Buyouts

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'Normalized' tech market favors those 'who can truly add value': Vista's Severson

'I see a robust M&A opportunity for platform companies,' Patrick Severson, co-head of Vista's Foundation strategy, said. 'It's linked to venture and growth equity financing being harder to get.'

After several turbulent years, private equity investing in technology now appears to be normalizing, creating fresh opportunities, many of the best of them in the mid-market.

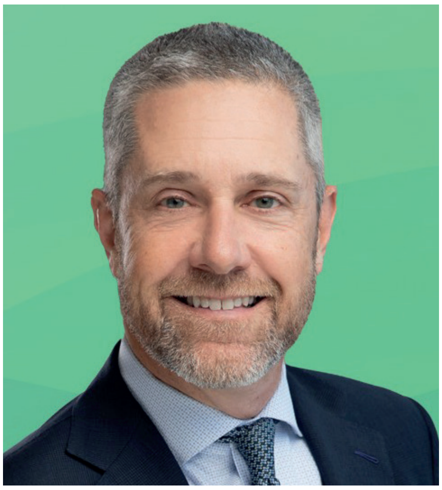
Positioned for the emerging dealflow is Vista Equity Partners' Foundation strategy, which acquires mid-cap enterprise software companies. Launched in 2010, the strategy has deployed more than $8 billion across four funds and more than 200 deals, including 45-plus platform investments. More than $8 billion has also been returned.

Vista Foundation Fund V is presently in the market with a $4 billion target, Buyouts reported last year. The firm declined to comment.

In a Buyouts interview, Foundation co-head Patrick Severson talks about the strategy's origins and focus, today's technology investment environment, and the mid-market opportunities available in the current vintage and as digitalization continues to unfold.

Why did Vista create the Foundation strategy?

Foundation came out of the success the firm has had over time. As Vista scaled and raised larger funds, we didn't want to leave behind the part of the market we built the franchise around. Foundation was launched behind that and has been scaling alongside the flagship fund.



Patrick Severson, Vista Equity Partners

We next launched Endeavor [Vista's small-cap strategy] as Foundation got itself firmly focused on the mid-market. Now we've got small, medium and large. As a firm, we're able to cover the gamut of the software industry.

All our funds are laser-focused on mission-critical enterprise software. It's all we think about. Then you pair that with the value creation side of things. The nice thing about being part of a $100 billion AUM platform is the resources we can bring to bear in the mid-market are significant.

Business development is the vast preponderance of our return driver in the mid-market. That's what you get rewarded for. There's not as much financial engineering you can do. You have to build a fundamentally good company.

What types of companies does Foundation target?

Foundation buys adolescent software companies. They are companies that have great products, they've got revenue, they're growing, they've got customers who love them. And they're reaching the point where their biggest challenge is, "How do I scale?"

We're purpose-built to guide them through the software teenage years: All the decisions they must make as they double, triple, quadruple in size and get to be adult companies, durable software franchises.

We help their go-to-market engines with what we call operational excellence: As you get bigger, how do grow profitably? And then use profits to perhaps accelerate your strategy with M&A? Many companies we work with haven't done a lot of M&A. We're able to show them how and help with sourcing and integration.

And on the talent side, it's about working with the founder or management to help build out the executive team as they scale. The beauty is we've got access to the software industry at large, both through our portfolio and our market reputation. We also help companies grow their employee base using Vista's center of excellence strategy.

In the mid-market, we've got a large buying universe of assets where we can look to pick the right one. And we've got a large universe of folks who are seeking those adult companies. Everything we do is designed around that transformation.

There's some overlap with the flagship strategy in terms of the sectors we're excited about, but there are some sectors that only mid-size companies are going to have advantages in.

The energy sector is one. In particular. the transition to alternative energy is something that is creating opportunity for software companies. An example is Energy Exemplar, an energy simulation software provider [acquired alongside Blackstone in 2024].

Healthcare is another. We like healthcare workflow and system-of-record businesses. We like governance risk and compliance software. Office of the CFO is a theme some team members are pursuing. Another we get excited about is vertical market software, companies that are targeting a particular vertical or niche.

Where are we in the technology investing cycle?

I think we're back to a more normalized market. Normalcy to me is a couple of things. One is valuations: They're resetting to a normal level, which doesn't mean they're resetting to everything at an on-sale price. We're just in ranges that look more appropriate.

Premier assets are going to trade at premier prices. Assets that have some work to do are going to trade at more appropriate prices. If you do the work, you're going to be rewarded. That wasn't necessarily the case in the last environment. There's probably more time needed to close the buyer-seller gap, but in my experience it never closes entirely.

So, it's normalized, but it's advantaged to people who can truly add value to their portfolio. Because 2021-22, our last normalized market, was a tailwind environment. Today, it's an environment where success is going to be driven by the decision-making of management teams and the value-added of investment teams.

Great assets, particularly in the mid-market, can trade in any environment. That's why we designed our strategy around building those assets. We've sold at least one asset in each of the past four years because if you build a great company, there's going to be a market for it.

We're always actively nurturing relationships with likely buyers. For us, that's mostly strategic buyers and the larger-scale GPs. That creates a nice space because when we get to scale, when we get to those late teenage years, those young adult years, folks already know our businesses.

An example is LogicMonitor [in which Vista sold a stake last year]. The buyers knew the business, liked the business, and we felt like it was a great opportunity for us and our investors to get some liquidity, but also to remain invested in that story.

What vintage opportunities does Foundation see right now?

The market we're in now is better for us because the amount of money that was in the sector in 2021-22, particularly in the venture and growth equity community, was at all-time highs. It made it so there was less discerning between different capital sources.

Today, companies that were expecting a financing round are finding it very difficult and are looking for new partners. It's a better universe for us in terms of getting to know a business, and making sure it's a good fit, instead of an environment where things were moving really fast.

We're seeing opportunities where sellers are interested in rolling some of their equity forward to bridge the buyer-seller gap. Then it's important to decide who you're selling to, because if you're the seller you're not only getting some liquidity, you're making a bet on the forward path.

I see a robust M&A opportunity for platform companies. The smaller, subscale assets with an interesting product, but that maybe is more of a feature than a full platform, are starting to find homes. Across our portfolio, we did about a dozen add-on acquisitions in 2024.

That will continue. It's linked to venture and growth equity financing being harder to get. If you're an unprofitable company that's subscale, and you don't have another financing round coming, what's your best

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answer? It's to join a platform.

There are two things we're encouraging people to do. One is add-on activity, where combinations could be interesting coming out of a market where there was a free flow of capital and maybe overfunding. The other is carve-outs, where you want to start building a relationship because those take time.

Everyone on our team is doing business development sourcing, targeting companies we're excited about. They may not be in market today, but we want to get to know them, understand them. And we want to maybe catalyze that event with them.

As digitalization continues, what trends are of most interest?

My day-to-day is software, and the power of software to enable efficiencies and capabilities in businesses in all sectors continues to be exciting. There are sectors at the front end of that digitalization wave.

We're fortunate to have this macro tailwind around generative AI, which is something that, as a firm, we've invested a lot of resources and thinking in. Across our portfolio, we have generative AI strategies around product and efficiency that are starting to come to the fore.

Investing around core AI infrastructure is earlier stage than we look at. Our job is to help companies with product market fit to take advantage of early success. When that AI infrastructure is in place, companies can stand on top of it and build practical, impactful solutions for customers.

For example, on the efficiency side, across our portfolio all but one are using what's known as code generative tools. It's enhancing developer productivity anywhere from 10-30 percent using these tools to automate and supplement your skillset.

On the product side, StarRez [a student housing platform backed by Vista in 2022] has developed software that uses generative AI to help with room check-in/check-out and damage assessment, eliminating the need for human intervention.

The great thing about the mid-market is we're able to take advantage of emerging software leaders. These are modern solutions disrupting legacy vendors, which may be at a larger scale but are unable to keep up with innovation.

Use of generative AI, such as code development, but also generative AI agents in terms of customer support and service, is going to be table stakes. Companies that don't take advantage are going to be left behind. Using the efficiencies gained to invest where your fundamental differentiation lies is key.