

## Ari Santiago and CompassMSP\*

Realizing full value in a programmatic acquisition strategy depends on quality due diligence and a thoughtful approach to post-deal integration

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Ari Santiago looked out his office window onto the street below. For most of the year, this was a quiet section of West Hartford, Connecticut, but today was different. A marching band passed by, playing a rousing, patriotic tune. In response, the crowd of onlookers shouted and cheered. Santiago watched the sea of red, white, and blue that ebbed and flowed to the rhythm of the parade. The mood that afternoon was festive, befitting the Fourth of July in the summer of 2021.

After a few minutes of taking it all in, Santiago turned his attention back to the work he wanted to finish up before a much-needed break. It had been a particularly hectic time for him as the chief executive officer of CompassMSP, a managed services provider that helped small and mid-sized businesses optimize their information technology (IT). The night before had marked the end of a sprint to close his first acquisition since taking the top job at CompassMSP six months earlier. The target was FTO Solutions, a managed services provider in nearby Stamford, Connecticut, and its CEO and founder, Nidhi Krishnamurthy had signed on the dotted line just before midnight.

But the truth was that striking the deal was merely the end of the beginning. Successful execution of CompassMSP's programmatic acquisition strategy required Santiago to do more than just assemble a collection of managed services providers. He had to integrate each firm he purchased into a cohesive whole. If he did not, the company would end up a loose federation of assets that would not be worth more than the sum of its parts.

Santiago was determined to prevent this from happening, and the FTO Solutions deal provided him the opportunity to prove he could. Through proprietary deal sourcing and rigorous due diligence, he had purchased a company that was about as perfect a target as he could hope to find. FTO Solutions bolstered CompassMSP's position in the northeastern United States and expanded its book of business in the non-bank financial services industry vertical. In addition, the firm was what Santiago referred to as a "fixer-upper." It had a solid foundation of customer relationships and strong service-delivery capabilities, but there remained room for improvement. Revenue had plateaued in recent years, and the cost structure was suboptimal.

By leveraging the pieces he already had in place and executing carefully designed integration plans, Santiago thought he could create significant financial value. He had created a financial model to underwrite his three-pillar approach. First, he would retain the seller, Nidhi Krishnamurthy, to run FTO Solutions as a subsidiary of Compass MSP. Second, he would implement a new sales playbook to increase monthly recurring revenue. And third, he would focus on optimizing the cost structure to lift overall profitability.

Of course, there were risks to this strategy, as with any, but Santiago felt that programmatic acquisition could work beautifully in the managed services industry. Despite this conviction, as

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\* Some names and financial information have been fictionalized for pedagogical purposes.

well as the experience of completing a few deals at his previous firm, he worried about successfully executing his first acquisition as the CEO of CompassMSP. He absolutely wanted to get this one right for his new investment partners. They had placed great trust in him and expected that he would deliver an internal rate of return on their equity north of 30 percent.

The stakes were high, and although he believed in his three-pillar approach, he knew that the outcome would hinge upon the soundness of his pre-deal due diligence and the quality of his post-deal integration—the unglamorous parts of the acquisition game. Santiago was particularly concerned about the financial model assumptions he had made in underwriting the transaction and what could be achieved during the integration phase. Even being slightly wrong could make a seemingly appealing acquisition a poor choice. To reaffirm his confidence before heading out the door to enjoy the holiday weekend, he opened his Excel spreadsheet and reviewed once again his investment case for acquiring FTO Solutions.

## **Managed Services**

By the early 2020s, information technology (IT) was an indispensable part of business. Virtually every firm, regardless of industry or geography, depended on at least some form of IT to enable their daily operations. However, despite the criticality of IT, many firms concluded that managing on their own all the hardware and software needed to operate was not a productive use of their time and resources. By outsourcing the management of their IT to a third-party vendor, firms could focus on their core competencies, the processes, systems, and knowhow that differentiated them from rivals in the marketplace. But competitive dynamics were not the only factor motivating companies to outsource IT management to what had come to be known as managed services providers. The rapid pace of technological change and the increasing complexity of enterprise technology made the burden of IT management greater with each passing year. Most firms simply could not keep up with it all on their own, and so the decision to outsource became easier to make, even for companies that had long preferred managing all their IT in house.

Because of these dynamics, in the early 2020s, the managed services industry was very big business. According to market research firm IDC, worldwide spending on IT outsourcing services approached \$100 billion a year.<sup>3</sup> The United States represented the largest geographic market, accounting for \$34 billion in annual spending, or more than one-third of the global total.<sup>4</sup> Besides being very large, the managed services industry was mature. By the early 2020s, businesses and governments around the world had been outsourcing to vendors the management of various parts of their IT infrastructure for decades. As a result, industry growth was modest, especially in developed markets such as the United States. IDC forecasted that, in the United States, growth in IT outsourcing spending would average approximately 0.5 percent per year through the middle of the decade.<sup>5</sup> But if the long history of IT sourcing meant that incremental revenue opportunities were harder to come by, it also reflected that the industry had become deeply entrenched in the daily operations of the organizations it served. In many cases, private- and public-sector clients relied so heavily on managed services providers that they simply could not function without them.

Somewhat surprisingly, however, the maturity of the managed services industry did not translate to dominance by a handful of large vendors. In fact, the 10 largest firms<sup>6</sup> in the U.S. market commanded less than half of total industry revenues.<sup>7</sup> Outside the top 10, the market was extremely fragmented. One estimate pegged the total number of managed services providers in the U.S. at nearly 70,000.<sup>8</sup> The vast majority of the firms in this long tail of the market served small and mid-sized businesses (SMBs), a segment that the industry giants had for the most part abandoned. Instead, they focused their energies on serving large clients, such as U.S.-based multinational corporations and the federal government, each of which could generate millions, if not tens or even hundreds of millions, of dollars in annual revenues.

## **Programmatic Acquisition**

Although the industry giants were not interested in consolidating the SMB segment, others were. There was an opportunity for more modestly sized firms to address market fragmentation by engaging in programmatic acquisition. And over the course of the 2010s and into the early 2020s, a number of managed services providers in the SMB segment embarked on the programmatic acquisition journey. Many of them had backing from lower-middle-market private equity firms, meaning they had access to the financing needed to capitalize on the industry-consolidation opportunity. Underpinning that opportunity were various features of the industry that made it amenable to a programmatic acquisition strategy. Those attributes did not guarantee successful execution, of course, and they were offset, at least in part, but by features that presented meaningful risks to would-be consolidators.

### *Favorable Characteristics*

The SMB segment of the managed services industry had six characteristics that made it an attractive context for programmatic acquisition. First, industry fragmentation meant there was no shortage of acquisition candidates. With tens of thousands of small firms competing for a slice of the market, the industry had plenty of room for many programmatic acquirers and offered each one of them considerable runway for pursuing a roll-up strategy. In the early 2020s, even after nearly a decade of meaningful programmatic acquisition activity in the space, the opportunity remained large.

Second, the industry had reasonably attractive growth dynamics. Although the days of high growth in the managed services industry had long since passed, there was a long-term, secular driver of demand: the ever-increasing complexity of information technology. This force was arguably the strongest in the SMB segment of the market, where firms generally lacked the resources needed to keep up with all the challenges posed by the proliferation of mobile devices, the rise of cloud computing, and the emergence of more, and more sophisticated, cybersecurity threats. Year after year, small and mid-sized businesses felt the burden of managing a complete IT stack become heavier and heavier. Most needed help, and that was where managed services providers came in. As a result, vendors focusing on the SMB segment could count on consistent, albeit modest, long-term growth in customer needs and spending on managed services. The ever-increasing complexity of information technology also made it hard for small and mid-sized businesses to reduce managed services spending during economic downturns. Spending proved quite resilient, even during the unprecedented economic collapse brought on by the COVID-19 pandemic. In sum, managed services providers enjoyed decent upside and limited downside to their revenues.

Third, recurring revenues accounted for 75 to 80 percent of industry sales and provided a solid foundation for industry cash flows.<sup>9</sup> In the typical arrangement, a customer signed a multi-year contract that required it to pay the vendor a fixed monthly fee for each “seat,” or employee of the customer, that was covered by the agreement and therefore would be supported by the managed services provider. For the most part, contracts in the industry were “take or pay,” meaning that a customer had to pay the vendor even if the customer did not make full use of the services provided. For example, if a customer signed a contract for 100 seats but ended up having employees to fill only 95 of those seats, the customer still had to pay for all 100. This assumed, of course, that the vendor provided services of sufficient quality, meaning that they met standards set in the service-level agreement. Ultimately, the typical structure of contracts in the industry meant that a competent vendor had a high degree of visibility into future revenues and cash flows. This predictability, all else being equal, allowed programmatic acquirers to borrow more money at more attractive rates, which, in turn, fueled a greater volume of acquisition activity and a faster rate of growth.

Fourth, if a managed services provider could win a customer’s business, it tended to enjoy meaningful benefits of incumbency. From the customer’s perspective, switching vendors was not a trivial undertaking. Setting aside the contractual issues outlined above, changing service providers involved a decent amount of effort on the customer’s part. And taking on the additional work required to effect a transition was inherently inconsistent with the primary reason why the typical customer decided to outsource the

management of its IT to a vendor in the first place. The typical customer wanted to focus on running its business, not dealing with the hassle and complexity of IT management, but replacing one vendor with another meant shouldering more of this burden, at least during the transition. There also was the risk of disruption to the business. The cost of a mismanaged transition from one vendor to another was high, especially for SMBs, which generally did not have the financial resources or internal technology staff to handle on their own any problems that might arise. As a result, most customers tended to be risk averse and took an “If it ain’t broke, don’t fix it” approach to retaining their incumbent managed services provider. Even though these characteristics should make customers relatively price insensitive, they are in fact somewhat price sensitive due to SMB customers having limited financial resources, and the option of using one of many service providers (even if switching was a laborious process). In addition, we discuss two important features under less favorable characteristics that limit gains from potential price increases.

Fifth, the managed services industry had low capital intensity. The typical managed services provider had a very small physical footprint and owned few “hard” assets. It did not have to build factories or buy expensive machines for production and transportation. Nor did it have to tie up sizable amounts of cash by investing in inventories. Instead, managed services was a “people business.” A firm generated revenues by renting the time and expertise of the IT professionals on its payroll. With some staff, leased office space, and a modest amount of low-cost technology equipment (e.g., PCs and smartphones), a managed services provider could set up shop and keep the business running. And ultimately, the low level of capital investment involved translated to more financial resources available for a programmatic-acquiring managed services provider to fund acquisitions, service its debt, and pay dividends to its owners.

Sixth, there existed in the industry a significant opportunity to create economic value through multiple arbitrage. Larger assets commanded higher valuation multiples for a dollar of EBITDA<sup>†</sup> than smaller assets did. This meant that a programmatic acquirer could purchase small managed services providers and enjoy the benefits of having the whole be worth more than the sum of its parts. In the early 2020s, the valuation gap between assets of various sizes was wide. A small managed services provider, which typically generated \$3–\$5 million in annual revenue and \$350–\$750 thousand in annual EBITDA, merited a valuation multiple of 4–6 times EBITDA. However, a large one, which brought in more than \$10 million in annual revenue and at least \$1.5–\$2 million in annual EBITDA, enjoyed a valuation multiple of 12–15 times EBITDA. The financial implications of this valuation differential were striking. As an example, as separate entities, three small managed services providers might be worth a total of \$7.5 million (3 firms times \$500 thousand of EBITDA per firm times an EBITDA multiple of 5). However, if combined into a single large managed services provider, the same assets might be valued at roughly \$20 million (3 firms times \$500 thousand of EBITDA per firm times an EBITDA multiple of 13.5).<sup>10</sup> Part of the multiple expansion was due to the belief that buyers could pay a premium multiple for a platform asset and then average down the multiple through incremental acquisitions made at significantly lower multiples.

#### *Less Favorable Characteristics*

Although the managed services industry had a number of attractive attributes, it also had four features that made it somewhat challenging as a context for pursuing a programmatic acquisition strategy. First, as a “people” business, the industry was very labor intensive. To a large degree, revenue growth occurred alongside headcount growth. The fairly tight linkage between revenue and headcount meant that managed services providers generally found it challenging to increase their gross margins beyond the low 40s. The best they could do was optimize the cost of service delivery in order to achieve modest improvements in gross margins. Large players in the industry overcame the labor intensity problem by offshoring a significant amount of work to low-cost geographies, most notably India. However, for the most part, this option was not available to managed services providers that catered to the needs of SMBs. SMBs generally

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<sup>†</sup> Earnings before interest, taxes, depreciation, and amortization

wanted to do business with a vendor that could, if needed, send an IT professional out to work at its offices or facilities. Geographic proximity to the customer was not compatible with offshore service delivery, so managed services providers that focused on the SMB segment of the market had no choice but to hire local, and in the process, give up the possibility of increasing gross margins through labor/wage arbitrage. At the same time, managed services providers in the SMB space did not have the resources to invest heavily in automation capabilities, so they could not count on significant improvements in labor productivity to drive the expansion of gross margins, either.

Second, throughout the 2010s and into the early 2020s, the IT industry experienced considerable wage inflation. In an increasingly digital world, the demand for technology workers had never been higher. Unfortunately, in the U.S., supply had not kept up with demand, so the competition for talented IT professionals was intense. Competition had driven wage increases year after year, and the upward pressure on labor costs in the technology space showed no signs of abating in the early 2020s. This labor-market reality posed a meaningful risk to a programmatic-acquiring managed services provider. Rolling up a series of labor-intensive firms at a time when wages were rising was not a recipe for growing the profit margins of the acquired assets. Gains from any price increases put in place are extracted by skilled tech workers who wield considerable bargaining power. And when one considered that the typical programmatic acquirer used sizable amounts of debt to fund its transactions, the possibility that rising labor costs would cause profit margins to actually shrink made an aggressive, inorganic strategy all the riskier.

Third, as alluded to above, managed services providers could expect to enjoy, at best, only modest pricing power. On the demand side of the SMB segment of the industry, customers generally had limited financial resources and, as a result, were highly price sensitive. On the supply side, there was no shortage of vendors for customers to select. This was because barriers to entry in the managed services industry were extremely low. It is not much of an exaggeration to say that a reasonably skilled IT professional could hang out a shingle, hire a few local technology workers, and, in relatively short order, be on his or her way as an owner-operator of a viable managed services provider in the SMB segment of the market. In essence, gains from any efforts to raise prices among relatively price insensitive customers might be transitory because of the potential that it attracts new entrants who will offer lower prices.

Fourth, and finally, programmatic acquisition was not new in the managed services space. A wave of consolidation began in the early 2010s and then accelerated towards the end of the decade and into the next one. Many of the programmatic acquirers that emerged in the SMB segment of the market during this time had the backing of lower-middle-market private equity firms, which had been drawn to the industry by the six favorable characteristics outlined above. With a growing number of private equity investors in the game, the competition for attractive targets intensified. The primary consequence of this competition was upward pressure on valuation multiples. A surplus of buyers made the SMB segment of the managed services industry a classic “seller’s market,” and buyers who wanted to gain a foothold in the space bid up the prices of assets. Rising prices compressed the size-based valuation gap between smaller managed services providers and larger ones. As a result, market dynamics eroded some, but certainly not all, of the opportunity for a programmatic acquirer to drive financial returns through multiple arbitrage.

## **Ari Santiago**

In the early 2020s, success in the increasingly competitive managed services space was not easy to achieve. Doing so required strategic vision and disciplined execution, to be sure. But for a firm to enjoy sustained prosperity, it needed a leader with great ambition, boundless energy, and incredible perseverance. If anyone embodied all three of those characteristics, it was Ari Santiago, the chief executive officer of CompassMSP, a West Hartford, Connecticut-based managed services provider.



Growing up in Connecticut the 1980s, Ari Santiago had been an athlete. He played sports all four seasons, and he had dreams of one day playing second base for the Boston Red Sox. However, his life took a dramatic turn shortly before his 14th birthday, in the winter of 1991. On a family ski trip to Vermont, Santiago suffered a serious injury, and it left him paralyzed from the waist down. No longer able to play his beloved sports in the wake of this tragedy, Santiago searched for another activity to fill his time and give his life purpose. He found it when a family friend gave him his first computer. Working with the computer provided Santiago with an outlet and propelled him in an entrepreneurial direction. About a year later, as a fifteen-year-old high school student, he launched his first business, which built and repaired computers for friends and family.

When Santiago headed off to college at Tufts University in the fall of 1995, he planned to follow in his father's footsteps and become a lawyer. However, once on campus, he began to realize that his future lay in technology, not law. At Tufts, Santiago established a reputation as the resident computer whiz, the person whom other students turned to whenever they needed help with their computers, even in the middle of the night. He also launched another technology business, a store that sold and serviced cell phones and pagers. This venture helped him develop his skills as a salesperson and taught him in the ins and outs of the emerging field of mobile devices.

In 1998, emboldened by these college experiences, Santiago decided to strike out on his own. He left Tufts without earning a degree and returned home to Hartford, Connecticut. There, he took a job at an environmental engineering consulting firm as the head of its IT department. Santiago enjoyed working at the firm, but in early 2002, he heard the call of entrepreneurship once again. He launched IT Direct, a managed services firm focused on helping SMBs, defined as those with between 25 and 500 employees, with their technology needs. IT Direct was initially a side hustle for Santiago, but by the spring, it had become his full-time job.

Over the next two decades, Santiago grew IT Direct from a one-man shop operating out of his apartment to a 70-employee company serving 130 customers. In 2020, annual revenues exceeded \$13 million and yielded \$1.8 million of annual EBITDA (**Exhibit 1**). To reach this scale, IT Direct had focused on serving customers in the northeastern United States and in the manufacturing vertical, which accounted for 90% and 70% of revenues, respectively (**Exhibit 2**).

Underpinning the company's success was a broad set of service offerings, including help desk support, backup/disaster recovery, data center services, software implementation, and technology consulting. But what truly differentiated IT Direct's go-to-market approach from its competitors was the packaging of those services into two easy-to-understand solutions. The first was AutoPilot. AutoPilot was the choice of customers who wanted IT Direct to manage all their technology needs end to end, from strategy and planning to operations and support. The second was CoPilot. Narrower in scope than AutoPilot, CoPilot was supplementary to a customer's IT department. Under this arrangement, IT Direct provided basic levels of help desk services, additional resources to support ad hoc technology projects, and expert advice on protecting against cybersecurity threats and maintaining regulatory compliance.

### CompassMSP

IT Direct's success attracted a lot of attention across the industry. CompassMSP, a Florida-based managed services provider that had been executing a programmatic acquisition strategy, was especially intrigued. It viewed IT Direct as a compelling acquisition target, one that would simultaneously grow its presence in the northeastern United States and strengthen its position in the manufacturing vertical (**Exhibit 2**). If a deal were consummated, IT Direct would be CompassMSP's eleventh acquisition since embarking on its programmatic acquisition journey in 2016.

In December 2020, CompassMSP agreed to purchase IT Direct. The combined company employed about 220 people, brought in nearly \$45 million in annual revenue, and generated approximately \$7 million in annual EBITDA (**Exhibit 1**). As part of the deal, the company would move its headquarters from Florida to Connecticut and Santiago would be the CEO. Newly installed as the head of a firm three times larger than the one he had been previously running, Santiago had a clear mandate: continue to drive CompassMSP's growth and profitability through programmatic acquisition. This straightforward directive was not as simple as it seemed, however, and Santiago knew it. He understood that articulating the strategy in the boardroom and executing it successfully in reality were two very different things. The former was easy, the latter was not, and it had three necessary, but not sufficient, conditions: careful due diligence, disciplined asset selection, and methodical post-deal integration. None of these was a trivial matter in its own right, but if Santiago could somehow achieve this trifecta, he would dramatically tilt the odds of a successful outcome in his favor. At the very least, he had to give it his best shot. Not only did he feel a strong sense of obligation to CompassMSP's investors, but they also expected him to deliver the goods, to generate high internal rates of returns on the equity capital they provided.

## FTO Solutions

Shortly after assuming the CEO position in January 2021, Santiago began to build a pipeline of potential acquisition candidates. Some of the targets carried over from a database that CompassMSP's deal team had assembled over the previous four-and-a-half years. Others were from Santiago's own network of contacts within the managed services industry. Santiago had established at least some level of connection with virtually all the CEOs of sizable managed services providers in the northeastern United States. However, given his roots in West Hartford, he had the strongest relationships with the CEOs of managed services providers based in Connecticut.

Santiago searched for targets that met the five criteria he set in collaboration with CompassMSP's board of directors and major investors:

- *Appropriate Size:* Acquisition candidates could not be too big or too small. Firms at the sweet spot generated \$3 to \$5 million in annual revenue and \$400 to \$700 thousand in annual EBITDA, or were roughly one-tenth the size of CompassMSP.
- *Geographic Fit:* Qualified targets would deepen the company's presence in one of its existing geographies: Northeast (Southern New England and New York City), Mid-Atlantic (New Jersey, Pennsylvania, and Maryland), Southeast (Miami, Tampa, and Jacksonville, Florida), or Midwest (Greater Chicago).
- *Industry Focus:* Viable candidates also would enhance CompassMSP's standing in one of its four industry verticals (Legal, Manufacturing, Non-Bank Financials, and Healthcare). The company had built strong service offerings for these verticals, and it believed these end markets presented plenty of opportunity for profitable growth.
- *Pricing and Packaging:* CompassMSP sought targets that looked a lot like it did. The best were those that offered similar packages of bundled services and charged comparable prices for them.
- *Asset Quality:* CompassMSP trained its sights on what Santiago referred to as "fixer-uppers." These were firms that had an attractive customer base and provided high-quality services, but, for one reason or another, had not realized their full potential in terms of revenue growth and profitability. They had some problems, to be sure, but those problems were solvable. As a result, fixer-uppers offered a skillful operator meaningful upside with limited downside.

By the spring, Santiago had narrowed his search down to Stamford, Connecticut–based FTO Solutions. FTO Solutions was a good match in terms of size, geography, and industry vertical. It generated \$4.4 million in annual revenue, nearly all of it from small and mid-sized hedge funds, registered investment advisors, and private equity firms headquartered in either Manhattan or Fairfield County, Connecticut. In addition, the company’s service offerings and pricing strategy closely resembled CompassMSP’s in the non-bank financials vertical.

As for asset quality, FTO Solutions seemed to be a textbook example of a fixer-upper. On the one hand, the company enjoyed strong relationships with its customers because its founder, Nidhi Krishnamurthy, was committed to delivering the best service possible and had a long track record of doing so. On the other hand, revenue per employee and revenue per customer were about 10 percent lower than what CompassMSP achieved (**Exhibit 3**). In addition, only 65 percent of FTO Solutions’ revenue was recurring, versus 74 percent at CompassMSP, on account of Krishnamurthy’s willingness to take on more project-based work for customers (**Exhibit 3**). These revenue dynamics resulted in suboptimal levels of profitability for FTO Solutions. It earned lower gross margins and enjoyed less leverage on operating expenses than CompassMSP did (**Exhibit 3**). There also seemed to be room to improve sales productivity and streamline the company’s overhead.

FTO Solutions seemed to check every box as an acquisition target. It was now up to Santiago to negotiate a deal. Lucky for CompassMSP, he had known Krishnamurthy for more than a decade, and they each had considerable respect, both professionally and personally, for the other. Santiago had last spoken with Krishnamurthy in January, shortly after assuming the CEO role at CompassMSP. They had briefly discussed CompassMSP’s programmatic acquisition strategy, but there was no talk of a potential tie-up involving the two companies. What’s more, Santiago did not get a sense from the conversation that Krishnamurthy was interested in selling anytime soon. Nevertheless, as winter gave way to spring, he broached the subject of a possible transaction.

Informal discussions began in late March and continued throughout April. By early May, Krishnamurthy had warmed to the idea of selling FTO Solutions. She knew that managed services providers of the same size as hers had recently traded at mid-single-digit multiples of EBITDA. This meant that, as sole owner of a business that generated \$576,000 in EBITDA, she stood to receive somewhere between \$2.5 and \$3 million of pre-tax proceeds.

### The Future of Nidhi Krishnamurthy

The potential remuneration was appealing, to be sure, but Krishnamurthy looked beyond the deal and into her future. She understood that, after deducting taxes, sale proceeds would amount to considerably less than \$2.5 to \$3 million. The payday would not be large enough to set her up for life. She was only 48 years old, and, as far as she knew, in perfect health. She also had become accustomed to maintaining for her family a lifestyle of comfortable affluence, which would not be sustainable without a meaningful stream of income. Then there was the issue of paying for her children’s education. Krishnamurthy’s two teenagers currently attended a private high school, and in just a few short years, they would be heading off to college, not to mention the possibility of graduate school after that.

Given all these financial demands, Krishnamurthy realized she could not afford to retire now. She would need to work for quite a bit longer, so the question was what came next for her professionally. She had worked for herself since founding FTO Solutions in 2006, and although she wanted to continue to do so, the prospect of starting a new venture now that she had reached middle age was daunting. As a result, she decided that if she ended up selling FTO Solutions, going to work for someone else was the best option at this point in her career. The most straightforward next step would be to join CompassMSP following a transaction, and it seemed reasonable to assume that the company would benefit from her continued



involvement during the integration process and beyond. Krishnamurthy knew FTO Solutions' business better than anyone else, had built strong relationships with customers, and deeply understood their expectations of a managed services provider. Perhaps, she thought, she could convince Santiago to let her run FTO Solutions as a subsidiary of CompassMSP or even serve as the general manager for the combined company's entire non-bank financials vertical in the Northeast region.

Besides these considerations, Krishnamurthy believed that staying on would give her the opportunity to further scale the business she had founded. FTO Solutions had been a fixture in her life for the last 15 years, and during that time, it had become a critical component of her self-image. She took great pride in having built FTO Solutions from zero to a company with \$4.4 million in annual revenue. At the same time, however, she felt some amount of disappointment. Despite her impressive accomplishments as an entrepreneur, she had become increasingly frustrated over the last few years. FTO Solutions' annual revenues had plateaued, and no matter what she tried, she seemed unable to take her firm to the next level on her own. Maybe, with the resources of a larger company behind her, she could finally achieve the breakthrough she had long sought and drive growth for FTO Solutions once again.

For his part, Santiago had mixed feelings about retaining Krishnamurthy. On the one hand, he respected Krishnamurthy's track record in the managed services space. He also appreciated that Krishnamurthy had considerably more knowledge and experience in the non-bank financials vertical than anyone at CompassMSP. On the other hand, he worried about how Krishnamurthy might respond to being an employee after working for herself for a long time. Having built a company from the ground up himself, Santiago understood the psychology of an entrepreneur. They wanted autonomy and demanded control. They expected to make all the important decisions and to have things done their way. And they had become accustomed to being the heart and soul of the organization. But the experience of an employee was fundamentally different. They were one among many and answered to the boss. The transition from leader to employee was not easy, and Santiago knew of many individuals who could not make it. In fact, that had been the result in most cases along CompassMSP's programmatic acquisition journey before Santiago had arrived at the company. In light of this history, he wondered whether Krishnamurthy would enjoy, or at least accept, the role of an employee, and whether she would achieve a good cultural fit within the organization. If she did not, Santiago would find himself facing the very real possibilities that she would either depart prematurely, before successful integration could be achieved, or attempt to carve out a personal fiefdom for herself and thereby permanently ensconce herself in the business.

In exploring a possible purchase of FTO Solutions, he decided that the best approach was to set Krishnamurthy's expectations appropriately and then gauge her level of interest. As discussions progressed, Santiago became more comfortable with the idea of giving Krishnamurthy a chance. At a minimum, he wanted Krishnamurthy to stay on for at least a year to help with the integration, and he planned to give her a greater stake in the outcome by requiring rollover equity as part of the financing for any transaction.

## Looking Under the Hood

In mid-May, Santiago and Krishnamurthy signed a letter of intent. Formal due diligence began. Guiding the process was a five-part framework that CompassMSP had developed from lessons learned in ten previous acquisitions. Leveraging this institutional knowledge and experience, Santiago set about evaluating FTO Solutions along five dimensions (**Exhibit 5**):

- culture,
- strategy and service offerings,
- clients and market focus,
- financial metrics, and
- ease of integration.

Santiago and CompassMSP's deal team performed a comprehensive assessment. To assess cultural fit and alignment of values, they talked with FTO Solutions employees at every level of the organization. They then sat down with Krishnamurthy and the company's other executives to discuss strategic direction and priorities. To gain a deep understanding of FTO Solutions' service offerings, Santiago and his team studied the day-to-day operations. They also reviewed, with the help of outside counsel, the contracts that governed the firm's 47 customer relationships. FTO Solutions' book of business followed the Pareto Principle, with roughly 20 percent of the contracts accounting for 80 percent of revenues. As a result, although CompassMSP and its lawyers analyzed each contract, they spent the lion's share of their time on the largest contracts, as measured by revenue. Fortunately, these agreements had terms that were fairly standard across the industry. A few had terms that were suboptimal, but they were not necessarily red flags, for there was nothing egregious and these contracts could be either renegotiated or not renewed at expiration anyway. While time-consuming and expensive, this detailed contract review was worth it, for the findings went a long way to increasing Santiago's confidence about, and comfort level with, what CompassMSP would be getting itself into if it acquired FTO Solutions.

To get an external perspective on the company and assess the quality of its services, CompassMSP's deal team interviewed FTO Solutions' largest customers. The feedback was very positive. For the most part, high levels of customer satisfaction were a good thing, but detailed analysis of the company's financials revealed that they were not always so good. In some instances, FTO Solutions was sacrificing its financial performance to go above and beyond customer expectations. When this situation occurred, the company delivered extra services that it did not charge for, incurred more expenses than it should have by exceeding contractual requirements by a large margin, or both. In the final analysis, Santiago did not believe these issues were prevalent enough to derail a deal. If anything, they provided opportunities for CompassMSP to realize value, for the problems were solvable. CompassMSP had seen them before at other companies it had acquired and, in response, had developed an integration playbook that could address them.

Having looked under the hood of FTO Solutions, Santiago decided to move ahead with an acquisition. He and Krishnamurthy struck a deal on the eve of the 2021 Fourth of July holiday weekend. Under the terms of the purchase agreement, CompassMSP agreed to pay \$2.9 million, or 5 times EBITDA, for FTO Solutions (**Exhibit 6**). Santiago financed 64 percent of the purchase price with debt, 16 percent with equity, and the remaining 20 percent with rollover equity for Krishnamurthy (**Exhibit 6**). The combined company had \$49.3 million in revenue, \$7.4 million in EBITDA, 244 employees, and 482 customers (**Exhibit 3**).

## **Post-Acquisition Integration**

Months before deciding to buy FTO Solutions, Santiago had already begun planning for the possibility of post-acquisition integration. That work paid off, because when the time came to sign on the dotted line, it gave him the confidence to do it.

FTO Solutions was Santiago's first acquisition since becoming CEO of CompassMSP. It was particularly important that this first deal succeed, so, in laying the groundwork to integrate the acquired asset, he drew upon the playbook that the company had developed over five years of executing a programmatic acquisition strategy.

The initial work involved addressing all the mundane details of running a business. These included rebadging employees, transitioning them to a new payroll system, and getting them signed up for a new health insurance plan. Running in parallel were efforts to establish clear roles and responsibilities for new employees, incorporate FTO Solutions into CompassMSP's management reporting structure, and consolidate the financials of the two companies.

Santiago also paid special attention to the emotional needs of the people who joined CompassMSP from FTO Solutions. He had been in their shoes earlier in the year when he sold IT Direct, so he understood the importance of making them feel welcome, explaining the company's culture and values, and setting appropriate expectations for how the integration would unfold. Not only were these steps the right things to do, but they also helped manage potential employee departures. Attrition could cause service disruptions for customers, a risk that Santiago took very seriously. He had to maintain high service levels during the integration, for he knew that customers would understandably worry about what the change in ownership would mean for them. At the same time, the period following an acquisition provided rival vendors with a golden opportunity to sow fear, uncertainty, and doubt among the customer base, and if they were successful, they could take business away from the acquired asset. Therefore, in addition to talking with employees from FTO Solutions, Santiago set up meetings with the firm's largest customers. During these conversations, he described his integration strategy, promised to minimize the impact of service delivery, and asked them to contact him directly if any significant problems arose.

One of the critical decisions that Santiago faced was whether to retain Nidhi Krishnamurthy and if so, for how long. At a minimum, Santiago wanted Krishnamurthy to help with the integration, and that was one of the reasons why he had structured the FTO Solutions to include rollover equity for her. Santiago also believed that Krishnamurthy was a talented leader in the managed services space and that CompassMSP could benefit from her skills and expertise in delivering services to non-bank financials in the northeastern United States, which had become much bigger business for CompassMSP as a result of the acquisition. However, part of Santiago was worried about how Krishnamurthy would respond to being an employee after spending 15 years as a CEO. The role change was non-trivial, and not everyone could make it. If CompassMSP's prior experience was any guide, the most likely outcome was that Krishnamurthy would either depart on her own or have to be exited within a year of the deal closing. Despite this reservation, Santiago ultimately opted to let Krishnamurthy run FTO Solutions as a subsidiary of CompassMSP. This helped get Krishnamurthy to "yes" on the acquisition, but Santiago genuinely thought that no one was in a better position to serve as general manager of the non-bank financials vertical within the northeast region than she was, at least for the foreseeable future. After talking at length with Krishnamurthy about what a spot for her in the combined company would look like, Santiago felt optimistic about her ability to work out as an employee.

Successful integration also meant confronting head-on any problems that came with the acquired business. In the case of FTO Solutions, there were two main issues that Santiago had to address. First, revenues had plateaued in recent years. During the due diligence stage, Santiago had concluded that the root cause was a suboptimal sales model. Once FTO Solutions had signed a customer, its focus turned almost entirely to service delivery. That approach had benefits in terms of maintaining high levels of service and customer satisfaction, to be sure, but it often resulted in missed opportunities to increase revenue through up-selling. Rather than constantly looking for new ways to broaden the scope of a customer relationship, as CompassMSP did, FTO Solutions had been reticent to, in some sense, always be selling. And in the situations where a customer relationship actually did expand over time, it was often achieved by FTO Solutions taking on more project-based work or selling extra units of commodity hardware such as servers and networking equipment. These revenue sources were not only relatively low margin, but they were also episodic, or lumpy, in nature, so they were worth less than the recurring cash flows brought in by managed services arrangements. To realize full value from the acquisition, Santiago knew that FTO Solutions' sales efforts had to change, and he planned to incentivize salespeople to do more up-selling and sign more managed services business.

The second area of improvement was FTO Solutions' cost structure. At the level of individual customer relationships, Santiago's analysis of the company's revenue per employee suggested that, relative to CompassMSP and other players in the managed services industry, FTO Solutions had been overstaffing its service delivery. Coupled with a lower mix of more profitable managed services revenues, overstaffing

compressed the company's gross margins. Operating expenses also seemed high. This was partly because FTO Solutions did not generate high enough levels of revenue per employee and revenue per customer to achieve operating leverage. But sales productivity was not the only culprit. FTO Solutions made marketing investments in wining and dining the well-heeled clients it served, and these expenditures had increased meaningfully during the same period that revenues had plateaued. In addition, overhead costs were excessive. FTO Solutions had more administrative staff than it needed, and besides its headquarters in Stamford, it maintained a sizable office in a desirable building in midtown Manhattan. Clearly, Santiago reasoned, there were expenses that could be cut without impacting service levels for customers.

To organize his thoughts and estimate the financial impact of the three pillars of his integration strategy (retaining the seller, implementing a new sales playbook, optimizing the cost structure), Santiago built a financial model that allowed him to toggle what due diligence had revealed to be among the most important value drivers for FTO Solutions (**Exhibits 7 and 8**). He believed that even with very conservative assumptions around post-acquisition customer churn, CompassMSP could restart FTO Solutions' revenue growth and increase its profit margins. Santiago projected in his base case scenario that over five years successful integration would result in \$1.2 million of new revenue and more than \$200,000 dollars in incremental EBITDA. And he believed that in an upside scenario, revenues and profits could increase substantially more. Regardless of which scenario he modeled in his spreadsheet, however, whatever Santiago achieved in reality would determine the financial returns he would generate for CompassMSP's investors (**Exhibit 9**).

## Conclusion

It was nearly 5 p.m. on the Fourth of July, and the parade was winding down. The crowds had thinned considerably as parade-goers turned their attention to backyard barbecues and a night filled with the colorful explosions of fireworks. Ari Santiago still sat in his office, silently studying the financial model for the FTO Solutions acquisition. Suddenly the phone rang, and he reached to pick it up. His wife was on the other end of the line, wanting to know when he'd be coming home to enjoy the holiday with their family. He assured her that he had been on his way out the door when she called. Satisfied, she wished him a safe drive, and he said he would be home before she knew it. They hung up. Santiago looked at his spreadsheet one last time as he gathered his things. He was more than ready for a break after all the hard work to close the FTO Solutions deal. He then left his office and closed the door behind him. As he headed down the hallway towards the elevator, his mind lingered on the transaction. Were his integration assumptions reasonable and achievable or was he setting himself up for failure as the new CEO of a much larger organization? Santiago was making a big bet on Krishnamurthy, FTO Solutions, and himself—and he needed to be right.

Exhibit 1: Financial and Operating Snapshot of IT Direct and CompassMSP

	IT Direct	CompassMSP	Combined Firm
<b>P&amp;L</b>			
Revenue	\$13,050,000	\$31,800,000	\$44,850,000
Cost of Sales	-\$7,856,100	-\$19,016,400	-\$26,872,500
Gross Profit	\$5,193,900	\$12,783,600	\$17,977,500
Marketing	-\$1,931,400	-\$4,547,400	-\$6,478,800
SG&A	-\$1,422,450	-\$3,275,400	-\$4,697,850
EBITDA	\$1,840,050	\$4,960,800	\$6,800,850
<b>% Margins</b>			
Cost of Sales	60.2%	59.8%	59.9%
Gross Profit	39.8%	40.2%	40.1%
Marketing	14.8%	14.3%	14.4%
SG&A	10.9%	10.3%	10.5%
EBITDA	14.1%	15.6%	15.2%
<b>Key Metrics</b>			
# of Employees	70	150	220
Revenue Per Employee	\$186,429	\$212,000	\$203,864
# of Customers	130	305	435
Revenue Per Customer	\$100,385	\$104,262	\$103,103
Recurring Revenue	\$9,396,000	\$23,850,000	\$33,246,000
% of Revenue That's Recurring	72%	75%	74%

Source: CompassMSP data modified by the case authors



**Exhibit 2: Revenue Mix Analysis for IT Direct and CompassMSP**

	IT Direct	CompassMSP	Combined Firm
<b>Geographic Revenue Mix</b>			
<i>Northeast</i>	90%	5%	30%
<i>Mid-Atlantic</i>	10%	15%	14%
<i>Southeast</i>	0%	60%	43%
<i>Midwest</i>	0%	20%	14%
All Geographies	100%	100%	100%
<b>Vertical Revenue Mix</b>			
<i>Legal</i>	10%	35%	28%
<i>Manufacturing</i>	70%	15%	31%
<i>Non-Bank Financials</i>	15%	20%	19%
<i>Healthcare</i>	5%	30%	23%
All Verticals	100%	100%	100%

Source: CompassMSP data modified by the case authors

Exhibit 3: Financial and Operating Snapshot of FTO Solutions and CompassMSP

	FTO Solutions	CompassMSP	Combined Firm
<b>P&amp;L</b>			
Revenue	\$4,400,000	\$44,850,000	\$49,250,000
Cost of Sales	-\$2,666,400	-\$26,872,500	-\$29,538,900
Gross Profit	\$1,733,600	\$17,977,500	\$19,711,100
Marketing	-\$646,800	-\$6,478,800	-\$7,125,600
SG&A	-\$510,400	-\$4,697,850	-\$5,208,250
EBITDA	\$576,400	\$6,800,850	\$7,377,250
<b>% Margins</b>			
Cost of Sales	60.6%	59.9%	60.0%
Gross Profit	39.4%	40.1%	40.0%
Marketing	14.7%	14.4%	14.5%
SG&A	11.6%	10.5%	10.6%
EBITDA	13.1%	15.2%	15.0%
<b>Key Metrics</b>			
# of Employees	24	220	244
Revenue Per Employee	\$183,333	\$203,864	\$201,844
# of Customers	47	435	482
Revenue Per Customer	\$93,617	\$103,103	\$102,178
Recurring Revenue	\$2,860,000	\$33,246,000	\$36,106,000
% of Revenue That's Recurring	65%	74%	73%

Source: CompassMSP data modified by the case authors

**Exhibit 4: Revenue Mix Analysis for FTO Solutions and CompassMSP**

	FTO Solutions	CompassMSP	Combined Firm
<b>Geographic Revenue Mix</b>			
<i>Northeast</i>	100%	30%	36%
<i>Mid-Atlantic</i>	0%	14%	12%
<i>Southeast</i>	0%	43%	39%
<i>Midwest</i>	0%	14%	13%
All Geographies	100%	100%	100%
<b>Vertical Revenue Mix</b>			
<i>Legal</i>	5%	35%	32%
<i>Manufacturing</i>	0%	15%	14%
<i>Non-Bank Financials</i>	95%	20%	27%
<i>Healthcare</i>	0%	30%	27%
All Verticals	100%	100%	100%

Source: CompassMSP data modified by the case authors

**Exhibit 5: CompassMSP's Due Diligence Framework**

**Culture**

Values are aligned with Compass

**Strategy / Services**

Do they sell professional services / product only to managed services clients?

How closely does their product match Compass Autopilot?

How do they price their services - a la carte or bundled?

At what level do they price their base product relative to our Autopilot?

Do they have a private cloud?

Do they have any unique service capabilities?

**Clients / Market**

Are the competitive dynamics in the market attractive?

Does target customer size overlap with Compass 25-300 users?

Do they have any vertical strategy or any overlap with Compass verticals?

Do they have any customer concentration?

Are clients generally growing?

Do they have a pipeline of organic growth opportunities?

**Financial Metrics**

MRR per client

AISP

Opportunity for cost synergies?

Opportunity for revenue synergies?

Any need for one-time capital expenditures at close?

Ongoing capital expenditure needs?

**Ease of Integration**

People

Processes / Systems

Source: CompassMSP

**Exhibit 6: Summary of the FTO Solutions Acquisition (\$000s)**

<b>FTO Solutions Acquisition (\$000s)</b>	
<b>Consideration</b>	
EBITDA	\$576
EV/EBITDA Multiple	5.0x
<b>Purchase Price</b>	<b>\$2,882</b>
Revenue	\$4,400
EV/Revenue Multiple	0.66x
<b>Funding</b>	
<i>Debt</i>	\$1,844
<i>Equity</i>	\$461
CompassMSP Funding	\$2,306
Rollover Equity	\$576
<b>Total Funding</b>	<b>\$2,882</b>
<b>% Funding Mix</b>	
<i>Debt</i>	64%
<i>Equity</i>	16%
CompassMSP Funding	80%
Rollover Equity	20%
<b>Total</b>	<b>100%</b>
Debt as % of Compass MSP Funding	80%
CompassMSP as % of Total Equity	44%

Source: CompassMSP data modified by the case authors



**Exhibit 7: Financial Model for the FTO Solutions Acquisition**

Year	Pre-Close	Post-Close	1	2	3	4	5
<b>Revenue Build</b>							
Number of Customers	47.0	45.0	46.0	47.0	48.0	49.0	50.0
Change		-2.0	1.0	1.0	1.0	1.0	1.0
% Change		-4%	2%	2%	2%	2%	2%
<b>Monthly Revenue Per Customer (\$000s)</b>							
Recurring	\$5	\$5	\$5	\$6	\$6	\$6	\$6
Project	\$3	\$3	\$3	\$3	\$3	\$3	\$3
Total	\$8	\$8	\$8	\$8	\$9	\$9	\$9
<b>Monthly Revenue Per Customer (% YoY Change)</b>							
Recurring			5.0%	5.0%	5.0%	5.0%	5.0%
Project			1.0%	1.0%	1.0%	1.0%	1.0%
Total			3.6%	3.6%	3.7%	3.7%	3.7%
<b>Abbreviated P&amp;L (\$000s)</b>							
Recurring Revenue	\$2,860	\$2,738	\$2,939	\$3,153	\$3,381	\$3,624	\$3,883
Project Revenue	\$1,540	\$1,474	\$1,522	\$1,571	\$1,620	\$1,671	\$1,722
Total Revenue	\$4,400	\$4,213	\$4,461	\$4,724	\$5,002	\$5,295	\$5,605
Cost of Services	-\$2,666	-\$2,666	-\$2,797	-\$2,933	-\$3,076	-\$3,224	-\$3,379
Gross Profit	\$1,734	\$1,546	\$1,664	\$1,791	\$1,926	\$2,071	\$2,226
Marketing	-\$647	-\$647	-\$681	-\$716	-\$753	-\$792	-\$833
SG&A	-\$510	-\$510	-\$529	-\$549	-\$568	-\$589	-\$609
EBITDA	\$576	\$389	\$455	\$526	\$605	\$690	\$784
<b>% Margins</b>							
Cost of Services	60.6%	-63.3%	62.7%	62.1%	61.5%	60.9%	60.3%
Gross Profit	39.4%	36.7%	37.3%	37.9%	38.5%	39.1%	39.7%
Marketing	14.7%	15.4%	15.3%	15.2%	15.1%	15.0%	14.9%
SG&A	11.6%	12.1%	11.9%	11.6%	11.4%	11.1%	10.9%
EBITDA	13.1%	9.2%	10.2%	11.1%	12.1%	13.0%	14.0%
<b>% Growth</b>							
Recurring Revenue		-4.3%	7.3%	7.3%	7.2%	7.2%	7.1%
Project Revenue		-4.3%	3.2%	3.2%	3.1%	3.1%	3.1%
Total Revenue		-4.3%	5.9%	5.9%	5.9%	5.9%	5.9%
Cost of Services		0.0%	4.9%	4.9%	4.9%	4.8%	4.8%
Gross Profit		-10.8%	7.6%	7.6%	7.6%	7.5%	7.5%
Marketing		0.0%	5.2%	5.2%	5.2%	5.2%	5.1%
SG&A		0.0%	3.7%	3.7%	3.6%	3.5%	3.5%
EBITDA		-32.5%	16.8%	15.8%	14.9%	14.2%	13.6%

Source: Case authors' analysis, CompassMSP data modified by case authors

**Exhibit 8: Key Drivers of the FTO Solutions Financial Model**

Initial Customer Churn %	5%	Beginning Gross Margin (%)	39.4%
# of Customers Churned After Deal Close	2.0	YoY Increase in Gross Margin (ppts)	0.60 ppts
# of New Customers Added Per Year	1.0	Beginning Marketing Margin (%)	14.7%
MRR Upsell - % YoY Change	3.0%	YoY Improvement in Marketing Margin (ppts)	0.10 ppts
MRR Price Escalator - % YoY Change	2.0%	Beginning SG&A Margin (%)	11.6%
Project Revenue - % YoY Change	1.0%	YoY Improvement in SG&A Margin (ppts)	0.25 ppts

Source: Case authors' analysis, CompassMSP data modified by case authors

**Exhibit 9: Equity Valuation Model for FTO Solutions**

Valuation Analysis (\$000s, except where noted)							
<b>Assumption Key:</b>							
Purchase Multiple		5.0x		% FCF Before Interest Conversion Factor		75.0%	
Starting Gross Debt		\$1,844		Interest %		10.0%	
Equity Rollover		\$576		Capex % Margin		3.0%	
CompassMSP Equity Contribution		\$461		Minimum Cash Balance		\$0	
CompassMSP % Share of FTO Solutions Equity		44.4%		Exit Multiple		10.0x	
Year	Pre-Close	Post-Close	1	2	3	4	5
Revenue	\$4,400	\$4,213	\$4,461	\$4,724	\$5,002	\$5,295	\$5,605
EBITDA	\$576	\$389	\$455	\$526	\$605	\$690	\$784
Free Cash Flow Before Interest			\$341	\$395	\$453	\$518	\$588
BOP Gross Debt	\$0	\$1,844	\$1,844	\$1,844	\$1,844	\$1,844	\$1,844
Debt Increase/(Decrease)	\$1,844	\$0	\$0	\$0	\$0	\$0	\$0
<b>EOP Gross Debt</b>	<b>\$1,844</b>	<b>\$1,844</b>	<b>\$1,844</b>	<b>\$1,844</b>	<b>\$1,844</b>	<b>\$1,844</b>	<b>\$1,844</b>
BOP Cash	\$0	\$0	\$0	\$25	\$104	\$248	\$469
Cash Inflow from Debt Issuance	\$1,844	\$0	\$0	\$0	\$0	\$0	\$0
Cash Inflow from CompassMSP Equity	\$461	\$0	\$0	\$0	\$0	\$0	\$0
Cash Inflow from Equity Rollover	\$576	\$0	\$0	\$0	\$0	\$0	\$0
Cash Outflow for Acquisition	-\$2,882	\$0	\$0	\$0	\$0	\$0	\$0
Free Cash Flow Before Interest			\$341	\$395	\$453	\$518	\$588
Less Capex			-\$134	-\$142	-\$150	-\$159	-\$168
Less Interest			-\$182	-\$174	-\$160	-\$138	-\$106
<b>EOP Cash</b>	<b>\$0</b>	<b>\$0</b>	<b>\$25</b>	<b>\$104</b>	<b>\$248</b>	<b>\$469</b>	<b>\$783</b>
BOP Net Debt/(Cash)	\$0	\$1,844	\$1,844	\$1,819	\$1,741	\$1,597	\$1,375
EOP Net Debt/(Cash)	\$1,844	\$1,844	\$1,819	\$1,741	\$1,597	\$1,375	\$1,062
<b>EV/EBITDA Multiple</b>	<b>5.0x</b>	<b>7.4x</b>					<b>10.0x</b>
Enterprise Value	\$2,882	\$2,882					\$7,840
Less EOP Net Debt	-\$1,844	-\$1,844					-\$1,062
Total Equity	\$1,038	\$1,038					\$6,778
Less Rollover Equity	-\$576	-\$576					-\$3,766
<b>CompassMSP Equity Value</b>	<b>\$461</b>	<b>\$461</b>					<b>\$3,013</b>
IRR at 5 Years	46%						
Year 5 MOIC	6.5x						

Source: Case authors' analysis, CompassMSP data modified by case authors

This case has been developed for pedagogical purposes. The case is not intended to furnish primary data, serve as an endorsement of the organization in question, or illustrate either effective or ineffective management techniques or strategies.

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## Endnotes

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<sup>2</sup> A. J. Wasserstein is the Eugene F. Williams, Jr. Lecturer in the Practice of Management at Yale School of Management.

<sup>3</sup> David Tapper, “Worldwide and U.S. IT Outsourcing Services Forecast, 2022-2026,” International Data Corporation (IDC), Report #US47708022, May 2022.

<sup>4</sup> Ibid.

<sup>5</sup> Ibid.

<sup>6</sup> Among the largest players in the industry were legacy IT services providers (e.g., IBM/Kyndryl and DXC Technology), Indian offshore vendors (e.g., Wipro and Tata Consultancy Services), and defense contractors (e.g., Northrop Grumman and General Dynamics).

<sup>7</sup> David Tapper, “Worldwide and U.S. IT Outsourcing Services Market Shares, 2020: Top 10 Worldwide and U.S. IT Outsourcers,” International Data Corporation (IDC), Report #US46370321, July 2021.

<sup>8</sup> “CompassMSP Company Update,” CompassMSP, November 12, 2020: 9.

<sup>9</sup> In the SMB segment of the managed services industry, 75 to 80 percent of total revenues were recurring. The remainder came from project-based work and hardware sales. Customers tended to spend more on project-based work during good economic times and less during bad ones. Hardware sales commanded very low margins.

<sup>10</sup> Based on conversations with CompassMSP executives.