George Ferris of Bilgola Capital LLC

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 George Ferris, founding and managing member at Bilgola Capital, LLC. Bilgola Capital invests in small, dynamic companies with a fundamentally strong business models led by ambitious and professional management teams. Beachgoer provides long term patient capital and seeks to build companies with sustainable enterprise value. George worked closely with management teams to help them accelerate growth and build profitability. George, thank you for joining us.

Speaker2: [00:00:49.26] Thanks very much. Thanks for having me.

Speaker1: [00:00:51.35] Right. So what was your background before investing in early stage companies? What did you do before this?

Speaker2: [00:00:55.98] Yeah, I have been running Balgowlah now for about a decade. Prior to that, I had a career of leadership in finance in one form or another. I was a CFO and a director of a global energy company that was about five hundred people worldwide. That was largely a trading company that traded in energy commodities and ran pipelines and storage facilities. It was a very successful business. Prior to that, I had six years in private equity with a firm called Allied Capital at Allied. We were focused on providing mezzanine debt and private equity to middle market companies. So companies typically that had about 10 million dollars, be it up. So I had a great experience there and learning the investment business and proud of that. I was an investment banker. I spent eight years with Merrill Lynch and Goldman Sachs in New York and part of that to use in Sydney, Australia, with a firm called Macquarie Bank.

Speaker1: [00:01:52.08] Great. So what excites you right now?

Speaker2: [00:01:54.09] Well, you know, we're obviously coming out of a period of some pretty significant economic disruption in the US and around the world. I'm pretty excited about coming out of covid. Obviously, I think that the you know, the fact the fact that it's coming at the end of spring is is kind of nice that we're all getting out enjoying a burst of growth. I think the the investment climate prior to covid was a situation where there was a rising tide lifts all boats, which may or may not be the best analogy after the blockage of the Suez Canal. By that time, that container line up. But irrespective, there was a ton of money chasing a very small number of deals. And as a result, there was a significant mismatch of supply and demand in the capital markets. And the market did not easily identify quality companies and purchase multiples were a little bit, let's just say, out of whack. Now that business models of companies have been tested through that crisis, quality is being rewarded and lack of quality is being identified more clearly because of the performance of the businesses. Through that through that time, I invest mostly in companies, in software as a service and technology services in one form or another. And in those two areas, there's a ton of excitement going on with companies that sell software as a service and the technology services.

Speaker2: [00:03:19.77] So lots of growth, lots of fundamentals. And in those two industries that are driving opportunities for companies, I would say in all cases the companies that I'm focused on investing in have a handful of characteristics that the industries, the industry fundamentals are very strong. Most of the revenue that they're generating is recurring either monthly or annually, but they're generally very capital light intensity, namely very, very limited capital involved their asset light businesses, very strong value propositions for their customers, limited customer concentration and very high customer retention have got to be paramount. And fundamentally, they're attractive. And those of those attributes software as a service and information systems have those in spades. There's a lot of secular, powerful trends of digitization and transmission of IT infrastructure and applications into the cloud that's driving software as a service. And there's usually some massive gains being provided to the users of that software in risk mitigation or automation of various tasks, etc.. So software as a service is a massive industry with lots of opportunity and then information systems that companies use are getting more and more complex, very important that companies invest in their IT in order to either beat the competition or remain competitive. And they need experts to help manage that. And so lots of fundamentals driving those two industries.

Speaker1: [00:04:56.52] Right. We see a lot of investors in a lot of startups out there. What's your advice for people investing in early stage companies where you tell them to do before they write that check?

Speaker2: [00:05:05.02] Well, I'm fortunate that I've had a great experience working with some professional companies, doing investing in due diligence. So I learned my lesson, my lessons in a larger firm from some very smart people. And thankfully, some of the mistakes that I might have made. Not necessarily with my money, and they were captured by smarter people than me, so the key things in my mind there are choose your market and develop a niche. There's clearly a ton of money chasing deals. Being opportunistic is very difficult because if there is so much money trying to distinguish yourself and your message in that crowded field is quite difficult. So trying to find an edge is important. I think that careful due diligence really matters. Cutting corners on due diligence can lead to some very significant mistakes and some of those mistakes can have significant consequence. Being very, very careful on the decisions of who you partner with really matters. The quality of a management team is is crucial and integrity is obviously hard to determine, but crucial in any in any long term partnership. And when you're investing in startups, these investments often take a lot longer to realize than you might hope. And therefore, making sure that you have a someone with whom you are in total alignment as a partner is crucial. And then the last point I'll make is that making sure that you have alignment of interests in the economic outcome, structuring the transaction so that your economic interests are aligned with your managers is also critical. Getting a sweetheart deal that punishes people can often have some adverse consequences. So those would be the the principal lessons that I think that I would have for investing in startups

Speaker1: [00:07:02.05] And on the other side of the table, startups. What do you tell them to do before they go out to raise funding?

Speaker2: [00:07:06.64] Well, I'm not a I'm not a startup operator. I'm an investor for a reason because I know I'm not really very good at running a startup. But I think that I've learned a few things in my time working closely with the CEOs of businesses that have been successful before raising third party capital. I think what I would first of all do is recommend trying to bootstrap the business, namely fund it with friends and family, get it to the point where you've built your value proposition very, very clearly. You can articulate a strong story to customers that you've established. A core group of customers go through a renewal cycle of those customer contracts because proving out that the value proposition exists and the customers believe it and come back for more is a crucial generator of value. I would say build out the management team, hire a few key people, because it's very clear in any startup that you must have depth of a team to cover all the different areas. Obviously, the management team will evolve as the business grows, but it's very important that you have some bench strength, build out the story and then also build a board of people in your network who you think are going to be helpful to advise you on building that company.

Speaker2: [00:08:27.10] So those you know, it's very hard to do all of that prior to raising capital because sometimes businesses are very capital hungry. But I think it's important to try to be patient initially to build out some of those things because the rewards will pay off in the longer term. Then when you're raising capital, finding people who you think not only can provide you with well priced capital on good terms, but also who can be helpful as a board member who believe in the long, long term direction, who share the alignment of interests. Those are crucial. And I've seen some situations where companies have chased dollars, brought on investors who are not necessarily aligned in their interests, and it does create some challenges. So not necessarily seeking the last drop of blood out of the stone on the pricing of the terms is important in order to get long term harmony in you in your shareholder group.

Speaker1: [00:09:23.68] Right. Well, let's talk about the state of investing in recurring revenue companies that, you know, how do you see the industry evolving from here? Of course, it's a great business model, but where is it going?

Speaker2: [00:09:33.40] Well, in software as a service, this I referenced a couple of times already that there's obviously an enormous amount of capital from private equity investors or growth equity investors looking to invest in these sorts of businesses. I think that there is a large amount of capital in that growth equity, private equity community looking for companies that have that have achieved scale and by scale, I think they probably view twenty million dollars of annual recurring revenue as a as a as an important benchmark. A notch below that. There are probably a smaller number of institutional investors looking for companies that have achieved, let's say, 10 million of ARAA. What there is a difficulty is, is a shortage of investors willing to put their capital. Into companies with less than 10 million dollars and even fewer than that willing to invest in companies with less than five million dollars, they are. Therefore, where I focus is as a smaller investor in software, as a service companies that have between two and five billion dollars in revenue of annual recurring revenue largely. There's a real shortage of investors there. There's a real shortage of quality investors there.

Speaker2: [00:10:47.83] I think that in the world of software as a service, there's an enormous array of the sorts of services that those the sorts of problems that those companies solve. They're all very nicely. The the the aggregate market size is obviously important to determine the scale of that opportunity. But I don't like to invest in companies that have not yet generated revenue because I'm not a technologist. I don't really understand enough about the competitive landscape and whether the technology implicit in one company's product is better than another company's product. I want to rely on the customers that they've put their money where their mouth is and they have reviewed those contracts before deciding whether there's momentum. And then I can make judgments about the the ability for that business to scale beyond that point. So focus on that two to five million dollars of revenue. There are hundreds of companies providing phenomenal software as a service, solutions in that range, the desperately in need of capital. So that that's that's the part of the market that I choose to participate in as it relates to software, as a service.

Speaker1: [00:11:55.15] And what do you think is the biggest change you'll see in, say, the next five years in this space?

Speaker2: [00:11:58.63] Well, what I'd like to do before we get to that, if you don't mind all, is just to go back also. Then the other other segment of the marketplace that I play in is the I.T. services, where this is not necessarily software as a service, but more providing labor based services on a recurring basis. And there is a very large community of companies out there providing managed IT services. And these businesses provide outsourced management of small and medium sized businesses. I.T. networks manage everything from security to back up to help desk to the management, the tools and coordinating everything, making sure that the of a company runs smoothly in the same way as in the sasy industry. There are tons of private equity firms looking to buy companies with more than 20 million of IRA. Well, the same thing applies in the services industry, where there are tons of private equity firms looking to buy companies with at least 10 million dollars of profits off of the door. And again, there are a handful of private equity firms looking to buy companies with between five or at least five million of the top in the services space. I focus on companies that have less than five million dollars of and typically between one and two million dollars to be put to the managed services industry is a massive industry. There are thousands and tens of thousands of providers in the US and globally. It's in a very fragmented space, lots of demand, and we're building a big business and making a lot of acquisitions in in that area, which is undergoing some significant growth.

Speaker2: [00:13:35.65] And so I think that in the SAS and the services space, the message that we have resonates very strongly with business and is we provide the necessary growth capital for these companies. We advise them on a lot of their principal day to day and strategic decisions. We help build their reporting dashboards to make sure that they understand the levers that they can pull to improve their performance. We help them raise additional capital if need be, and then help execute on acquisition transactions and provide a lot of the M&A advice. So within SAS and services, that that's sort of the range of opportunities that we are providing and how that industry is evolving. The successful companies are growing very rapidly and getting a lot bigger. So it's been an exciting time. And then I see a question that you asked a moment ago, the biggest changes coming. I think it's more of the same. I think the tailwinds that are driving growth in software as a service and manage I.T., a powerful long term trends, you know, the the market share gains by software as a service over on premise solutions are significant and will continue to grow. And there are tons of entrepreneurs who are coming up with great ideas that need capital. So lots of opportunity there. And there are hundreds of owners of managed I.T. services companies that are looking to join partnership with another large provider in order to join a bigger team. So lots of lots of continued growth in those two sectors, I believe.

Speaker1: [00:15:14.05] Right. Can you give us more color around your investment thesis? You talked about recurring revenue in the two to five. Dollar annual recurring revenue range, but can you be more specific about the criteria for what you look for in companies that you want to invest?

Speaker2: [00:15:28.39] Well, I think that most of those characteristics would fall into that, that the industry first of all, there are some things that I don't like to invest in, industries that are heavily regulated or where there's a high degree of technical expertise needed, for example, fintech or health care, the provision of health care services. I don't invest in those because I record as I do not have an edge in trying to understand those industries. Outside of that, the the areas that I choose to invest in are typically business-to-business companies, namely, they sell, they sell to another business customer as opposed to a consumer on a recurring revenue basis with very limited capital and intensity. I don't like to invest in businesses that have a lot of assets required on their balance sheet, because I think that that can create some real challenges with cash flow management and requires a lot more capital and therefore they often can be capital inefficient. And that if if there is a strong value proposition that the service provides to the customer, that will solve a lot of competitive challenges and a lot of pressing issues and everything else. So as long as the value proposition is strong and defensible and sustainable, those will then lead to long term growth stories. Businesses that have high degrees of customer concentration, those are really challenging in the same way that heavily regulated industries are subject to, you know, what I call struck with the pin risk where someone in government or someone, one individual or one decision maker can make a change that can dramatically upend an industry the same way customer concentration can decimate a company. So if there is a significant concentration with one or two or three customers, that's typically a significant hurdle for me. And then the rate of customer retention or opposite that the attrition rates are very important because that's a that's an indicator to me of the value proposition. And then it's great if this acquisition opportunities as well, because that's just another lever that you can pull to try to help the business grow. So those would be the principal characteristics of the businesses that that I see.

Speaker1: [00:17:47.50] Right. So for companies in your space, what are the challenges you find your startups facing most?

Speaker2: [00:17:53.50] Finding people is is really hard and I don't know about you, but I think that you can build relationships with people and with investors because you're typically spending a lot of time with them hiring people. When you're having a one hour, two hour series of interviews before you make a judgment, it's really, really difficult to make judgments about senior members of management. So I think that the entrepreneurs who are really good at making judgments about people, that's a skill set that I think is phenomenal and is often very difficult to find. So that's certainly a big challenge. I think that a subset of that, which is the hardest that I've found at least, is hiring the right salespeople. And if you can find someone who knows sales and marketing and who can hire sales and marketing people, well, that will go a long way to helping a business scale because the churn rate among salespeople is is unfortunately very, very high. I think that a huge distinguishing characteristic of successful entrepreneurs in startups is the ability to think strategically, to step back from the daily fray of the battle of of running a company, to be able to identify the long term trends, to make long term decisions and think strategically about where you want to be in the industry, defining the market that you want to play and how you want to price your product, how you want to build your management team, and how do you want how you want to distinguish your product. Those are really important because it helps unite the whole team around a critical message and then finding the capital, choosing the right people to bring bring on as shareholders and as directors is a defining characteristic of some of the successful companies in any startup.

Speaker1: [00:19:49.18] Right. Then on the other side of the table, what's the challenge you as an investor face in this space? What do you struggle with most?

Speaker2: [00:19:55.63] Finding good opportunities, having pricing discipline and knowing when to say no? Honestly, I mean, I am different than the average institutional investor in that Bill Gola is a family office. We don't have to put money to work. We just choose to invest in businesses that we like. We have long term patient. Approaches to investing in businesses and so where some institutions feel like they might have to put money to work and they have to also make realization of those investments at different points in time. I think that can often lead to some adverse outcomes to to operate. So I think that knowing when to say no, knowing where to draw the line on on risks that you see in your due diligence process, those are crucial issues that will distinguish successful from less successful investors. I'll be candid. I've had some misses, but I've also had some successes. And so you learn these things the hard way. A lot of these observations, I think, come through backing companies that perhaps were a little too young for it or didn't necessarily have all those attributes that I thought I'd talk through earlier. But those successful companies have had all those attributes in spades. So that's that's that's my perspective, I guess.

Speaker1: [00:21:22.24] Well, you see a lot of different subsectors in applications inside this recurring revenue world. If you had to pick one or two subsectors or applications that are good, many opportunities to pursue, what would you put at the top of the list?

Speaker2: [00:21:34.87] Well, that's a good question, whole. And I don't think I really have any specific things. I will I will say that I typically am opportunistic when I see an opportunity that I like, I dive in and move quickly, do a lot of work conversations with management and try to get a get to a point of understanding to be able to make the judgment about investing or not. But I define more by by what I don't want to look at. I don't want to look at turnaround opportunities. I don't want to look at heavily regulated opportunities. And I don't want to look at some of those other things that don't have those characteristics. And there are just so many different areas that of businesses that come up. So and then the other part that I haven't mentioned necessarily yet is that we've been fortunate in the US where despite covid, which was a very short, sharp recession, we've gone through a period of extended economic growth. There will be a recession at some point. And I have no ability really to judge when that will happen. And I don't try to pretend that I will ever be able to estimate when that will happen. I've been wrong, you know, calling for the, you know, the sky to fall many times before. So I choose not to try to forecast economic cycles. I choose to identify businesses that are strong, that will withstand the cycle. When it happens, they will inevitably be another downturn in the economic cycle. And when that happens, I just want to make sure that we have a business that is prepared for that, that has those attributes. That means that it will survive through the cycle and hopefully prosper and emerge on the other side of it in a very strong, strong manner. So those are the sorts of businesses that I like to try to to invest in.

Speaker1: [00:23:21.70] Great. Well, in the last few that we have here, what else should we cover that we haven't?

Speaker2: [00:23:24.91] Well, I mean, I think that for early stage investors, there's a a very imperfect market for raising capital. I think what you're doing here, whole with your organization in trying to connect investors and entrepreneurs is phenomenal. I'm based in the Washington, D.C. market. There's a community of early stage investors up here. We all work together to try to find those opportunities in the same way. So I'm sure you're doing nationwide and mostly in Texas, but I think it's great to try to find ways of making this market a little bit more efficient and to break down some of those barriers to identifying opportunities.

Speaker1: [00:24:07.48] Great. How best for listeners to get back in touch with you.

Speaker2: [00:24:10.57] I have a website that is Bill Goala Capital Dotcom. That's Bael Geo, a capital dot com. My contact details are on the website. For reference, I have to some extent that's a little south of the border than than where you are from originally from Australia. And Bill happens to be a beachwear. I learned to to serve as a as a kid in northern Sydney. So that's the reference to my cell phone and my email address are listed there. But I look forward to getting in touch with anyone with with any questions.

Speaker1: [00:24:45.85] And thank you for joining us today and hope to have you back for a follow up soon.

Speaker2: [00:24:48.88] Awesome. Thank you very much for your time.

Speaker1: [00:24:51.31] Investor Connect helps investors interested in startup funding. In this podcast series, experienced investors share their experience and advice. You can learn more at Investor Connect eg. 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 Connect. This podcast is for informational purposes only and should not be relied upon as a basis for investment decisions.