



# M&A IN THE MANAGEMENT CONSULTING SECTOR

MARKET UPDATE

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ERG PARTNERS

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# M&A Activity in the Management Consulting Sector

## Market Update

- The consulting and professional services market experienced considerable setbacks as a result of the COVID-19 related lockdown. However, following a COVID related slowdown, the management consulting market is recovering and expected to continue its growth as clients require support in growing their businesses, adapting to new market realities and solving their business problems.
- Despite the otherwise slow economy and restrictions driven by COVID-19, the M&A activity in the consulting sector is healthy and expected to further accelerate.
- In 2020, the management consulting sector M&A activity began to change: Transactions tend to be smaller, more focused acquisitions to gain a specific skill-set, regional presence or access to new clients.
- New companies from adjacent sectors enter the sector through acquisitions, financial investors look for investment opportunities reflecting their confidence in the continued to growth of the sector, and consulting firms, often funded by private equity, pursue M&A strategies to accelerate growth, broaden their service offering, expand globally and access new clients.
- The key M&A trends including record levels of cash held by private equity firms, availability of private debt capital, and strategic buyer M&A appetite, have combined to create a favorable environment for management consulting firms evaluating strategic alternatives over the next 12 to 18 months.
- In this note, we provide an update on the sector M&A activity, discuss recent developments and offer our view of the outlook for 2021-2022.

# COVID-19 and Its Impact on the Management Consulting Industry

- The outbreak of COVID-19 has disrupted the management consulting industry: The sharp decline in business confidence in 2020 has been damaging to consulting firms, as major clients have cut non-core operating expenditure, including consulting expenses.
- Certain client sectors, such as travel and leisure, that have suffered significantly as a result of the pandemic have delayed, reduced the scope of and canceled consulting projects, resulting in lost revenues.
- However, while the pandemic has been detrimental to businesses operating in industries where physical proximity is critical to generating revenue, the impact has been much smaller for businesses providing high-end, mission critical solutions organized to deliver their services remotely.
- The successful transition to complete virtual delivery throughout the last few months by many high-end consulting firms has mitigated material negative effects of the pandemic related slowdown.
- Furthermore, COVID has accelerated interest in certain high-end consulting subsectors. The specialized, high-end consulting market is expected to continue its growth strongly post-COVID as companies need external help devising and refining strategies to grow, optimizing processes, adapting their businesses to new realities and managing change.
- All independent management consulting companies have had to manage their cost structure aggressively as a result of the slowdown. Many firms have downsized their staff numbers, lowered wages, and reduced partner profit share. Those with leaner overhead burdens had an advantage, and were able to retain talent and are coming out of the slowdown in a strong position.

# 2020 M&A Activity in the Management Consulting Sector

- Following 2019, characterized by a number of large, high profile transformative deals in the management consulting sector, 2020 saw a drop in both the number of transactions and deal value.
- The acquisition of Duff & Phelps by a group of private equity investors, and the acquisition of a majority stake in PA Consulting by Jacobs Engineering in November were the only \$1bn+ transactions in the sector.
- However, M&A activity in the small and medium sized management consulting market remained healthy throughout the year with numerous transactions.
- 2020 deals had certain key differences:
  - Transactions were universally smaller
  - More focused acquisitions to gain a specific skill-set, regional presence or access to new clients: buyers focused on financial services, public sector, regulatory compliance, digital transformation, cyber security/digital privacy consulting and data analytics are some of the specific consulting capabilities
- While some of the traditionally most active acquirers reduced their level of activity, a handful of serial strategic buyers completed multiple transactions.
- Interest among strategic buyers and financial investors for differentiated targets in the management consulting sector, particularly those that have successfully migrated to digital delivery, continues to be strong.

# Drivers of M&A Activity in the Management Consulting Sector

M&A activity in the management consulting sector is driven by a combination of factors:

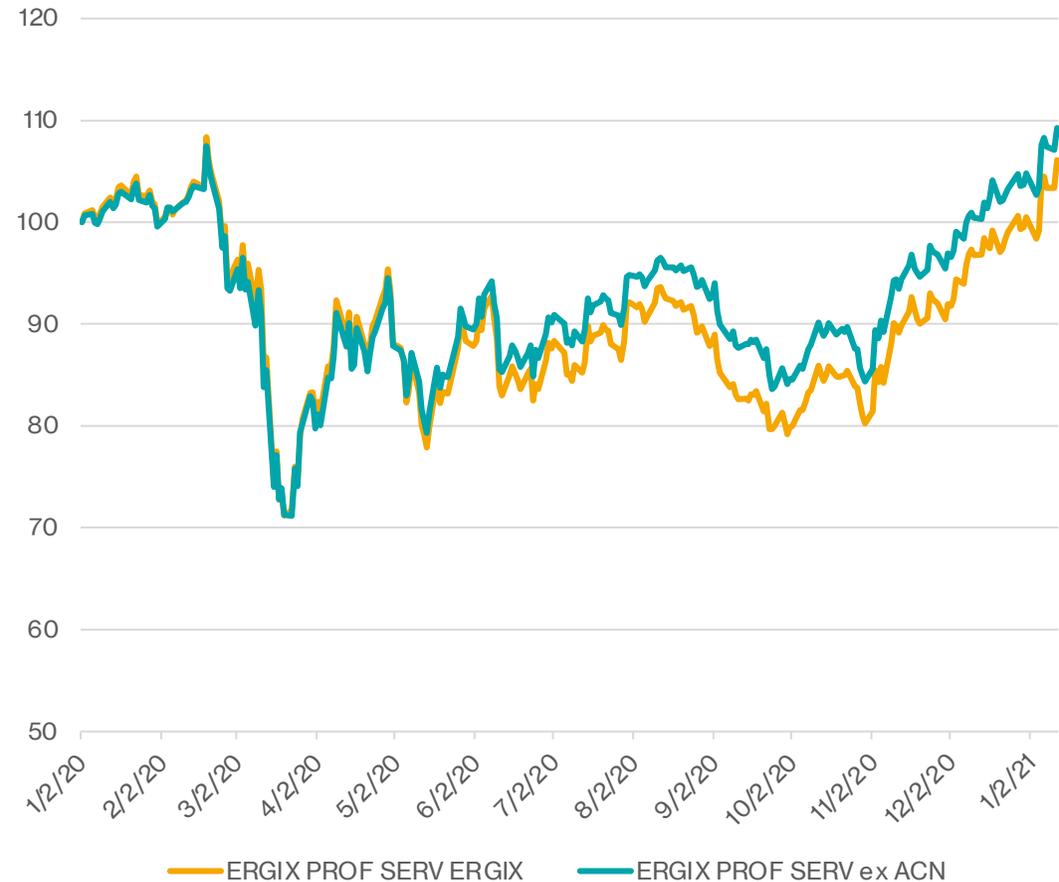
- **Favorable capital market conditions:** Significant amount of private equity capital and the availability of debt financing for acquisitions is a key driver of M&A activity.
- **Need to accelerate growth:** Large companies are struggling to grow organically in the current economic environment and look to accelerate revenue growth with inorganic initiatives.
- **Strategic imperative to expand capabilities:** Various buyers pursue acquisitions to expand their capabilities and footprint to be able to offer a more comprehensive offering of services to clients.
- **Financial investors expect sector recovery and continued growth:** Financial investors focus on sectors that are expected to rebound strongly from the COVID related slowdown and continue to grow like the Management Consulting Sector. In addition, many investors see an opportunity to create value through a roll-up strategy to build global player with scale and a comprehensive offering. Furthermore, remote working has increased the attractiveness of the sector to investors as reduced real estate requirement reduces fixed costs and makes integration processes easier.
- **Strong share prices of publicly listed companies:** Large consultancies are taking advantage of their recent strong share price development to pursue acquisition strategies.
- **Availability of targets:** Aside from taking advantage of favorable market conditions, COVID-19 has led many founders of independent consulting firms to re-evaluate their strategies and seek to combine with larger entities for their own risk management purposes.

# Management Consulting Share Price Performance

- In line with the overall market, share prices of publicly listed consulting companies dropped by almost 30% in March 2020.
- While the index rebounded from its worst losses by May, volatility remained high.
- However, since November the index has climbed by almost 30% and are currently up by more than 9% compared to the beginning of last year reflecting investor confidence in the recovery and continued growth of the sector.
- Another observation is that Accenture has started to consistently outperform the market since June reflecting its size and resilience.

ERGIX: unweighted index of enterprise consulting/professional services firms consisting of Accenture, CRAI, Exponent, FTI, Hackett, Huron, and ICF

## ERG Partners Management Consulting Share Price Index



# Broad Range of Buyers

- Both strategic and financial buyers were active in the management consulting M&A market in 2020.
- The strategic buyer categories that pursued acquisition-led growth strategies and completed transactions included accounting, large diversified professional services companies, medium sized management consultancies and risk management companies.
- Financial investors, principally private equity funds, continued to invest in the management consulting sector either to acquire a new platform or to grow their existing platform.
- A handful of strategic buyers completed multiple transaction in 2020:
- Large companies including BDO, Alix Partners, Deloitte, EY, CapGemini and Accenture continued to expand and reinforce their consulting capabilities through multiple acquisitions, with Accenture being by far the most active buyer with 25 transactions.
- Medium sized consultancies SIA Partners and Begbies Traynor continued their international expansion through acquisitions outside their home markets.
- Notable private equity transactions in the sector include StonePoint Capital's acquisition of Duff & Phelps, ICV Partners' acquisition of the Mintz Group and Limerston Capital's investment in Axiom. In addition, private equity investors supported various deals by their portfolio companies including Alix Partners, GardaWorld, Ankura, Duff & Phelps.

## Key Strategic Buyers in 2020

**AlixPartners**

**accenture**

**BDO**

**A  
&  
M**

**Capgemini**

**SIAPARTNERS**

**Begbies Traynor**

**WIPFLI**

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# Valuations, Due Diligence and Transaction Structures

## Valuation Drivers in the Management Consulting M&A Market

There are several key factors that can drive valuations :

- **Growth opportunities:** Buyers or investors will evaluate the mix of organic and inorganic growth drivers. For the latter, they will focus on management's track record of successful M&A execution and integration as well as the roadmap for future acquisitions. The more detailed the inorganic growth plan the more attractive the target is likely to be.
- **Value of platform vs. individuals:** Buyers or investors focused on acquiring ongoing revenue generating platforms and avoid companies reliant on a small number of individuals. Targets that have built a broader and deeper client coverage model are significantly more attractive.
- **Uniqueness of skill sets and capabilities:** Hard-to-find skill sets and expertise, unique intellectual property, strong client relationships in a specific vertical, drive valuation multiples higher.
- **Repeat and recurring revenue:** In the current environment, buyers ascribe a higher value to revenue that is generated by subscription-based services than by project-based work. Even if a firm does not have firm long-term contracts with clients, the ability to show a high percentage of repeat business and long-standing relationships can result in higher valuations.
- **Revenue concentration:** From a risk-management perspective, buyers or investors get concerned if a large percentage of revenue is driven by a small number of large projects or generated by a few clients.
- **Management's track record.** In the current environment investors and buyers focus heavily on the managements track record of navigating through difficult times and, in particular, demonstrated ability to manage the cost in periods of negative revenue growth.

# Valuations, Due Diligence and Transaction Structures

## Transaction Structures to Manage Risks

- We have seen robust transaction valuations in the last twelve months as buyers have been prepared to pay for strategically important targets, and large private equity backed companies from adjacent industries have been able to take advantage of their low cost of capital.
- In the current COVID environment, we have seen buyers willing to overlook short-term slowdown in targets' performance but carefully manage their risk exposure through highly structured deals. This has resulted in offers/deal structures with smaller upfront cash portions and larger earnouts and equity rollovers.
- We have seen buyers increasingly focus on the sustainability and resilience of business - including recurring revenues and the leadership team's ability to manage costs - as part of their due diligence.
- Buyers have figured out how to conduct their deal due diligence remotely, yet most deals post-lockdown have involved parties that already knew each other well.
- However, the healthy transaction valuations obscure the deals that did not happen: Companies that lack differentiation, scale, diversified revenue sources and client base have generally not been successful in finding investors or buyers.

# M&A Outlook for 2021 - 2022

- The key M&A trends including well-funded private equity investors looking for new acquisition opportunities, availability of private debt capital, and strategic buyer M&A appetite have combined to create a favorable environment for consulting businesses evaluating their strategic alternatives over the next 12 to 18 months.
- We expect interest and M&A activity in the management consulting market to remain robust, as financial investors focus on the sector that is expected to rebound strongly from the COVID related slowdown and continue to grow as a result of the need for advice on how to grow, increase efficiency and solve their business problems.
- Various strategic buyers, often backed by private equity, are pursuing acquisition strategies to accelerate growth, expand their global presence, broaden their service offering, access new client groups, and achieve scale.
- As the management consulting market recovers, we also expect more companies to try to take advantage of the strong market demand and seek a sale or a recapitalization in 2021.
- We anticipate the trend of smaller, more focused deals to gain new capabilities, access to new clients and expand to new markets to continue in the year ahead.
- In addition, we expect overall valuations in the sector are expected to remain healthy for targets with a differentiated offering representing a strategic priority for a buyer.
- Buyers will continue to carefully manage their longer-term risk exposure, resulting in deal structures with relatively smaller upfront cash portions and larger contingent components. Private equity acquirers will continue to expect rollovers by management teams to ensure alignment of interests.

# ERG Partners

## Professional Services and Consulting Sector Advisory Leadership

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Over the years, ERG Partners has worked with a full spectrum of independent consulting and professional services companies helping them build and realize shareholder value.

ERG Partners combines in-depth industry expertise with market leading advisory skills, and prides itself on its excellent reputation, execution capability and experience in cross-border transactions.



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