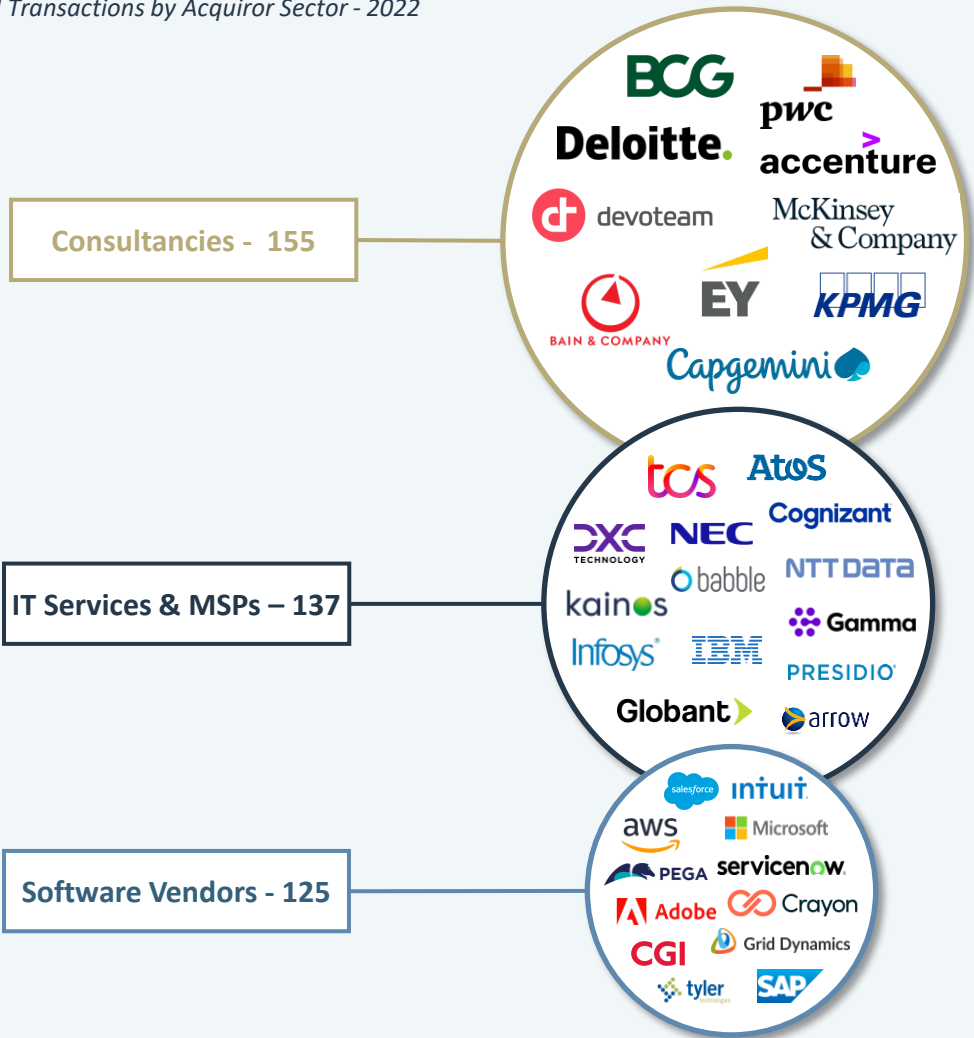


ICON has built relationships and tracked strategic agendas for buyers across the DTxS sector that have completed notable transactions

- We have seen a blurring of lines between traditional consulting firms, IT Services players, and digital technology companies
- Most strategics are scouring for acquisitions across the entire Digital Transformation value chain
- This is best demonstrated by Cognizant, traditionally an IT Services major, that has made acquisitions across consulting, data & analytics, and cloud to help supercharge revenue growth
- Accenture, on the other hand, has gone in the opposite direction and has pivoted away from its consulting roots, reinforcing its prowess in IT Services and cloud through acquisitions

Activity spread across key buyer groups

Closed Transactions by Acquiror Sector - 2022



Acquisition Themes

Large-cap



Cloud



CX



Design & Consulting

Mid-cap



Digital Engineering



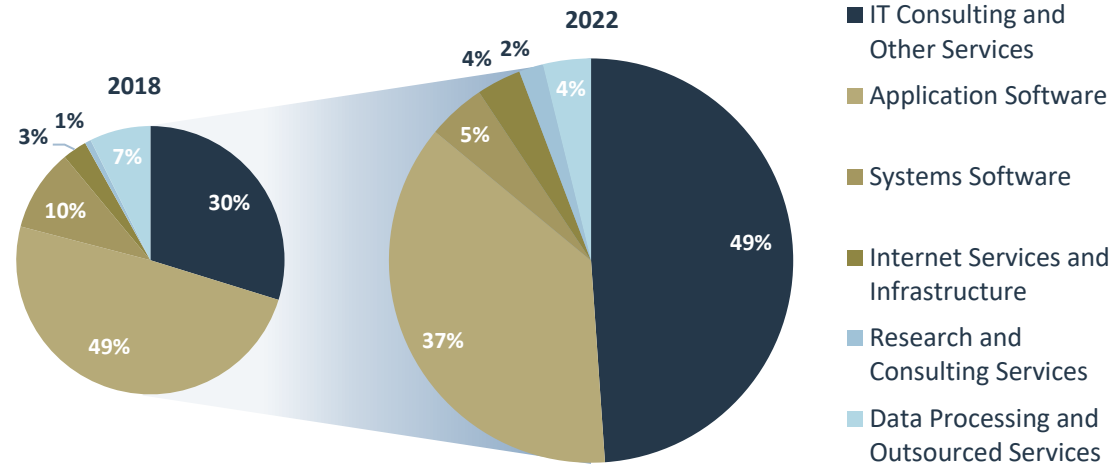
Analytics



Automation

Buyers most focused on consulting capability across geographies

DTxS M&A activity - Top 5 sectors



Deal activity spread across a diverse range of geographies – FY2022

M&A



Financing



Notable transactions - Strategics



TARGET DESCRIPTION

- Digital customer experience agency focusing on digital transformations
- Focuses on Healthcare sector

n/a.
Apr-22
5,404

DEAL DESCRIPTION

- Acquisition adds further depths to Valtech's healthcare experience
- Enhances its cross-disciplinary capabilities

PAST TRANSACTIONS - 31

(Jan-23)
 (Aug-22)
 (Apr-22)



TARGET DESCRIPTION

- Digital transformation company
- Expertise in mobile, cloud, web, blockchain, RPA and AI technologies

\$18.6m
Sep-22
3,640

DEAL DESCRIPTION

- Strengthens CTG's digital offerings in AI, ML and intelligent automation
- Help to accelerate their digital transformation strategy

PAST TRANSACTIONS - 6

(Mar-20)
 (Feb-18)



TARGET DESCRIPTION

- Digital transformation service provider specialising in Pega technologies
- Operates a low-code scalable architecture

n/a.
Sep-22
284,379

DEAL DESCRIPTION

- Further enhance Capgemini's capabilities in its digital customer experience offering
- Acquired established EU market presence

PAST TRANSACTIONS - 66

(Nov-22)
 (Oct-22)
 (May-22)



TARGET DESCRIPTION

- Digital transformation services and solution provider
- Specialism in Cloud & DevOps

n/a.
Jan-23
284,379

DEAL DESCRIPTION

- Acquisitions follow investment from Partners Group in Apr-22
- The company expects to continue its acquisitive strategy in 2023

PAST TRANSACTIONS - 15

(Jan-22)
 (Oct-22)
 (Feb-22)



TARGET DESCRIPTION

- Software consultancy and product developer
- Specialism in agile and DevOps techniques

£202m
Dec-21
308,949

DEAL DESCRIPTION

- Expands Congizant's custom software product engineering capabilities
- Expands global footprint and portfolio

PAST TRANSACTIONS - 86

(Dec-22)
 (Nov-22)
 (Nov-22)

PE universe: building platform strategies



ICON's sector expertise and network in Private Equity gives us unique insights into this universe, and growth drivers for companies within

- Private Equity's platform strategies have largely focused on sectors like Managed Services and Infrastructure Solutions
- As the sector matures and automation becomes mainstream, that approach seems to be evolving. ICON has had discussions with a number of sponsors building vertical-specific capabilities across DTxS categories – combining services, consulting and product lines
- Cybersecurity, Governance & Compliance, Data Analytics and Cloud Services are prime categories where such a platform approach is prevalent

Notable transactions – Private Equity



TARGET BUSINESS DESCRIPTION

- Digital transformation services and solution provider

£25M
 Feb-22
 135

DEAL RATIONALE & ADD ONS

- Investment is to support the acquisitive growth strategy
- Acquired Silverchip following investment



TARGET BUSINESS DESCRIPTION

- Hosting and cloud solutions business created in 2019 from a merger
- Operates a portfolio of hosting brands across Europe

\$17m
 Jul-22
 3,640

DEAL RATIONALE & ADD ONS

- Has made a series of acquisitions across the European hosting, managed services, and security markets
- Recent acquisitions include Leadinfo, a lead gen business, & iubenda, a compliance & privacy solution



TARGET BUSINESS DESCRIPTION

- Consulting, software engineering and digital product development company
- One of the largest initial funding rounds in Europe

\$140m
 Jan-22
 1,744

DEAL RATIONALE & ADD ONS

- Capital to support the scaling of product design and deep-tech engineering abilities
- Start of buy and build story – recent acquisitions include Mistral Technologies & Wayseven Technologies



TARGET BUSINESS DESCRIPTION

- Digital transformation and managed mobility services provider

£87m
 Oct-21
 2,052

DEAL RATIONALE & ADD ONS

- Investment will support the investment in people, markets and go-to-market initiatives
- Recent add-ons include Aurotech, a data science and engineering services business, and Ambit, MSP specialising in data & cyber



TARGET BUSINESS DESCRIPTION

- Provides software development and engineering services
- Pure-play AWS service provider

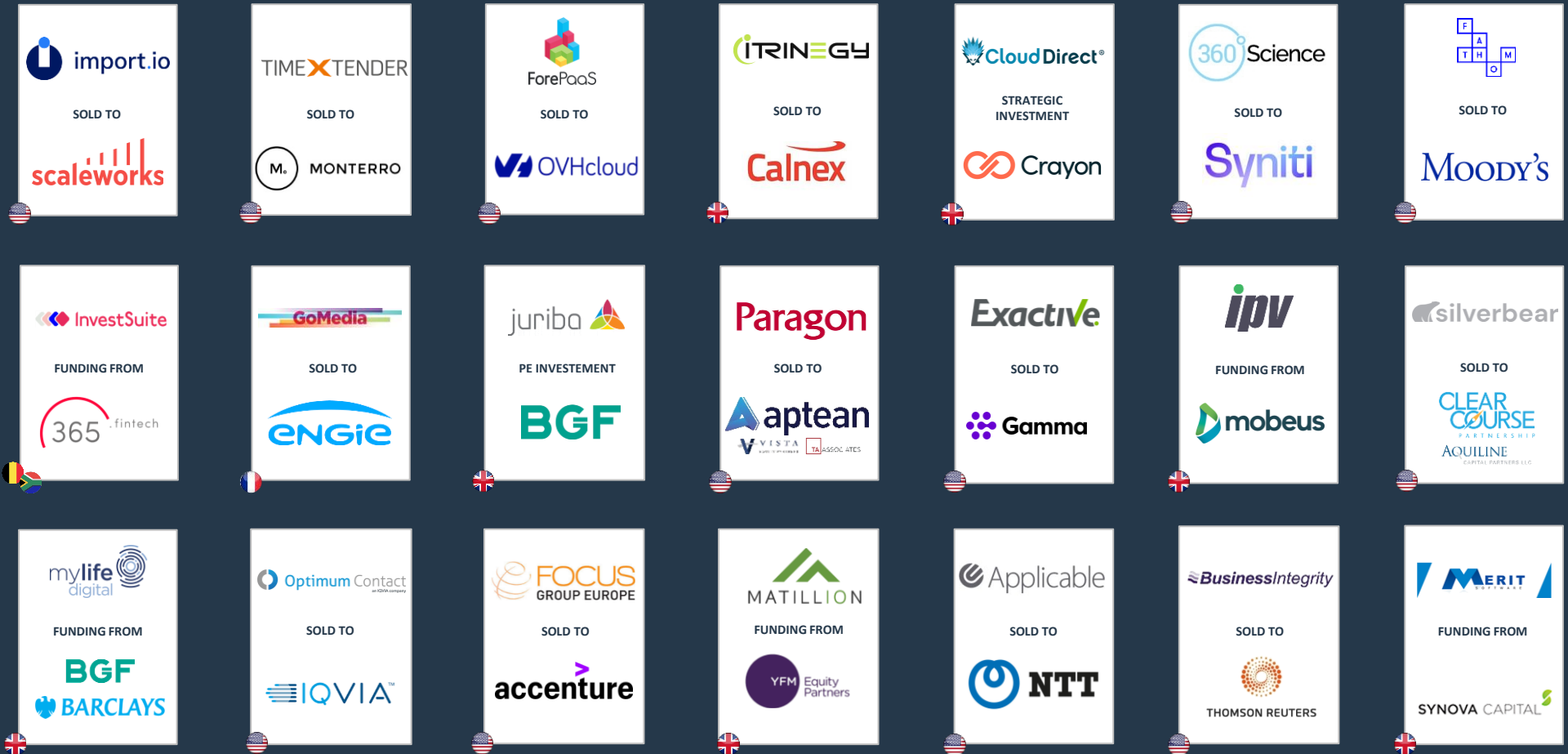
n/a.
 Dec-20
 366

DEAL RATIONALE & ADD ONS

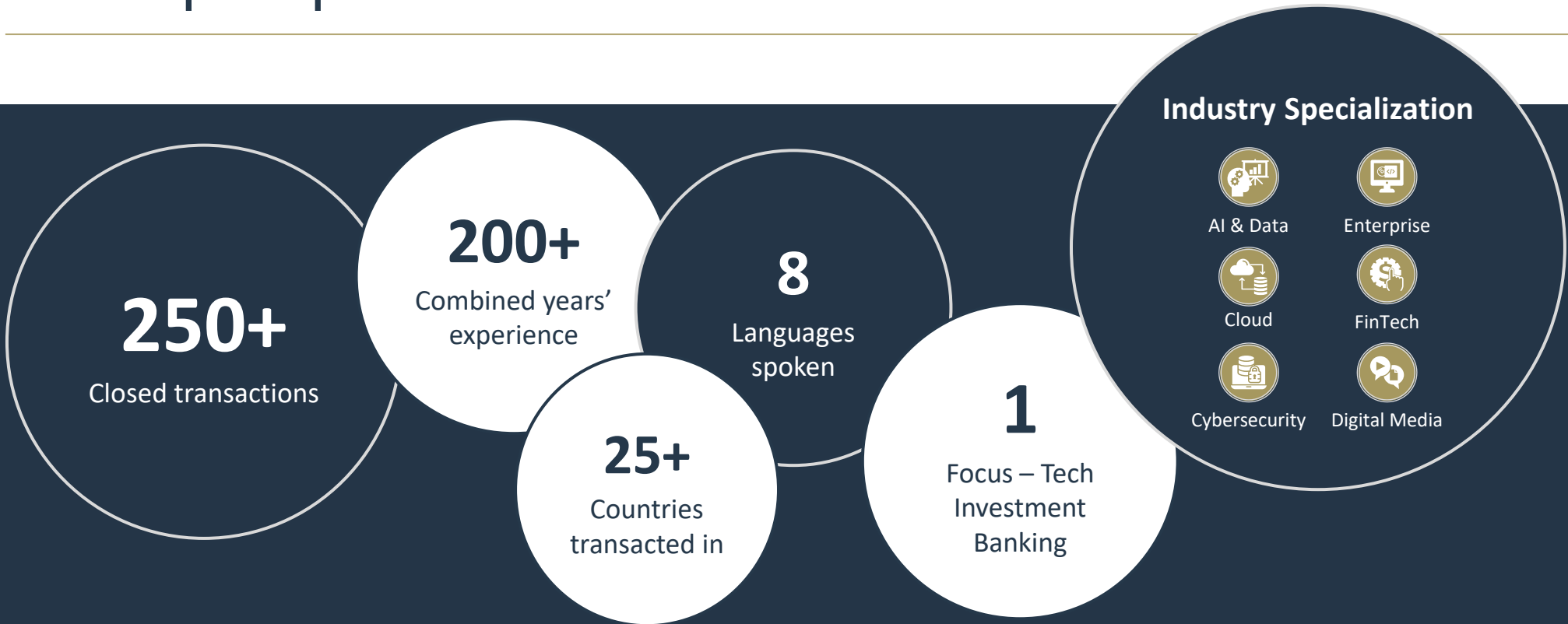
- Investment is support the business to scale
- Acquired Autsoft, Hungarian software development company in May 2022

ICON's Transaction Record in DTxS sector

Selected recent deals advised by ICON Corporate Finance



Deep Experience



Banker Backgrounds



ICON's DTxS Sector Coverage

Consulting & IT Services, Cloud



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