

SaaS Show 4 -- The Impact of COVID-19 on the SaaS sector What Is the Updated Investment Thesis for the SaaS Sector?

In today's show, you'll hear investor perspectives on the COVID-19 impact on the SaaS sector.

This is Investor Perspectives, I'm the host of Investor Connect, Hall T Martin, where we connect startups and investors for funding.

It's the time of COVID-19. Software as a Service is currently undergoing tremendous change across the U.S. The lockdown has disrupted many industries such as travel, hospitality, restaurants, and more. We have investors and startup founders describe the impact of COVID-19 on the SaaS market.

Our guests are:

1. [Matt Oguz](#), Chief Investment Officer, [Iris Family Office](#) and Founding Partner at [Venture Science](#)
2. [George Spencer](#), Managing Partner, [Seyen Capital](#)
3. [Chris Hall](#), Principal, [Escalate Capital Partners](#)
4. [Nick Adams](#), Managing Partner, [Differential Ventures](#)
5. [Jason Kraus](#), Partner, [EQx Fund](#)
6. [Karey Barker](#), Founding Managing Director, [Cross Creek](#)
7. [John Gu](#), Principal-Growth Equity Group, [Spring Mountain Capital](#)
8. [JD Weinstein](#), Head, Global VC Practice, [Oracle](#)
9. [Stuart Kime](#), Co-Founder, Chief Future Officer, [hOp](#)

I hope you enjoy this episode.

For more episodes from Investor Connect, please visit the site at: <http://investorconnect.org>

Check out our other podcasts here: <https://investorconnect.org/>

For Investors check out: <https://tencapital.group/investor-landing/>

For Startups check out: <https://tencapital.group/company-landing/>

For eGuides check out: <https://tencapital.group/education/>

For upcoming Events, check out <https://tencapital.group/events/>

For Feedback please contact info@tencapital.group

Our first guest is Matt Oguz, Chief Investment Officer, Iris Family Office and Founding Partner at Venture Science, Venture Science

Hall T Martin: [00:17:49] So, based on the pandemic, have you updated your investment thesis for the SaaS sector, and if so, how?

Matt Oguz: [00:17:58] So based on the pandemic, again, parallel to what I described, you know, we're looking at any companies that cater to this new extension of the economy or this new digital economy. You know, these are always companies to just keep an eye out for. But other than that, our core thesis is to make sure we avoid biases, and, you know, we do two things. We make sure we're very calculated in terms of how we select investment opportunities and how we deploy capital. And number two, we only would like to go after the best of the best. So, the second part of it is essentially more of an internal preference for us, but, you know, we're fortunate that we're here in the San Francisco Bay Area, Silicon Valley, where really the best of the best companies are here, and those are the ones that we still like to go after. So, a few minor adjustments and tweaks, and we also obviously started looking closer and closer into the life sciences realm and maybe technology companies that create platforms and products for life sciences companies as well. So, we're going to continue looking at that.

Our next guest is George Spencer, Managing Partner, Seven Capital

Hall T Martin: [09:35]:-So did covid change your investment thesis for the SaaS and if so, how? What are you doing differently now than before?

George Spencer: [09:42]: I would say I'm looking for a little bit more health care focused stuff than I was before. And I also recognize that the capital efficiency in some of these aspects and some of these telehealth businesses, which are pure SaaS. Alright it is quite remarkable, you know, vis a vis kind of the traditional SaaS businesses where you're sort of slugging it out and investing 30 million bucks to get to 15, 10, 15 million dollars of revenue. I mean, we're seeing companies that can get to that stage on 5 to 10 million dollars in the telehealth space.

Our next guest is Chris Hall, Principal, Escalate Capital Partners

[00:13:12] Hall Martin: Great. And so, based on what happened with COVID, have you updated your investment thesis for what you look for, and if so, how?

[00:13:20] Chris Hall: We just say that the bar is probably a little higher, you know? We have our, you know, hard mandate and soft mandate pretty much, so things that we have to have and things that we like to see, and there's no such thing as a perfect deal, right, so you bend on a few of these aspects but it's less COVID and just more the uncertainty in the market, capital is drying up a bit, and thankfully we finished fundraising our _____ fund early December last year, so we have, you know, full funds to deploy, but it's just we would have to stretch less, right, in certain things you look for like size, you know, ideal margin, growth rate, kind of burn-rate profile, returning revenue, all that stuff, like we can be closer to. You know, I try not to make too many sports analogies in case you're not a sports fan it doesn't make sense but, you know, we're not chasing balls, right, maybe not necessarily right down the middle but it's we're not 0-2 on the count so we gotta wait for the right pitch. So still very active, but can just be more selective.

Our next guest is Nick Adams, Managing Partner, Differential Ventures

Hall T Martin: [00:11:58] OK. And then, so has your investment thesis changed for the SaaS sector based on COVID, and if so, how did it change?

Nick Adams: [00:12:07] It hasn't changed that much, to be honest with you, because, you know, we're so data and data-science focused in our thesis, which ties into SaaS and we invest across three layers of SaaS and technology. So, we have the application layer of technology which is applying A.I. to a specific business use case or challenge. Then we have platforms which basically enable data scientists, data engineers, and others to better deploy data science across their own organizations. And at the bottom of the pyramid, we really have the infrastructure. How do we ensure that your technology, your environment can support these big, heavy, complex algorithms with massive data sets to make split decisions in near real-time? So for us, we've stayed pretty true to that because we think the adoption is just still so early, and a lot of that, you know, a lot of the data, I think, will be the next iteration of applied software or service applications, kind of replacing some of the existing solutions today that are really data collection and workflow-oriented. But now, how do you now make all that process and information actionable? So, that's where we're continuing to look and invest.

Our next guest is Jason Kraus, Partner, EQx Fund

[00:11:30] Hall Martin: Have you updated your investment thesis since the pandemic, and, if so, how did it change, if at all?

[00:11:37] Jason Kraus: Yeah, so our thesis is around the founder first, so that part would remain the same. We look for – yeah, we have a split among, like, we have some serial entrepreneurs we've invested in a pretty tight relationship with the Boston Harbor Angels group. So some of the companies that had success in the past have come back with new, or the founders there have come back with new companies that they're now the CEO of, and we've gone in as investors into those businesses. We have some corporate leaders from companies like Google and Pfizer and other corporates that have started companies and have shown previous leadership expertise in the past; and then startup founders, we really got into now and love the work they're doing in their current venture. So the overall thesis there has stayed the same, but there's some shift in opportunities we see becoming bigger now than before. So just to give a couple of examples, like, we invested throughout the pandemic, we invested in a company that basically was in the retail space, the big fashion chains that went bankrupt and the founder or the new ownership now bought it out and turned it into a pretty large ecommerce business, the company Dress Barn that had hundreds of stores across the US, and now is sort of a startup and growing pretty quickly. We had another one that was in the wine or canned wine industry, and has grown as that user base comes. A lot more people are staying home, not necessarily looking to open a bottle of wine every however many times a week, but if they have a single serving option, they're more likely to do that. And then, yeah, some other areas we shifted into that we might not have been inclined to or they might not have been as much of a priority on our investment thesis beforehand, but the industry shifted to be a little bit more exciting through the pandemic.

[00:14:13] Hall Martin: Great. Are you seeing any activity in the supply chain side of it, the visibility systems, manufacturing or those type of things?

[00:14:21] Jason Kraus: Yeah, I think one area and areas like, there have been, especially at the beginning of the pandemic, a lot of supply chain disruptions, either being tied to one particular manufacturer or vendor being only focused in areas overseas or other or even only being in the US. So I think there's been some shift in companies focusing on the next time we have any sort of delay and shutdown, how can we manage or sort of have the next in line supplier lined out, that can be our backup plan of if one supplier has to shut down for a certain period of time, we can stay running smoothly and continue on our process there. And there's a couple of companies trying to solve that as well, and more of a technology around that system.

Our next guest is Karey Barker, Founding Managing Director, Cross Creek

[00:21:07] **Hall Martin:** And so many groups are changing their investment thesis based on what happened during COVID – what impact did COVID have on your investment thesis, and did it change, and, if so, how?

[00:21:21] **Karey Barker:** That's a great question. It is a type of risk that most of us were not prepared for. When we think of a big gap down market like we saw in March, we're usually expecting sort of the high beta sectors to come down the most, and, of course, as you know, high growth technology companies and biotechnology and other sectors that are usually considered to be higher risk sectors

have really outperformed during this period, because they're risks, they were actually seen as low risk to this specific event with a pandemic. So I think it's changing everybody's thinking around what kind of risk we're trying to manage the portfolio towards. Specific to us, we've always believed strongly in diversification. We do have a lot of exposure to all kinds of healthcare – healthcare services as well as biotech. I think that's something that is reinforced in this environment because you can't – sure pandemic was in lots and lots of people's risk exposure, something could happen, but I think very few people were really planning their portfolios around this being the event that would happen. So I think that we'll continue to focus on diversification of all kinds across stage, sector and geography in our portfolios, because we honestly, you know, none of us really know what the next thing is, and I think diversification is the best tool to be prepared for the unknown. So I think that's clearly one change in strategy, and I do think that we are spending a lot of time thinking about permanent change, behavior change of consumers, businesses, everything else. And what industries and ideas and companies COVID has really opened the doors for that we should be moving towards more rapidly, there are something like telemedicine is a great example that it was gaining share but very slowly. And I think the number of people that tried something like that during COVID really accelerates the potential for companies to be created in that category sooner faster. So I think we have changed our focus in terms of which industries we think our near term opportunities, and some of those are industries that COVID really accelerated the traction stage for those businesses where they may have stayed in sort of early opportunities for many more years, and they've gone from sort of early – I think education is another great one, I mean, online education has been gaining share very, very slowly for a very long time, and all the parents trying to homeschool has just radically changed the timeframes for many of these companies.

Our next guest is John Gu, Principal-Growth Equity Group, Spring Mountain Capital

[00:08:10] **Hall Martin:** So how did you update your investment thesis for the SaaS sector because of COVID?

[00:08:16] **John Gu:** So for us, we took a more conservative mode to underwriting in the sector. I think we look at not just – we looked at things not just from a sector perspective, but also kind of looked at things from a business model perspective. And so, for a lot of companies, when they're coming out with innovative products, they have to find new budget lines, they have to find new customers _____ to create budget basically to allow customers to buy the product. That could be difficult I think in an environment such as the pandemic, when people kind of just pull back on spending, and really focus on core costs. So we're looking for companies that are targeting enterprises versus SMBs, and targeting hard budget lines instead of more experimental budget lines that can be subject to contraction. From an end customer perspective, we're looking for companies that are not exposed to either the pandemic, so _____ from companies that serve as hospitality and the travel sectors as well as companies that actually were exposed to the trade wars that played out over the last two years. So basically, taking a little bit more of a defensive stance as we're looking to the marketplace.

Our next guest is JD Weinstein, Head, Global VC Practice, Oracle

[00:12:59] **Hall Martin:** That's great. Cool. And so, have you updated what you look for in this sector as far as startups for your accelerator, and what you think's going to be successful in the future, any change you made based on what you saw come out of COVID?

[00:13:16] **J.D. Weinstein:** I think what it does is it reaffirms a lot of the initial points we look at as a large strategic partner. And so, as an updated thesis, I would really spend time on renewable rates are key to sustaining growth. So focusing on net retention, expanding accounts, focusing on churn, and a future proof go-to-market strategy.

Our final guest is Stuart Kime, Co-Founder, Chief Future Officer, hOp

[00:23:38] **Hall Martin:** So how should investors update their investment thesis to take advantage of this new shift, it seems like, it's going from Facebook to micro social networks in the next generation, just because people want more control, they want to get away from the outrage and they want to do other things here, but how does investor participate in that?

[00:23:57] **Stuart Kime:** Well, I think, contact me is one. Right? We're obviously building out channels in a lot of different areas and we think there's some interesting ones in like nursing facilities and healthcare that we're interested in. Obviously, there's a long ways to go in apartments, because in apartments 50% of people in America turnover every year. They're not happy with where they live, and that's multifamily is seeing a real strong rise in COVID as we sort of get this like K-shaped rebound in the economy. I think that another interesting way of positioning is going to be in, there's gaming communities that are really strong. And so places like Discord, I think Zoom has seen a big up shoot and then recent downturn with the Pfizer announcement, but all, you know, I'm not a public investor, I mostly am a private investor, so to me it's looking at deals that deal a lot with owning audiences instead of running audiences.

[00:25:10] **Hall Martin:** You think that's the key as you look for those who actually own their audience and they're not running it through Facebook or LinkedIn or what have you, they have a direct control or connection over it, because you go to Facebook, they do manipulate that, they do control what happens to your group _____ groups myself together, and they say, one of the challenges of Facebook is when you get to a certain size, they start to control what you can do, unless you're paying for it. And so, once you're inside that world, you lose a little bit of control there, it seems like there's a motivation now to move outside of it if you can get more control, and maybe there's other things they want as well.

[00:25:48] **Stuart Kime:** Yeah, and to put it in finance terms, think of it like CapEx versus OpEx. So if you're Matthew McConaughey, and you have 4.2 million followers that have said they wanted to hear from you on Instagram, right, you can try this yourself at home, you go to Instagram, click on Matthew McConaughey or officially mcconaughey, and scroll down through the video, and you'll see that his average video count is only like 350,000. So the best in breed you will get on Instagram is 9% reach. So reach is one of the most undervalued statistics to me, because in the new, when you look at these crazy valuations for Google and Facebook, etc., even Amazon to some degree, it's because the most important commodity after the Google or the internet revolution, is a second of human attention. So if you look at like over time, people all fought over land, and in America that's adjudicated in Washington, DC, so

that's its central power. And then the next, the Industrial Revolution meant that now capital is more valuable than the land that factory is on, so who can control capital, and that's why you see the tension between New York and Washington DC. But after the internet revolution, you have this new layer of warfare or whatever you want to call it, that's based on human attention, how many seconds of human attention do you have, and Silicon Valley is sort of the center of capital. So this little triangle that fights each other is fighting between I want to tax the land, I want to tax the capital, I want to tax the human attention. And so, to understand reach, you have to realize that, or I'll put it even more specific terms, if you take Facebook's entire monthly revenue and you divide it by the monthly active uniques times the average session time, you'll see that every second of human attention is worth about 0.2 of a penny. So if Facebook is like the Walmart of human attention and influence, so you can go buy an audience and influence it in whatever way you want on Facebook for roughly 0.2 of a penny per second. So that's the – and so to take it back to how the CapEx versus the OpEx effects of operating that, if you CapEx the acquisition of your audience, you're not going to have to pay to communicate to it along the way. If you're going to rent your audience on Facebook or one of these other mega platforms like Twitter and Instagram, then you're going to have to constantly pay the OpEx to lift above that 9% reach into how much ever you're going to have to pay over and over again to talk to it. So even Matthew McConaughey, I'm just using him as an example because he's a local here in Austin, he has – his greatest, his deepest reach is only about 50% of those 4.2 million people.

[00:28:59] **Hall Martin:** Okay. So to increase your reach, you're really going to have to go own your audience, you're really going to have to shift and model and get out of the big Facebooks and LinkedIns and create your own world, so to speak, where you control it and you have direct control as well. I think we saw a little bit of that through in the COVID, if you are a brick-and-mortar and people came by the mall, and you were renting that audience, so to speak, that was tough to work. But if you were on ecommerce and you had a direct list of customers that would come buy from you, well, you survived the pandemic better than most because you had a dedicated audience that you owned, you didn't have to rent. So that could be one way to look at it. You need to own your audience or own the consumer, so to speak, that's coming to you, because I heard that many times during the COVID, those who have their own audience did well, those who were just renting it primarily foot traffic through the mall or what have you, they suffered a lot.

[00:29:56] **Stuart Kime:** Well, now that store becomes just a line item on all your other CACs, right? Everybody is a direct hit consumer brand, so if you have a physical store, and it's not bringing you that as many net new customers as your other CAC channels, then it's just going to get cut, like everything else. I mean, in the internet, it's all about metrics, and then the ones that aren't performing have to get cut.