Chris J Younger of Class VI Partners

Speaker1: [00:00:04.77] This is the Investor Connect podcast program. I'm Hall Martin and the host of the show in which we interview Angel Investors, venture capital, family offices, private equity, many other investors for early stage and growth companies. I hope you enjoy this episode. Hello, this is Hall Martin with Investor Connect today we're here with Chris Younger, managing director at Classic's Partners Classic's Partners provides investment banking and financial advisory services to middle market businesses and entrepreneurs in Colorado and across the U.S., the principles of class partners have completed hundreds of middle market transactions and strategic advisory engagements. And by using a disciplined process and extensive research, Classic's partners is able to provide you with the experience and judgment necessary to complete your transaction. Chris, thank you for joining us.

Speaker2: [00:00:51.03] Paul, thanks for having me. And thanks for doing what you're doing for entrepreneurs out there. They I'm sure they appreciate it.

Speaker1: [00:00:57.06] Great. Well, so tell us about your background before you started investing in early stage companies.

Speaker2: [00:01:02.11] Yeah. So I I've had a little bit of an eclectic background. My wife calls it career Adyghe, but I started out as an attorney. I don't hold that against me. I'm fully recover. I've been through the 12 steps and every once in a while I have a relapse. But I started out as attorney in Silicon Valley firm called Wilson Sonsini and worked with startups and young companies doing private financings and then did some public offering work that I left there. I decided that. That law and I were not a great fit, and then I went to work for an investor group where I helped them develop a consolidation strategy in the communications industry. And so we went out and acquired. So I was the deal guy. We went out and acquired about 27 companies over a couple of year period. So it was it was a lot of activity in a very short period of time. And we built that company. We got it over a billion in revenues. And ultimately I became the president and chief operating officer of that business. So my reward for doing it, for doing all those deals was to I had to integrate them, which I think took some took some heat away from me. I used to be a lot taller and probably took some years off my life. So but in any event, we integrated the business and dealt with 9/11 and the recession and and then we sold it to

Avaya, which is a communications company. And then after that, I actually tried to retire. I spent a couple of years doing some investing and after a little while, my wife told me I needed to find a hobby. And so my partner and I started our investment bank back in 2005. And through that we've represented a lot of different companies and have worked with lots of founders, lots of entrepreneurs. And, you know, for better or for worse, we've seen, I think, a lot of the bad movies that occur and some good ones as well. So it's been it's been a really, really fun ride.

Speaker1: [00:03:00.27] Right. So what excites you right now?

Speaker2: [00:03:02.55] You know, with all the activity that's happening after covid? You know, I am I'm really optimistic. And I was optimistic at the beginning of that that, you know, the level of cooperation across the world of pretty much all relevant scientists that would have something to do with developing treatments or vaccines. You know, that work has, you know, made incredible advances in such a short period of time. You know, the fastest vaccine we've ever developed, you know, by a factor of four, I think. And the other thing that has been really encouraging and we get to see this every day is how adaptable entrepreneurs are. I think they're going to lead us out of covid. They're going to lead us out of, you know, whatever economic challenges any of our communities have. And it's and it's because they can act quickly. They can react quickly. They have this again, this ability to be really nimble and some really enthusiastic about what we're seeing from entrepreneurs. And then add on to that, you know, there's just a lot of capital in the market. Ignored the stimulus, right. That is being sent out, which, you know, be in the hands of consumers. I think savings rates in the United States are at an all time high. But the you know, the amount of private capital that's available out there is kind of inspiring. And I think that'll be great for private capital markets.

Speaker1: [00:04:28.62] Great. Well, you see lots of startups and lots of investors. What's your advice for people investing in startups out there? What do you tell them to do before they write that first check?

Speaker2: [00:04:37.95] That's a great piece of advice, obviously, and I think a lot of investors know this, but kind of get to know the team and be prepared to support that team. You can't expect to invest in a young company and just abandon them or leave them to their own devices. I'm assuming a lot of your listeners are angel investors that have experience operating and growing businesses. And so the you know, the knowledge that you accumulate in over twenty or thirty years of working in this sector, you know, you want to be able to pass that on to these young teams that are, you know, there aren't as experienced but have a lot of energy. I also think that, you know, every business has kind of discoverable risks in it. And so be prepared to kind of dive in and kind of understand them, be able to help the team address them. And then I think the final piece of advice that I would give is, you know, you really you have to understand that owners or an entrepreneur is going to look at risk in their business fundamentally differently than an outside investor would. They are going to be more comfortable with the risks. They're going to probably see fewer risks and less risk in their business. And as a result, you know, the opposite of perceived risk is more value. You know, they're likely going to see their business is more valuable maybe than an outside investor would.

Speaker1: [00:06:00.90] All right. And then on the other side of that table, what's your advice for people running startups? What do you tell them to do before they go out for that fund raise?

Speaker2: [00:06:07.71] Yeah, that's a great question, Paul. I think it's almost the flip, right. Understand that investors are going to see and evaluate risk in your business a lot differently than you do. And so getting objective feedback about, hey, what is it that an outsider is going to see in your business and being, you know, prepared to address those, you know, objection. In that sales process is going to be really important, being transparent with your investors as to I think the the very best entrepreneurs are not oblivious to the risks in their business, but they've thought about them. They're part of their business plan. They understand and have a strategy for how to mitigate those risks. And so I think it's again, it's it's really just getting an objective assessment of your own business so that you're prepared to talk with folks who are just going to see your business differently. And and the final piece of advice I would give is when you take on an investor, particularly for a young business, you know, that fit with that investor is really important. These are going to be folks that you're going to. You're going to share lots of information with you're going to have lots of debates with and you want to make sure that they are going to be good to work with, you know, high integrity, ideally, they're fun to talk to. Ideally, they're really smart and have lots of experience. But get a list of questions together to help you objectively evaluate that fit. Don't get necessarily attached to the highest valuation that's being put on your company, but pay particular attention to, hey, who's this person that's going to be your partner over the next three or four years?

Speaker1: [00:07:47.80] Ok, great. Well, let's talk about the state of investing in startups. How do you see the industry evolving?

Speaker2: [00:07:53.18] Another good question. I think the you know, what we're seeing is there's capital leaving public markets and coming into private markets. One of the things that I mentioned at the beginning of the of the show was there's a lot of capital out there. And when you have interest rates as low as they are, public market valuations as high as they are, it's natural to see capital flow from, you know, the lower return environments in the public markets to higher return environments in the private markets. And so we're seeing that there's there's a lot of capital there. And it's not just equity capital. We're also seeing lots of private debt capital. There are a lot of credit funds out there that are more aggressive than your traditional lenders in providing that capital. Now, as a result of having all this capital and this is good for your entrepreneur listeners. Valuations are near historic highs. There's the deals that we're doing. You know, it's as high as we've seen them in terms of what investors are willing to value companies, which is terrific. And I think the final thing is, as you think about in particular debt capital, if any of your listeners is contemplating that while it's available, it's relatively inexpensive. You want to be pretty careful to make sure that you don't take on so much debt that that becomes a hamstring for growth. And so while equity capital may be more expensive, particularly for a young business that's definitely more flexible, which sometimes is more important than the cost of capital just because of what that business needs to get done over the next several years.

Speaker1: [00:09:31.01] Right. Well, what is the biggest change you think we'll see in, say, the next three to five years in this space?

Speaker2: [00:09:35.63] I think the number of players in the market, there are new funds getting created every week. I think the amount of capital right is to the extent that public markets continue to be highly valued, we're going to see more capital coming into the private markets, which likely will lead to increasing valuations in our particular market. The availability of debt capital has a big impact on overall deal valuations. And we're seeing debt that's pretty flexible, pretty inexpensive and pretty available. And so I would expect valuations to continue to increase. I also think and we're seeing this in all the deals that we work on, when you have more capital coming into the market and the valuations are higher, those expectations from the investment community are going to be higher. What that means is they're going to be doing a lot more diligence in the deals that we work on. We see most institutional investors when they're putting capital into a business or acquiring a business, you know, they're investing a quarter of a million, a half a million, three quarters of a million dollars with advisors, lawyers, accountants, consultants, other folks that can help them do the due diligence that's required to make sure that they're not making a mistake.

Speaker2: [00:10:52.79] And so for your entrepreneur clients that are raising capital or maybe they're going to exit at some point, you've got to be ready for that level of diligence. It is I liken it to the three worst medical exams you've ever had all the same time. I mean, it's it is very invasive and it is really difficult to get through without a certain amount of pain. So you can't wing that as an entrepreneur. You've got to be ready and prepared for that. On the flip side, the growth story for these businesses, right. When valuations get to be that aggressive, you've got to have a really well considered and thought out and defensible growth strategy and that you've got to be able to have not just the story, but to back up behind the story, to be able to convince somebody that, yes, this what we're anticipating in terms of our growth is doable. It's achievable. It's you know, it's not a high jump. We believe that we can get there. And you've got to be in a position to be able to support that with numbers, which is the language that investors speak very well.

Speaker1: [00:11:52.49] Let's talk about your investment thesis. What is your investment thesis and what's your criteria for funding startups?

Speaker2: [00:11:58.82] Yeah, so our you know, when we think about owners or entrepreneurs, you know, the the best ones are going to anticipate that level of risk in their business. And they're going to address those risks proactively, even if that means they've got to make more investment now. To generate returns later, and so you as a as an entrepreneur, again, you want to be you want to have looked at your business just like an investor would, well ahead of when you're going to have that conversation. And also think like we talked about, you know, the best owners are going to have a really clear, understandable, defensible growth strategy that they've, you know, thought long and hard about and hopefully have tested in the market. We see a lot of entrepreneurs that have great growth stories. But if you don't have that evidence behind it to support it and make that growth strategy kind of more believable, it really, you know, as good as they may sound to the entrepreneur, it'll it'll ring hollow to those investors. If you haven't haven't really thought about it carefully.

Speaker1: [00:12:58.25] You mentioned one or two startups that fit your thesis.

Speaker2: [00:13:01.00] Now we're seeing a number of SACE businesses that have been very thoughtful about what it takes to acquire a customer. What's the long term value of the lifetime value of that customer? They understand the significance of having a really, really high incremental gross margins. And they also, because of their revenue model, is recurring, sometimes contracted. You know, if they've been disciplined about retention, you know, hopefully reducing customer churn, you know, those businesses are some of the most attractive that we see in the market today and are are capturing, you know, almost unbelievable valuations. And that's just because those those businesses, when you think about the cash flow that they're going to generate, that cash flow is a lot more predictable. Those those businesses, you know, they've they've got a good proven plan. And, you know, for businesses that we see in the market, as those businesses start to get beyond, five million of revenues are our annual recurring revenue and up to 10 million, they start to get more attractive to institutional investors. There's there's some magic numbers for them. But those you know, you've got a as a savvy business. Right? There are some key metrics that we just talked about that they've got to be thoughtful about. And but those businesses are doing really, really well in this market.

Speaker1: [00:14:22.52] All right. Well, let's talk about the challenges in the space. What are the challenges in this space for the startup? What do you see your startups struggling with most?

Speaker2: [00:14:30.77] So we spent a lot of time talking to CIOs. And I would say the number one regret when we talk to CEOs that have been there and done that is they failed to build their team early enough. And that's true for a lot of different reasons. They may be concerned about cost. They may have some control issues. They may believe that there's no one that could do the job as well as they can. But that notion of investing in your team early and if you're investing in quality team members, the businesses that we see that have done that grow much faster, more predictably and with less drama. I also think a lot of entrepreneurs don't think through customer dynamics as well as they should. How reliable is that customer base? Is that customer a repeat customer, a recurring customer? Is it a project customer really having a clear understanding of, you know, what it takes to get that customer and then what they're worth to that business is something that I think entrepreneurs can really benefit from. I also think that and this really relates to the failure to build a team early enough is a lot of companies, you know, if your revenues are less than 30 million or so, it's really likely that there are going to be some key elements of that business that are way too dependent on the owner.

Speaker2: [00:15:52.94] The owner may be the principal salesperson. The owner may be the principal product development person. The owner may be the one that's in charge of operations. And failing to reduce that dependence of the business on the owner has a big impact on valuation, and it also has a big impact on how scalable that business can be over the long term. And then as we talked about, I think a lot of entrepreneurs, particularly when they are going to talk to investors, a lot of them have just failed to think objectively about how somebody else is going to look at their business. And as a result, they may be unprepared for the objections that they're going to hear from the investor community and the best entrepreneurs. Right. Have thought about it, have thought about the objections and will have good well thought out answers to that. So those are the kind of biggest challenges that we see for entrepreneurs.

Speaker1: [00:16:42.35] And then on the other side of that table where the challenge challenges, you see the investor facing in today's market.

Speaker2: [00:16:47.96] Well, when you have as much capital as there is, these deals are highly, highly competitive. Some of the deals that we're working on are getting 20 or 25 bids. And so that's a lot of competition for deals and for investors. It's not inexpensive to review a company in detail to to enough detail to be able to make a bid. And so that takes a lot of time for them. And conversely, without much competition, you know, valuations are really high. And so, you know, that sometimes requires that these investors use too much debt in their financing structures, which can, can and will have an impact on those businesses down the road, particularly if they have operating challenges. And I think the final piece that we see is given the level of activity, a lot of these investors are getting spread really thin in terms of the number of companies that they can legitimately oversee and and contribute to. And particularly for young startups, you know, investors ideally. Right. You're going to be there as a sounding board and be able to help them navigate the inevitable challenges that they're going to have. And so if, you know, if you're doing that for three or four companies, that's manageable. If you're doing that for 10 or 15, it's it's really not manageable. And unfortunately, it does a disservice to the entrepreneur.

Speaker1: [00:18:08.78] And so you see a lot of applications and sectors out there. If you had to pick one or two that you think are good, immediate opportunities for investors to pursue what you put at the top of the list today.

Speaker2: [00:18:17.90] Yeah, SAS, as I mentioned, is a really attractive vertical to be focused on, particularly when, again, that that. Lifetime value to cost of the acquisition of the customer is good when the margins are high, when churn is low and when growth is good, those are really attractive businesses. We are also starting to see I think covid was a good reminder that having the majority of our manufacturing offshore probably does not put this does not put our supply chains in this country on a good footing. And so we're starting to see investment dollars coming back and manufacturing coming back into the U.S.. There was a I think for a long, long period of time, we saw an exodus of manufacturing, whether it was to Asia or Mexico. But now we're starting to see some of that come back, particularly as it relates to pharmaceuticals and protective gear and that type of thing that we, you know, I think was a big wake up call here in the U.S. And then the final industry that has also been, I think is covid has highlighted how attractive these businesses are. Is these direct to consumer product companies? They've established an online presence. They're not selling through retail. They probably are not even selling through Amazon, but they have established their own online presence. So they have a direct relationship with those customers. You know, the margins generally are much, much higher than if they're having to go through retail or certainly through Amazon. You know, we see gross margins and a lot of those businesses that are over 50 percent know those businesses are really attractive and, you know, starting to attract a lot of investment dollars

Speaker1: [00:19:53.11] In the last few minutes that we have here. What else should we cover that we haven't?

Speaker2: [00:19:56.11] They've a lot of great questions. Well, I would say, again, for for an entrepreneur, make sure you're planning ahead. Again, the best deals that we see is where when the business owner has clear intentions, they've planned well ahead of that of that goal. And then they've executed really well. I've talked a lot in our in our session here about understanding kind of the levels and types of risk in your business to be able to communicate intelligently and thoughtfully with your investors. You know, we're happy to we as a tool, you can get it on our website, but we're happy to make it available to your listeners. It's called co-pilot, and we use that to assess the business where it allows us to. It's basically a questionnaire that a business owner and entrepreneur fills out. And then it tells us when we get the report and we'll make that report available, it basically tells you, hey, what risks in my business should I be particularly concerned about and what are the strategies for trying to address that risk? And so it's like I said, you can access it by emailing me or you can access it through our our website. Just reference this podcast when you do so.

Speaker1: [00:21:07.63] Right. Well, how best for listeners to get back in touch with you.

Speaker2: [00:21:10.32] You know the best way you can. You can access us through our website, which is w w w declasse six partners. So class GeoEye partners, dotcom or you could certainly email me. It's criss-Cross at Classic's partners dot com and and welcome. You know, any inquiries for folks that need help.

Speaker1: [00:21:29.89] Right. We'll put those in the show notes. And I want to thank you for joining us today and hope to have you back for a follow up soon.

Speaker2: [00:21:34.96] Oh, thanks so much, Hol. And thanks again for what you're doing for entrepreneurs. Right.

Speaker3: [00:21:40.48] Investor Connect helps investors interested in startup funding. In this podcast series Experience, investors share their experience and advice. You can learn more at Investor Connect, Doug. Paul Martin is the director of investor Canek, which is a five Wannsee three non-profit dedicated to the education of investors for early stage funding. All opinions expressed by Hall and podcast guests are solely their own opinions and do not reflect the opinion of Investor Connect. This podcast is for informational purposes only and should not be relied upon as a basis for investment decisions.