Roper Technologies (ROP)

Strategic Acquirer Focused on Strong Management and Culture

Roper Technologies, Inc. (ROP) is a diversified operating company focused on acquiring and operating good businesses that generate high returns on investments. Our investment in Roper is the outcome of studying the company for several years and acting when the combination of due diligence and market opportunity finally crossed.

BARTON HOOPER
Director of Equity Research

Barton joined Weitz Investments in 2007. Prior to joining the firm, he was a research analyst at Oak Value Capital Management and Trilogy Capital Management. Prior to his investment management experience, Barton worked at George K. Baum & Company and was a certified public accountant at Deloitte & Touche LLC. Barton has a bachelor's in accounting from the University of Missouri and an MBA from Washington University in St. Louis.

Great Operator, Good Businesses, In Niches

The history of Roper dates back to the early 20th century with the founding of the Geo. D. Roper Corporation, eventually assuming the name of the Roper Pump Company. The modern version of Roper begins in 1981 when the company was reorganized into Roper Industries and began a series of acquisitions that took the business into fluid handling, test and measurement, and analytical equipment. Over time, Roper has transitioned away from industrial, energy, and process industries to focus on software and other asset-light businesses.

With the appointment of Brian Jellison as CEO in 2001, Roper entered into an era driven by a simple, yet effective, performance culture that guided the company's strategy. Jellison's key emphasis was to acquire cash-generative businesses, let them run as independent entities, and focus on cash return on investment (CRI). The lynchpin expressed by Jellison's approach is to only acquire businesses that can overcome these hurdles quickly. He eschewed turn-around businesses, was always willing to walk away when the fit was not right, and wasn't afraid to pay full price for the right company. Jellison took this approach because he knew that the combination of a good underlying business with a strong management team that embraced the CRI culture would allow for expanded margins and more organic growth than what the acquisitions had historically generated.

Sadly, Jellison passed away in 2018. He was replaced by current CEO Neil Hunn who, despite the tough circumstances of his appointment, has maintained Roper's strong track record and strategic discipline. With the recently announced sales of three of its companies (as discussed below), Roper will operate 44 separate businesses that mostly operate in small, distinct niches. Roper's largest business generates approximately $800 million in annual revenue, which is less than 20% of total sales.

Because of Roper's emphasis on good businesses with high CRI, the company has gradually focused its acquisition activity on software businesses and those with network/marketplace elements (at Weitz, we see network/marketplace-oriented businesses as those that facilitate transactions between buyers and sellers without taking much, if any, inventory risk). The types of businesses Roper focuses on often require little investment capital and typically have recurring, or predicable, transaction-related revenues. Even when Roper acquires a more product-based business like the 2012 purchase of medical equipment producer Verathon, there is often a razor/razorblade characteristic (selling a product that requires a specific ongoing consumable), high services content, or both.

Roper signaled that its emphasis on software and technology was more permanent when its name changed to Roper Technologies in 2015. Its success in acquiring software and network/marketplace-oriented companies allowed it to re-segment operations in 2019 to provide more transparency to investors. Roper's four segments are Application Software, Network Systems and Software, Measurement and Analytical Solutions, and Process Technologies.

While Roper is an active acquirer, it has not typically turned over its portfolio. We believe the company's recently announced sales, as well as four others since 2015, represent a continued emphasis on higher-return businesses and give Roper an opportunity to redeploy capital in acquisitions with even more appealing characteristics. On a pro forma basis, presuming the completion of the recently announced sales and prior to deploying the roughly $3 billion of proceeds, the Application Software and Network Systems segments will represent approximately 65% of revenues and 70% of Roper's EBITDA (earnings before interest, taxes, depreciation, and amortization). Though we are not forecasting any further divestitures, it wouldn't surprise us if the company eventually spins off the Measurement and Process segments. While those businesses no longer "fit" with the targets Roper evaluates today, they collectively have attractive economics with EBITDA margins above 30% and little need for capital.

Unique Culture

The Roper culture could be summarized as “think long term, do better than last year, drive organic growth, provide complete transparency, and hire over yourself.” These attributes are reinforced through institutional structure and management principles. A defining characteristic of the company is that it is unapologetically decentralized – there are fewer than 100 people at Roper’s Sarasota, Florida, headquarters. In an era of platforms and forecast synergies baked into acquisition multiples, the company does not have common enterprise resource planning (ERP), human relations, or other management systems. Over the years, we have attended meetings with sell-side analysts and investors who repeatedly ask management why they don’t implement more centralized policies such as purchasing, accounting, etc. Roper’s management has been consistent in their position that the benefits of such programs are outweighed by the downsides of bureaucracy and less transparency at the operating company level.

While Roper encourages adoption of best practices, hosts roundtables for the leaders of its businesses, and works to ensure good ideas are broadly disseminated, it leaves all major decisions to the managers of the operating companies. Roper’s management team is not passive, however; the team spends its time helping its managers develop strategic plans, identify and recruit talent, and act as a resource for advice and accountability.

One of the unique elements of Roper’s culture and decentralized process is that it doesn’t have a budgeting process for compensation purposes. The mantra to its operating managers is to grow revenue and EBITDA organically, and there is no cap on compensation. While every compensation system has its flaws, the Roper team believes its approach encourages long-term thinking and complete transparency. They believe their process enables them to identify problems early, as a manager has fewer ways to game a budgeting or compensation system that is not overly complex. Another interesting feature of the Roper culture is that business unit leaders are not paid for results from acquisitions – this allows these managers to spend all their time thinking about and planning organic growth strategies.

Acquisition Advantage

An underappreciated element of Roper’s longer-term strategy has been its ability to identify for acquisition businesses with large share in relatively small niches. In these areas, there is not often a large profit pool to attract significant competition. And due to the relative lack of scale of a standalone niche business, there can be fewer strategic buyers, making it easier to acquire new businesses.

Another advantage is that Roper was early to identify the divestiture of good businesses by the private equity (PE) sector. Of course, Roper’s focus on software and marketplace/network businesses means it is often competing with PE firms for acquisitions, but it allows management to understand the lifecycle of businesses owned by these firms. Because the Roper team has often met with and performed due diligence on a company being acquired, it is likely more familiar than the businesses than other interested parties may be. This gives Roper the confidence that they understand the basis of a fair price which, to outsiders, may look somewhat expensive.

Roper’s long history of holding good businesses indefinitely and letting its managers have considerable autonomy sets it up as an acquirer of choice for good, sought-after businesses. One of the admirable characteristics of Roper’s approach to acquisitions is the consistent application of its criteria. Though no business with as much acquisition activity as Roper has a perfect track record, we don’t believe the company has deviated from its core focus of buying good businesses with high CRI potential, and Roper has yet to purchase what we would consider a “turnaround.”

Niches, Culture, Acquisitions = High Quality and Long-Term Opportunity

After performing due diligence on the company and its various businesses over the course of several years, our team concluded that Roper’s strong operating units, excellent culture, and unique acquisition strategy add up to a business that fits in well with our Quality at a Discount investing approach. The company sits on the upper end of our quality score matrix – our proprietary quality scoring system that accounts for competitive position, return on invested capital (ROIC)/capital efficiency, reinvestment runway, cash flow consistency, management team, and financial leverage. Our belief in Roper’s high-quality nature eventually culminated with the company’s stock price reaching a discount to our estimation of intrinsic value, creating an opportunity for us to add it to several of our portfolios.

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IMPORTANT DISCLOSURES

Past performance is not a guarantee of future results. All investments involve risks, including possible loss of principal.

As of 09/30/2021, Roper Technologies, Inc., constituted a portion of the net assets of Balanced Fund, Hickory Fund, Partners III Opportunity Fund, Partners Value Fund, and Value Fund as follows: 1.2%, 0.0%, 0.0%, 0.0%, 2.4%.

Holdings are subject to change and may not be representative of the Fund's current or future investments.

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