Executing the Roll Up Strategy in the Tech Industry | Steven Freidkin & Christopher Carstens

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SUMMARY

Chris Vollmann Carstens and Steven Bradkin from Ntiva discuss their approach to executing a roll-up strategy in the tech services industry, emphasizing the importance of cultural fit and operational efficiency in mergers and acquisitions. They share insights on how to create value through integration, the significance of recurring revenue, and the challenges faced during the M&A process.

- *Successful roll-up strategies require a strong cultural alignment between acquiring and target companies.*
- *Ntiva has completed 15 acquisitions, focusing on enhancing operational capabilities and service offerings.*
- *The managed IT services market is fragmented, presenting numerous acquisition opportunities.*
- *Key factors influencing valuation include EBITDA multiples, customer concentration, and organic growth potential.*
- *Cash and rollover equity are preferred in deal structures, with 60-80% cash and the remainder as equity.*
- *Emotional aspects of selling and the role of investment bankers can complicate the M&A process.*
- *Building relationships and community engagement is crucial for sourcing deals and fostering trust.*
- *The integration process should be swift to maximize value and avoid complications related to earnouts.*

Hello M&A scientists, welcome to the M&A Science podcast where we learn from the best in M&A to uncover proven techniques for enterprise value creation. If you're interested in learning more about how to optimize your M&A practice or want to get involved with our community of forward-thinking M&A practitioners, visit mnascience.com and subscribe to our free weekly newsletter. If you want to keep up with us on the go, head to LinkedIn and follow M&A Science. I'm your host Kison Patel, CEO and founder of M&A Science.

Joining me today is Chris Vollmann Carstens, Chief M&A Officer at Ntiva, and Steven Bradkin, CEO and founder of Ntiva. Ntiva is a managed IT service provider focused on helping customers grow and reduce risk. Today we're going to talk about how to execute a roll-up strategy in the tech services industry.

Gentlemen, how you doing today? Awesome to be here. Thanks for having us. Hey, thanks for taking the time from doing deals to have this conversation. If we can kick off a little bit about your background. Hi, it's it's great to be here today. I'm Steve Bradkin, the founder and CEO of Ntiva. Uh you know, truthfully, I was born a geek and I've loved solving people's problems with technology for many, many years. Uh in the last seven or eight years, I partnered with private equity to help continue to scale our business and our core purpose of growing people using technology as that accelerator. And through our partnership with some of the greatest private equity groups out there, we've successfully completed 15 acquisitions as of today. And so now I know quite a bit about technology and also the art of deal making and integration and all the other good stuff that comes with M&A.

Awesome. How are you, Chris? Yeah, first of all, thanks very much for for having us today, Kase on. I'm an avid listener of your podcast. So it's it's exciting to to be here on the other side of the microphone. My background is a bit more finance traditional coming up to this point in time. I've taken a lot of steps along the way before joining Intiva from FP&A, investment banking, energy infrastructure investing as well as management consulting. But I've spent the last 3 and 1/2 years now with Intiva standing up and leading our corporate development practice, which essentially means that anything from very first conversation through the diligence and execution of the transactions that we bring on board as well as the full integration of the companies that we acquire. That all falls under my remit.

And I'm very fortunate to be working and partnering with Steven as we go about trying to build a fantastic MSP here at Intiva. So Steven, you got the founder background. You built the business up, then partnered with private equity, really scaled it out, which is where M&A got introduced to the strategy. And Chris, you come from the finance background, worked in banking, familiar with the mechanics of the deal, and you're partnering up to join that effort as well.

Can you elaborate? How do you guys actually work together? Look, so from some from my perspective, you know, I've I've really enjoyed working with CVC. It's it's it's actually been a great partnership. So, you know, the way that I've been able to look at it is I've been in this industry now for close to 30 years. I have relationships with many of the managed service providers that are out there across the US. This is one of these really tight communities where there's enough business to go around and people most of the time are open and learn and grow from each other.

So, I've been able to do that for many years, uh, share some of the lessons that I've learned and learn from others. So, in the process of doing that, I've I've had the honor of building relationships with fantastic folks, uh, who ultimately understand what is happening in our industry and how there is a lot of consolidation going on. So, using those relationships, which have already established trust, and then introducing them to CVC, who's able to really dig into the details of their business, help us understand what the potential value might be, and drive us all the way through a transaction, uh, you know, it's really a great, um, partnership, as I said. So, CVC doing a lot of the data analysis, helping to figure out what kind of value we can put to these things, me coming in from time to time and using, uh, you know, my relationship with the people, the trust that's been established over the years, and ultimately my hands-on understanding of both what it takes to run an MSP, as well as what it feels like to sell your business, right? So, I've done that, right? And and doing that helps me really get connected on a personal level in a meaningful way with these, uh, these folks that we hope to bring into our ecosystem, as CVC really is able to dig into all of the detail, and ultimately make it so we successfully, uh, close the transaction and get it integrated in in ways that I could never imagine. Uh, you know, his detail orientation and and expertise around numbers is is unmatched.

I think I think the greatest, uh, strength that we bring to bear here is that we do have two different, uh, um, you know, pockets of of focus and interest and and expertise that we're able to bring together toward the pursuit of bringing on board the right type of MSPs into our into the ecosystem. So, the fact that I'm you know, fortunate enough to speak you know, daily and sometimes multiple times a day with Steven and become armed with his, you know, years long, decades long industry expertise, his unvarnished guidance, and as well as just frankly the cheerleading and enthusiasm, being able to bring that to bear um in the conversations that I'm having with with individuals, uh it's really it's really an honor uh to be part of this uh this mini M&A team that we do have at Entiva. I think the other thing that that's really important to to to hone in on and something that that Steven touched on is the personnel element is such a critical factor for our success, and it's something that we really try to impress upon uh in the transaction work that I'm doing day in and day out. So, it can be very easy to check the box when it comes to uh revenue at this size, EBITDA at that size, growth at X, uh you know, gross margin at Y, but until you can uncover the the the personal uh attributes, the culture, the feeling of those individuals that are coming into this business, that's where ultimately the long-term success can come from. Uh because as much as this is a technology-driven organization, technology-driven industry in which we operate, it's really the people that is that core element to it. And so, being very wise and smart uh and relatable uh to these individuals who share a lifelong passion to technology and and, you know, managed service, that's where that um that success can come from. And I think uh Steven and I work very well together uh in situations, in conversations with with prospects so that we can, you you drive at outstanding outcomes for ourselves playing on each of our respective strengths.

What do you guys create value when it comes to executing on a roll up? Yeah, so look, I I think we'll we'll both riff on this a little. So, to um you know, in terms of creating value and executing a roll up I I I got to zoom back out to what we're about here at Ntiva, and that is this purpose of growing people. Okay? And I know that sounds a little uh amorphous, but it's the truth, right? We exist to grow each other, and technology purely accelerates that growth.

So, understanding that and really doubling down on that culture and our core values that supports that culture is critical. So, before we can create any value in a roll up we must make sure that the organization has similar values to us. And if we don't, it is and I've learned this the hard way, it is uh it is value destruction, not creation. So, once we uh get over that hurdle, which is a big one, then we're able to bring in uh other MSPs and provide a deeper um set of products and services that could be sold into them. In many cases, these smaller MSPs don't necessarily have effective account management, sales and marketing. They might have a handful of security products or services that they resell, but they don't necessarily have the in-house expertise for it. Uh you know, come 5:00 p.m. in their local time, they may not have the right after-hours support, so they can't offer 24/7 services.

Uh there's just a lot that is expected for the best-of-breed MSPs to deliver. And so, bringing that to market is expensive. And to do it right in a unique way requires material investment. And a lot of the smaller players are struggling with how to make that investment, when they'll see a return, so on and so forth. So, we're able to join forces with them, apply our sales and marketing model, apply our account management, bring our scaled products and services as we integrate and become one, and really create value through the the cross-sell, upsell that comes with that, the hopeful improved client retention that we're able to bring to the table, and then ultimately the effective organic sales and marketing engine that we drive in the markets that we serve. Uh so, that's just a a start of it. Uh CDC, I'm sure you can add a few and I'm I'm we can go back and forth a bit. Yeah, I'd be happy to. I think it's also important to acknowledge sort of what the the managed IT services environment or ecosystem looks like overall is an incredibly fragmented market across the US.

Depending on who who uh uh has created the count, are there 20,000, are there 30,000 different MSPs in the US alone? Most of whom are very small mom-and-pop shops or one-or-two-person uh uh outfits, and they've been around for a long period of time, 10, 20, even 30 years or more. And so, that question of where does that business go, where does it transition? Um that becomes an ever-present question in the mind of those leaders. And to the to the points that Steven just mentioned about some of the challenges that um business owners are facing, that's where really what helps to create an opportunity where we have a a plethora of businesses that we can seek to evaluate so that we can really find those companies that align with Intiva from a cultural perspective, from a vision perspective, etc. It's not as though everyone in the market is going after just one or two organizations, um and if not then you're then you're out of luck. So, I think that's that's an important consideration to make as well as as to why roll-up is such a such a pervasive strategy uh within the MSP space. And then I think it's also uh you know, worth mentioning at the end of the day we are trying to create value for ourselves as a business, for our shareholders. Um and it is a somewhat of a classic play that if you can buy at a buy smaller organizations at a lower multiple, combine them with combine them with your organization, and as you seek to realize your own investment uh in some period of at some period of time to sell on at a higher multiple, you can you know, take advantage of that multiple arbitrage um through the course of that through the course of that process.

So, I'm hearing improve operations, increase the number of solutions that the business can can provide of the acquired business, and that the opportunity is a space is very fragmented, which means there's quite a few of these assets you could potentially acquire that as you consolidate them, then we get the valuation uh arbitrage on the multiplier. How how does the mechanics of that work? And I'm just at a high level, like if you're pitching this to the private equity firm in terms of um the whole scheme of things of hey, there is value that's going to be generated, and you know, and I I don't I don't know if you're open to sharing just like rough multipliers, like I I'm looking at uh the data room space, and you see a lot of small ones you can buy at 3x revenue, roll them up, get to 5x revenue. You know, what what is a little bit of that high level uh fundamental look like versus um you know, how much of a deal so forecast around the synergies you would create from doing the deal? Like what does that pitch look like?

Yeah, I mean I can start just, you know, at a high level on the on the multiples perspective. So within that within the industry, it's typically looked at from a multiple of EBITDA perspective. That's that's where most transactions are are priced off of. And you know, there are a whole host of factors that can go into determining what an appropriate multiple might be for a business. You know, obviously size, but you know, the measure of recurring revenue as a composition of of overall revenue, as well as the overall uh you know, sophistication or maturity of the business uh and the list goes on and on around uh client concentration, etc. But for the most part, for businesses um you're looking at anywhere from a you know, a mid single-digit uh EBITDA multiple uh is probably a reasonable baseline place to start. As businesses start to creep up in size, you could be tracking closer towards a a higher single-digit multiple. And then as you can can really combine forces and become something much more akin to a scaled MSP, the multiple can jump into the mid-teens or closer towards the mid-teens. So you can see a fairly material uplift in in multiple um by by combining forces, presuming that you can execute well as a combined entity and you're not facing um you know, high levels of client attrition, employee attrition, um or other challenges to the to the operational uh performance of the business. But if all things equal or all things uh going as as intended, that's an element that you're able to to take advantage of um and that's you know, before necessarily considering you know, any um you know, any synergies or other other uh cost opportunities that you're that you're uh could potentially take advantage of.

Yeah, you know, and and just to be on the higher end of that multiple, right? Like um and and the market is really consolidating now. It's been happening for the last decade, but a lot of activity's going on now where there's some larger players coming out. You know, I I liken this industry to like telecom in the 1980s when there was 25,000 mom pop bells, and today there's, you know, two or three or four Verizon or equivalents that are out there, right? So, the same thing is happening in our space.

So, a lot of this is new. But, the way we see it to be at the upper end of the valuation spectrum, so call it the the mid-teens or above, we're talking 25 million or greater of EBITDA. We're talking about operational maturity that has proven that as new dollars come in at that larger size, you're able to consistently drop the same or more as a percentage as contribution margin in the business. Uh you need to show that you have a proven track record of client retention. You need to to show that your growth has not just come from acquisition, but also you have an organic sales and marketing engine that supports it as well. You likely need to have certain industry vertical expertise where you can show knowledge towards more, you know, one or more industry verticals where you can market to them and have a little bit more price elasticity as a result of that. You want to show good strong employee retention as well, as well as training programs to help support them.

You need to have a robust and certified security offering as well because the risks associated with uh you know, not providing security properly for yourself and your clients is huge. Uh you could have, again, to get to the higher end of this stuff, you could offer services like digital transformation, uh you know, help clients leverage uh generative AI to go where the proverbial puck is going with technology as opposed to where things are today. Like those are just some examples. So if you've got those, right? You're going to be in the upper right-hand side evaluation. And then the less like you know, you could chip away and we could talk about the negatives. Well, you're not this. You have single customer concentration. You You haven't proven that as you grow your margin goes up. You don't have organic sales and marketing. That brings you all the way back to you know, the mid singles, right? In addition to obviously the number being smaller. So as we look at deals, we want to see again, I I sorry to keep repeating this, but first that culture fit and alignment with purpose first, but then once we see that, then we're able to look at all of those variables that I just shared with you and go, are we missing any of those in our investment thesis? If so, does acquiring this company help us achieve that? Creating benefit to the whole thing.

So that's something we're always looking for. And then separate from that, hey, bringing them in. They've got almost everything, but they're only 2 million of EBITDA. That's the simplest way to think about it, right? Like they're rocking and rolling, firing on all cylinders. We can bring them in and we're bringing them in at you know, 10 and we're worth 15. All example numbers, right? That's the simplest way. But the reality of what I'm trying to share here is there's so many variables that create this value. We know what the market will bear for those that are firing on all of the cylinders or most of the cylinders that I just shared with you. And there are so many companies out there that you know, have some of these pieces together, but not all of them. So joining forces and bringing it together in an intelligent way creates a tremendous amount of value.

Um so that's period. I'll say, you know, when it comes to synergies, to me that's always been a dirty word. Um I love the idea of efficiencies that come from these businesses. I can tell you out of 15 12 or more were negative synergies, right? So, they were scenarios where we buy a business, maybe there's multiple arbitrage associated with it, but we absolutely needed to go in there and put in account management, help uh strengthen their technical staff, um even increase the compensation of some of these folks, uh improve their benefits, just really do things that ultimately cost more money, but create more overall value. So, maybe the EBITDA depresses a little, but we're able to move the multiple up because we're doing business the right way.

What's healthy organic growth for you? Uh so, so from from my perspective, healthy organic growth is in the, you know, mid-teens every year. So, something, you know, something around, let's call it 12 to 18% is healthy organic year-over-year growth. Now, I want to flip this around for when you start evaluating a target. And then I would take it that that growth would actually be a big factor in how you value it if a company is growing that 15, 20 plus percent versus they're stagnant. How do you walk me through how do you sort of look at that and how that affects the value? It's a critical piece of of information just to understand the trend of the business. Can they continue to grow? Have they been able to grow themselves without necessarily having to rely on a single anchor client that you know, that may have driven a lot of their growth, you know, in early days.

Being able to have a strong mix or an even spread of clients and being able to see them all continue to grow either through, you know, size increase themselves or additional offerings or opportunities to add to wallet share. Those are things are are really helpful to see because what we want to do is if we bring a new organization on board, we want to be kind of the extra spring to their springboard for growth um you know in the in in the path going forward. We don't want to in an ideal world, our preference is not to to to come across a business what that is stagnant or declining um and then having to over ended over index to uh fix the organization before you know taking it taking it uh forward. Um really hoping to partner with organizations that are on the up, but recognize the challenges that they're facing at the size that they're at and using our broader platform as that extra spring in the springboard to really launch up the launch up the curve um from a you know from a scalability perspective. So that's that's an important element that we're that we look at when we're evaluating businesses and I think it also speaks to just that the hunger and the desire and the interest of those owners to get on to the next level uh with a you know potentially larger organization like Intiva. Um that measure of enthusiasm and excitement and passion for their clients, passion for their people um really can reflect itself in you know the top line growth of the business. Um but it all all these different pieces fit together to create the the picture for us in looking at a target and saying wow, that's something that's a business that we really want to have part of our organization. And I think it's what's also important to reflect on is that given the amount of uh M&A activity that's happening in in our space that we need to be able to clearly differentiate ourselves from other possible buyers uh in the space by talking about the things that are incredibly important to us like being a legacy defining brand with a presence in our community by being able to to be the quote gold standard where we want clients, employees, vendors, heck even other M&A other MSPs to want to become part of our organization.

And then we want to be able to show that this is a place where you can generate real value for everyone that's involved, not just you know yourself and your pocketbook, but also for your clients, for your team from a growth growth opportunities perspective. And the other thing that I would just touch on is the fact that we've done 15 acquisitions, being able to demonstrate to a prospective target that we know what we're doing when it comes to the acquisition and integration side of the transaction. That measure of confidence and comfort for them so they know that their life's work will not be eroded when it comes into the larger organization like Intiva.

Those are really important things to be able to demonstrate to them. We're trying to sell them on Intiva just as much as they're trying they're trying to sell themselves to us. And through that kind of combined effort is really where you can get at the the highest and best outcome that that everyone's striving for. So I'm getting it's not like an absolute formula that you have this much growth and it's going to directly impact valuation, but it's more about your level of confidence and how you can work with that organization to grow them basically.

Yeah, that's exactly right. It's not it's not it's not a strict formula Keys on where if I plug in these four factors, it's going to spit out Y multiple. It's much more of a mixed picture that you're that you're trying to create and I think you given given the different factors that you have involved, you can be more creative when it comes to the multiple that you're contemplating or even you know the structure of the transaction that that you're contemplating, which I know is something that that that we want to talk about as well. But, we really want to be able to to craft a solution that gets at solving the, you know, goals and aspirations for that seller just as much as it solves the investment thesis and and and goals for us as we approach the the transaction. And if you can get overlap in a positive way between those two sides, that's where that that success is going to come from, you know, straight out the gate as well as, you know, over the long term.

Is that the same for when you look at the revenue sources of how much of it's reoccurring versus not? Yeah, so in our in our business, it's primarily oriented around a recurring revenue as the as the major driver of value for businesses. It's the priced on a, you know, by user paid per month on a annual or multi-year contract, and that certainty of revenue now and into the future is where value comes from in our business. And so, you know, for for us, we're a majority recurring revenue business, 70-plus percent from what we derive from that those recurring revenue sources. And so, we want to partner with organizations that that share that similar revenue mix and have that similar approach to having that contractual agreement in place with our clients on an annual or multi-year basis so that we know that when we acquire this business, we've got that view out to that revenue profile with a high degree of certainty on the go forward.

We don't have to keep hunting month in and month out for for every for every dollar that we're going to earn. Like, we we're going to we're going to start at a pretty solid base level, and we seek just to grow and expand off of that. You When you mention the customer concentration, what's like a red flag scenario look like to you? A red flag scenario with customer concentration is a company that derives call it 20 or 30% or sometimes even more of the revenue from a single client.

That client happens to be on month-to-month contracts or has been, you know, coming up for renewal in a short period of time and they just found out that they're going up for RFP. So, they've got to you've got to navigate that or you're just going off the basis of I we've never really had a contract in place with this client, but they've been, you know, they've been around for 10 years or 15 years. So, you shouldn't expect them to go anywhere, you know, just on account of this transaction taking place. You know, take take my word for it. You'll be you'll be fine.

Those are the sorts of things that that cause us a little, you know, moment of pause or concern we'll try to try to understand. It really helps to be, you know, diversified among among the client base so that you're not unusually reliant on one or two or small handful of clients because as much as we're in a recurring revenue business that does provide greater certainty than other revenue streams, you know, you're never at 100% or 1,000% certainty that the clients that you've got today are the ones that are going to stay forever. You've really got to work to keep them.

And so, you want to, you know, you want to give yourself some measure of protection as you're going through an an evaluation. And if frankly if someone's too too concentrated, you know, we'll raise that up to them. And then if it's over the course of a evolving relationship and and and, you know, friendship with a prospective owner, if you can work with them over a year or two years or sometimes even three years for us to diversify their client mix, then they become that much more of a of a palatable business to acquire. And frankly, the multiple that we'd be willing to pay is higher.

Um so they themselves will be able to generate more off of it than they might otherwise would if they sold sort of right at that moment in time when they had 20% single client concentration. Yeah, you know, and and what CBC shared there is true. Like we have over the years developed a ton of great relationships with folks that may have had something like single customer concentration or any of the other factors I told you holding them back from the valuation that they really wanted. And so we kind of stick it out with them and help support them and give them advice and guidance along the way.

Uh you know, similarly, uh where people may want a little bit more of an accelerated outcome, we're not going to be able to adjust our value that we put to a business that has high customer concentration. However, uh we can work with a seller to roll over more into our business where that customer concentration may not seem as great. So as an example, maybe we can only value this business at six or seven times their earnings, but we could allow the seller to roll 50% instead of what we might expect 10%. And that allows them to get an opportunity to get the value creation and the accretion that comes from us bringing together where a $5 million revenue business with a $3 million annual recurring customer is heavy customer concentration, but a $3 million annual customer in our $175 million year business is not. That's really good way to look at it.

I I got more red flag questions, but before we get into that, so far you've made this sound pretty easy to do. What are the challenges of doing a roll-up? I think I think I think the biggest one that that you know Steven Steven talked about it's it's it's the culture it's the people it's getting on the same page or or ensuring that you're on the same page with a prospective buyer from a vision and mission and priority before you really get down the path. It can be very distracting sometimes just on the level of interest and activity in our space to get sellers clamoring after the highest dollar or you know the most aggressive potential buyer out there. And so being able to to be disciplined in our approach when it comes to evaluating a business across all the factors that we've talked about qualitative as well as quantitative.

I think that's one of the biggest challenges that that we face. And if we get to too aggressive with dollars in our eyes on a particular business cuz it's got a very attractive EBITDA margin profile. We have we have seen that you know come back to bite us because we kind of we got over our skis a little bit a little bit too far on on on on an acquisition and you know really helps reinforce the need for this kind of discipline to be to be smart in the space.

Yeah my my two biggest challenges like if I if I just had to like name them it would be first unqualified investment banker involvement. And that can be from you know the early stages of whispering in somebody's ear that they're half a million dollar EBITDA business with single customer concentration making 95% of it is worth 20 times earnings. Right? So could be from that stage to taking them through the process and not actually being with them through it to help them really really understand what is coming up next where they need to be providing value, but at the same time blocking folks like us from helping work directly with the seller. So, again, number one would be unqualified investment bankers.

And by the way, there are qualified ones, but the unqualified ones create a lot of challenge. The the second is really and and I I mean this and I am I am guilty of this myself. It's the emotions of the sellers. And really getting in touch with what those are and really connecting with people at a deeper level so that we can work through that together. And I got to tell you, you know, these are you know, the the the typical profile, not always, but it's typically you know, an alpha male CEO founder of one of these businesses that we're dealing with. And I have outliers to that, but like that's the typical.

And you know, they're feeling scared and out of control and confused and changing, you know, what they've spent the last, you know, X number of years in their life focused on and this is their identity and they don't know anything else. And so, it's a very scary time. And people the the the description of that that person I just gave you doesn't always get in tune with those emotions. So, it might display itself in erratic, illogical behavior through the due diligence process to try to get to close and that can create conflicts and fights on both sides and just make people, you know, just just keep one-upping each other versus really getting to the core of that, which is, yeah, this is emotional. This is challenging. I get it. I feel it. Let's talk about what's really going on so we're not distracted with, you know, the details of this one customer contract that, you know, we think says this and you think says that, let's get to the core of of really where the challenge is because we're together wanting to create something amazing that would be better together than separate, right? And and and so, you know, again, number one, unqualified investment bankers, and then two, getting in touch with and working with the emotions on both sides, frankly, buyers and sellers.

I think that ties right back into the culture piece, too, of the organization cuz you got to manage that, but then you sort of uncover more about how your broader entities are going to work together. That's right. Earlier you said you've seen the other side of when that doesn't work well or where you don't put enough emphasis on it. Tell me about that. I want to know because I haven't done a deal for our company yet and eventually will. Yeah, I want to learn that earlier.

So so so I I I must admit I I really am grateful for both private equity sponsors that I've had. Like they have both been phenomenal, okay? They do what they say they're going to do, they care about people, we're culturally aligned. I spent a lot of time and energy making sure that was the case in you know, both of the sponsors that we've had this for but we've had for Intiva. Um early on in the hold with my first sponsor, there was a um a mid-market managed service provider that was literally less than a mile physically from a big location that we had with lots of mass in the market, etc. etc.

And this was a group that did not share our values, right? They were very sales heavy, their focus was on closing new deals as as often as they could and moving to that. The value of an employee was just based on their billable utilization. So, the people that got celebrated the most were the people that were over 100% utilization and burning out and focusing on, you know, billing multiple customers at once. You know, you can I can keep going, right? So, there were some red flags that I saw that I went, I don't think this is really the Entiva model. And what I heard back was, it's okay. They're right around the corner.

There's lots of synergies. There is lots of opportunity for us to have error here and lose an employee or client or two and it'll still be okay. Just give it a shot, right? And I said, okay, you know, let's give it a shot. Nothing was okay, right? So, not only did we lose employees and clients, but it became the energy focus to try to make it right, to try to make it fit to or to try to fix the problems that were coming from it.

Instead of focusing on the positive momentum of the rest of the organization, all the energy and attention went to stopping the bleeding here and trying to turn this around. So, all the the potential value creation that came from that disappeared very very quickly. And it was again, it was a result it was a mismatch in target customer profile. It was a mismatch in you know, what what they value out of people and and frankly, how they go after customers. That's interesting.

Thanks for being open and honest about that. Um how'd you ultimately like resolve that issue? It was a painful process. Um I mean, it started with trying to salvage things, right? Trying to like if if I'm being I'll continue the authenticity and transparency for you, right? So, at first it was, well, how can we make these customers and these employees happy? So we were like, okay, let's try to change this. Let's try to adjust that. Let's make a division that just focuses on this and and let's let's let's put all of this energy to to stopping the issues. That was not working, right? Like that's like it's like pretending you're something you're not, right? It just doesn't work.

So soon after we pivoted to this concept of like we don't need everybody to like us. We need them to respect us and know who we are and and frankly if they're going to fit, client or employee, they fit into the model we know we will deliver well and we can scale for them and we can create success. So so after about, you know, a year, year and a half of the trying to almost say anything to keep things on the rails, we shifted to we were wrong.

This is what we stand for. This is what we're about. If you're interested in being part of that, we would love to have you. You know, for a client, we're going to we're going to go out of our way to to you know, give us the opportunity to do that. For an employee, if this is not the right fit for you, we'll part ways in a very positive way, but let's not try to keep putting a square peg into a round hole. And that was really hard, right? That was really hard because I spent a lot of money for that, right?

Like a lot of money went out the door and I felt very responsible for protecting it. And you know, in retrospect, obviously don't do the deal, but if you notice what's happening early like that, think about ways to maybe carve it back out. Get it to a different group that would be maybe better support for what they're doing or you know, and we apply this now with every deal that we do, however good of a fit or not. We go in right up front and we say this is who we are, this is what we're about, we're going to nail it for you, but you know, this is how we do things. And it's going to be a little bit different than the way things were done before. And oh by the way, we we do that in a collaborative way understanding that if there are better ways that things are done, we're open to that, but we also have certain values and culture that we just leave with and are non-negotiables.

So if you relive this again in a future deal, I guess when when would be the point in time you'd walk away from the deal? Oh. Going through that similar Oh, I mean that in that specific example, I would walk away from the deal uh early when when frankly I I would have walked away when learning that what was celebrated in the organization was billable utilization, not client satisfaction, not uh you know, technical results, but billable utilization. Like don't get me wrong, I like finances and that stuff's important, but but doing it by burning people like it's very law firm or legacy law firm mentality, right? Like in order to be successful here, you need to bill 4,000 hours a year, but you only work, you know, show up to work 2,500 hours or 2,000 hours. It's okay, figure it out.

Yeah. Yeah. Uh that's that's uh a really good point in in how to look at it that way. And by the way, you know, when I share this, it's not to say Entiva's better, right? We are just different. We have a certain set of values and we need to we need to really own them for what they are. And by the way, when you do that, magic is made. Talking about the other organization that focuses on billable utilization, look, there are business is business models for that. And if you put two organizations together that focus like that and have competitive technical resources that like to one-up each other by how much they can bill and how many things they can complete. Great. You could do that and probably put together an incredible uh an incredibly profitable uh company.

But that's not what we're about. Big emphasis I'm getting is know your culture. Cuz the better you know your culture, the better you can identify whether there's a culture fit. I think that's a a key component. Yeah, and that By the way, that's easier said than done. You know, I don't think I knew our culture till 20 years into the business. That's a fair point. But what it what it gets at is, you know, as we're as we're learning about uh businesses and speaking speaking with business owners, it's less about spending those initial conversations with that or that initial time on understanding the ins and outs and the specific drivers of the P&L. Uh it's really about trying to understand that owner or owners, what is their motivation, what are their interests, what do they seek to to hope to have happen through a possible transaction.

You know, what do they what do they see for outlook for their employees, for their clients, how do they go about delivering service to their clients? Kind of getting a sense of of all the the qualitative aspects of the of the business, see if there really is that alignment with with how we do things here at Entiva. And if there is, then you continue to to march down the path to to learn more and more and dig into the minutia of of the numbers and the like. And but if you recognize early on that there are things that, you know, don't look like they're a lot, that they they line up and don't feel like they they'd ever line up, then it's um you know, thank you very much for your time.

You know, it was you know, wonderfully insightful to to to learn about your business. It's clearly, you know, doing doing well, but you know, for reasons X or Y, don't see it as being the right fit for us here at Tioga. Um, but you know, if you're looking to transact like I'm happy to introduce you to others that you think um, you know, might be might be a great spot for you. How do you source deals?

I know you mentioned Steven's Rolodex earlier, but I can't imagine that being infinitely scalable. Maybe it is. It's a as it's tough. I mean, the the challenge is because it's such a a people-driven business having those connections made and frankly any any warm introduction is worth infinitely more than a cold outreach. And so, what I'm really driving towards and what where I spend a tremendous amount of my time is trying to cultivate warm relationships with individuals through some sort of commonality, whether that's the executive team and their network, whether it's Steven and his network, whether it's vendors of ours and existing within, you know, their community of of clients, whether it's industry events or other sort of thought pieces like webinars and the like to kind of build the community for ourselves so that when I'm reaching out to have a more frank or direct conversation or even just to introduce myself, it's not a blank stare as a as a response and it's also just a way to differentiate ourselves given the volume of inbounds that business owners receive particularly in our space. So, it's it's trying to trying to create that that separation for us so that, you know, when that conversation can happen, it can be A, it's a response to an to an inquiry and B, it can jump start into a fruitful conversation. But, it's really about trying to go down multiple routes at at the same time. And that's not withstanding, you know, the mention of uh bankers, advisors, other market participants that are in this space to help kind of broaden broaden the the outreach. Um it's really trying to pull down on multiple levers simultaneously because this isn't a business where you can go down just a single route only and hope to have the type of sustained success um that you want to have. Yeah. You know, and I'll add to that, right? So So as I mentioned before, the managed service community in general is very closely knit. So while I certainly don't know all of them or even 10% of them because it's so fragmented, the reality is it there's, you know, one or two degrees of separation between everyone, right?

That's That's the reality. So understanding that and really being in an engaged in this community and doing it in a genuine way where we want to help others be more successful by sharing our what what has helped us be successful or frankly sharing the failures to avoid, it's a rising tides lift all boats concept, right? So we believe we do this for the industry, the industry gets stronger in the process of doing it, people learn about who we are, there's brand recognition and name recognition, and that leads to inbound lead generation, right? No different than how we would prospect for a customer that's in need of managed IT services, right?

Create meaningful, useful content, get it out to the audience that you're looking to support, you know, maybe the majority of those people are using it and never call you, but at some point there's going to be a triggering event where their their IT stops working or they need something and and our name is going to be familiar. It's the same thing on the on the M&A side, right? We help provide guidance of, you know, what not to do when doing your first acquisition or what not to do when building a security operations center or what are the best practices to create a 24/7 service desk? How do you create a service um uh how do you create an effective internship program? How do you break through from a $5 million business to a $10 million business?

Um you know, what's it like to start working with an advisory board and how early should you have that exist in your business? How do you you know, how do you apply a good sales and marketing engine? All these little things, right? If we're able to share that openly with our competitors and that is something that they find value. It it creates a relationship. We can obviously ask if there's an interest to join forces at some point, but more often than not, these little seeds that get planted at some point the seller is going to or or the owner of this business is going to want to make a change. Uh they're going to want to maybe focus on on something specific within the organization. They might hit a a growth uh plateau where they feel stuck and they would rather not go the next stage alone, whatever it might be.

And then they'll remember us, we hope, and they'll reach out to us, right? And so it's a lot of seed planting and cultivation. That's really interesting. You're taking a playbook for marketing demand generation and applying it specifically for M&A interest. That's right. I like that in terms of organic approach. A lot of the biz dev that Chris mentioned in terms of doing the outreach, building those relationships. Are the advisors, are you using buy-side M&A advisors or Absolutely. Yeah, absolutely. So we've got we've got advisors that are out there looking for us as well.

You know, we're we're happy with them bringing anything to the table if it's the right fit. You know, we're we're we're pleased to to compensate them for it as well as you know, celebrate them when the deal is closed and tell the world how awesome they are, right? So you know, we we absolutely to to us that's just casting a wider net. But I can tell you you know, to date at least most of the success has come from the the cultivation that I described over those leads. Though those leads have worked too. Well, and then do you find a lot of stuff coming in through auction that you're bidding on or is it more of like a proprietary? Yeah, we definitely see a lot that come in on auction. You know, so there's not one like I mean we're we're one of the the names out there that that get opportunities brought to us because frankly we've shown that we can do these at different sizes and scales and we have the capital to support it. So we do get pulled into many many auctions, but I would say we we probably go forward with less than 10% of what we see on the auctions front.

So let's say we found this proprietary deal you someone we know through conferences and finally we open up the conversation about selling the practice and then you you've gone through the early discussions. Seems like a really good fit. We talked about culture as a red flag, but let's eliminate that. You know, we've we've kind of said hey, culture fit seems pretty good. All right, what are other red flags you're looking for that would be these showstoppers that you you'd want to identify before LOI?

Yeah, you know, I I personally look at and and CBC will have many many others to add here. This is this is where his a lot of his expertise comes in as well. But when I see a company that suddenly in the last year or two has gotten wildly profitable I get concerned, right? Like it's the over preparedness for a sale. It's the removal of extra technical resources, the basically squeezing every last ounce of water out of a rock. Right? Like when I see that in a business Yeah, they're squeezing the margins. Yeah, that that is always concerning for me.

Um so that's certainly a red flag. Uh when I see a lot of customer churn it's a red flag and when I see a lot of employee turnover, it is a red flag. Um so those are those are just a a handful from my side. CB, see what you got. Yeah, I think I think for me, um you know, spending a lot of time speaking with the owner and if the owner or owners, if that individual is not super articulate or doesn't may not necessarily come across as as open and genuine about what he or she wants to do after the transaction. Basically just trying to say exactly what the they hope I want to hear.

Um that can give me a little bit of pause. It's again, it's like is this too good to be true? Uh and taking this separate aside from the cultural elements uh that have you know, hopefully you check the box on. But you know, the reason why that's important for us is that when we get get towards or get close to a letter of intent of putting putting that forth, it's not just about the value and structure of a transaction. It's about a lot of other ancillary attributes um around the business. It's understanding, you know, what that leader or leaders want to do after the transaction. How does that fit in uh with Intiva as a whole? Even being as specific as this is going to be your manager, this is what you're going to get paid. Oh, and these are also your your two or three critical resources that we want to make sure we've got uh you know, homes for uh and and and you know, great great spots in development uh a pathways for them. We want to be able to to talk about all those sorts of things. And if there's ever points where you know, there's a measure of of hesitation or skepticism or or close-guardedness and that comes through and we're just trying to round out the picture and understanding of the business, that can be a a a moment of pause or concern to really try to understand what might be leading uh towards that.

And I think I think the other thing too is that if if you if you get presented one picture of the business, you know, from a financial perspective and you've you know, you've set forth on the on the letter of intent and suddenly all the details come in, you know, the next week and it looks very different uh from what you expected it to be, uh that's a big red flag as well. And wondering, you know, what's your what sort of person uh this individual may might be, uh that's going to be a big cause for for concern as well and likely a red flag to uh to walk away.

These are good ones. We had the over prep. We see EBITDA margins sort of jumping up uh more than they should. You have um customer churn. And then I I think Chris, you're digging into like figuring out what's really meaningful for that owner in this transaction and seeing where there may be hesitation. So, let's say we we get past all of this and we find a deal that's worth putting an LOI together. Can you talk me through how do you structure this? Cuz I I don't know if you're like our business, we're a pretty small company. We like holding on to cash. So, I don't know if you're sort of using other tools to reserve cash or do you like doing all your deals in cash? Do you like earnouts? Are you using bank debt?

I think CVC should answer this more more holistically. But one of the one of the things that I got from my first sponsor that I'll share with you and I I carry forward to today is they valued our equity more than cash. So, in an ideal world we would be paying more cash and having more equity for the shareholders than we would be bringing people in. Now, with that said, we want people to have skin in the game. We want people to have connected be connected to the organization, especially if they're staying and growing with us.

But, really um especially at the time when interest rates were near zero, uh we're a very leverageable company when it comes to debt, right? So, one, you know, knock on every piece of wood around me, uh you know, right now we're we're profitable and and that cash flow allows us to to uh put uh money into investments such as acquisitions. And also, the fact that most of our business, again, knock on every piece of wood imaginable, is recurring revenue that supports that.

It's very um lender-friendly. Uh so, our ability to use leverage in the business to get access to cash and make it so less equity needs to go in is real. And that includes doing uh you know, whether whether we're we're looking to to take a portion of the seller's proceeds as rollover equity into the business. I I think just expanding on that, you know, earlier in our transaction history we were quite creative or felt we were being quite creative by involving not just cash and rollover equity, but also things like earn-outs, different kinds of earn-outs, different mechanisms in there as a as a possible means to manage risk, uh incent the seller, uh try to do a whole host of things. But, what we quickly figured out, particularly because we are an organization that fully integrates the businesses that come on board, um that utilizing a tool like an earnout, while promising in theory, is much more challenging to deal with after the transaction has closed itself.

So, managing it administratively or operationally or curtailing the speed of integration because there are concerns about an adverse impact to earnout achievement, we've come away from utilizing that as a tool in our structure and gone to, you know, a much more simplistic approach where it's uh largely majority upfront cash and a slug of rollover equity. We think that the the rollover equity, because of how we we view the business, how we anticipate we will continue to grow and build uh and expand, we see that there's tremendous value that can be offered to the buyer so long as they, you know, a are are in in with us on the story, but also can help them, you know, meet or even exceed their own um value guidelines if they're if they afford themselves the the a period of time to to elapse. Um you know, if they're comfortable with a certain slug of cash upfront, but then they can see the value appreciation that can come for that rollover equity over, you know, a multi-year period of time, um that's an approach we we would prefer to take cuz we think it just gets everyone on the same page uh in a much more straightforward and easy manner. And it doesn't impinge our ability to proceed rapidly with integration because, frankly, the faster that we can move through integration and get that business part of the Entiva engine, that in and of itself is generating value for that rollover equity in a much more expeditious manner than might otherwise happen if you're dealing with you know, the intricacies of managing to a gross margin based earnout.

So that's kind of how we've evolved our thinking around structure structuring transactions. And I think from a seller's perspective, it's easier to understand just two key two components to be thinking about as opposed to having to understand the nuances and track and manage the particulars of some esoteric earnout 6 months or 12 months or longer post transaction. What's like the ideal structure percentage-wise of how much cash versus how much rollover equity?

Yeah, I mean for for us, we've found success on the upfront cash side, you know, call it 60 to 80% or 60 to 80% cash and the balance being rollover equity. We love for individuals to be committed in for that you know, 20 to 30% rollover equity. We found success with that balance at play and I think that that's that provides enough of a chunk of cash for those buyers to get really excited about while also seeing a meaningful opportunity that can come with a rollover equity in you know, a period of years.

So yeah, that's sort of the the balance that we've come to. But ultimately ultimately we want to you know, work to a a solution or work to a mix that is going to get that that individual excited. So if we need to be a little flexible on those numbers based on their particular needs or desires to more rollover equity or or you know, more upfront cash. Like as As as we can have the open conversation about that and what their desires are around it, let's work together to to figure out something that's going to get you excited as the seller and us excited as the buyer.

I know we're hitting close on time. Uh last two questions. What's your biggest advice for practitioners doing roll-ups for the first time? I guess if I were to sum it up, I would say be intentional, right? Like know what you're looking for and be intentional about what you're trying to create with it. Yeah. The other thing The other thing that I would say is you may feel as though it it it is somewhat similar to a sales practice, a sales engine, the sales pipeline that you need to work through, but there are enough differences between it whether it's the time elapsed, whether it's the the magnitude of the decisions being made, that just being aware that it operates on a different time scale from what you may may initially anticipate, uh and will likely take more time, you'll have a lower conversion rate of outbound interest to, you know, received messages and conversations to what you were expecting. So, just being being able to recognize those differences and being able to commit for a long period of time to see the results come through, that's where you're ultimately going to find success.

It doesn't come easy. What's the craziest thing you've seen in M&A? Well, I guess we'll start and end on culture fit. So, there was this opportunity in um in Fort Wayne, Indiana. So, like like one of our earlier opportunities, we come with uh you know, my whole team and go enter this conference room, really great numbers, MSP, uh like good good consistent results. It's a market that we're really interested in, more than 20% EBITDA.

Uh not necessarily a ton of growth, but a lot of just consistency in the business. So, he's excited about it. And uh I get there, and first we're we're like welcomed by the receptionist, and we're we're about 10 minutes early, and we're ushered into this conference room. And we're told very specifically not to sit at the head of the table, because the head of the table is where the owner is to sit. Like, okay. But, if you look at the room, too, what you'll notice is like all the chairs on the side are about 6 in shorter than the chair at the head of the table.

And to make matters worse, behind the head of the table is like this piece of art that's just like a a lion in almost like attack position. And I remember sitting there and waiting, and and by the way, we're we're it's now like 5 minutes after the appropriate start time, and this person walks in. So, he's 5 minutes late. Sits down in a chair that's 6 in taller than everybody else in the room with a giant lion looking over his head at us.

And at that point, it was just, you know, curiosity questions, but there was a 0% chance that this was a culture fit. So, I would say, from crazy perspective, it was like none of that would have ever been known on paper, right? Like, just just on like the CIM, if you will, that was sent to us ahead of this, looks like a good business. Let's go meet them. Let's go Let's Let's see Let's see what the deal is. But, man, like that was the craziest like like experience that I've had seeing seeing just cultural mismatch, and just frankly the gall of that approach.

Wow. That's interesting. I don't know I don't have anything to add to add on that one. I think my my crazy story is is nowhere nowhere near nowhere near that. So, I like I like sticking with the with Stephen ones there. I I think that's a great one. Uh just uh hey, there's a reason why you want to go there and see it. This has been great, gentlemen. I enjoyed this conversation. You've helped me become a better M&A scientist.

Thank you. Thank you. Done. Hey, those of you still with us, thank you and till next time, here's to the deal.