7 MILE ADVISORS™

Microsoft Services

market landscape
q2 2019

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Overview
With Satya Nadella's leadership, Microsoft's prowess has transitioned from desktop application dominance to enterprise infrastructure innovation. Microsoft has created its own vibrant network of products and significantly leveraged partner relationships. This report highlights how the market has embraced the rapid ecosystem growth and the robust outlook for M&A activity within the space. 7MA tracks closely the Microsoft ecosystem, and some of our historical research can be found on our website.

Microsoft Segmentations
Intelligent Cloud – This is the granddaddy and driver of the entire ecosystem, especially Azure. Azure is Microsoft's "ever-expanding" set of cloud services and supports open source technologies in addition to Windows apps and services. According to Microsoft, 90% of the Fortune 500 companies run on this cloud service. Importantly, Azure provides a degree of security that is not easily replicated by other cloud services. This segment also broadly includes AI, machine learning, and other cognitive capabilities.

Dynamics 365 – Microsoft's cloud-based ERP and CRM enterprise system represents the ongoing evolution of a combined ERP and CRM product and includes Dynamics 365, Power BI, and AX. In the past, enterprise software has been built on layers of complex databases for the use in unique business products. Dynamics is a more standardized software with consistent

forward

streamlined databases. This allows partners to customize and innovate within the platform for solutions that can be used across the entire customer base. It also allows for "tighter" integrations with other apps.

Productivity – Productivity includes both Office and Sharepoint. Office, of course, is the Microsoft software suite that may be as synonymous with Microsoft as Windows is. Importantly, the productivity suite also functions as a cloud-based SaaS for business environments.

Microsoft Partner Network (MPN) – The MPN offers tech companies resources to build business offerings around Microsoft technologies and gives companies product licenses, technical support, and online training. Furthermore, the MPN gives access to connect and collaborate with other companies and technologies within the partner ecosystem. As with other competitive partnership programs, services companies can build opportunities through the MPN. A notable feature is the concept of co-marketing efforts with Microsoft, leading to a greater desire by partners to resell products (indeed, most of these companies will have at least some revenue sleeve for reselling). We usually find that a close-knit relationship with Microsoft involves dedicated resources managing the Partner Network as it relates to marketing dollars and navigating complexities of rebates as well as additional incentives. This last feature is another attribute we find to be unique with regards to the MPN.

MICROSOFT ECOSYSTEM

Partner Public Comps

Few companies or transactions executed in the Microsoft Ecosystem are pure-play Microsoft. However, in Exhibit 1, we have selected IT Service sector companies that have substantial Microsoft capabilities to form an indicative basket of Microsoft ecosystem partners. As a basket, these companies trade near 12x trailing EBITDA and near 2x trailing revenue and typically with gross margins north of 30%. We find that gross margin is a vital metric with respect to M&A viability; buyers frequently hope to acquire targets offering accretive gross profit. Perficient and Cognizant lead the gross profit category in our basket; however, gross profit computation methodology across companies can vary. For example, Capgemini gross profit as presented is 12%, which is clearly not presented in a consistent manner relative to other basket companies. Further, inorganic growth (i.e., M&A) is increasingly a significant growth driver for Microsoft Ecosystem players.

For additional information on public companies in this and other sectors, please see our Earnings Report Summaries.

Perficient, Inc.

Perficient, Inc. provides information technology and management consulting services in the United States. The company designs, builds, and delivers solutions using middleware software products developed by third-party vendors. Its solutions include portals and collaboration, such as searchable data systems, collaborative systems for process improvement, transaction processing, unified and extended reporting, and other services; and platform implementations services, including application server selection, architecture planning, installation and configuration, clustering for availability, performance assessment and issue remediation, security, and technology migrations. The company also offers management consulting services in the areas of organizational change management, business analytics, project management, process excellence, and other; and cloud services comprising architecture, business value and health checks assessments, strategy and road maps, and vendor evaluation and selection services. Perficient, Inc. was founded in 1997 and is headquartered in St. Louis, Missouri.

CGI Group Inc.

CGI Group Inc. provides information technology and business process services in Canada and internationally. It offers application development and maintenance, portfolio management, quality assurance and testing, modernization, and migration services; agile, business transformation, change management, CIO advisory, cybersecurity, data analytics, digital enterprise, project management, and industry-specific business consulting services; business-to-business and customer operations support, purchase management, revenue management, and supplier payment services; and data center facilities and management, technical service desk, printing and document management, remote infrastructure, transformation, storage as a service, data vaulting, disaster recovery and archiving as a service, bottomless edge-to-core storage, and file sync and share as a service, as well as infrastructure solutions and consulting services. The company was founded in 1976 and is headquartered in Montreal, Canada.

HCL Technologies

HCL Technologies Limited provides software, business process outsourcing, and information technology (IT) infrastructure services worldwide. The company offers IT infrastructure management, cloud computing, data center, managed mainframe and maintenance, network, service integration and management, and workplace services, as well as autonomics and orchestration services, products, and platforms. HCL Technologies Limited was founded in 1976 and is headquartered in Noida, India.

MICROSOFT ECOSYSTEM

DXC.technology

DXC Technology

DXC Technology Company, together with its subsidiaries, provides information technology services and solutions primarily in North America, Europe, Asia, and Australia, The GBS segment offers technology solutions comprising enterprise, cloud application, and consulting services; application services; analytics services; business process services; and industry software and solutions. The GIS segment offers cloud and platform services; workplace, mobility, and Internet of Things services; and security solutions. The USPS segment delivers IT services and business solutions to all levels of government in the United States. DXC Technology Company was founded in 1959 and is headquartered in Tysons, Virginia.

Capgemini

Capgemini

Capgemini SE provides consulting, technology, and digital transformation services. It addresses clients' opportunities in the world of cloud, digital, and platforms, as well as enables organizations to realize business ambitions through an array of services from strategy to operations. The company's Consulting Services segment offers strategy and transformation consulting services primarily in digital transformation that enhance the performance of organizations based on intimate client relationships, and the knowledge of client industries and processes. Its Technology & Engineering Services segment provides assistance and support to internal IT teams of client companies. Capgemini SE was founded in 1967 and is based in Paris, France.

Cognizant

Cognizant Technology Solutions

Cognizant Technology Solutions Corporation, a professional services company, provides consulting and technology, and outsourcing services worldwide. The company operates through four segments: Financial Services; Healthcare; Products and Resources; and Communications, Media and Technology. It offers business, process, operations, and technology consulting services; application design and development, and systems integration services; application testing, consulting, and engineering services; and enterprise information management services. The company was founded in 1994 and is headquartered in Teaneck, New Jersey.
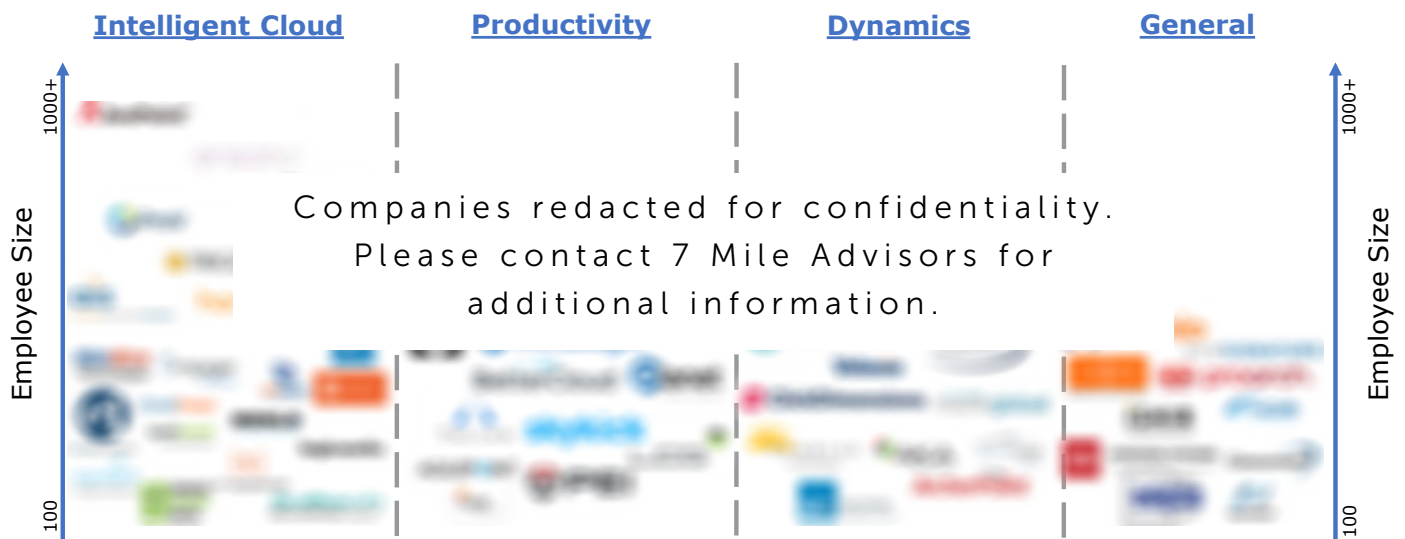
Exhibit 1: Public Basket

Company	TEV $m	LTM Rev $m	Rev Growth YoY	GP %	EBITDA %	TEV / Rev X	TEV / EBITDA X	# FTEs	Rev / FTE $k
Perficient, Inc.	994	498	3%	36%	12%	2.0	16.6	3,060	163
CGI Inc.	20,278	8,541	6%	30%	17%	2.3	13.8	74,000	115
HCL Technologies Limited	21,334	8,393	10%	35%	23%	2.5	10.9	-	NA
Capgemini SE	22,514	15,110	5%	12%	13%	1.5	12.0	211,300	72
DXC Technology Company	23,028	23,880	32%	30%	23%	1.0	4.2	150,000	159
Cognizant Technology Solutions Corporation	38,705	16,125	9%	39%	21%	2.4	11.7	281,600	57
Average	21,142	12,091	11%	30%	18%	2.0	11.5	119,993	113
Median	21,924	11,825	7%	33%	19%	2.2	11.8	112,000	115

share price as of 02Apr19

There are over 64,000 partners in the MPN, and countless others within the ecosystem itself. The companies represented in the landscape below (see Exhibit 2) are major middle market players with capabilities suited for the Microsoft ecosystem. They also represent many of the top technology vendors in the space, and most are repeat Microsoft Gold Certified Partners. We've organized these companies by both size and segment, broken out between Intelligent Cloud, Productivity, Dynamics, and one for more general Microsoft capabilities. Of course, most of these companies have significant overlap between these verticals, so we have tried to focus on their primary services. These Top 50 prospected companies are among the most exciting players in this space.

Exhibit 2: The Microsoft Ecosystem

Companies redacted for confidentiality.
Please contact 7 Mile Advisors for
additional information.

Cloud Is The Driver

The Cloud is a primary factor in the growth of both products and services. For instance, consulting work is becoming increasingly popular due to Cloud features. Many customers can cater their own solutions directly, but there are countless choices available. The decisions can become overwhelming. Enter consulting: In being well versed in a variety of cloud applications, the consultant can vet the choices and help choose the application suite best suited to the individual customer needs. (Besides, consulting already offers among the most lucrative margins.)

Industry vertical specialization has also been increasingly attractive. It can be a differentiator amongst competitors, but customer demand is the real catalyst. Channel firms can focus on an industry and attain a "know-it-all status in a niche market," (1) allowing the firm to move beyond horizontal solutions and to become specialized. After all, most infrastructure engagements are repeatable, but understanding the specific uses of applications that pertains to an industry is critical to establishing credibility in a vertical.

The rise in the popularity of Microsoft products can be seen in several places. Interestingly, while the Office suite has hardly been a scrappy underdog in business usage, it was nonetheless at a disadvantage in the battle with G Suite to become the cloud app suite of choice. Google and G Suite had the early advantage as Microsoft was slower to get into the cloud application game, but adoption of G Suite has flatlined more recently. Conversely, Office adoption has exploded (see Exhibit 3).

Why might this be? Familiarity is one answer. Outlook, Word, and Excel are nearly synonymous with "email," "paper," and "spreadsheet" in many business respects. If a company has been using the Office suite, it's not an easy task to have them switch. The Office suite also has a more comprehensive plate of offerings than the G Suite (whose offerings are by no means thin), and the apps tend to be more diverse. That range allows for the provision of so many solutions to companies of all different sizes. Finally, using Office gets a company access to Microsoft offerings and the full range of Microsoft benefits (3).

Exhibit 3: Office 365 adoption has accelerated past G Suite

Cloud App Suite Adoption
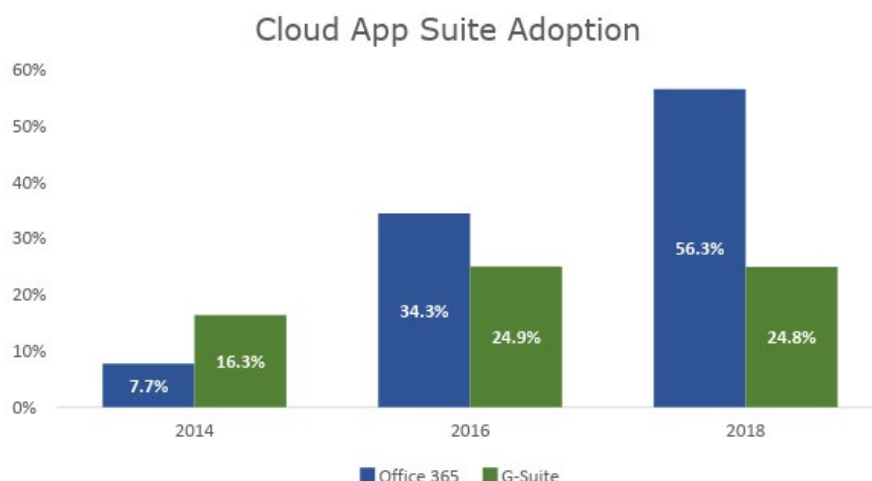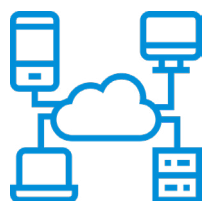
The growth of Cloud has been driven by a variety of factors, including various types of digital transformations and the simple migration of business to the cloud - for instance, from filing papers to backing up on-premise servers. But why Azure specifically? In some cases, the reason is simple but obvious: Microsoft is not a competitor. Unlike Amazon, Microsoft isn't actively competing against the customers of Kroger, Walgreens, Walmart, or other retailers. Amazon's ubiquity in consumer spending habits sometimes works

against it when it comes to businesses making decisions about the digital services they pursue.

Historically, Microsoft has also had a significant customer base with on-premise server software, an attribute typically not shared by AWS or Google Cloud. As a result, Microsoft's hybrid solutions are more robust in part due to necessity – Microsoft had to derive solutions for customers that migrated to the cloud at their own pace as well as to help integrate on-premise with cloud. In other words, Azure has fewer restrictions by not needing to be wholly cloud-based.

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Still, the likely single biggest reason that Azure has grown so tremendously is its security features. As more and more companies migrate from on-premise servers to a cloud system, security is paramount. With all the programs, apps, and general private access a business uses each day, those businesses need security, and multiple logins can be a nightmare. What makes

Source: Microsoft

Microsoft's products and services so appealing on this front is single sign-on (SSO). Dozens of Office 365 programs, for instance, are integrated under single sign-on.

SSO makes things easier for users, increases efficiency (for example, fewer helpdesk calls for password resets), and improves security. The main cause of security breaches is compromised credentials, and the more username and password combinations needed to log in, the worse the password security tends to become. That is, the first password might be really strong, but the twelfth may devolve into something easily hacked. Also, the more combinations needed, the higher the likelihood that they are written down somewhere, and thus less secure. By contrast, SSO requires just one password, one that can be made more robust.

According to a study by Bitglass (2), global cloud adoption reached an all time high in 2018 at 81%. However, only one-third of those organizations are deploying SSO. This huge lag suggests that security breaches will continue for most companies. It also suggests that solutions to both prevent and deal with breaches will be valuable.
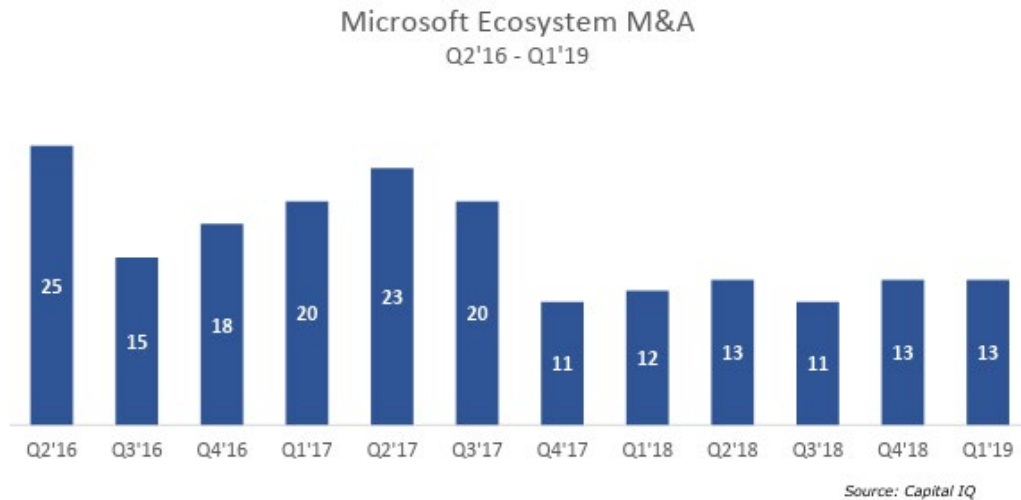
The attractiveness and growth of Azure isn't to downplay the popularity of other solutions, especially AWS. Indeed, AWS is among the most popular cloud applications as many organizations move to off-premise hardware (Azure is more popular for on-premise). However, what's interesting is that the finance and healthcare industries are among the slowest adopters of AWS versus among the highest of Azure (and Office 365). The reason is likely due to SSO adoption as authentication is hyper-critical for protecting identifiable information.

Cloud security is a high value deliverable in this ecosystem, though pure-play security firms remain somewhat of a unicorn in a space ripe for M&A activity. Fortunately for Azure, it remains the leader of the pack in this regard.

M&A ACTIVITY

It's a heavily fragmented market, and with the explosion in growth by Office and Azure, firms in this area are getting gobbled up. Nearly 200 M&A deals (see Exhibit 4) have been closed in the last three years in the Microsoft ecosystem (7MA has been an advisor on at least seven in the last year alone). By some counts, nearly half of all IT Services M&A transactions are with Microsoft Partners (4).

Microsoft Ecosystem M&A
Q2'16 - Q1'19

Quarter	Deals
Q2'16	25
Q3'16	15
Q4'16	18
Q1'17	20
Q2'17	23
Q3'17	20
Q4'17	11
Q1'18	12
Q2'18	13
Q3'18	11
Q4'18	13
Q1'19	13

Source: Capital IQ

Successful targets of M&A tend to share several characteristics, among them double-digit revenue growth, gross margin greater than 40%, and proprietary and scalable services/solutions. One of the most sought-after features is a recurring revenue stream, which tends to lend itself to Azure and is indicative of why companies integrated with Azure are so sought after, especially by financial sponsors (5). The buyers in these transactions have been a healthy mix of strategic companies and financial sponsors, although no one firm has dominated the acquisitions. For instance, 7MA recently acted as the advisor to SADA Systems' divestiture of its Microsoft business unit to Core BTS, a national IT solutions provider. In another 7MA deal in 2018, Ernst & Young acquired Sonoma Partners, a consulting firm that specializes in Dynamics 365.

What's notable is how few firms have performed multiple transactions; we estimate that less than 10% of these acquisitions have been made by repeat buyers. These buyers include Kaseya Limited, Thompson Street Capital Partners, Insight Venture Partners, and CGI Inc.

Kaseya Limited

Kaseya Limited provides cloud IT management solutions for IT departments and managed service providers, and small to midsized businesses. The company offers Kaseya VSA, a solution to manage and automate IT environments from a single dashboard; Kaseya AuthAnvil, an identity and access management software for single sign-on and multi-factor authentication solutions; Kaseya BMS, a business management solution to support various business back-end requirements, including service desk, customer relationship management, finance, project management and billing, time and expense tracking, and inventory management; Kaseya 365 Command, an Office 365 administration software; TRAVERSE MONITORING, a performance monitoring and management solution for IT professionals, as well as to monitor and manage networks and data centers; and Kaseya One for infrastructure monitoring.

THOMPSON STREET CAPITAL PARTNERS

Thompson Street Capital Partners

Thompson Street Capital Partners is a private equity firm specializing in growth capital, recapitalizations, management buyouts, industry consolidations, corporate divestitures, and take private investments in middle market companies. The firm seeks to invest in companies having revenues between $20 million and $200 million and EBITDA between $1 million and $20 million with equity investment of $10 million and $40 million and enterprise value between $25 million and $150 million. It also seeks add-on transactions for portfolio companies with no EBITDA limits. The firm prefers to take control and majority position in its portfolio companies and selectively consider minority positions in growth companies. Thompson Street Capital Partners was founded in 2000 and is based in St. Louis, Missouri.
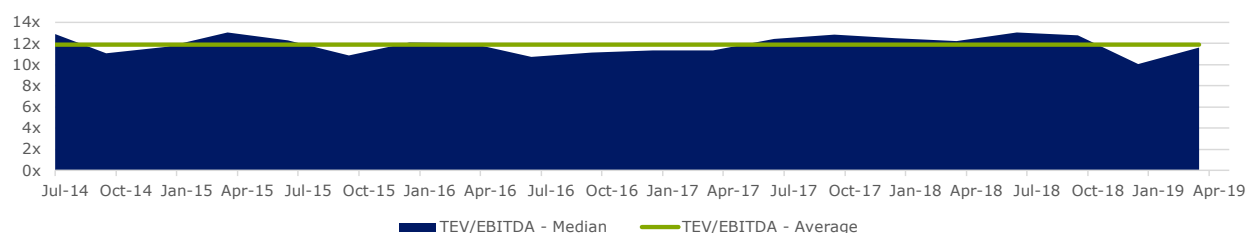
INSIGHT VENTURE PARTNERS

Insight Venture Partners

Insight Venture Partners LLC is a venture capital and private equity firm specializing in investments in expansion capital, emerging growth, growth capital, growth equity, buyouts, capital for mergers and acquisitions, take privates, recapitalization, PIPE deals, pre-IPO, later stage, middle market, mature, recapitalization and carve-outs. The firm typically invests in the technology sector with a focus on consumer-facing technologies, e-commerce, internet, mobile, new media, online gaming, infrastructure software, on-premise and SaaS-based software, infrastructure, internet software, application software, data businesses, online and on-demand businesses, retail, enterprise application software, e-commerce software, business-to-business commerce, software-enabled services, B2C products, post-secondary education, and data enabled services sectors. It makes worldwide investments. The firm targets investing between $3 million and $500 million in companies at all stages in their life cycle. It seeks to take a seat on the board of directors of its portfolio companies. The firm engages in both majority and minority investments and purchases both primary and secondary shares. It also makes co-investments.

Also notable is the apparent deceleration in deal frequency, which we believe could be at least partially explained by several factors. For one, interest rates in 2018 finally started to rise for the first time in many years, and while there remained plenty of capital in the market, the higher cost of capital may have contributed to fewer deals happening. More importantly, we suspect the lack of repeat buyers and deceleration in deal flow could be due to buyers making platform acquisitions in the space. Thus, purchasers are taking the time to get a prior acquisition integrated with existing operations and get a good sense of the market before going on the next hunt for an add-on deal. Could the quieter 2018 lead to a flurry of activity in 2019 and 2020? We believe so, and it will be interesting to see how this develops given how much value these companies represent.

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Public EBITDA Multiples Over Time

Chart legend: ■ TEV/EBITDA - Median ▬ TEV/EBITDA - Average

X-axis: Jul-14, Oct-14, Jan-15, Apr-15, Jul-15, Oct-15, Jan-16, Apr-16, Jul-16, Oct-16, Jan-17, Apr-17, Jul-17, Oct-17, Jan-18, Apr-18, Jul-18, Oct-18, Jan-19, Apr-19

Recent Transactions

Date	Target	Buyer / Investor	Total Transaction Value	Target Revenue	TEV / Revenue
3.11.19	Acando AB (publ.)	CGI Inc.	370.75	300.27	15.4x
3.11.19	Velosio	Harren Equity Partners	-	-	-
3.6.19	Inventio.It A/S	Dustin Group AB (publ)	-	16.08	-
3.1.19	HAND Ent. Solutions	Beijing Baidu Netcom Science & Technology	81.96	427.72	3.5x
2.19.19	Saratoga Technologies	Sharp Business Systems	-	-	-
2.13.19	Axispoint Tech. Solutions	-	15.00	-	-
2.1.19	Conway, Dierking & Hillman	Red Level Networks LLC	-	5.00	-
1.31.19	Nelite France	Exakis SAS	-	-	-
1.30.19	Dynamic Business IT Solutions Pty Ltd.	rhipe Limited	5.75	-	-
1.25.19	Service Bus. of EG A/S	DXC Technology Company	-	-	-
1.24.19	Cloud Comrade Pte. Ltd.	ST Telemedia	-	-	-
1.14.19	Capax Global, LLC	Hitachi Solutions America	-	-	-
1.9.19	TS Tech Enterprises, Inc.	CompassMSP, LLC	-	-	-
12.31.18	Stratus Solutions, Inc.	Applied Insight, LLC	-	-	-
12.28.18	INNITO	Admiral Dynamics bvba	-	-	-
12.4.18	Lighthouse Comp. Serv.	Converge Tech. Solutions	23.20	82.00	0.3
12.3.18	Think4 IT Solutions	King of Servers	-	-	-
11.8.18	Charterhouse Voice & Data	August Equity LLP	-	-	-
			-	-	-
11.8.18	SYCOR GmbH	Allgeier Ent. Services AG	-	97.05	-
10.29.18	Sierra Systems Group	NTT DATA, Inc.	-	-	-
10.21.18	Arden Group	Babble Cloud Holdings	-	-	-
10.3.18	Content & Code Ltd.	IT Lab Ltd.	-	15.60	-
9.27.18	Iron Bow Technologies	H.I.G. Capital	-	-	-
9.26.18	M-Theory Group, LLC	Breakaway Capital	4.50	-	-
9.18.18	Jayway AB	Devoteam SA	-	22.37	-
8.28.18	4iG Nyrt.	Konzum	-	53.67	-

CONCLUSION

This report provided insights into the Microsoft Ecosystem, what's driving its growth, and what some M&A characteristics may look like. As Azure and the rest of the ecosystem's adoption has been on a meteoric rise, the value of companies associated with that ecosystem are along for the ride. This is an active and dynamic space that's also highly fragmented – a ripe recipe for deals in 7MA's view. While better security measures remain elusive as a pure play for some companies, joining the Microsoft Partner Network and throwing a hat in with Azure is a compelling driver of value. We anticipate that high market demand will remain for those within the MPN and especially for those with Azure integration.

Are you a Microsoft Partner? Some conferences that may be worth attending:

1. Microsoft Inspire | July 14-18, 2019 | Las Vegas, NV

2. Microsoft Ignite | November 4-8, 2019 | Orlando, FL

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