MW Executive Perspective®

Unique Viewpoints from Industry Leaders

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Ken Hubbs

Managing Director, Riordan, Lewis & Haden Equity Partners (RLH)

Editor's Note: *In this month's issue of MW Executive Perspective,* ***martin****wolf interviews Ken Hubbs, Managing Director, RLH. Ken joined RLH in 2005 and has over twenty years of private equity and growth equity experience. Prior to RLH, Ken worked at multiple private equity firms including Westar Capital, General Catalyst Partners, where he was a co-founder, and Kirkland Messina. Ken was also a member of the founding team of Upromise, a rewards network of major brands funding college tuition via rebates, and he began his career in the investment banking division of Smith Barney. Ken holds a Bachelor of Arts degree with University Honors from Brigham Young University and a Masters in Business Administration from Harvard Business School. He currently serves on the boards of Avella, Siteworx and Patient Care America.*

Q1 saw the busiest quarter in M&A for eight years—why do you think M&A is so popular right now?

There are a lot of factors that go into M&A activity, but one big factor is that the credit markets are very liquid right now, and as a result buyers are able and willing to pay higher prices. Interestingly, this suggests that the prices that we're seeing are not necessarily indicative of the prices of any particular asset but are instead a reflection on how much buyers are able to borrow. We're also seeing as a result the emergence of a sellers' market, where the increasing M&A activity causes more business owners to want to sell, continuing the trend.

I could say similar things about last year, when loose credit markets were also able to drive dealmaking. Ultimately there are a lot of sellers seeing these conditions and recognizing them as the opportunity that they are.

Given these trends, do you expect M&A to continue, accelerate or slow down?

Separate and aside from the private equity market, I am a firm believer in the efficiency and lack of predictability in the public capital markets, which lends itself to passive investing compared to active investing. With regards to M&A, I'm not sure what potential shocks might affect the macro economy—economic, political or who knows what—but if forced to make a prediction I would say I expect current trends to continue.

What does RLH look for in a transaction?

We are very focused on businesses with high rates of organic growth – typically 20% per year or more. To achieve that rate of growth in an

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economy that grows at 2% per year in total typically requires the business to be in a sector which is benefitting from long-term macro growth factors. Also, we expect our companies to be very much a leader in their space — through, for example, thought leadership or offering a distinctive solution. Furthermore, we've focused on a few verticals - specifically Business Services, Healthcare, and Government Services. As a result of our focus on macro growth drivers and those three sectors, we've invested in quite a number of human capital professional services firms like IT consulting firms. Based on all that experience, we've built up a playbook to help these types of companies develop strategic plans to continue and even accelerate the growth of the business. In terms of deal structure, we prefer to partner with the entrepreneur/founder and the existing management team - provide them with partial liquidity and have them retain a substantial stake in the enterprise as we work together to create much greater value over a five year time period.

We're seeing many investors shifting their focus toward SaaS or other high-value services. Are you tailoring your valuation expectations to these higher value services?

Generally speaking, we recognize that recurring revenue in a business is more valuable and deserves a higher multiple than non-recurring. Whether the recurring feature comes from long-term contracts, or subscription-type services or software, it definitely commands a premium. Overall, our focus remains on firms that are primarily services / consulting oriented, rather than pure SaaS software business. We invest frequently in consulting providers that are technology agnostic and provide clients with opportunities to choose and implement the solution that best fits their need. Often, a portfolio company will develop some valuable intellectual property that they use in delivering their solutions but we don't typically invest in companies whose primary line of business is selling software, whether on-premise or SaaS. Commercial software technology is always changing—it used to be on-premise, now it's SaaS. In the healthcare IT world it used to be Cerner and Meditech were the leaders —now Epic has become the most successful EMR software provider. In the SaaS/CRM world, Salesforce has emerged as a major player—essentially, the landscape is always changing and our companies seek to be positioned to understand and adjust to all those changes.

Walk me through your investment in Inspirage. What was the thought process behind that investment?

With Inspirage, we first identified the macro growth trend. Inspirage provides consulting services around Oracle Edge software products that help manufacturing companies manage their supply chains, and in particular track all components throughout the process. Even for a company like Apple, a company that outsources all of its manufacturing, the ultimate assemblage of the iPhone takes an incalculable number of components and pieces coming together in perfect timing harmony. As consumers demand mass customization, as time to market with new products becomes an even more important competitive factor, as product lifecycles have shortened due to rapid advancements in technology, the supply chain becomes ever more complex. Inspirage helps its clients respond to these long-term trends by selecting and optimally implementing the right supply chain software, from both a business and technology perspective. And at Inspirage, the leadership team has deep supply chain experience from both the software and professional services sides. Perhaps as importantly, we really enjoy working with the management team. It's still early, but Inspirage is a very promising partnership—and we're excited about the opportunity.

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How has your personal career experience influenced your current role at RLH?

I spent the first two years of my career in investment banking. While there, I ended up on the team providing services to what are now called PE firms (then we called them the Financial Entrepreneurship groups). I realized that was more interesting to me because it opened the doors to transactions and deals, while remaining active and involved in growth and development of businesses from a strategic and board level. I made the shift to a PE firm in the mid-90's and have been involved in private equity since. I was part of the founding team of General Catalyst Partners in Boston, but ultimately my family and I decided to move back home to CA, which is where I'm from. I'm personally most interested in middle-market companies, $25-100M revenue, and that's what RLH targets. And finally, I enjoy the partnership approach here at RLH. In our agreements with the entrepreneurs and founders, we've gone out of our way to ensure we're there alongside them as they build their company.

What does a private equity investment offer that a strategic does not?

For the entrepreneur, partnering with the right private equity firm is an opportunity to create partial liquidity and diversify personal wealth while maintaining a significant equity position and continuing to lead the expansion of their business. With a strategic, you are giving up the ability to direct the future of the business and giving up the opportunity to profit from its future success because you have sold 100%. You become an employee, not an owner. With a private equity firm, you get the ability to continue to build your business (which is often why you became an entrepreneur) in partnership with a firm aligned with you.