KEYNOTE INTERVIEW

Driving value in tech

As competition for assets increases, investors are getting creative in identifying value, say Deloitte's Ryan Jones and Nick Israni

Q What are GPs looking for when assessing tech investment opportunities?

Ryan Jones: A decade ago, the dynamics were very different for tech investors, with the ability to borrow inexpensive debt and take advantage of expanding multiples.

Since then, we've seen an investment mindset shift from growth at all costs towards growing profitable companies and creating value during ownership with strong management teams. And therefore, an increasing need for clarity with value creation plans during diligence. Shifting diligence focus to analytics driven top and bottom-line quality of earnings, with deep operational and technology analysis against benchmarks to highlight potential areas of opportunity.

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Additionally, there remains a lot of dry powder on the sidelines which GPs must deploy.

Nick Israni: Agreed. As part of the diligence process, there is a key focus on understanding what scalability and growth will look like. Five years ago, the market saw the inflection point for the move from on-premise to cloud, but now it is about how an asset will scale to support the revenue thesis. Investors are querying how robust the underlying technology is to support that sales pitch, as ARR is still the key metric that buyers are focused on.

The other thing is understanding the differentiated IP in the business and the commercial defensibility play. The ability for start-ups to rapidly build competitive solutions with access to third-party data has grown and those barriers to entry have often reduced, so investment committees are especially focused on the sustainability of competitive positioning.

Q What subsectors are compelling right now?

RJ: On subsectors, software is where the most investment momentum continues. Specifically, cybersecurity, fintech, healthtech, lifetech and school education. However, I also believe there will be increased interest in the areas of the tech infrastructure market – we are seeing a lot of investment interest in fibre and data centre assets and

anticipate seeing an increased interest in semiconductors.

The reality is there is an increasing need for tech infrastructure in support of the growing, global tech economy that has been underinvested historically. This represents a new opportunity.

NI: Other subsectors driving deal volume include vertical SaaS businesses supporting digitalisation in subsectors with high-growth potential. Another ongoing focus is on technology infrastructure, cybersecurity and technology services.

Finally, there is appetite for assets where tools like generative AI are disrupting legacy software plays, with new data-based models being built. We are moving past the initial Gen AI-hype cycle, and investors are recognising the opportunity and limitations of Gen AI investment, with a current focus on operational efficiencies, predictive analytics and differentiated product expansion by embedding Gen AI into commercial solutions.

Q How can buyers and sellers get deals done?

NI: From a seller's perspective, a lot of effort is being made on the sell-side to ensure due diligence is set up for success, optimising the way the value creation proposition is presented to the buyer. We also see technical and product diligence becoming more common, bridging the gap between commercial and IT/cyber due diligence. The latter being increasingly seen as 'table stakes' given an increasingly complex cyber-threat landscape.

The increase in the level of data being produced and stored by businesses is also leading to buyer expectation of granular information being made available by sellers to enable testing of deal hypotheses, and data being seen as a building block of value creation plans, and as a crucial enabler to wider operational improvement.

We have seen a reset around valuation expectations on both sides and, for buyers, a key differentiator is having a clear view on the post-acquisition value creation thesis and how private equity can be an ally to management to deliver that.

Lastly, we are also seeing a lot more effort from investors to get to bilateral processes. With banker-led deal processes so competitive, deals run more smoothly for those private equity firms with their own sourcing capabilities.

RJ: One additional thought when it comes to corporate carve-outs. A seller focused on day one readiness simplifies a lot of things as many buyers are chased off by the challenges foreseen on day one, so confidence in sellers' transition plans can go a long way.

Q What value creation levers are proving to be effective in tech today, and what impact do longer hold periods have?

NI: Given longer hold periods, investors can be more focused on sustainable growth rather than short-term gains and drive more credible ARR on exit. Another focus is core product development, which is important when positioning for exit and can create bolt-on M&A opportunities.

Longer hold periods in turn, allow for better implementation of those strategic acquisitions, as well as optimising go-to-market sales motions to address inherited inefficiencies of scaling teams, improving cross functional co-ordination and investing in systems and data platforms that create transparency and predictability at each stage of the sales process.

A lot of companies are investing in benchmarking around cost structures, which can create opportunities to add additional value.

RJ: Focusing on software, the main way to grow is through add-on M&A and, of course, a focus on go to market. Areas like customer segmentation is where a lot of companies over-index to the middle market and miss opportunities to move upward to enterprise, or adjacent into the federal market for incremental growth.

We also see the channel and product as two key levers for value. Innovating and expanding channels to market with resellers, partners and ecosystems are often ripe opportunities, as well as modernising products to the 'cloud' or optimising research and development operations for cost and speed to market.

Longer hold periods also mean private equity firms should think differently about creating value with increasing input from operating partners and management teams, from diligence to exit.

Q Going forward, where are the opportunities?

RJ: Corporate carve-outs and take-privates in parts of the software industry and broader infrastructure landscape will likely continue to drive capital flows and momentum. Infrastructure is a broad market but as it moves into technology it is probable that areas like semiconductors, data centres and fibre will see a lot of investment in the coming years.

Technology has historically been thought of by investors in terms of technology companies. But technology now exists in every industry and is core to most business models. For instance, a number of high-profile, household name brands have diverged from their original business to the extent that they no longer operate in one sector. Are they tech, transportation or apparel companies?

I believe we will see more GPs focused in non-traditional sectors, prioritising technology transformation to make assets in these industries operate and monetise more similar to tech-like companies. This will open a new era of investment opportunity. ■

Ryan Jones is a US private equity leader at Deloitte Consulting and Nick Israni is a UK software and technology value creation services partner at Deloitte