Bob Morse of Strattam Capital

This is the Investor Connect Podcast Program, I'm Hall T Martin. I'm the host of the show in which we interview angel investors, venture capital, family offices, private equity, and many other investors for early-stage and growth companies. I hope you enjoy this episode.

[00:00:23] **Hall Martin:** Hello, this is Hall Martin with Investor Connect. Today we're here with Bob Morse, founding managing partner at Strattam Capital. Stratum Capital invests in founder led independent B2B software and technology companies outside of Silicon Valley. We believe in aligning with founders and CEOs before signing _____ our five-point plan process to allow execution with purpose, excitement and efficiency. We connect companies with the people, process and scale needed to reach their potential. Bob, thank you for joining us.

[00:00:51] **Bob Morse:** Pleasure to be here, Hall, thank you.

[00:00:53] **Hall Martin:** So what was your background before investing in early stage companies, what did you do before this?

[00:00:58] **Bob Morse:** Well, a little bit about me, I come from a family of teachers and engineers, let's say, growing up, if you weren't either building something or teaching someone, people kind of wondered what you were doing. And so, I have an engineering degree, but then went into finance which left most of my family relations scratching their head as to what Bob was doing, something with money. I would say, as I think about the finance world today, and how private equity has evolved, building and teaching are more important skills for the investor now than ever, maybe that can be something we touch on as we have our conversation here today.

[00:01:34] **Hall Martin:** Great. And so, what excites you right now.

[00:01:37] **Bob Morse:** When we look across the private equity world today, we focus on the technology piece of the world, and I think a lot of people think of Silicon Valley with technology, but in fact, it's part of the economy of every state and everything we're doing. And I think in the venture world, if you look at the statistics kind of three quarters or more of the venture capital is in place in Silicon Valley basically or maybe the Seattle area. But if you look at tech employment in the country, three quarters of it is outside the State of California or Washington. And that's where three quarters of the companies are. Those are the people that we're working with. So not typically the enabling technologies, but people who understand business problems, and it's a huge ecosystem, it's a really rich set of companies, and those are the people that we're spending our time with.

[00:02:26] **Hall Martin:** That's great. And so you deal a lot with startups in the space, so what's your advice for people investing in startups, what do you tell them to do before they write that first check?

[00:02:35] **Bob Morse:** In my experience, it's easy to put startups into sort of two categories. There are enabling technologies, and then there are people who are addressing a particular business problem in a particular end market, and it's really important to be clear about which of those two you're falling into. For me, having spent 15 years in Silicon Valley, which is home to a lot of these enabling technologies, there really is a benefit to scale and probably a monopoly on a lot of those enabling technologies in some of the tech hubs. But they don't have a monopoly in understanding business problems. People who worked in industry, who worked at a particular company, you know, I worked at Kraft, I had this problem, I left, I've written the software now that Kraft uses to do to their promotion, say, and General Mills and down the line, those are the companies that we work with. And so, to me, understanding how to employ those enabling technologies to solve a particular business problem and industry, ideally, one you've worked in, has been the secret sauce for the founders that we work with.

[00:03:39] **Hall Martin:** Great. On the other side of that table, what's your advice for people running startups, what should they do before they go out to raise funding?

[00:03:46] **Bob Morse:** We tend to work with startups not in the sort of seed stage, but once they've gotten several million of revenue and a product that works. And so, a lot of questions on the minds of our founders are, I've got a window where I know a large piece of the market needs my product and how do I get there faster. And a lot of times we are talking with them when we're investing, but we also do a lot of add-on acquisitions for other companies that we're invested in. And I think one of the questions both for the investors and the founders is around exit, particularly in today's market with today's prices. And I don't know if people are spending much time thinking about this question of sale or sort of joining up with a larger strategic, but I think that's one that doesn't get a lot of discussion in a lot of the investing circles. It's either I'm going to sell for cash or I'm raising money. I think that's a really important topic, maybe one we could take a minute on, if you think that'd be of interest to the listeners.

[00:04:44] **Hall Martin:** It would be. What's the difference between those two and how do you approach it?

[00:04:48] **Bob Morse:** Well, a couple of thoughts. One is, the founder has a lot of good choices in these cases in terms of what they want to do, and one of the things we hear from founders sometimes as the business grows as you get to 25 people or 50 or 75, your job which might have started in product or talking to customers, becomes much more administrative over time. For a lot of people, I like building product, but I don't necessarily like business administration, thinking about the healthcare package or

whatever else. And so, we've had several interesting conversations with engineering and product led founders, where they say, the big secret, and I don't know who to tell this to, is, I don't really like the job of CEO of this company that I now don't quite know how to get out of, I would rather be back to building things with a team that I love. And in a few of those cases, we said, well, look, why don't you have that company join ours, and why don't you run product across this entire larger organization. And we've got some people like business administration, who like dealing with all those pieces. The second thing I would say is people are either deciding to join and play an important ongoing role in that or to move on to other things. A lot of times these golden handcuff deals, I think are really terrible exercise for the founders, in that they're stuck for a few years, they're not part of the long term future, but they don't have the control to run the business the way that they used to or the way that they would like to see it, and I've seen so many people agree to do it with good intentions but have it not work out well. There are very productive stories for founders who think that as part of a larger organization, they can get their product into the hands of all those people who need it, who desperately need it, if they would like to see that happen, and maybe they can get back to some of what they loved about the business early. But being really clear about that and choosing a company that would like to do that, I think is the trick.

[00:06:45] **Hall Martin:** Great. That's a good point to bring up for founders that get further along, they have to make a decision about when's the right time to move on and get back to the things they love, because you're right, I used to work for a company where early days is about building product, making customers successful; later days, it was about budgets, forecasts and hiring plans that had nothing to do with products or making customers successful directly. And so, it was tough, tough to spend time doing things that you really didn't want to do anymore. So there's a timeout limit for some of these guys, I guess. So how's the industry evolving, where do you see it going at this point?

[00:07:19] **Bob Morse:** I think it's evolved a lot. When I got into this, a long time ago, in the private equity market, people used to talk about the illiquid, private markets. Boy, there's so much liquidity in the private markets now, I think it's better to call them the liquid private markets. In technology last year, over 30% of all the M&A was done by either a sponsor backed company or private equity or venture capital firm. That's double what it was five years ago and 10 times where it was a decade or more ago. And so a lot of, in my early days in private equity, when I was in my sort of late 20s and 30s, the philosophy of a lot of investment firms was to find assets that the market had mispriced. We are going around finding things that the market hasn't priced correctly. I think a lot of that's gone away in the private equity world and in the venture capital world. If you and I had a software company today, we're trying to figure out exactly what it's worth, we could make a handful of calls or just return a handful of the emails we're getting every day from people who want to offer us capital, and get a pretty good sense of pricing. So to me a lot of the value add at least in the private equity businesses, what value you're going to add while you are an investor in the company as opposed to have

you bought something at a particularly good value or can you sell it at a particularly good value. I think it's changed the nature of a lot of investment firms, we have more people who actually run software companies or run marketing or product or engineering, it's not just finance people like myself. And we've invested in that kind of a team at Strattam. If I would say those two themes, one is the illiquid markets have become liquid, and two is the value creation has moved from identifying bargains to what are you going to do with the company during your ownership period to really change the game.

[00:09:17] **Hall Martin:** Right. And so what's the biggest change you see coming up in the near future?

[00:09:21] **Bob Morse:** Well, one of them is around the deal process itself. We do something a little different, and I think other people are starting to do it, I hope more do it, which is to be very transparent during the investment process. We actually share our diligence on the company back with the founders that we work with, and then say here's what we saw, what are the top things, actions that we could take, should take post-closing that will have a positive impact, called the five-point plan. Setting that action plan before signing is actually unusual. Typically, the deal closes and then the operating partner or somebody else gets involved and there's a strategic value creation or some other engagement value add program done after closing. Doing it before closing forces you to have the hard conversations when you haven't agreed to work together yet. And our founders love it, we've now invested across 29 different founder led companies across nine platforms. We've done this in every single case, because they know what they're getting, and they can stand up on the day that the deal closes with the team and say, we had a lot of good choices, we chose to work with Strattam, and here's what we're going to do with the money, one, two, three, four, five. If you work on one of those five projects, good things will happen for you and the company. As opposed to saying we've just taken some money from a new partner and just keep doing what you're doing, we'll let you know in 30 or 60 or 90 days, which, boy, if I heard that, I'd be wondering if my resume was up to snuff. I would be so nervous. And in a few cases where we can agree and we lose the deal, and they go on to decide different partners better, that's okay, that was going to be that deal that you closed, and then you had the heart to heart and realize you really saw the world differently. And these companies we're working with, all have a set of good choices. And if we don't see the world in the same way, they should find someone who does, and that's kind of how you prove that the process actually works. And it's just so different from this, I want to optimize just and play my cards close to the vest for the transaction, and then we'll open up the hands after the deal is done. It kind of flips around the cards.

[00:11:32] **Hall Martin:** Eventually, you have to get in alignment with the team or it's not going to work, so might as well do that as soon as you can.

[00:11:38] **Bob Morse:** Yeah, I've had this problem in the past, and I refer to it as the, I would say, first board meeting surprise problem. I don't know if you've ever bumped into that, but the deal closes and you go to the first board meeting, and then one side or the other reveals something that was known before closing, but maybe wasn't shared or shared clearly enough, and you realize, oh my goodness, this isn't the way – I didn't realize you were going to send an operating partner here who was going to be here three days a week to advise me on the business, I thought I was running this; or I didn't realize just sort of what the terms of trade are, when, by having this conversation upfront, it eliminates the first board meeting surprise problem, at least, what I find is, there won't be one on our side, because we've shared our cards, and when we share our cards and the things that we're worried about, I would tell you almost always the person is reciprocating on the other side, here are some of the things that I'm worried about, because they're just so many pressures in the deal process itself to only say the best thing or the right thing or to say it in a way that your broker or friend told you to say in terms of describing the business. And those are the things that lead to that first board meeting surprise.

[00:12:50] **Hall Martin:** That sounds like a great process others should adopt. So tell us more about your investment thesis, what do you guys look for when you invest in deals up front?

[00:12:58] **Bob Morse:** Sure. Well, I talked first of all about our focus on people who are solving problems in particular industries, as opposed to, what I'll call, enabling technologies. An enabling technology, Slack or a cloud compute platform, that's a broad tool, those are, I think, better suited to venture capitalists or people working at scale. But for us, there are a lot of themes that many industries are working on to spend management, customer engagement or citizen engagement. We've got a business called Rock Solid here in Austin that does citizen engagement for cities and towns like a 311 system that people might be familiar with, let people pay bills or get licenses or other things not having to go to the town hall. I would say, particularly in COVID, when many of these things we used to do in person, we can no longer do in person, it's been incredibly valuable to governments who tend to be a bit lagging in their technology, to be able to communicate with their citizens in different ways, ways that might be normal if I was going to interact with my airline or my online brokerage, but I can't do yet with my local government. And so that opportunity for some of the industries to do better customer citizen engagement, and there's a huge amount we could talk about in data and analytics. So those are some of the themes that we're investing behind, and seeing a lot of opportunity in.

[00:14:25] **Hall Martin:** Great. Well, you talked about some startups you've invested in already. Are there any others that fit that thesis?

[00:14:30] **Bob Morse:** Yeah, I've mentioned another business that we're in. I think it's an interesting challenge right now. We are investors in a business called SSB, which also

has an office here in Austin. They do fan engagement for professional and college sports teams. So the University of Texas would be a client, half the NFL and NHL, it used to be very focused on helping people fill a stadium or do ticket purchases and how to engage with fans, but now we find ourselves in a time when none or very few people can go to the stadiums, and all of a sudden people are trying to figure out how do I communicate with my fans when they don't go to a game. And a lot of organizations don't have a good answer to that, and this is a place where using technology to be able to track through social, through online events, through all the different ways that you might engage with that fan is incredibly important. And so we find people very interested in that solution, even while cutting back on everything else, while we wait for the opportunity to be able to go and enjoy a game in person again.

[00:15:34] **Hall Martin:** Great. So you deal with a lot of startups, what are the challenges you see that startups face out there these days, what do you see them struggling with or spending most time on?

[00:15:44] **Bob Morse:** We see people, usually once they have their product with a certain set of customers intact already and trying to get the scale, _____ said, we're not in that seed stage. And for a lot of them, they're struggling with all the challenges of growth, many of them on the technology side are thinking about do I go alone or do I have a partner ecosystem, so how do I get there faster. Many also are thinking about how much service do I provide to my customers, I think that's a very rich topic. We have a lot of people who want to value things on our multiple recurring revenue and want very pure business models. But the reality is in a lot of areas, including government and education and healthcare, you have clients who really need some help adopting those solutions. And particularly, as a small company, providing the services to help people know how to use your product is essential. So those are some of the topics that we talk about over and over again – how do you build services to get people to use your solution, and how do you have the right relationships in the ecosystem so that people know and you don't have to do it all yourself?

[00:16:55] **Hall Martin:** Great. And on the other side of that table, what do you see investors struggling with, what are their challenges they face these days?

[00:17:02] **Bob Morse:** Well, I think one of the biggest ones is the one I talked about before with that first board meeting surprise is trying to really get to know the companies. I think the markets are so frothy, a lot of times the processes are really reduced in terms of the ability to really get to know what's really worrying the founder before investing. And the second thing, I would say, is we're in a market where prices, multiples are, the highest I've ever seen, the multiples for public software companies have run up almost 80% this year, even though growth outlook hasn't really changed. In the private markets, they're up more like 15% as a multiple. And so I think a lot of investors are asking themselves, boy, if I have to pay these prices, what can I do to help move the needle for the companies I invest in – do I have some background in opening a

door with a partner or in hiring or in technology and product or in go-to-market or some other thing where I'm confident I'm not just sort of trying to pick a winner and letting my money ride, but I can help influence a successful outcome? And when I talk to people who were building firms around the industry, that question is really on the tip of the tongue for people.

[00:18:16] **Hall Martin:** And so, in your sector, what sub sectors and applications do you think are good opportunities for investors to pursue today?

[00:18:24] **Bob Morse:** Well, one of the things I think will be a long term tailwind coming out of this in terms of sectors is we have a bunch of sectors in the economy that had used technology, but COVID is really forcing them to get serious about the digital transformation. If you look at education or healthcare or government did some technology usage, but when forced by COVID to see can you really work remotely, they realized it wasn't ready for primetime. You saw here in Austin, the City of Austin, in the spring, spent $22 million upgrading its distance learning, and there's never a spare $22 million in the Austin Public School District budget. So they did that because they said, look, we're really serious about this and doing it in the right way. And we see that with our healthcare clients and some of these others. So I would say some very big and markets that had been slow adopters have made a huge stride forward in their adoption, and so people, those have always been sort of the great market of next year. And next year, I think maybe is finally this year for some of those slower adopters.

[00:19:32] **Hall Martin:** Well, it's good advice. Well, in the last few minutes that we have here, what else should we cover that we haven't?

[00:19:37] **Bob Morse:** The last thing I want to just talk about briefly is one of the things we saw after the recessions in 2003 or the recessions ‘08, ‘09, are some people who had founded businesses and taking it through the recession and they get to the other side and they say, I'm glad I survived that but I'm not sure I really want to do this for another five years, I might be interested in taking on a partner. I would say, particularly with COVID, we're having more of those conversations than ever. And those conversations could be an opportunity for some of the startup companies here to think about a business that they might be able to acquire or a customer base, or maybe it's something someone who's thinking about succession planning, having done it for a long time, I just think there are going to be a lot of very rich conversations with founders who have businesses that haven't come to market or thought about a partner in a long time, that as the world opens back up next year, we'll be having that conversation for the first time in a long time. And so, I think they'll be a really, both a set of new companies, but also a set of some existing companies that are these sort of growth technology companies that will be interested in talking to investors for the first time in a long time. And for the investors listening, those can be rich conversations, and for the people running those businesses, realizing what a strong hand they have and how different some of the

approaches to different investors can be, I think you probably hear a lot of those on the podcast here and it'll be a good topic for people to keep in mind.

[00:21:07] **Hall Martin:** That'd be a great day when it comes, looking forward to getting back to the normal or the new normal they call it now, to reengage with many of those companies. So how best for listeners to get back in touch with you?

[00:21:18] **Bob Morse:** By email would be great. We're here in Austin, bobmorse@strattam.com, and I think you're going to circulate some of the rest of the contact info. Be happy to touch base with people, and I really, really appreciate you inviting me here to talk a little bit about our approach to this market and my thoughts.

[00:21:34] **Hall Martin:** Great. We'll put your contact details in the show notes. I want to thank you for joining us today and hope to have you back for a follow-up soon.

[00:21:41] **Bob Morse:** Thanks Hall.

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