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Technology, Media & Telecoms

M&A update
Digital agencies Summer 2017

"Digital agencies with multinational customers and key chief marketing officer (CMO) relationships are currently in the spotlight as professional services, media networks and private equity buyers increasingly covet the leading platforms. Demand dynamics are driving valuations higher and we believe that timing is optimal for stakeholders to contemplate strategic options, such as a full or partial monetisation."

Hamish Shah
Partner,
Catalyst Corporate Finance

Global M&A themes

A wave of global digital and traditional agency M&A activity continued during Q1 2017, exceeding the record level of transactions observed during 2016. Around 130 global agency deals were announced versus some 120 deals in Q4 2016. Both periods represented transaction volume growth of over 100 per cent over Q1 2015. Almost 60 per cent of transactions focused on digital agencies. The UK is the fourth-largest global market for agency M&A, behind the US, China and India.

Whilst the 'Big 6' media networks continued to be prolific acquirers of traditional creative, PR and design agencies, much of the increased demand, specifically for digital capabilities, emanated from global professional services providers. Examples include the acquisitions of Karmarama by Accenture, Market Gravity by Deloitte and ecx.io by IBM and investments by LDC in Fishawack, private equity KKR in Hangar Seven and DBAY Advisors in Creston.

Digital versus traditional agencies

Digital agencies deliver services for the creative and technical development of internet-based products. These services range from social/mobile marketing, branding, PR, mobile apps and web/video technology development through to full, multi-platform online campaigns. The business model involves contractual and project-based revenues from the provision of creative and technical services. Advertising agencies utilise traditional 'paid media' (newspapers, television, radio and magazines) and revenue is generated via advertising placement rather than services and content provision.

Traditional media network M&A model

The Big 6 are serial acquirers of both traditional and digital agencies, with some typically acquiring upwards of 25-40 global agencies annually (typical enterprise value range of £10-£50m). Although the strategic rationale can comprise the acquisition of data analytics skills or control positions in key international markets, the main driver is often the pursuit of growth and value creation via multiple arbitrage.

Media networks acquire agencies to create shareholder value in three ways:

- acquire sub-scale targets at low multiples (5.0x-7.0x EBITDA) to create value via the re-rating of the acquired EBITDA up to the trading level of the acquirer (9.0x-11.5x EBITDA)
- extraction of cost synergies to generate incremental EBITDA and therefore shareholder value
- acquisitions of multiple, high growth agencies can be accretive to acquirer EBITDA growth thereby supporting an upward re-rating of the trading multiple of the media network.

Given the financial engineering objectives of the acquisition strategy, the primary imperative for the acquirer is to minimise the acquisition multiple, in addition to often imposing stringent earn-out or deferred consideration structures on selling shareholders.

Media networks focus on minimising entry multiples

"The barrier between tech and marketing strategy continually blurs, and the role of the blue-chip CMO has grown in importance to the Board. Ownership of the CMO relationship has become a priority for consultancies, and this theme is coming through in their M&A. Consultancies and business process outsourcing providers previously sought to integrate acquisitions, leading to culture clashes. Now, digital acquisitions are operated independently, so that brand equity, culture and client relationships are preserved."

Richard Holden
Partner,
Catalyst Corporate Finance

Professional services M&A model

In contrast to the media network model, the professional services model has been more discerning with a focus on digital agencies and skills. Global corporate expenditure on digital marketing is $230bn and growing at 15-20 per cent whilst traditional marketing spend is flat to declining in many key markets. CMOs have been reallocating their budgets towards digital agencies as they acknowledge this represents the most cost efficient, measurable and returns-enhancing marketing strategy.

Traditional consulting and business-process outsourcing revenues have been under pressure as corporates seek to rationalise costs, and because the return on investment on consulting services is not always accurately measurable or recommendations easily implementable.

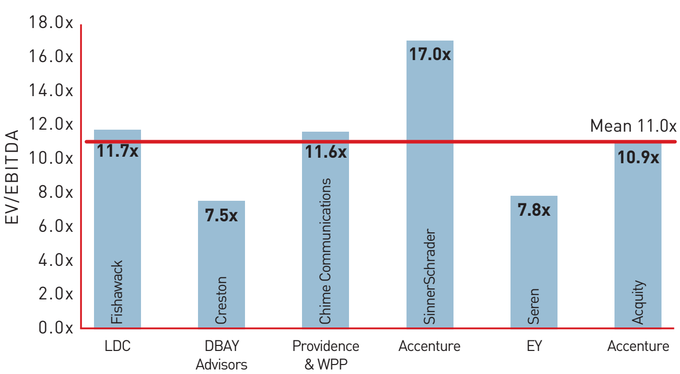
Professional services providers have targeted digital marketing expenditure as a high growth, new consulting revenue stream by encouraging corporates to outsource their marketing operations. Cross-selling into captive clients increases 'share of wallet' and can also protect existing revenues via increased customer entrenchment. However, they have often been unable to adequately nurture the requisite skills, creative culture and CMO relationships organically.

Acquirers typically seek the following attributes:

- leading edge digital agencies with global multi-national customers
- genuine CMO level relationships
- digital revenue mix higher than 50-60 per cent and growing
- digital content curation and social, video and mobile skills
- data analytics and search intelligence capabilities to deliver tangible customer ROI
- ability to retain and incentivise key employees.

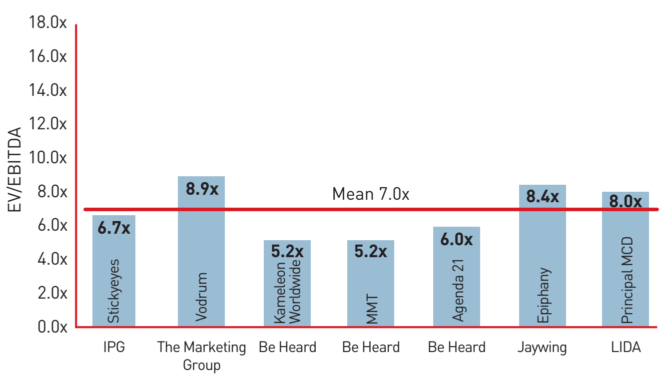
As acquisition rationale is driven by industrial logic and not financial engineering, acquirers do not solely rely on traditional EBITDA multiple methods and instead take a fundamental view of valuation. For the best quality assets, professional services acquirers have internally sponsored and delivered significantly higher valuations than media networks. Deferred consideration structures, when used, tend to be less severe and are more often linked to staff retention and not financial performance. This means there is a higher probability of crystallising any earn-out.

Figure 1: Alternative acquirers



Source: Catalyst Corporate Finance, S&P Capital IQ, Mergermarket

Figure 2: Traditional acquirers



Source: Catalyst Corporate Finance, S&P Capital IQ, Mergermarket

Professional services and PE buyers have justified higher entry multiples

Resurgence of private equity (PE) interest

Private equity interest in building digital agency platforms has also increased in recent years despite business value being contingent upon people, skills and relationships. There are several factors driving this resurgence:

- many PE houses are now priced out of Software-as-a-Service (SaaS) and technology transactions
- the potential to acquire at reasonable entry multiples
- revenue shifting towards recurring and digital, away from project-based and traditional media
- buy and build potential and scalability to drive exit multiple expansion
- multiple exit options: professional services, media networks and IPO.

Figures 1 and 2 compare M&A multiples for traditional media network acquisitions versus alternative PE and professional services deals. Although the charts are representative of a small percentage of deals, where metrics were disclosed, the analysis suggests that media networks pay materially lower multiples. However, this does not take into account that professional services and PE tend to acquire (higher value) market leaders only.

Figures 3 and 4 highlight that since 2013, Accenture and Deloitte have been the most acquisitive professional services acquirers while Dentsu and WPP have been the most acquisitive media networks, in the last twelve months.

Summary

Analysis of the M&A environment suggests that timing is currently optimal for owners of agencies who are seeking to monetise shareholder value in the near-to-medium term.

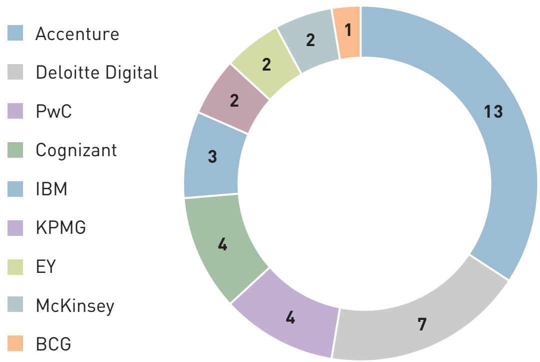
Agencies with leadership positions, CMO relationships and data analytics skills tend to elicit greater buy-side traction.

There are currently heightened levels of competitive tension in agency sell-side transactions, with multi-vertical and PE demand expanding exit multiples towards highly attractive levels.

"The shift in advertising spend to digital platforms has allowed for more accurate targeting and analysis of media initiatives. As the efficiency of corporate marketing functions comes under increasing scrutiny and budgets begin to tighten, agencies that allow corporate marketers to measure ROI through advanced analytics platforms are increasingly of interest to both international agencies and consulting firms."

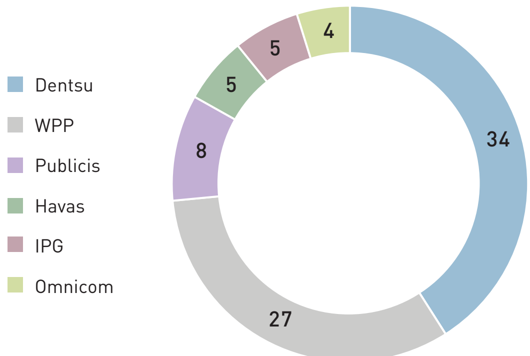
Jamie Dickson
Senior TMT Analyst,
Catalyst Corporate Finance

Figure 3: Professional services acquisitions since 2013



Source: Catalyst Corporate Finance, S&P Capital IQ, Mergermarket

Figure 4: Acquisitions by the 'Big 6' in the last 12 months



Source: Catalyst Corporate Finance, S&P Capital IQ, Mergermarket

Notable UK transactions

Date	UK targets	Target description	Acquirer	Country	Deal value (£m)	EV/ EBITDA
Jul-17	Aquila Insight	Data analytics	Merkle	US	n/d	n/d
Jul-17	Intermarketing	Full service creative agency	Advantage Smollan	UK	n/d	n/d
May-17	Switch Design Consultancy	Design, brand and digital communications solutions	Pure Consultancy	UK	n/d	n/d
Mar-17	Legend Engage	Social media marketing and insights agency	Four Communications	UK	n/d	n/d
Feb-17	Space Creative	Design, digital and marketing services	Wrapped Agency	UK	n/d	n/d
Jan-17	Marketing Source	Data and digital marketing	Equiniti	UK	n/d	n/d
Dec-16	Code Computerlove	Digital marketing and communications agency	MediaCom Worldwide	US	n/d	n/d
Dec-16	Kameleon Worldwide	Content marketing agency	Be Heard	UK	4.8	9.0x
Nov-16	Karmarama	Full service advertising agency	Accenture	Ireland	n/d	n/d
Nov-16	Creston	Marketing solutions	RedWhiteBlue Champion	Isle of Man	72.0	7.5x
Oct-16	Target Media & Communications	Lifestyle and media business	Havas	France	n/d	n/d
Sep-16	4Ps Marketing	Search marketing services	NetBooster	France	n/d	n/d
Sep-16	Summit Media	Online marketing services	TCC Global	Netherlands	n/d	n/d
Sep-16	Stickyeyes	Digital marketing services	IPG	US	16.9	10.6x
Sep-16	Bloom Media	Digital agency	Jaywing	UK	8.2	n/d
Aug-16	Rippleffect Studio	Full-service digital agency	IDOX	UK	2.1	n/d
Jun-16	The BIO Agency	Provides digital agency services	Tech Mahindra	India	22.0	6.9x
May-16	We Are London	Customer experience and service design consultancy	Globant	Luxembourg	n/d	n/d
Apr-16	Twogether Creative	Creative agency	Next Fifteen Communications	UK	7.2	n/d
Feb-16	Creator-Mail	Digital agency	Inspired Thinking Group	UK	n/d	n/d
Jan-16	Seven Publishing Group	Digital content marketing agency	KircherBurkhardt	Germany	n/d	n/d

Source: S&P Capital IQ

Recent digital agency credentials

itg — Growth capital investment by Bridgepoint

Traffic4u — Sale to IPG MB

dq&a. — Merger with incuBeta

Seven — Sale to C3 Creative Code and Content / Hubert Burda Media

Contact us

If you would like to discuss this report in more detail or the opportunities for your business, please email Hamish Shah at hamishshah@catalystcf.co.uk or call +44 (0) 20 7246 0500.

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