Bravo's alpha

Thoma Bravo just closed Fund XII on \$7.6bn, twice the size of its predecessor. Managing partner Orlando Bravo tells Annabelle Ju how the firm evolved from a generalist private equity shop to a software specialist, and his own role in that transformation

PHOTOGRAPHY BY DOUG HOLT

Orlando Bravo achieved his ambitions early: at the age of 35 he was named managing partner at a private equity shop. Not only that, his name was added to the firm's title, making Thoma Cressey Equity Partners into Thoma Cressey Bravo.

Bravo's energy fills a wooden-panelled seventh-floor conference room in New York overlooking St Patrick's Cathedral as he explains the two specific software deals that started his meteoric rise and allowed him to become partner.

The Puerto Rican was 27 and fresh from Stanford Graduate School of Business when he joined TCEP to learn the ropes under one of the grandfathers of private equity, Carl Thoma.

The firm's co-founder believed in giving young people opportunities to prove themselves, Bravo says. His own arrival at TCEP coincided with the dot-com crash that led the generalist firm to focus on its buy-and-build strategy in the software sector.

As part of the new approach, Thoma allowed Bravo to lead the acquisition of Pennsylvania-based product distribution software provider Prophet 21. It was the first software deal TCEP had ever done, and one of the earliest take-private transactions in the sector. The acquisition happened at a time when lenders were not very willing to provide capital, Bravo recalls, and the deal involved "almost no leverage" as a result.

Software was a relatively young industry then, and companies weren't running as efficiently as they could be.

"These companies with very high gross margins could be very profitable, but at the same time most of them were losing money," Bravo remembers.

To address this issue, Bravo brought in the firm's first operating partner, Marcel Bernard, and completed six add-on acquisitions.

"He proved himself immediately, and has been a leading force behind the company's dominance as a software and tech specialist ever since," Bernard says of Bravo. "His knowledge, dedication, creativity and commitment – to Thoma Bravo and its portfolio – has led to an extraordinary streak of successful companies."

At exit, the Prophet 21 deal produced a 4.7x money-on-money multiple in three years, and Bravo used the same strategy with VECTORsgi, which produced 2.9x in 2003. These successful deals propelled him into the partner seat at TCEP as early »

» as 2001 at the age of 30, and allowed him to begin running its software group.

"We have a firm that really measures deal success," he tells *PEI*. "You do deals, you put up good numbers then you can move forward."

Once Bravo took charge of the software investment team at Thoma Cressey Bravo, the firm migrated from being a generalist buy-and-build shop to one focused on software, healthcare and business services.

"It was important as private equity started becoming more industry-specific," he says. "And as the industry matured, we were at the forefront of that."

The San Francisco-based firm started to develop a repeatable framework for assessing, operating and running software companies, at a time when operations took a back seat in the private equity world.

Despite the fast-changing technology landscape, the $16.9 billion-AUM firm has maintained that operating framework, which has three key components. First, it specifically targets software companies with recurring and stable revenue streams. Second, it identifies company-specific ways to improve the operating profile of the business. And third, it uses add-on acquisitions to consolidate the industry. Of the more than 150 software and technology deals the firm has done since 2000, most were add-ons, according to Bravo.

Thoma Bravo, which was renamed after Bryan Cressey departed to found his own firm in 2008, also usually maintains the management team of the portfolio companies it buys.

"We only work with the existing teams; we don't look to change management," Bravo says.

A specialist firm running niche-sector companies wouldn't perform without a team focused on portfolio operations. When the first operating partner, Bernard, joined to work with Prophet 21, he was a one-man band. But the division grew quickly, and now there are nine professionals dedicated to its portfolio companies.

"The collaboration among operating partners has improved significantly; we have at least two operating partners per company working with the management team," Bravo adds.

He adds that his firm, which also has an office in Chicago, holds monthly reviews with all the management teams. They are supported by advisors – there are currently two – who help the operating partners work on software companies of any size.

"We've worked with Orlando many times on both sides of the table and have seen him build Thoma Bravo into a truly differentiated leader in the software private equity sector," the head of M&A at an investment bank in New York tells *PEI*. "He has built a tight team of partners who have a lot of expertise in the software space which allows them to move very nimbly when needed to create tactical advantages."

UPPING THE FUND SIZE

The firm has also kept its strategy unchanged. It has stuck to its mandate of making 12 to 15 investments per fund, despite a dramatic increase in fund size over the years. Its Fund X closed in 2012 on $1.7 billion, for example, while its Fund XII, closed in September on $7.6 billion.

"The companies that we are looking at today are the same as the companies we looked at five, 10 years ago," Bravo says. "But they're much larger because they're consolidating and buying their competitors. So we're buying the same companies with the same strategy, with the same operating plan, with existing management, but they just require more equity because they're bigger entities."

Bravo breaks down the history of software-focused buyouts into three phases. In the early period of 2000 to 2005, there was little lending into the sector, and large »

"These companies with very high gross margins could be very profitable, but at the same time most of them were losing money

4.7x

Multiple on Prophet 21, Bravo's first software deal

2.9x

Multiple on VECTORsgi, his second deal

1/3

Portion of Fund XII which is deployed

$7.6bn

Final close for Fund XII

» buyouts were few and far between. The GPs had a smaller amount of assets under management, and were chasing fewer targets in the sector.

"It was really competitive; even though you were in a situation where prices were lower, winning a deal was hard," he recalls.

The next period of 2005 to 2010 saw industry-wide consolidation and new access to the credit market. That wave, although interrupted by the financial crisis, gained momentum thanks to a more established track record and very few bankruptcies in the sector.

And since 2010, larger players have entered the markets, capital has become cheaply available, and prices have soared with it.

"I see increasing deal activity; it's unstoppable right now," Bravo comments. "There are a number of factors pushing that, such as changes in business models, software activist investing and interest from large public company CEOs in going private."

In the first half of 2016, the technology sector saw 2,041 deals, inching the whole of 2015 by 2 percent, according to advisory firm EY. That had been the record set after the dot-com bubble and crash. The second quarter of this year had 28 deals at or above $1 billion, outstripping the record of 20 massive deals set in the fourth quarter of 2015.

GOOD DEAL, BAD DEAL

Bravo initially won't pick one exemplary investment, but eventually he nominates the Blue Coat Systems deal. In February 2012, his firm and Ontario Teachers' Pension Plan acquired the cybersecurity provider in a take-private transaction worth about $1.3 billion. Thoma Bravo's purchase price, for its 21st platform investment in the software sector, was $960 million, one of the largest cheques it had ever written for a single deal.

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"One of the things that made it successful was that we knew the industry sector well; the security software space is an area we had a long track record in," Bravo remarks, citing other portfolio companies such as IT security and compliance automation provider Tripwire, which the firm bought in 2011. "So we were very comfortable with Blue Coat's technology and growth prospects."

And it established a good partnership with Blue Coat chief executive Greg Clark, Bravo says. The team accelerated the growth rate and profit margins by emphasising customer service, and made accretive bolt-on acquisitions – such as network security provider Crossbeam Systems in 2012 and digital network processor Netronome in 2013 – to build the largest global cloud security infrastructure.

"We saw eye-to-eye in terms of how to improve that company and operate it," Bravo says of Clark.

Three years later, in March 2015, Thoma Bravo sold Blue Coat in a $2.4 billion all-cash transaction to Bain Capital, realising a 3.4x return on its original investment, and a gross internal rate of return of around 60 percent.

He does, however, admit there are many deals that could have performed better if the firm had made more bolt-ons, been more aggressive in product development or hired more sales people to support revenue growth, for example.

"There's always more that can be done at these companies," he says. "So one thing we could've done better is that we could've held assets for longer."

He points specifically to higher education software platform provider Datatel, which it acquired in 2005 alongside Trident Capital, HarbourVest Partners and JPMorgan. After a 2006 dividend recap among investors, Thoma Bravo exited Datatel with a 4.0x return in 2009 in a stagnant deal-making environment.

Bravo claimed at the time that Datatel was in a stable market – the colleges and universities of North America – that wasn't at risk of going out of business. He still holds that view today, calling Datatel a "phenomenal company" and an asset that, looking back, would've fared better had Thoma Bravo held it for longer.

"But we're in the business of raising new capital and returning money [to our LPs], so we have some constraints that we're happy to deal with, and we do."

Bravo describes Fund XI, which closed in May 2014 on its $3.65 billion hard-cap as "fully invested", but adds "we may do one more deal".

The latest vehicle, Fund XII, raced past its $7 billion target in nine months this year. It was about a third invested when *PEI* spoke to Bravo, less than two months after the fund's final close.

Bravo attributes its robust deal pipeline for the vehicle to the current high-valuation environment, where people are inclined to sell. He does, however, emphasise staying disciplined and making sure the firm only buys the right assets in a booming seller's market.

The tech industry clearly remains a fertile ground for private equity deals, 10 years after Bravo got his name above the door. ■