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Orlando Bravo's three tips for software investors

There are many mistakes one can make in technology and software investing, but the biggest of them happen ahead of the initial investment, says Thoma Bravo's Orlando Bravo

Thoma Bravo founder and managing partner Orlando Bravo is a champion of the idea that private equity is best suited to running and building software companies. Indeed, at times he is almost evangelical about the asset class's ability to transform those businesses.

Private equity has an unmatched opportunity to develop and improve software firms with a "rolling up their sleeves" attitude, Bravo tells Private Equity International – a view that is shared at a time when public market equivalents have seen declining share prices amid market turmoil.

On the topic of liquidity, Bravo puts "so much of a discount on buying a piece of paper than buying a company, if the benefit of owning a piece of paper is that you can transfer it immediately when you want". He argues that "if you get into something [and] you're so worried about your ability to sell it instantaneously, then you shouldn't get into it in the first place".

Bravo's brimming enthusiasm has been met by impressive demand from investors. Looking at its flagship strategy alone, Thoma Bravo broke the $10 billion barrier with 2018-vintage Fund XIII, which closed on $12.6 billion against a $9 billion target, according to PEI data. The firm is currently raising Fund XV, which has already collected $20.27 billion – not far off its $22 billion target, and substantially larger than its $17.8 billion predecessor, which closed in 2020.

Here are Bravo's top tips and pitfalls to avoid in software investing.

Plenty to consider

There are a lot of mistakes one can make in technology and software investing, Bravo says. The biggest occur when assessing the quality of the product at the outset – something "very difficult" to reverse during the investment period. Historical figures on gross and net retention rates can act as a guide to assessing whether an asset is of high quality, "but they are not definitive".

On the product side, investors should be probing how much has been invested into future functionality, the quality of that functionality – speed features, for example – and how these key aspects fit with what the market wants moving forward. "That is just absolutely critical to nail," Bravo says.

As part of that, firms should assess their own managerial capabilities within their product management and research and development functions in order to navigate issues that could come up from a development and engineering standpoint.

Know your market

The addressable market for a software company is again a factor, but this too should not be used as a lone deciding factor on whether a business makes an attractive investment, Bravo says.

Delivering a "very important solution for your customer – something that is very, very valuable to them" – is more important than the total addressable market, he adds, suggesting firms invest in "very high quality while doing something specific – maybe for a vertical that's smaller, maybe for a horizontal use case that may be smarter".

That sense of value may not be clear. "It's certainly not on the balance sheet [and] may not have been factored on the [profit and loss statement]."

Secondly, firms should consider what a company's competitive advantage is over others trying to pursue the same solution.

"You cannot have the best product that takes a long time to implement, that is very difficult to use, that is very difficult to explain and is very difficult to sell if you're addressing a problem in small business," Bravo explains.

"You're guided by historical numbers to see if your quantitative and qualitative judgments are consistent… There's a lot to think about there."

Investing in a downturn

Thoma Bravo is yet to see "a big impact" from 2022's downturn market and potential recession in customers' commitment to spend money with its software companies. However, the firm is preparing itself in advance for that possible outcome, Bravo says.

"We're doing things differently in terms of being more conservative with how we run our companies… Nobody's immune to [a potential slowdown]," he notes.

Bravo suggests investors in software "continue to take less leverage" and focus on earning returns through owning and operating companies in partnership with management teams.

However, SaaS investors "always have to be investing" in order to remain competitive, he continues.

"Manage that [profit and loss] a lot more closely. Be very, very careful that, in whatever investment decisions you're making, you don't dip your margin at a time where it looks like it's going to be difficult."

If you are doing more speculative investments, Bravo adds, "you have to make sure the market is ready for you now… In many cases, now may not be the right time." ■