KEYNOTE INTERVIEW

Finding opportunities in fragmented markets



Coming out of the pandemic, MidOcean's David Kieselstein, Barrett Gilmer and Dhruv Prasad say the key to success in business services is to take a focused, thematic approach

Q What are the current challenges and opportunities for investors in the business services space? What does MidOcean like about the area historically, and where are you currently focusing your attention within that?

David Kieselstein: First, business services is a broad descriptor, so I'd just like to clarify that we are not generalist investors. We focus on very specific market opportunities based on thematic angles that we have identified, and we leverage our strong operating partner team to tighten those thematics and drive proactive deal sourcing.

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The vast majority of our deals are executed in exclusive processes, and our team of 22 operating partners works with our investment team as an essential element in that sourcing success. Our operating partner roster is actually slightly larger than our deal team, and we incorporate them into our investment process at every step.

The specific areas of business services that we focus on include human capital and IT services, education and training, out-of-home entertainment, healthcare services and B2B route-based services. We also have deep experience in information services.

There are numerous attractive qualities to these segments, but crucially we like the fact that, by providing ongoing services, there is both a recurring revenue stream and a direct and regular interaction with customers. That creates both predictability and an opportunity for us to grow those relationships. In addition, these markets are relatively fragmented, so there is both the ability to steal share by delivering better service, and to acquire and improve performance of less scaled businesses as part of our value creation plan. That said, each of our thematic areas of focus will have its own specific criteria.

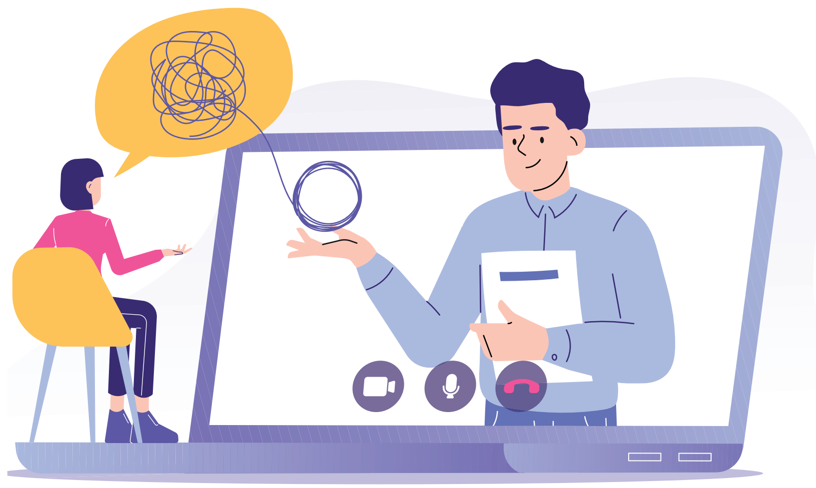
Q Within info services specifically, what types of deals do you find attractive right now, and how competitive is that marketplace?

Barrett Gilmer: We are particularly focused on data and insight businesses that tie directly to business decisions and operations. This usually drives better financial metrics like net retention and makes the products stickier during economic cycles. We don't go after generic platforms, as those tend to have more cycle risk, but instead we use our thematic investing approach to identify specific end markets that we like and then go deep into those. We are looking for strong long-term sector growth, coupled with attractive dynamics like fragmented suppliers and customers.

We use our operating partners and their sector knowledge to help with networking and direct sourcing, as we look for angles that others might not see and businesses that others might look past. Music Reports falls into that category, where Dhruv is currently president and CEO, and so does Zonda.

With Music Reports, which we acquired in August last year, we found a company with great business fundamentals, but also with some industry complexity due to a once-in-a-generation regulatory change. Dhruv helped us get on top of that during our diligence process.

With Zonda, in 2018 we acquired and merged Hanley Wood, the leading B2B information services company serving the US residential construction industry, and Meyers Research, the leading provider of real-time market data and advisory services to the home building industry. We saw two very unique data assets, but the media platform created complexity for other buyers. David is one of the best B2B media CEOs around and he helped us craft a plan to focus the media business on the core residential construction sector, which has resulted in the data business representing more than 80 percent of EBITDA today.



Q What are the key elements of identifying a good info services deal?

Dhruv Prasad: An example of our approach is Music Reports. I was working with MidOcean exclusively as an operating partner for about a year in the experiential services space, looking at opportunities up and down the value chain in audio, video and live entertainment. We identified investment targets that fit our thesis, and we were early to recognize developing positive trends in the global music ecosystem – including new applications using music, like social media, connected fitness and gaming.

We did a deep dive on data and technology service providers positioned to benefit from this trend and that led us to a small group that included Music Reports. Other potential buyers couldn't get past the complexity inherent in music licensing and the pending regulatory change, but our sector knowledge allowed us to figure that out, box the key risks, and acquire the business outside of an auction at an attractive valuation.

There are three things we love about Music Reports: its core proprietary asset, Songdex, which is the largest independent database of music rights information in the world; its industry-leading suite of 'must buy' B2B tools and technology; and its team of experts. As the two founders were stepping down, I joined the business as president and CEO.

At MidOcean, we like to look for multiple ways to win, which is the case at Music Reports. We see organic growth from operating enhancements and investments, we're launching a new product offering, and there are plenty of adjacencies in music and entertainment licensing and administration that would make sense to combine through M&A. It's still early days, but we see an exciting open field in front of us.

Both of those acquisitions were made in exclusive processes. When we get an early and exclusive look at a company and get embedded with the management team, the vision and expertise of our operating partners tends to get management teams eager to work with us.

Q What have you learned about good deal processes from the transactions you have done in the space so far?

BG: We're really focused on three things: having multiple ways to win as Dhruv just explained, deep specific sector knowledge, and a highly relevant operating partner. Questex and Zonda are great examples of these.

Questex is a leading global B2B information services company with digital and trade shows that we acquired in 2018. We tracked the company for more than 12 years and were able to acquire it in an exclusive process. We're viewed as one of the most knowledgeable investors in tradeshows having had prior success with Penton, where David was CEO, which was basically a bigger version of Questex. We first invested in Penton in 2007 and built it up from $60 million to $140 million of EBITDA, completing 13 acquisitions before selling it to Informa for $1.6 billion in 2016. And in Questex we saw an opportunity to use that playbook. We also saw multiple ways to win – operating enhancements, solid organic revenue growth, margin opportunity and M&A, where we've already closed three acquisitions.

With Zonda, we tracked the opportunity for 15 years. We acquired both Hanley Wood and Meyers Research simultaneously through exclusive processes, attracted to their proprietary decision-making info, which is mission critical to companies in US residential construction. We saw a transformational opportunity to combine the two leading data players in that space, working with David to reduce the amount of media revenue in a thoughtful way over time and to unlock tremendous value. Zonda's tagline is 'building the future of housing,' and we don't feel that would have been possible without this transformational merger.

Q Finally, what do you see as the outlook for these deals in 2021, as businesses emerge from the pandemic environment?

DK: We had a very active 2020, despite the pandemic. There were processes that were stalled, and people were sometimes reluctant to do deals because they couldn't meet management face-to-face or they were focused on issues within their portfolio. We quickly got our hands around our portfolio – which performed extremely well – and then completed three acquisitions of new business services platforms, as well as a number of strategic add-ons.

We expect to see a lot of dealflow in 2021, due to both pent up supply from those delayed processes and impending changes to tax policy. We think information services will continue to be an attractive area to play in, having shown solid growth through covid, typically quite resistant to recession, and still ripe for some strategic growth capital. We also expect to see an increase in the outsourcing of human capital services as businesses further embrace flexibility in their business models as learned from covid.

Prices have certainly remained high in general, but we have been disciplined and will continue to do so. Within information services, our areas of focus are not in the most overheated segments of the sector, such as pure play enterprise software. We like the combination of growth, predictability and in-reach pricing and we have a clear playbook for driving overall enterprise value.

We are known as a very founder-friendly firm, so as tax policy triggers more founder sale activity later this year, we expect to be one of the beneficiaries of that.

Last, we will continue to leverage our operating partners to help us source opportunities through their strong relationship networks. Between them, they have direct connections with nearly 7,000 CEOs. We use these relationships to try and get ahead of opportunities and potentially even unlock opportunities where founders were not necessarily planning to sell. We believe having a focus and knowledge around our key thematics gives us a significant leg up and our playbook, operating partners and founder-friendly approach set us apart. ■

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DAVID KIESELSTEIN

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BARRETT GILMER

David Kieselstein is the chairman of private equity at MidOcean Partners; Barrett Gilmer is managing director and co-head of business services; and Dhruv Prasad is operating partner