PE Hub

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PE DEALS

Lateral's Richard de Silva: A lot more deal activity in 2025

There are great opportunities for US platforms to make international acquisitions.

PE Hub's Outlook series of Q&As featuring insights from private equity thought leaders continues with Lateral Investment Management founder and managing partner Richard de Silva. Based in San Mateo, Lateral is a mid-market PE firm investing in lower mid-market companies in the manufacturing, healthcare, infrastructure and technology sectors.

PE Hub caught up with de Silva to learn more about the dealmaking outlook in 2025 and why tech-enabled services have been attractive to PE firms.

Richard de Silva, Lateral Investment Management

What is Lateral Investment Management's focus in dealmaking?

We are a growth-oriented technology buyout firm. Our core team has been together since 2018 and we invest in companies that are founder-owned, bootstrapped businesses. We focus on opportunities where we can help in terms of accelerating growth, and to transform what are typically services companies when we encounter them and help them to become more software-enabled recurring revenue businesses.

That transformation is our secret sauce. It's how we really look at creating value both for our investors, but also for the founders we back. We're different than other tech buyout firms in that most of the tech buyout world is very focused on B-to-B SaaS [businesses]. That has become the predominant playbook, to look for on-premises software companies to work and transition them to the cloud.

The transition to the cloud is mostly played out. And a lot of these firms have scaled and become much bigger than the original opportunity that they were going after. We're still looking for lower mid-market companies with what we think is a new secular trend which is for services companies that we can help transform into more software-enabled solutions businesses.

There is a huge market of services companies out there. There's $5 to $10 of services spend for every dollar of software spend. And particularly with the increasing prevalence of AI and machine learning technologies, there's an opportunity to take what has historically been heavily people-based businesses and do a better job of automating them and making the workflow and business process more software-enabled.

What makes tech-enabled services businesses so attractive to PE firms?

Historically, there's been a bright line between services and software. Tech-

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enabled services and what we are now starting to call technology-based solutions, which really leverages technology for higher margins and recurring revenue, is an opportunity set to invest in the technology sector in profitable companies at reasonable valuations that we can optimize and scale.

The challenge with tech-enabled services historically has been low margins and relatively low growth rates. Ultimately, they're carrying a lot of overhead costs. What's happening in what we're calling tech-based solutions is more SaaS-like characteristics where you have recurring revenue that creates predictability and higher margins with the benefit of software or software based revenues.

The predictability and margins are what people like about SaaS businesses. You can look out 12, 24, 36 months and know what the revenues are going to be. Then to be truly tech-based, a company shouldn't be a cost-plus kind of staffing business, but one where the productivity of the people is really much better than a typical tech-enabled services business. Technology-based solutions companies operate at 60 percent-plus gross margins.

They'll never get to software margins. They'll never get to 90 percent gross margins but should be able to achieve greater than 50 percent gross margins. And ultimately tech-based solutions companies achieve characteristics that are more SaaS like and follow the Rule of 40. If they can generate 20 percent growth and 20 percent EBITDA margins, they're as good as the SaaS business if you couple that with a recurring revenue business model. That's what we look for in tech-based solutions. It's the next phase of where tech-enabled services need to go, which is combining people and software to deliver an SaaS like business model.

Is there anything you can share about how dealmaking has gone for you this year?

For 2024, what we found was a lot of activity in the first half of the year, but the quality of the deals wasn't great. Owners of high-quality businesses were really holding back. They were hoping for markets to look better, which they have started to look better in the second half of the year. In the summer we saw a flood of deal flow. We've been very active in a number of different areas.

In terms of talent also, we're seeing a lot of movement, particularly from some of the bigger firms, some of the tech buyout firms actually had layoffs after a slow 2023. They cut from the bottom but then some of their stars left, because they could see the writing on the wall. Some of these firms that have raised multibillion dollar funds aren't going to generate carry at the same levels as before.

[We had an] opportunity to bring people on and built a dedicated originations capability that's focused on sourcing proprietary opportunities this year at Lateral. We hired Kyle Hutchinson, who was previously with K1 where he was VP of originations. At Lateral, we're building an originations team around him and are finding that particularly in the originations market, there's a lot of movement as some funds are evolving away from proprietary originations to intermediary coverage for sourcing as they rely on banks for access to bigger deals to manage their bigger fund sizes. That leaves some more white space for smaller funds like ours who want to just be focused on proprietary deal originations for sourcing new opportunities.

What's your outlook for dealmaking in 2025?

We're back in more of a cycle. The stock market has been booming with the recent rate changes. The public markets have gotten ahead of themselves, especially in certain segments of tech. Once again, there's a nice spread between private and public valuation comps. That means, there are more transactions where the spread between more reasonable expectations of founders and what PE firms are willing to bid is getting narrower.

I think there will be a lot more deal activity. And as the Fed continues lowering rates, public markets are getting what they wanted. I don't think the Fed is going to keep lowering rates beyond the middle of next year. My expectation is we're going to see a correction in the public markets which will again put pressure on valuations. For value-oriented investors like us, that's an opportunity. We're seeing reasonable valuations now. I think we'll see even better valuations in the second half of next year.

Are there any other categories or subsectors within technology that are attractive to dealmakers?

There are four broad areas that we look at. Tech-enabled services is one of them. The second is technology-based solutions, which is one step up from tech-enabled services, which are real SaaS-like companies. We have a company called Morae that bundles technology and services around legal tech and it's a heavily recurring revenue business. They have very clear visibility on contracts, and they use technology and people to generate high gross margins.

The third is industrial tech. There's a ton of money going into re-shoring domestic manufacturing as Fortune 500 companies rethink their supply chains post-pandemic and want to make sure that they have at least partial sourcing in the US. In order for that to make sense, there has to be automation. In order for a US-based manufacturer to have viable economics, there needs to be a significant amount of software investment that brings automation and efficiency.

Finally, we do play in the software market, but in the software market we want to see a mixture of software and services which gives us low-hanging opportunities

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to improve the business. If a company already has 90 percent-plus software revenues, it will trade at high revenue multiples. There is a large group of tech buyout firms that will pay premium prices for that type of business.

But if a company has revenues that are 30 percent services, 70 percent software, it mostly falls outside of the deal criteria of technology buyout firms. That's where we fit in because we like to find businesses that are under-optimized where we have an opportunity to improve the company and partner with the management team to create something that, ultimately is widely accepted as deserving of a higher valuation.

We'll take a company that is 60-70 percent software, 30-40 percent services and work with them to build to a 90 percent software, highly recurring revenue business. And we have a playbook to execute on this strategy successfully with the help of a group of former technology company CEOs as operating partners.

What's your strategy when it comes to growing companies that have a mixture of software and services?

We have a portfolio company called FirstClose Inc (FCI) that sells software for banks and credit unions to enable home equity loans. When we invested in them two years ago, they were mostly a data services provider that was selling information and an API but they hadn't built out the workflow of an SaaS product. In the last 18 months, we've helped them hire a chief technology officer, a chief marketing officer, a head of sales, all with a goal of transitioning them to an SaaS-based product. The company started with 200 customers and was already a profitable business.

We've helped them transition their customer base so that now 70 percent of their customers are on their SaaS product. That requires a happy customer base that is interested in adopting new functionality. Banks and credit unions, in this case, had a compelling reason to do that because of the growth in the home equity market. As rates have gone down and mortgages have slowed down the home equity market has taken off.

FCI's customers therefore had a compelling reason to figure out how to make a more efficient underwriting process for home equity. We have also worked closely with the talented founding team that is still very much in leadership and has a ton of conviction to build and scale the company. We have augmented the founders with key hires who have proven track records and how to implement a SaaS model.

Transforming from services to SaaS is a tough transformation. It's very much about managing execution risk. If you can do it successfully, which FirstClose has done, you've gone from something that is valued at an EBITDA multiple to something that should be valued on a revenue multiple.

Are there any trends in tech on your radar?

We're not cutting-edge technology investors. We invest more in businesses that use technology, but we don't want to be on the bleeding edge of technology. We don't take fundamental tech risk. There are two related trends that we are navigating. I alluded to one, which is more about re-investment in domestic manufacturing. And then correspondingly, we're seeing great opportunities for US platforms to buy international acquisitions.

And we've done that successfully for Morae, our legal tech company which at the end of last year, bought a company in South Africa called Exigent Group, which has a Cape Town-based AI development team. If that AI development team was based in Silicon Valley, that company would have been worth a lot more, given the crazy market of AI valuations.

But we were able to buy a profitable business with a 40-person group of data scientists and PhDs in computer science and acquired it for a reasonable price because it was in Cape Town, South Africa. Morae has also acquired attractive growth businesses at in the United Kingdom and Australia. We don't do platform investments in those locales, but we'll happily do an add-on acquisition if it has solid fundamentals and brings capabilities that might be prohibitively expensive to build organically.

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