KEYNOTE INTERVIEW

Playing the macro trends in software

Specialisation provides the necessary expertise to take software firms to the next level, says Hg managing partner Matthew Brockman

Sector specialisation and knowledge-sharing can enable private equity to take advantage of long-term trends in software and technology services, and so help companies to develop further and faster. Over the past decade, Hg has transitioned from a generalist European mid-market buyout firm into a software and services specialist, with a three-fund structure that enables it to invest in the full range of small-cap to large-cap software and services companies.

The shift has turned Hg into the biggest private equity investor in European B2B software, with a portfolio equivalent to the continent's third-largest software group by value. Specialisation and focus in software and services can increase synergies between portfolio companies and drive growth, explains Hg managing partner Matthew Brockman.

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Q When and why did Hg decide to focus on software and services?
Software investing has been a key focus for Hg since the early 2000s and had been very successful for us. Since the 2012 fund vintages – Genesis 7 and Mercury 1, our first small-cap fund – we took out other verticals and only focused on software and technology services. We now have three funds from 2017, with the addition of Saturn to focus on larger businesses, exclusively for software and services.

The reason to focus on software and services is really because of the macro picture. Business processes – how people file taxes, pay employees, buy insurance products and the like – are more tech-enabled and tech-supported than ever. We think that is a very sustained, long-term trend.

From a private equity investment perspective, specialisation matters, and it is increasingly hard to be a generalist. Expert knowledge of particular verticals, and expert knowledge of how people use technology and services to improve workflow efficiency, is hugely important for delivering top-quartile returns in the future.

Q Were there structural changes needed to become a specialist software investor?
There were three main structural changes. The first was implementing a very clear strategy, with the organisation aligned in its way of thinking about and investing in software and services.

The second thing was architecture of funds. We developed a smaller fund to sit below our mid-market fund, and a larger cap fund above it, to give us three funds focused on software in Europe.

That means we are able to invest in small companies with an enterprise value of €100 million right up to companies worth multiple billions in enterprise value. We now look to make 10 to 12 software services investments a year across these funds, which is probably four or five times more than anyone else in Europe.

The third piece is a really specific operational capability. We regularly have to deal with the same questions: how to get a better sales organisation; how to deliver customer success; whether it is possible to develop software better offshore.

Repeat application of knowledge and expertise is hugely important. We now have 180 people in the firm, and over 30 in our operations portfolio team. The application of that kind of scale to such a focused strategy is a real competitive advantage.

Q Which macro trends are driving software use?

All those business activities around processing payments, paying employees or filing taxes, collecting and disseminating business data, are increasingly automated. One reason is simply processing power. Moore's Law states that every two years your computer's processing capacity typically doubles – that's been a very long running trend.

Another is that AI and increased use of data means more automation in white-collar jobs – accountants, lawyers, insurance brokers, tax officials. That's another decades-long trend, and we are still very much at the front end of it.

Software is also replacing hardware spend as hardware costs fall. This trend is accelerated by the ready availability of cloud-based processing power. A great consumer-focused example of this trend is something we can all see regarding TV.

In the UK, for instance, you used to perhaps spend thousands on a TV set and hundreds on a TV licence from the BBC. Now you're more likely to spend hundreds on a TV but are paying monthly subscriptions for streaming with Netflix, Amazon and Sky – all of which you can also consume on the go. People are loading up lower hardware spend with higher software spend – that is the big trend we are backing.

Taking a long-term view with Visma

Q How has Visma changed over the 13 years you have been an investor?

Visma is a software company that has grown hugely from an enterprise value of €450 million in 2006 to over €8 billion now. It's done meaningful M&A and added products that it can sell to its growing customer base in the enterprise resource planning market.

The company has gone from being a Norwegian business, to being a pan-Scandinavian business, to now having a large footprint in the Netherlands. The game plan, to be a leading provider in smaller markets, has served it really well.

Q And how has Hg's operational plan for the business changed?

We underwrote the focus on SaaS and its potential to drive Visma's market about four to five years ago.

At that time SaaS in SME company applications was relatively nascent, so we were taking a view about how that would grow, but it has worked really well. We also focused on increased functionality, more recurring revenue and more value to the software products it sells.

We have recalibrated the plan at Visma every three to five years. The original thesis from 2006 has evolved through new investment cycles although topics like sales organisation and organisational evolution remain. The fundamental value of the business still underpins our plans.

Q How has experience from Visma helped you with other software businesses?

We are applying the ideas that played out at Visma across other portfolio companies. For instance, at IRIS, a similar UK business, we are adding new verticals and new products in a similar 'playbook'. We are also trying to find more of these businesses that fit with the fund architecture point. Can we find other companies with 10 or 15 years of growth ahead of them? Can we start with small beginnings?

One of the deals in our Mercury 2 fund is FE Fundinfo in wealth and asset management. We started with a €20 million deal to buy FundInfo, merged it with FE and now have a €100 million enterprise value business. We think it has got huge prospects and multiple years to scale and grow.

Q How do these macro trends translate into practical opportunities for private equity?

One of our core themes is investing in software companies that we can help professionalise. Typically these companies have been built by founders and entrepreneurs; they have very good products that serve a discrete end-market. Often there's a huge opportunity to develop the business commercially, whether that's the sales organisation, marketing, customer relationship work, or how the product is delivered or priced.

The second theme we like to back is buy-and-build. You are essentially taking a business that has a network of happy customers and a great market position, and using that platform to acquire other pieces of functionality the customer group is going to use. If you own a small company buying payroll and bookkeeping services for example, chances are you are probably going to need some HR products to help manage your workforce and you are probably going to need tax and compliance products or expense reporting products also.

Q These sound like broad themes, so why is specialism so important?

The advantage is that we have the capabilities in-house to handle those workstreams. As an example, take a business such as A-Plan, which is a broker of UK insurance policies.

Our data team at Hg has done a huge amount of work on the customers, their proclivity to buy policies and how we can cross-sell other things they need. In order to achieve this view of the customer, first we had to migrate the entire business's IT systems onto the latest generation cloud software product, the first business in Europe to adopt this kit. Then we were able to do a huge amount around automation, back office and software support for that business to make it hugely more efficient and profitable when it serves its customers.

As specialists, we can de-risk a business improvement plan. It's quite scary for a CEO and CTO when a company like A-Plan is being told to go re-platform its entire IT system for the first time in 20 years, and then go and use big data to improve the customer journey. They could waste a load of time and consulting fees and still buy in the wrong product – and get the wrong stuff out.

> *"People are loading up lower hardware spend with higher software spend – that is the big trend we are backing"*

Because we have done it across dozens of other businesses, we know when it is going to work and when it is going wrong. We can reduce the failure rate of corporate improvement plans and speed up the processes. This idea of our portfolio sharing their homework, and reducing the risk of change projects, is at the heart of what we are doing.

Q How else are you encouraging companies to share knowledge?

We run 25 to 30 portfolio-led conferences a year. We get all the companies together to look for best practice sharing, facilitating interaction and knowledge. Most of our companies are doing similar things for customers but in different vertical markets. They are happy to share their homework because they are not in competition, but they do face a lot of the same challenges.

We run social platforms to connect people. We have built an online, closed network system called Hg Hive, which now has well over 1,000 new executive members from 30 Hg portfolio companies in the last 12 months. We host a lot of our own knowledge on that, so people can click and download Hg plans or contacts in areas like cybersecurity or customer success.

It also enables them all to talk to each other and compare notes. The synapses are increasing with each new investment we make and business we back so you have an exponential increase in direct knowledge sharing rather than it always coming through Hg.

Q What does the future hold for software and services investing?

The trends we have seen for the last few years look like they are persisting and probably accelerating. Genuinely multi-tenant, hosted SaaS software is becoming more prevalent and the value in the software is increasing.

This is because of the data. If I have a multi-tenant hosted product, I know how my customers are using the software and can see where they are spending time and where they are getting value.

I get so many information sets. Then I can run that data through a predictive engine to work out what else I can do for that customer, based on this knowledge. That activity is more and more prevalent and more and more valuable. ■