

TECH INVESTING

Where disruption is an asset

The technology sector is booming, but how do you spot a successful investment? Whether in AI, big data or software as a service, it is the dynamic disruptors that yield the best returns, says Permira's co-head of technology **Brian Ruder**

“Where innovation is happening, disruption is likely to occur. We look at which side of the disruption curve a business sits



Ruder: looking for businesses that are beneficiaries of disruptors

No longer niche and nerdy, technology is hot. From pest control to pharmaceutical to fast food companies, sellers are positioning assets as technology businesses in order to grab the premium. This blurring of sector boundaries and the presence of technology across company operations prompts the question: what exactly is a technology investment?

We asked Permira's co-head of technology Brian Ruder, co-head of consumer Dipan Patel and principal Andrew Young to explain.

Q Companies across sectors are being marketed as technology businesses. How do you determine what's truly a tech investment?

Brian Ruder: Technology is both a very easy and a very difficult thing to spot because it is pervasive. It exists in every sector. At the highest level we think of it as the automation of almost anything in a repeatable way. From a sector standpoint we are focusing on digital, whether that be software, internet services, or the underlying infrastructure that enables digital transformation across the five sectors in which the Permira funds invest. It's impossible to be a growth investor in the industrial, consumer, financial services or healthcare spaces without having a view on technology businesses in those sectors.

Q Innovation and disruption are constant in the tech sector. How do you account for them when making investment decisions?

BR: At our scale, our funds don't invest in the big disruptive trends directly but there is a variety that we track closely: AI, big data, Internet of Things. We are interested

in finding businesses that can benefit from those trends in a secondary or tertiary way.

Dipan Patel: For instance, at Ancestry.com our funds have made a large investment into the application of big data technologies in the DNA side of that business. It is an example of where our funds haven't invested directly into these technologies, as many of them are nascent, unproven and it's unclear who the winners will be, but are investors in the operating cost and capital expenditure.

Q How do you size the disruption risk?

BR: Where innovation is happening, disruption is likely to occur. We look at which side of the disruption curve a business sits. The Permira funds love investing in businesses that are clear beneficiaries of disruption, but may be underappreciated to by the market, for example data integration software business Informatica, which we backed in 2015. It plays in the enterprise, cloud and data management space and most people would have considered it to be a legacy business.

We recognised that the company had a tremendous innovation capability and was moving into much newer and interesting areas around themes that we thought would be growth drivers for the next 10 years. It was, therefore, a really dynamic disruptor with a deep installed software base and a fantastic tailwind in the explosion of data use in every industry.

Q Are there any particular sub-sectors within technology where you are seeing more opportunity?

BR: Our two pillars continue to be software and heavily software-enabled »

» businesses, and then internet and online. Within that there will be specific sub-sector themes that we find more or less interesting at any point in time. Education technology was a big area that was very interesting to us a decade ago. Renaissance Learning was a very successful investment for our funds. But lately we've found that theme to be better understood and less exciting.

Other areas we focus on include niche infrastructure, such as carrier neutral data centres such as Teraco in South Africa, which we backed three years ago. It's a collocation facility with outstanding access to power in a market where power is often not a consistent utility. Being carrier neutral and a massive peering point, clients also can access any part of the global data network



“Investing is a flywheel. Over time the more businesses our funds invest in, the bigger our network grows, the more dealflow we're able to generate”

Dipan Patel

from that one facility and get the best price from networking providers.

Q So tech opportunities are global?

BR: The core of where we see opportunities continues to be Europe and the West Coast, but Asia also offers big potential.

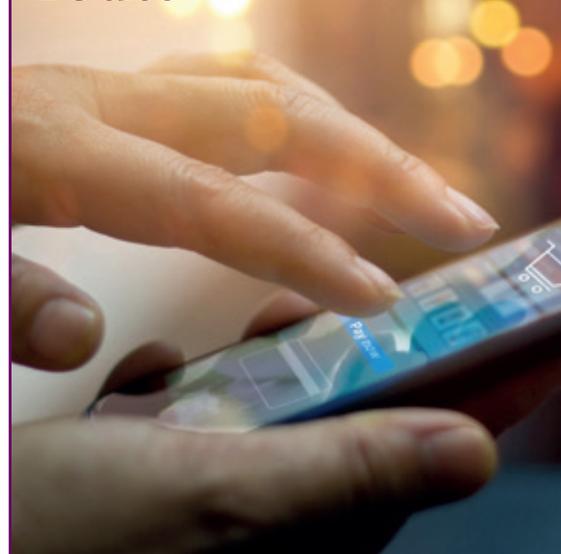
DP: In some of our more developed countries, we typically play some kind of market share shift, meaning offline to online; banks to non-banks. In food and apparel, for instance, neither of those industries are growing very fast so we're focused on the niches and share shifts happening within them. In Asia it is different and that's why it's exciting. There is wealth creation and there's a GDP dynamic.

Q In such a competitive investment environment, how do you source tech assets?

DP: The first thing is to be where innovation begins. We are the first European private equity fund to have a dedicated Silicon Valley presence. Richard Sanders, co-head of technology, set up the office 10 years ago with Brian joining shortly afterwards. Investing is a flywheel. Over time the more businesses our funds invest in, the bigger our network grows, the more dealflow we're able to generate, the more companies are funds are able to invest in. We've been able to build our brand and attract talent to our portfolio companies, and we've established a great senior advisor bench. We have seven senior advisors who are deeply integrated into our workflow. Between them they serve on the boards of around 20 great technology companies, which further amplifies our reach and connectivity.

BR: Getting a good view on what's happening in the boardrooms and the strategy of scale corporations is also important.

Taking the alternative route



Permira funds acquired a minority stake in Swedish online alternative payment business Klarna Bank last year with a transaction value of \$2.25 billion. Andrew Young outlines the GP's approach

Q Why Klarna?

Klarna has a unique market position with strong structural growth tailwinds. It is a payments-meets-consumer-finance business adding value to both sides of the transaction. As a firm we had spent a lot of time in several processes for payment businesses carved out from banks. Then we threw away the traditional approach and came at it with a much more digital perspective. We looked at businesses empowered by technology and riding trends like e-commerce and alternative payment methods, which is a great place to be.



Q How significant is technology to Klarna's value creation plan?

Investment in technology and data is fundamental to a business like Klarna, which serves both sides of an e-commerce transaction. Its purpose is to make transaction flow smoother. When you do that, customers convert more with larger basket sizes. Merchants love that. It's a very simple equation.

This year the board has approved hiring around 1,000 additional people, mostly in engineering, to create proprietary software, solutions and experiences for merchants and consumers. It will go further with tech-enabled services for merchants by offering traditional banking services like

lending. On the consumer side, Klarna

is one of the few payment busi-

nesses in the world that

knows exactly what item

a customer has bought

because that is part of

the credit decision

process. It provides a

shopping experience,

is a consumer portal

and it is moving in-store

too. Online is fantastic but

omnichannel is increasingly

important.

The business is enhancing its product

suite; pushing into travel, merchant lend-

ing, an app linked consumer card – while

also proving out new geographies. Historically

Klarna has been seen as a northern

European/German-speaking phenom-

enon, but that is changing. The business

signed a deal in mid-September to acquire

Close Brother's Retail Finance, which is a

mostly online point of sale financing busi-

ness in the UK. The US is going to be

important too and other geographies in

Europe. ■



Q Permira acquired a minority stake.

Is that unusual?

Taking a minority stake

is a new strategy for Per-

mirra. It's a way to participate

in companies that our funds would

have liked to have acquired but that option

wasn't available.

Competition in the fintech space is

strong and control isn't always avail-

able. Klarna is a scale disruptor and

there are not very many in this segment.

Another way that our funds can compete

is to take a minority stake and support

Klarna's team to continue to grow into a

larger and more globally relevant business

through investment M&A and with more

capital. There are six lead shareholders,

of which we are one of the more active

shareholders.

“ Competition in the fintech space is strong and control isn't always available

Andrew Young

What's on their strategic list one month might be on the divestiture non-core list the next. Carve-outs are a wonderful area to invest in because technology is a sector where M&A activity and strategic change are constant.

The era of simple investing is gone. To wade in and decide to become a technology investor today at scale is virtually impossible without getting lucky. You've got to have sector knowledge and credibility; knowledge of the business in whatever markets they operate; and a view on operational optimisation.

Q Are we in a bubble and is it about to burst?

BR: There may be a bubble but it's nothing like the dotcom boom of the late 1990s.

Then you had massive company forma-

tion of businesses that had absolutely no

right to exist. Valuations are beginning

to catch up because a decade ago, tech

businesses were significantly undervalued

versus the rest of the economy relative to

their growth characteristics, resilience of

business model, acyclicity, revenue recur-

rence and visibility. The survival rate of

business innovation over the past five years

will be dramatically higher than it was 20

years ago. ■

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