

TAPPING INTO ENTERPRISE SOFTWARE EXPERTISE IN PRIVATE CREDIT

“Success occurs when opportunity meets preparation,” the saying goes, and today it seems especially apt for certain private credit investors in enterprise software. With traditional sources of financing for many of these companies drying up, private credit managers with deep sector expertise find themselves in the position to source more attractive opportunities and instill additional downside protection to support better risk-adjusted returns. The sector is also drawing increased attention from institutional investors.

“Venture capital and growth equity, which used to be very strong sources of financing for these businesses, along with the IPO market, are very difficult right now, which is creating a terrific deployment opportunity for private credit managers with the know-how to source the right deals,” said David Flannery, Senior Managing Director and President of Vista Credit Partners, which is the private credit arm of Vista Equity Partners.

Vista Credit Partners is uniquely prepared for this moment given Vista’s singular focus on enterprise software and its credit investment capabilities being a natural extension of its private equity investment strategy. “On the private credit side, we’re following a tested 20-plus-year playbook in terms of our investing style and portfolio management,” Flannery said.

LEVERAGING THE PLATFORM

Vista Credit Partners taps into extensive institutional knowledge, relationships and best practices developed by Vista Equity Partners, a pioneer in enterprise-software investing with more than 85 portfolio companies and \$100 billion in assets under management, to form partnerships with both mid- and late-stage companies looking for flexible credit solutions – as well as operational support to drive sustainable growth.

“Our investing style is, quite plainly, adopted from our private equity teams in terms of the types of businesses and metrics that we focus on. We’re able to leverage Vista’s expansive ecosystem to source deals, conduct due diligence, execute the underwriting and provide companies with operational support, which we believe makes us extraordinarily unique,” said Flannery, who has led Vista Credit Partners since 2018. “We have a unique setup – we believe no other software-focused lender has access to anything at this scale.”

Currently, almost two-thirds of Vista Credit Partners’ portfolio is non-sponsored deals, many of them founder-led companies through its FounderDirect channel. “These are businesses that are still founder owned and founder led, and not owned by private equity sponsors,” Flannery said. The other third is sponsor-backed deals, lending alongside nonaffiliated private equity firms that buy technology

businesses and need an experienced credit partner that understands the industry.

MISSION-CRITICAL SOLUTIONS

Like Vista Equity Partners, Vista Credit Partners focuses exclusively on enterprise software and holds a strong conviction in its durability as an asset and its large and growing role in today’s digital economy.

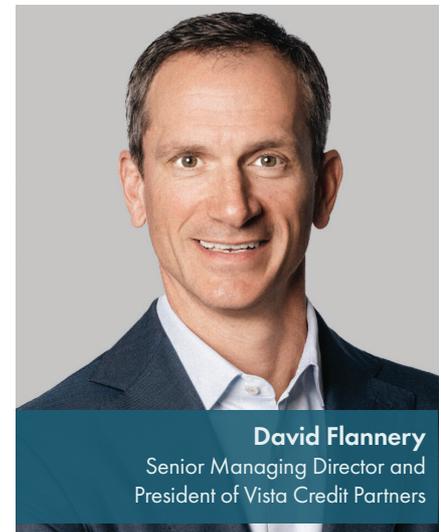
“Today, just about every company in every industry in all corners of the globe uses companywide software, making it mission-critical to modern businesses, no matter the economic climate. That exceptionally strong and growing demand driven by ongoing digitization of organizational workstreams is one reason that enterprise software has one of the lowest default rates out of any industry over the last 20 years,” Flannery said.

The public-private distribution of these companies is also providing tailwinds to private credit lenders, according to Flannery. “There are more than 100,000 technology and software companies across the globe, and 97% are privately held. This provides a significant opportunity set for investors to partner with lenders with the experience and expertise to source the most attractive private market opportunities.”

In addition to enterprise software’s place in the digital economy, the reason that the sector is so appealing to investors is that its companies tend to have highly predictable and recurring revenue streams.

“In addition to enterprise software’s place in the digital economy, the reason that the sector is so appealing to investors is that its companies tend to have highly predictable and recurring revenue streams,” Flannery continued. Enterprise-wide contracts are usually long term, over two to four years, and the software solutions typically involve high degrees of complexity, lengthy installations and extensive staff training. A driving factor in revenue stream predictability is the sector’s ongoing adoption of software-as-a-service delivery models, or SaaS, where customers pay monthly, quarterly or annual subscription fees.

That kind of reliability is prized not only by loan underwriters, but by investors as well. “Software is very sticky, it doesn’t turn over, it doesn’t churn in the enterprise con-



David Flannery
Senior Managing Director and
President of Vista Credit Partners

text,” he said. “That’s what supports the predictable and long-term nature of the revenue and makes it something you can underwrite to.”

CREDIT’S MOMENT

While private equity came in at the early inception phase for enterprise software, credit is seizing its moment.

As the Federal Reserve’s interest rate hikes continue to bite and traditional bank lenders pull back, venture capital and growth equity has retrenched, and the IPO market remains mostly closed. VC-backed technology IPOs were down 80% through June compared with a year ago, according to PitchBook data, while late-stage VC activity was down 50% for the same period.

In this environment, many enterprise software companies – particularly late-stage, founder-led businesses – are finding that incremental investment from a venture capital firm is often more difficult to attract and more expensive in nature, and they are looking for additional sources to finance growth. “That obviously is going to drive a lot of great companies to seek out credit as a potential alternative to the venture community,” Flannery said. In addition, the IPO market can be volatile, even in the best of times. “Businesses are hesitant to jump in, even if the IPO option is available,” he said.

Thanks to a favorable backdrop, enterprise software today presents what Flannery calls a target-rich environment with a plethora of software companies looking for like-minded, long-term capital partners. “There just aren’t that many groups who have the domain expertise the way we do with software. It makes us stand out and allows us to drive preferential terms,” he said.

While offering a broad product suite to meet a company’s

Investment INSIGHTS



financing needs, Vista Credit Partners is seeing increased traction through its non-sponsor offering, FounderDirect, that has deployed over \$1 billion this year. The firm identifies situations in which founders have spent a decade or more building a formidable company, but they are not ready to sell to private equity and face an unfavorable IPO market, Flannery said. “They’re looking for less-dilutive capital that can help them continue their growth path and someday be ready for an IPO. We can source those deals with our private equity teams, and we can do the due diligence and underwriting with the support of our internal Value Creation Team.”

DEFENSIVE FOCUS

Institutional investors have watched developments in the technology sector with keen interest, and many regard enterprise software as a defensive opportunity — particularly with today’s uncertain economic outlook. “There’s a lot of uncertainty in the world, which is driving investors into more defensive areas. It’s taken some years, but the investor community has come to recognize software’s repeatable, recurring and predictable nature, and the sector has proven just how resilient the cash flows and revenues can be,” he said.

Risk mitigation in private credit is another draw. “There’s a strong belief in the institutional market that the structuring in private credit is better [for investors], and better downside protection comes in the form of lower leverage,” Flannery said. Strong covenants are typically in place, with an opportunity to do more thorough due diligence. “That structuring reduces risk, and you’re still able to extract a coupon or spread premium versus traded credit in the broadly syndicated market.”

In addition, private credit is typically tied to floating-rate benchmarks, which means it automatically resets higher when rates rise and can better retain value versus longer-term bonds, whose values are eroded by higher rates, he pointed out.

LOW LEVERAGE

An important characteristic of Vista Credit Partners’ portfolio companies is a prudent use of debt. “We rarely find founders taking as much leverage as their company could actually support, and we love that about our business,” Flannery said. “We think that keeps things pretty conservative.”

Companies that may need capital but whose management teams take a judicious approach to leveraging up present excellent investment opportunities, Flannery said. Their companies operate responsibly and remain creditworthy while delivering solid returns for private credit managers.

Vista Credit Partners prefers to invest in companies that have at least \$500 million in enterprise value. “These are big, scaled, proven businesses and business models,” Flannery said. Its loan commitments typically start at about \$100 million and scale up from there. “If you think about a \$100 million credit investment versus a half a billion dollars of enterprise value, those are lower-leverage, lower-risk, lower loan-to-value investments.”

SECRET SAUCE

Vista Equity Partners had the hands-on company founder in mind when it developed its approach to value creation more than two decades ago. Its Value Creation Team is comprised of operating executives and more than 100 enterprise software subject matter experts — former practitioners, in many cases — who help the management teams of its portfolio companies implement best practices across core functions of their businesses including product and technology, go-to-market, and talent and business operations.

Vista Credit Partners’ portfolio companies gain access to this value creation expertise to help drive product innovation and sustainable growth. The team also facilitates networking and knowledge-exchange opportunities with executives from the broader Vista ecosystem, as Vista Credit Partners’ portfolio company executives have access to Vista Equity Partners forums and events such as the CXO Summit and Global Hackathon.

We’re able to leverage Vista’s expansive ecosystem to source deals, conduct due diligence, execute the underwriting and provide companies with operational support, which we believe makes us extraordinarily unique.

In addition, Vista Credit Partners deal teams tap into value creation personnel to support them in the due diligence and loan underwriting process, leveraging their deep domain expertise to identify companies with product superiority and sustainable valuations that will endure and expand over the life of an investment, Flannery said. “Imagine the level of private equity-style due diligence and underwriting that we can do as a lender that allows us to do these non-sponsor transactions. It’s critical to get this done the right way.”

Access to Vista Equity Partners’ Value Creation Team is yet another differentiating factor for Vista Credit Partners among its private market peers. The team helps identify good prospects for investment and assess their fit within Vista Credit Partners’ portfolio. Once invested, company management has ongoing access to the team for consulting support and to implement best practices. “It’s a powerful benefit that helps us get the underwriting done the right way and ensures our companies really perform,” Flannery said.

SEAT AT THE TABLE

Another Vista Credit Partners value-add gleaned from the private equity side of the house is to have either a board seat or board observer rights at a large number of com-

panies in the portfolio. “It’s unique and very beneficial,” Flannery said of the approach, which has been more prevalent in private equity than in private credit. “It’s a powerful way for us to stay on top of performance. When a company is a bit off on something or missing something, we have an early indicator on that because we’re in the boardroom. We can bring in the Vista Value Creation Team early on, before a small problem becomes a big problem, to help fix it.”

The strong synergies among the credit team, the private equity operation and the firm’s portfolio companies help cement strong partnerships. “Because of our history, our private equity partners and other people in the Vista ecosystem have personal relationships with these founders and CEOs, which makes it a lot easier to get business done,” Flannery said. “The pieces really fit together very nicely.”

HIGHLY DISCIPLINED APPROACH

Despite its ability to access a vast opportunity set across the enterprise software sector, Vista Credit Partners remains highly selective and disciplined in its investment approach, increasingly choosing to pass on opportunities despite favorable market conditions, Flannery said.

“We really just want to partner with the highest-quality companies, the companies that are far along in their development and with really great founders and CEOs,” Flannery said. “It’s probably unique that we’re having record deployment and a record-high pass rate at the same time.”

As of June 2023, Vista Credit Partners has grown to over \$7.7 billion in AUM and has deployed over \$11 billion in more than 560 investments since its founding in 2013.

So what’s next? “We’re excited about 2024 and the opportunities that we’re already seeing. We think it will be a really interesting year to partner with other private equity firms that can provide access to subsectors in enterprise software as well,” Flannery said. “We enjoy partnering with great founders and management teams who have proven products, market demand for their technology and a real aptitude to grow and scale a business, and who are looking for a partner like us to provide support. That’s where we see the most opportunity.” ■

Sponsored by:



pionline.com/vista-private-credit23

Disclaimer: This article does not constitute an offer to sell or a solicitation of an offer to buy any interests in any security. Past performance is not indicative of future results. Private credit investments entail a high degree of risk and are not suitable for all investors. Statements contained in this Presentation (including those relating to current and future market conditions and trends in respect thereof) that are not historical facts are based on current expectations, estimates, projections, targets, opinions and/or beliefs of Vista.