Daniel McCarthy of Theta Equity 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. Daniel McCarthy, co-founder of Equity Partners, assistant professor of marketing at Emory University, founded in twenty eighteen Theta Equity Partners, is a Seattle, Washington based valuation services firm. Firm specializes in customer based corporate valuation that refers to valuing firms by forecasting their current and future customers behavior and predicting their future financials. Their equity partners caters to private equity and venture capital firms, corporations and public equities. Daniel, thank you for joining us.

Speaker2: [00:00:53.41] Thanks so much for having me on.

Speaker1: [00:00:54.57] So what was your background before you started doing early stage investing in what you're doing now? What did you do before?

Speaker2: [00:01:00.93] Yeah, it's kind of a winding path. I actually had been yes, I went to Wharton for undergrad and after I graduated, I was kind of dyed in the wool finance person. So I'd spent about six years on the buy side at a Value-Based Hedge Fund. After that, I moved to Bass. I went back for my Ph.D. in statistics at the Wharton School. So that's always kind of been my passion, just kind of predicting things. So it was in the second year of the PhD that someone had recommended that I go and speak with this one professor of marketing, Peter Fator, and he basically had really turned me on to the problem of predicting what customers will do. So I finished my my PhD, but had basically pivoted towards marketing, just predicting future customer behavior. And it was in the middle of all of that, that Kivett that I made this transition to, this topic of customer base, corporate valuation, which is basically the main thing that I've been focusing on the past five, six years and is the core of the technology that we've been building and developing and data.

Speaker1: [00:02:06.39] Right. So what excites you right now

Speaker2: [00:02:08.58] In terms of what excites me right now? This is kind of speaking to my passion of customer base corporate valuation, but it's really being able to take transactional data and CRM data, which has often been kind of ignored in the valuation process and using it to to better understand just the underlying unit, economic health of firms and on the post acquisition side to to further leverage it, to basically do budget reallocations to to maximize the value of the firm. So I think that it's an area that we're starting to see a lot more companies waking up to to how how much value you can create, how much insight you can generate as part of the diligence process. But I still think there's a lot of additional ground to cover and we're just taking the first few steps there.

Speaker1: [00:02:54.78] Right? Well, you see a number of startups and also investing. What's your advice for people investing in startups? What do you tell them to do before they write that first check?

Speaker2: [00:03:03.12] Well, honestly, I think, you know, knowing what your core competency is is very important. So I wouldn't want to say that what I'm good at is what everyone else should look at the world. That being said, I think, again, there's this is gold in the transactional data. And so if you have firms that even firms that are relatively early on, as long as they've had a better call it a year's worth of customers that they've acquired and been able to see their behavior, that's really when you can start you kind of pivoting your business and just running it around where you're finding value. So one of the things that we will almost always see is that depending on the business, between 40 and 80 percent of your customers are going to be one and done. They're going to try you out and then they're going to leave. And most of the value is going to be coming from this really small group of people. So being able as an investor to understand what is it that sets those people apart? How are they different from all those much lower value customers? That can be absolutely critical. And at that early stage, that's when you can really make the larger pivots once you've kind of matured past a certain stage, you can still pivot. But, you know, obviously those changes become a lot harder to make. So, yeah, so to me, I think as an investor, being able to take in that sort of data for businesses that have been around for a long enough period of time and and be able to to draw insight from that, I think that that can really help avoid economic landmines.

Speaker1: [00:04:29.40] Right. So what's your advice for people running startups? What do you tell them to do before they go out to raise funding,

Speaker2: [00:04:34.56] Before they raise funding? Again, as speaking as an angel investor. I like to see the numbers. The first having full transparency as to how the customers have been performing. There's a certain set of disclosures that I really like to see. And if I don't see them, then I wonder, is that because they they just neglected to put it in or is there something to be worried about here? So to the extent that you're kind of providing us with an adequate amount of customer level disclosure, I think increasingly that's becoming table stakes. So don't don't don't hide. Don't hide it. And so let's

Speaker1: [00:05:12.00] Talk about the state of investing. How do you see the industry evolving? Where do you see it going from here?

Speaker2: [00:05:17.19] Again, I'm going to sound like a broken record, but increasingly, I think especially as as. Business as more and more of customer level transactions are being tracked. It's going to be easier and easier to to run the numbers on your business in this way. So in terms of where we're heading, you know, we're speaking with many other firms, not just ours, that have whole data science teams as part of their investment committee and as part of the investment group. So I really see there being kind of a big move towards just even if it's not our sort of models, just in general looking at business from a fundamental perspective, but looking at it in a more quantitatively rigorous way.

Speaker1: [00:05:58.96] And what do you think is the biggest change we'll see in the next five years,

Speaker2: [00:06:02.32] The biggest change in the next five years? That's a great question. Honestly, I think that the biggest thing that I'm still wondering about myself is we're seeing this big push towards privacy. And, you know, obviously there's been this big move towards all data being available to everybody. But I think that we're seeing pushback now. I think that's going to be more consequential for people in marketing when they're thinking about targeted marketing. Yes, that obviously will have big impacts for people on the startup side. But even on the investor side, I do wonder if there's going to be some level of taking a second look before they put the full transaction log in the data room, for example. So so I think what is going to necessitate is not a move away from the sort of quantitative methods I've been talking about, but how we can do them in a more privacy preserving way. So a lot of my research has actually been about how we can be able to derive insight from aggregated data. And I think that that could be one way where we can fully preserve the privacy of consumers while still getting the sort of insights that we really need about economic health.

Speaker1: [00:07:13.03] Well, let's talk about your investment thesis. What is it and what do you look for in a startup?

Speaker2: [00:07:18.31] Honestly, I like to see signs of early traction for my angel investing. The big thing is having at least you call it at least a bunch of months where I can get some conviction about repeat business. Even if you haven't been able to go all the way to observing full customer lifetimes, getting evidence that the unit economics are proving themselves out in the current margins and where you you can see where the margins should be know should they be able to kind of grow, grow, grow a bit more. But then I think much more importantly, seeing signs that customers are going to continue to come back a lot. And oftentimes we've now done many delinquencies on very young companies where there's just no repeat business. And very regularly you'll see, you know, 80, 90 percent of the revenues coming from totally new customers. And it's just not changing. Now, you'd expect some of that because it's because they're young and because of strong growth and growth will naturally increase that proportion of revenues coming from new customers. But still, it can really be kind of this orthogonal dimension that that can be very hard to to track for very young companies unless you're specifically looking for it. Yes, it really when I looked through all the angel investments that I've made, it's kind of been one of the things is to see evidence that the customers come back with with a good amount of regularity, or if they don't, that the margins are so good on a very first purchase that it more than pays off the acquisition costs.

Speaker1: [00:08:53.84] Are there any startups that fit that thesis you can call out?

Speaker2: [00:08:56.62] Yeah. The three that that really stick out to me are fig loans. You know, they're a nontraditional lending company, a company called Pipe, which monetizes customer contracts. So they'll kind of extend loans against against customer contracts. And a company called Where Clouds that says fulfillment in last mile delivery service, that it's kind of like the Uber for logistics. And in all three cases, especially, you often see this would be to be this great repeat business for the businesses that are are their clients.

Speaker1: [00:09:33.34] Right. So what are the challenges you see startups face today when they launch their business?

Speaker2: [00:09:38.77] Yeah, the big one, I think, is just migrating towards product market fit. And especially if you're on the software side, there's kind of this this tension, especially if you're getting VC funding to gun it for the IRR. And I think for many businesses, that's that's a good thing. I think for some of them, again, when we think about product market fit taking on project revenue, you have people who are willing to pay you money and essentially fund your R&D. I think there could be some circumstances where it could be a very non dilutive way of of being able to migrate your way towards product market fit without having to give up 30 percent of your equity to to venture capitalists. So. Yes, it's really hard to know, and I think it requires just good judgment to know where to draw the line, what what what would be good business to take on and what would be business that's going to really just slow you down and potentially push you in directions that will prevent you from scaling.

Speaker1: [00:10:40.96] Then what are the challenges you see investors face today when they're funding startups?

Speaker2: [00:10:45.78] Well, especially these days, evaluations are they're pretty steep, especially here in the US. And so I think there's kind of a race towards earlier stages to the point that there are many companies where I would have no I think I would have no edge. And you just kind of looking at a management team, maybe looking at prior prior exits that they've had and being forced to being forced into a pre money valuation of 10 million plus. I know that that's just not going to be an area that that I'm going to invest in. So, yes, I think sometimes one of the most wise things that you can do is know when to sit it out. So for me, this just many situations now I'm just sitting it out

Speaker1: [00:11:27.93] Right where you see a lot of different applications and sectors out there. If you had to pick one or two that are good media opportunities for investors to pursue, what would you put at the top of the list?

Speaker2: [00:11:37.15] I'm very interested in kind of alternative financing companies, and I think that that's a very interesting area where it's easier to quantify return on investment and both at the level of individual loans or whatever that financial transaction might be. But then also the counterparty that you're doing business with and how your business is expanding with them. So I think those are when we think back to the companies I mentioned earlier, pipe and fig loans, both would fall in that in that categorization. So I think that those are really interesting, interesting businesses that can potentially scale very well if done right. Right.

Speaker1: [00:12:13.67] When the last few minutes that we have here was we covered that we haven't.

Speaker2: [00:12:16.89] I guess that the main final thing I would say is not to underappreciated, just some of the nuance required to really properly run the numbers and get things like customer lifetime value. I think a lot of people think they know how to calculate it, but it's actually really hard, especially when you're trying to calculate it for very young customers at the individual level. And so one of the things that I've spent most of the past five, six years doing is building these very well validated predictive models that validate well at the individual level. So, again, if that's something that you'd be interested in exploring further know, that's exactly what that Equity Partners does.

Speaker1: [00:12:55.80] Great. Great. And you're also working at Emory University as a assistant professor of marketing. Can you tell us more about that?

Speaker2: [00:13:02.76] Yeah, that's so that's that's my primary job. So I basically teach a course called customer lifetime value. And most of my research, again, is about about this very same this very same topic. So, yeah, what what I'm doing on the one side is essentially very similar to what I'm doing on the other side, which is again, why I think it's very mutually reinforcing and also great, great for the students. In my course we learn how to first how to think about on a philosophical level, think about the value creating opportunities that that lie within customer centricity and in how you can go about some of the modeling. So things like customer retention modeling, customer spend modeling, it's it's not trivial. But I'd say the fall semester course you can actually come away with the tools that can work really quite well. So, yeah, so that's kind of what I pursue on the on the teaching side, research has been, again, mostly about customer based evaluation in some flavor or another, although there's a lot of my work that also kind of goes into some of the methodological aspects of different parts of the problem. Increasingly, I've been gravitating towards more policy oriented research, so I just finished a project on the kind of economic spillover benefits that are created by scooter activity and all the major scooter companies have been jumping on to it. Bird line, spin, scoop, you name it. They've been they've been talking about it, so they're very excited about it. And I think it's again, it all kind of revolves around better understanding, like how consumers make purchases and how they spend their money. So it's an area that I think would be more than enough to talk about for quite a while to come.

Speaker1: [00:14:43.68] Oh, well, great. Well, how best for listeners to get back in touch with you?

Speaker2: [00:14:48.03] The best way would probably be on LinkedIn. Honestly, that's where I that's kind of been my center of gravity for social media. So if you did search Daniel McCarthy, Emori, LinkedIn, I think that should that should pull me up. Obviously, Twitter is kind of the other major platform that I use. So underscore MKR. That's my my Twitter handle.

Speaker1: [00:15:09.30] I want to thank you for joining us today and hope to have you back for a follow up soon.

Speaker2: [00:15:13.05] Looking forward to it. Thanks so much for having me.

Speaker3: [00:15:14.91] Investor Connect helps investors interested in startup funding in this podcast series Experience. Investors share their experience and advice. You can learn. Or at Investor Connect, Doug. Paul Martin is the director of investor Canek, which is a 523 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