INTRODUCTION
Todd: Hello, and welcome to another episode of BDO’s Private Equity PErspctives Podcast. I’m Todd Kinney, National Relationship Director in BDO’s Private Equity practice based here in New York City. I’m really thrilled to welcome two guests to talk about their playbook for success and the latest trends in PE. First up, I’d like to welcome Jeff Volling, who’s a Principal and Investment Officer with Bessemer Investors. It’s great to have you here today, Jeff.

Jeff: Thanks, Todd.

Todd: Next, I’d like to introduce Sam Levy, a Director at Equiteq.

Sam: Thanks, Todd. Very glad to be here.

INTRODUCTORY QUESTIONS
Todd: Great to have you here. Let’s jump into things. We’ll get it kicked off. Jeff, I’m going to start with you, Bessemer Investors’ platform, and the broader organization structure are a bit unique. Maybe you could tell our listeners a little bit about your firm?

Jeff: Thanks, Todd. I appreciate you having me on today, and I will be glad to tell you a little bit about our platform. You mentioned it, but Bessemer Investors is a bit unique in that we’re backed by one investor, which is the investment vehicle, the Phipps family. The Phipps family wealth goes back to Henry Phipps who was a business partner of Andrew
Todd: Got it. Well, I appreciate that background. Sam, turning to you—can you tell our listeners a bit about Equiteq’s focus?

Sam: Yes. So, we’re about 60 professionals globally. We focus on the knowledge economy. That is, B2B, asset light companies—mostly services, software, and data. We’re also a little bit different in that we offer strategic advisory, transaction preparation, and M&A services. Myself, I’ve been with Equiteq for a bit more than a year. During 15 years of M&A experience, I’ve worked in primarily on sell-side M&A with a focus on IT services, financial services and security. So, that’s overall fintech, cyber and related services.

DEALMAKING STRATEGIES

Todd: Great, thanks. Certainly sounds like you both have a wealth of experience to bring to the conversation today. Selfishly, I’ve always liked to have a PE professional and an investment banker on to talk about both sides of the market and keep each other in check a little bit. So, let’s dig in here. Jeff, I’ll start with you and then Sam can weigh in. Maybe you can describe a little bit about how you’re working to get deals done during the pandemic and highlight some of the nuances between your approach.

Jeff: Sure, we’re certainly living in interesting times and it has impacted pretty much every industry I think and ours is no different. As I mentioned earlier, our firm has some unique differences from traditional private equity and we think those are important in any market conditions but even more important in the current environment. For us, we’re really trying to emphasize and take advantage of our flexibility and ability to take a very long-term view on the current situation. In particular, what that means is looking at things like minimizing or even forgoing the use of leverage at the time of the initial investment and looking to potentially recapitalize things when they’re more stable, taking a very long-term view on the earnings history and future potential of businesses that we look at and really try to understand and properly value the potential for a rebound on the other side of the current disruption. We’ll also look at minority transaction structures that would enable sellers to retain more equity for a potential sale at a later date. Also, I mentioned that we don’t take fees and we think that’s really important in this environment so that any cash that’s either invested or generated from operations can be used for the benefit of all shareholders. So, we really try to emphasize our points of differentiation and how can they be applied in this market. We also, finally, I’ll just say, really try to focus on sectors where we have past experience or a particular focus recently so that when we’re evaluating a situation, we can really move with speed and certainty, which we think are just absolutely paramount in this environment.

Todd: Sure, makes a lot of sense. Sam, what are your thoughts?

Sam: I think first, our industry moved to be more and more remote over the years through technology. But there are different needs for the pandemic. There have been some aspects of dealmaking that have definitely changed. For us, that starts with sourcing. I think we have signed four or five new mandates during the pandemic and three of these have been without ever meeting the team on the other side of the client—which is very unique. Through dealmaking, there have been some wrinkles and mostly time extension during the process, where we have to be more hands-on and keeping the lines of communications open between buyers and potential buyers and sellers, in my case. But definitely for closing, what we see throughout is there needs to be one physical interaction, even if it’s limited to a long coffee or a lunch, or a management presentation that is needed. Obviously, the last aspect is internal and how to manage the communications within the firm but also sometimes with the client where meeting is not sitting down together, that is not an option anymore. But that’s come a long way and we’ve already progressed towards that before the pandemic to make things go faster.
VALUATION & FINANCIAL MODELING

Todd: All right. Certainly, that seems like some solid strategies across both of your firms. So, thanks for that input. Sam, this one to you. In terms of the valuation and financial modeling background that you bring to the table, I'm curious how Equiteq is explaining the current economic situation to clients, and when really a recovery may happen?

Sam: So, the environment has recovered rapidly at least in the B2B space generally, much faster than I can say anyone would have expected to do back in March or April. So, that's a little bit behind us. Deals are happening and as I mentioned, the velocity of some deals was affected or had been affected. There were a good two months where things were going much slower. And I would say we're back to some level of normality now. That being said, I think we're still far from a full recovery like what we had late last year, in January or February. But I would say, I'll be a little mindful here—if I knew when the full recovery will be, I probably would not be here.

COFFEE BREAK WITH BDO’S DOUG HART

Todd: We always like to throw out some crystal ball questions. So, we'll let you go on that. But some very useful intel there, Sam—thanks. I think our audience is certainly going to find that content pretty valuable as they're trying to figure things out for themselves and their firms. Next, I'd like to turn it over to our Coffee Break guest, Doug Hart. Doug is a Co-Leader of BDO's Technology practice, and he is based in our San Francisco office. Let's hear what Doug has to say.

Doug Hart: Hi, this is Doug Hart. I'm co-leader of the National Technology industry here at BDO. Today, I'd like to cover some trends that we're seeing in the intersection of technology and private equity.

First of all, to set the stage, the latest deal numbers in the tech space, despite COVID, are really strong. For VCs globally across verticals and stages, more than 1,000 companies receive funding and raised a total of $7.5 billion in August 2020, up from $4.4 billion in the same time last year according to PitchBook. On the PE side, the investor appetite for tech buyout funds is really strong. According to Preqin, tech-focused PE funds have attracted more than $30 billion in fundraising through July 2020, and that includes large funds such as $10 billion for Francisco Partners, shift by large non-tech funds such as Carlyle, KKR, Warburg Pincus into tech spending. But that doesn't even include the $21 billion raised, that Thoma Bravo is in the midst of presently. So, again, I think it's going to be a possibly record year in terms of tech funding for PE funds.

The distressed deals that PE is seeing in other industries are not really quite as relevant for technology. You do have some tech companies that are selling into distressed industries. For instance, you might sell software to restaurants or health clubs, or if you're selling possibly hardware or capital equipment, you're seeing some disruption of your supply chains. Also, some companies are moving away from large capital expenditures. So, you are having some subsectors in tech being impacted. But generally, businesses, when they're looking to cut spending, it's in travel, hiring, events, marketing, entertainment, CapEx, but technology generally is we're not seeing is on that list for cuts or reductions. In fact, in many cases, we're seeing companies increasing their technology spend. So, I think that's part of the reason for the strength of tech sector in deals.

The tech sector is still getting deals done during COVID. For certain industry sectors, we've seen deal flow slow because PE professionals and companies and targets are lacking comfort with remote due diligence in assessing management teams and assessing fit. But tech-focused private equity investors have traditionally been comfortable with remote deals for years since they are tech-savvy, and frankly, they're utilizing the technology of the companies they invest in, oftentimes. Also, finally, there is downside protection for tech companies because their largest cost is payroll. So, if they hit some COVID headwinds, they're pretty nimble at reducing cost to maintain EBITDA. Those are some factors that's keeping the tech pipeline of deals strong.

So, where are there opportunities in tech? Tech, again, has been more resilient to the pandemic, but it's not one-size-fits-all within tech. So, what types of deals are getting done? First of all, what we are seeing is financing terms or spreads are wider than pre-COVID. So, it's a little bit of stretch there. But the tech industry is not a one-size-fits-all. There's a lot of subsectors—software, SaaS, hardware, internet, social media, telecommunication, and semiconductors.

Among those sectors, where are we seeing the most opportunities available? First thing is subscription models. Again, that can be software/SaaS or it can be a combined hardware software, or it can be internet or social media. Basically, we're seeing increasingly that software companies and even some hardware software companies are focused on building their annual recurring revenue streams, and we're actually seeing renewal rates for subscriptions. They're generally not being impacted unless you're selling into an incredibly distressed sector. In fact, some are seeing that maybe renewal rates for solutions and technology subscriptions are actually up because basically, rather than a big CapEx investment for customers, you've got a smaller buy. What we're seeing also is in a pandemic, when you're looking to reduce costs, this is a smaller monthly cost.
Secondly, what we’re seeing is company CIOs are using COVID to accelerate their cloud transformation, so the adoption of things like security network and capacity application monitoring—all these things in the deep, dark bowels of kind of keeping your remote workforce efficient—we’re actually seeing an increase in spending there.

So, what are the main takeaways? First of all, the pace of tech deals hasn’t slowed and largely valuations haven’t been significantly impacted. Look for business models that are either currently subscription-based or can be shifted to subscription-based models. So, that is it for today. Now, back over to you, Todd.

Todd: Thanks, Doug. Now, let’s return to our conversation with Sam Levy and Jeff Volling.

CRITERIA & AREAS OF FOCUS

Todd: Jeff, at Bessemer, you invest across a wide range of situations and structures. I’d ask you, what type of investment criteria do you look at and what’s your general approach to sector focus?

Jeff: Thanks, Todd. It’s a great question and I mentioned earlier that especially in this environment, we’re really trying to stick to areas we know and have a view on. In broad brush strokes, we focus on investments across the industrial business services and consumer sectors but those are incredibly broad sectors. So, we’re perpetually trying to refine our thinking around them and identify particular subsectors that are most relevant for us based on our past experience, our extended network of industry resource, and just what’s going on in the world generally. So, it’s probably too much in this conversation to get into all of our subsectors of interest in detail. We do try to keep our website updated with them, so that’s worth checking out. But I will give you just a quick example of the sector that we think is representative of where we’re focused, what we like and how we try to leverage our experience. Flow control is a sector that we really like because a lot of the businesses in that sector tend to exhibit characteristics that we look for. For example, highly engineered products that are relatively low-cost component but critical to the performance of high-value systems and often have stable demand from after-market parts and service revenue streams. Last year, we invested in a company in that space called Leonard Valve, which manufactures a highly engineered valve that regulates the mixing of hot and cold water in commercial and industrial settings. Leonard exhibited a lot of what we look for in industrial products and flow control. But one interesting aspect of the investment was that Leonard’s products, particularly their newest generation of electronic valves, have some features that play a really interesting role in ensuring water purity and driving energy efficiency. As a result of that, we’re building on our experience there to develop a broader thesis across related industrial service categories like HVAC, plumbing, and refrigeration where those same themes are highly relevant. So, that’s just one quick example of how we try to leverage our experience and the themes that we’re focused on to develop sectors, really subsectors, of priority and focus.

Todd: Got it. Thanks, Jeff. Always good to plug your website along the way. Good job.

Jeff: Can’t miss the opportunity.

Todd: Yes. Sam, in terms of taking on new engagements, the question is, how has the pandemic impacted your approach to the business in doing deals in general?

Sam: So, I mentioned a little bit before how we’ve successfully taken on new engagements. If anything, I would say that we’re a little bit more careful in taking those new engagements. We’ve been, I would say, lucky and more active than any time I can remember. The moral is, we cannot afford to take a company to market that will not transact, in general, but especially now. We are probing a little bit. We have time to probe our prospects a little bit further, doing more diligence ahead of taking a new engagement. And look, we’re definitely concerned about a potential second wave, second lockdown, second slowdown, both personally and for the team’s morale and for our clients and we don’t want to end up having more difficulties down the road. The question is not whether business will be there, I think it will be there—the first wave has proven that. But I think a lot of people have a two-layered bracket lead on how to adapt. And now a lot of those firms, at least in the B2B space, have adapted and have transformed accordingly. That prepares us a little bit better if there is a second wave.

KNOWLEDGE ECONOMY SECTOR OUTLOOK

Todd: Got it. Good insight there, Sam. We’re going to shift gears again, but Sam, I’m going to stay with you on this one. So, I see your investment banking career has largely been focused on B2B tech and services. Maybe you could share with our listeners, your thoughts around some of the tailwinds the pandemic is creating for the knowledge economy and also, some areas where you’re finding the most opportunities in this environment.

Sam: Yeah, I would start by not ignoring that there have been some casualties in our space. If I think of sales performance improvement, training, HR-focused services, those have been very much impacted. However, I can say that the space has not behaved as badly as envisioned. I think Gartner is looking at a 5-6 percent increase for the full year in activity. Don’t quote me on these numbers, but that’s for 2020, and actually thinking of 5-6 percent positive before 2021. So, it’s been quite good and going
forward, definitely a good amount of tailwinds. I’m spending some of my time in the security space. It was a space that actually didn’t need any help for growth. If anything, the pandemic has accentuated the need for secure solutions and it’s mostly to the fact that people are more careful about privacy but also the perimeter around the enterprise that has expanded and needs to be secure as well.

Beyond that, we’re really just making sure we’re prepared for some additional volatility as the market reacts to the uncertainty of potential policy changes. We’re fortunate that with our capital base, we can and do take a very long-term view on things and we’ll continue to do that through this election cycle as well.

Todd: Yes, appreciate that. How about you, Sam? What’s on your radar?

Sam: Yeah, I will second Jeff here. Activity, usually in election years, as I’ve said, it’s slowing down. Typically, there’s a bunch of activity before trying to close before the end of the year or before the election even and then a slowdown. This year is different. It has slowed down but for different reasons and now, as I said, we’re more busy than ever. So, I’ll take it month by month or week by week from now. In terms of the reasons, I’m sensing as what Jeff outlined, really the potential tax reform is a concern among our plans.

Todd: Agreed. Well, I’ve really enjoyed the deep dive into what’s at play in the market and some of what’s behind your collective success. My colleagues and I at BDO really value our broader relationships with Bessemer and Equiteq, so thanks for being here today. I know you guys are busy. Stay safe.

To our listeners, thanks so much for tuning in. If you haven’t already, we’d love for you to subscribe, rate, and leave a review of the show on iTunes. Until next time, this is BDO’s Private Equity Perspectives.

CONTACT:

SCOTT HENDON
Private Equity Practice Leader
214-665-0750 / shendon@bdo.com

TODD KINNEY
Director, Private Equity Industry
212-885-7485 / tkinney@bdo.com

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