HOW TO VALUE A SAAS COMPANY

This white paper is written for entrepreneurs, angel investors, and the management teams of SaaS businesses. The intent of the paper is to describe the approach used by most professional investors and strategic buyers to value a SaaS company. By better understanding the concepts and mechanics of valuing a SaaS business, management will be better able to articulate and maximize the value of their company, and also have a clear and more accurate estimate of the likely outcome of a sale process or equity raise. The framework described in this paper is designed to be adaptable to the public stock market environment well into the future.

Like all businesses, a SaaS company is worth what a buyer and seller can agree upon, and is based upon an estimate of the current value of its future cash flows. That simple sentence includes two important concepts: 1) *real SaaS valuations are determined in the marketplace between two parties, and* 2) *the basis for the negotiation is a set of assumptions about the size, timing, and predictability of the future cash flows generated by the business.*

In the following pages we will try to add insight into both the general parameters of the marketplace, and the key assumptions about future cash flows common to all SaaS businesses.

The paper is broken into seven sections:

1. Basic Valuation Formula
2. State of the Markets (Public and Private)
3. The Private Company Discount
4. Company-Specific Value Drivers
5. The Balance Sheet
6. Other Value Drivers
7. Example Valuation Analysis

Median Public SaaS Company Valuation Multiple

Sources: NASDAQ, Pacific Crest Securities, Bessemer Venture Partners, CapitalIQ, Saphire Ventures and Redpoint Ventures.

The Basic Valuation Formula:

For SaaS businesses, the net present value of future cash flows has been reduced to a shorthand formula based on a multiple of the company's annualized recurring revenue (ARR).

ARR x Multiple = Company Value

Anything that will impact the size, timing, and predictability of future cash flows will be incorporated into the revenue multiple, including company-specific factors such as growth rate, gross margins, retention, and market size. Macro factors, which are generally accounted for in an index of publicly traded SaaS companies, also influence the multiple.

The company-specific factors drive the projected cash flows, and public company multiples reflect the implicit macroeconomic discount rate. Said differently, the macro environment sets the baseline valuation multiple for an "average" SaaS business, and the company-specific factors adjust it from there. Sometimes the baseline multiple is 7 times ARR, sometimes it's 2; it just depends on when you are selling. On the previous page is a chart of the median public SaaS valuation multiples since 2007.

We will further develop this public market baseline multiple below in the "State of the Market (Public)" section.

Why do SaaS companies trade on ARR, while all other businesses trade on EBITDA or Net Income?

The basic reason is that for growing SaaS businesses, net income takes a long time to materialize, even if underlying unit economics are solid. Sales and marketing expenses are recognized up front, while revenue lasts many years. This makes new customers unprofitable in the short term, even though they will be profitable over their lifetime.

If a SaaS business is growing quickly, there are more new (temporarily unprofitable) customers than older, more profitable customers. Therefore, the total company net income will be negative even though if the business simply stopped growing, it would immediately throw off cash. For this reason, revenue is a better indicator of long-term cash flow than is net income or EBITDA. This will change over time as the sector matures, but even for the largest SaaS businesses today, there is little relationship between overall profitability and valuation.

"Anything that will impact the size, timing, and predictability of future cash flows will be incorporated into the revenue multiple."

What is included in ARR?

On an individual company basis, it's relatively easy to split out the different revenue streams (i.e. recurring software license revenue, implementation revenue, custom work revenue, etc.) and potentially value them differently based on their profitability and predictability. We see this done a fair amount and discuss later in the paper. Remember, however, that most valuation benchmarks, both public and private, are based on total revenue under the general assumption that the majority of revenue is recurring license revenue.

Data from our annual survey of over 400 private SaaS companies indicate that average SaaS businesses generate 80% of their revenue from licensing and 20% from professional services. If your revenue streams have that ratio or higher, there is no separate adjustment for revenue mix, and 100% of your company's revenue should be included in the valuation formula. If your ratio is significantly below 80%-20% software to services, your multiple will be lower, and beyond some level, the business may not be viewed as a pure-play SaaS company and may therefore be valued using a different methodology. Valuation adjustments for lower gross margins resulting from a higher percentage of services revenue are accounted for separately.

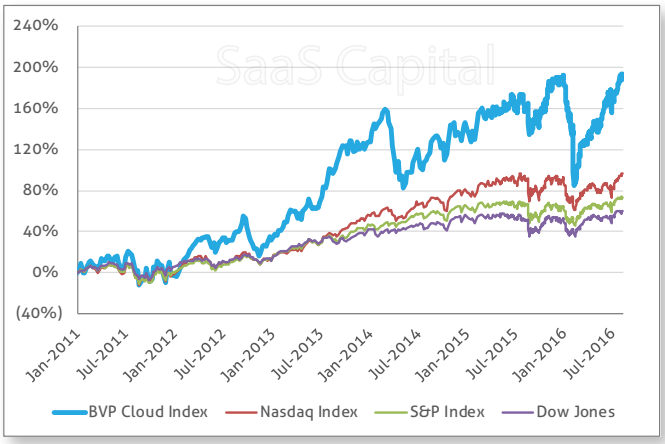
Having outlined the basic approach, let's turn to the current state of the markets first, and then discuss each of the company-specific factors second. Keep in mind, the general market conditions change constantly, so you will need to refresh the public data in this section whenever you calculate a specific

valuation. We have identified the approach and resources you can use to do so.

The State of the Market (Public)

The public market is the backbone of the framework because it provides freely available, real-time valuation data. Bessemer Venture Partners does a good job tracking a SaaS-specific index that is shown below. Simply go to their site at any time for the most recent version: (bvp.com/strategy/cloud-computing/index).

BVP Cloud Index



There are some interesting trends to point out in the data above. In the larger scheme of things, investors in the SaaS sector have significantly outperformed other equity indexes over the last four years. It's also clear that these are volatile stocks, subject to large price swings in both directions. (Since we started writing this paper, until its final release, valuations increased 17%.) Early 2014 saw a large correction, as did early 2016. That said, there are two primary factors protecting SaaS valuations from a fundamental sector meltdown:

1. Underlying trends of cloud infrastructure and SaaS application adoption are more supportive than ever before.
2. The business model does not lend itself to a crash. Through the 2008 recession, no public SaaS businesses had an actual decline in revenue, and all shifted their cost structure to immediately become more profitable.

So while we believe SaaS valuations are subject to corrections in the public markets when prices are overvalued, we also believe they have a natural floor of support in a stock market or economic downturn. As the chart to the left clearly indicates, when possible, it has been a good strategy to delay the sale (or a capital raise) of a SaaS business if prices have dropped well below their historical norms.

Investors and corporate buyers quickly react (more quickly on the down-side) to changes in the public market. As of the writing of this report, the relevant public market valuation data is displayed below. This is a direct download of the Bessemer Cloud Index spreadsheet.

What the chart conveys is that a typical public SaaS business has $298 million in revenue, is growing at 26% year-over-year, has gross margins and retention rates of 71% and 93% respectively, and is worth about 6.1 times expected 2016 revenue as of 8/9/2016. So, now we have a starting point.

The great thing about public market data is you can easily find it, and it's updated every few seconds. The weakness in the data is that it is not representative of most private SaaS businesses, which are generally much smaller.

		Multiples				Operating Metrics			
Date: August 9, 2016	Market Cap	EV/Revenue		P/FCF	EV/EBITDA	Revenue	Growth	Gross	Gross
		2015	2016	2016	2016	2016	15 - 16	Margin	Retention
Median	$1,913	7.8x	6.1x	45.8x	30.9x	$298	26%	71%	93%
Mean	$4,784	8.3x	6.3x	41.2x	32.3x	$517	28%	71%	100%
Low	$106	0.6x	0.6x	18.7x	14.8x	$73	5%	46%	80%
High	$57,065	23.8x	16.4x	75.0x	54.1x	$6,649	68%	89%	187%

State of the Market (Private)

The drivers of value in the private markets are the same as in the public markets, although the valuations tend to be lower because the companies are typically smaller (riskier) and the investors do not have liquidity in the shares (they can't buy or sell them whenever they want).

Private SaaS valuation numbers are hard to come by, but we have tapped two primary sources for this paper. The first source is our own portfolio of companies, eleven of which have sold shares within the last 20 months in either a sale of the company, or in an institutional equity raise. The second, a much larger data set, is from our friends at the 451 Group who track and report on technology company data for a living.

Half of the SaaS Capital equity events were due to the sale of a business, and the other half were from equity financings. The average valuation over the last 20 months was 4.1X ARR, and the median was 3.8X. On average, the businesses were growing at 35% year-over-year at the time of exit, and had $9 million in ARR.

Over the last two-and-a-half years, the 451 Group has tracked over 800 private SaaS exits. The mean revenue multiple for those transactions was 6.0 times ARR in 2014, 4.8 times ARR in 2015, and 4.3 times ARR to-date in 2016. The businesses were similar in size to those in the SaaS Capital portfolio at about $8 million in ARR, although we do not know the growth rates.

Based on these data points, the private market multiple for an "average" SaaS business growing at about 40% has averaged 4.0 times ARR during the second half of 2015 and the first half of 2016.

To be clear, however, the public market has rebounded and recent private exits have as well. The appropriate multiple adjustment of the recent valuation increases is accounted for in the next section.

The Valuation Multiple Spread

Because the public market numbers change so frequently, and the private valuations are hard to find and *are at a considerable time lag,* the best approach for valuing a private SaaS business at any point in time is to isolate the private-to-public market discount, which is relatively constant, and then apply that discount to the current public comps.

"Applying a 1.3 times discount to the 'Expected Current Year' public revenue multiple gets you to a current private ARR valuation multiple."

The discount has generally remained between 1.5 times and 2.5 times ARR when comparing private and public companies of similar growth rates at similar points in time. Based on the private data above, and the public market comps over the same time period, the current private company discount is 1.9 times on an ARR basis. Unfortunately, and to add to the confusion, private valuations are generally reported on an annualized revenue basis (ARR), while public valuations are reported as a multiple of either the prior calendar year revenue, or the expected current calendar year revenue. And while it's possible to estimate current ARR based on expected calendar year revenue, and vice versa, the relationship between the two actually changes over the course of the year.

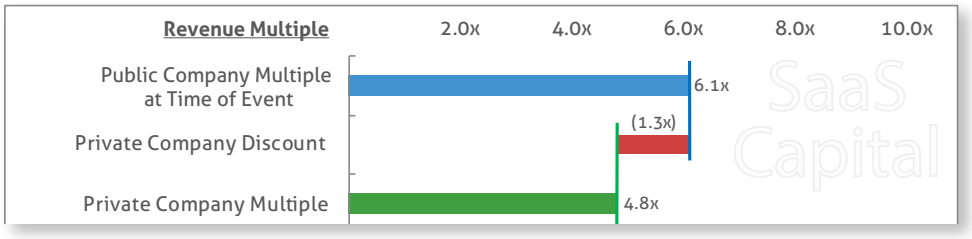
For simplicity purposes, and recognizing this is only one of a myriad of other factors driving valuation, our analysis suggests applying a 1.3 times discount to the "Expected Current Year" public revenue multiple gets you to a current private ARR valuation multiple. Using 1.3 times instead of the actual ARR discount of 1.9 times will compensate for the fact that the public multiple is based on expected future revenue and the private multiple is based on actual current run-rate revenue. The math as of August 2016 was: median public valuation multiple based on expected 2016 revenue of 6.1 times (see Bessemer Cloud Index table), less the discount of

1.3 times, equals the private ARR multiple of 4.8. This is a higher multiple than the actual private market data above because that data spanned many months and several stock market fluctuations; a multiple of 4.8x ARR is consistent with current public markets which have risen significantly over the last few months.

As mentioned, this discount is relatively consistent across time and is particularly relevant to smaller SaaS businesses. For larger SaaS businesses above $50 to $75 million in revenue, private and public values actually converge, and might possibly invert, because those businesses have the scale to go public but choose to remain private.

So if your SaaS business is private, does not have the revenue to go public, is growing at around 40% year-over-year, and has "average" gross margins and retention rates, current market comparables would suggest it is worth about 4.8 times ARR as of August 2016.

Update this base level multiple at any point in time by subtracting the private discount of 1.3 from the then-current median public expected revenue multiple pulled from the Bessemer Cloud Index. The chart below graphically illustrates the composition of the multiple.



Company-Specific Drivers:

Having established the basic formula of SaaS valuations as a function of ARR, and having established a way to calculate the baseline ARR multiple at any point in time, it's time to analyze the company-specific factors that will drive that multiple higher or lower. To maximize value, individual company characteristics need to be carefully evaluated, isolated, and placed in the overall context of the broader market.

Drawing from our experiences selling and financing hundreds of companies, our proprietary research of over 1,000 private SaaS Companies, as well as public market data; we have put together a list of value drivers every operator should pay attention to as they go about preparing for an equity raise or sale of their company.

Listed in order of importance, the company-specific financial valuation drivers are:

1. Growth and Scale of Revenue
2. Addressable Market Size
3. Revenue Retention
4. Gross Margins
5. Customer Acquisition Costs

Valuation Driver #1 – GROWTH and SCALE of Revenue

How much revenue is there today? How long will it take to get bigger, and how likely is it to happen?

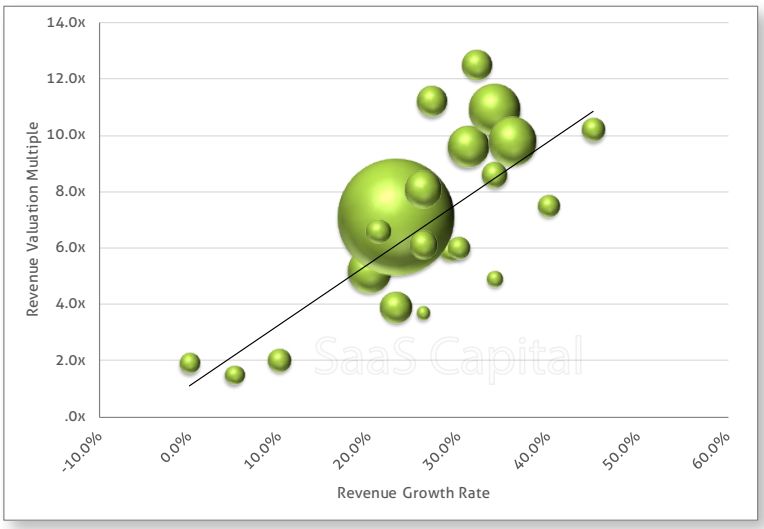
Historical growth rate is the single biggest driver of valuation. In fact, it has dwarfed all other factors for a long time. The reason growth is so important is that it indicates both the timing and the likelihood of future profits. Faster growth means larger expected cash flow sooner, and because of the recurring revenue model, high historical growth rates are a good indication of future growth rates.

The relationship between growth and a higher revenue multiple is easiest to see in the public market and is shown in the chart below. The correlation is not perfect, but it is very strong at 0.78 and outweighs all other metrics by a long shot. The faster-growing businesses are getting the higher multiples, while the slower-growing businesses are getting lower multiples.

The companies included in the chart below are all traditional B2B SaaS companies and it excludes firms like LinkedIn and LifeLock, which are in the Bessemer Cloud Index but operate meaningfully different models.

Revenue Multiple vs Growth

(Bubble Size = Annual Revenue)



Source: Bessemer Venture Partners, August 15, 2016

"Historical growth rate is the single biggest driver of valuation."

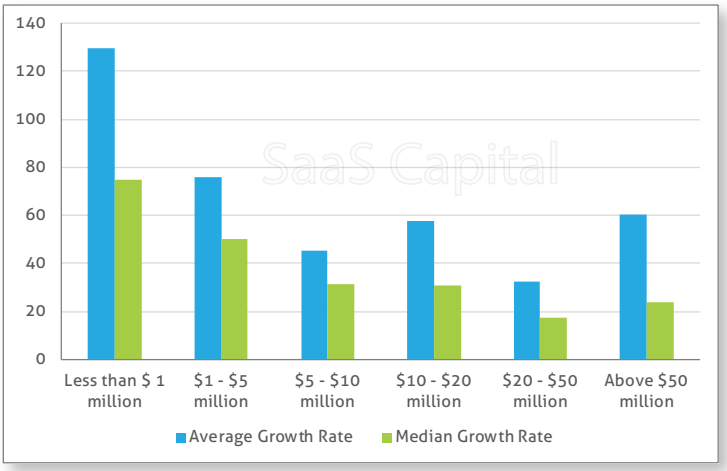
The size of the bubbles on the chart indicates the relative size of revenue of each company and demonstrates that both growth rate and the overall scale of the business lead to higher valuations. You'll see in the chart that for the same growth rate, the larger bubbles receive a higher valuation multiple than smaller bubbles. Larger companies are less risky, and if they are still growing nicely at scale, by definition, they have a large addressable market. Companies above the median growth rate of 28% had revenue multiple 3 points higher (7 vs. 4) than those below the median growth rate. Companies above the median revenue size of $340 million had revenue multiples 3.1 points higher than smaller businesses with the same growth rate.

In translating the chart into the private markets, it is important to recognize that it is much easier and more common for a $5 million ARR business to grow at 40% than it is for a $500 million ARR business. This is simply due to math (size of the denominator) and the normal growth curve, which slows over time for all businesses. (Refer to SaaS Capital Research Brief 6, ***The Daunting Math of Growth***, for more details.) Byron Deeter at Bessemer Venture Partners frequently points out that smaller SaaS companies often fail to recognize this, and likes to point out that they are growing faster than their public competitors and, therefore, should get a premium valuation. The relevant comparison, however, is to compare the growth rates of the companies when they were both the same size. Many public SaaS business now growing at 25% were growing at 200% when they were $5 million or $10 million in ARR.

The basis for being able to support a valuation "growth premium" is whether your company is growing faster than its similarly-sized peers.

Below are the median and average growth rates for SaaS businesses of different sizes based on our 2016 survey of over 400 private SaaS companies.

SaaS Company Growth Rates by Size of Business



If your business is growing faster than its peers based on the chart above, you should be able to objectively garner a higher multiple. How much higher? You could look to the slope of the line on the public market graph for guidance, but that is not actually that useful.

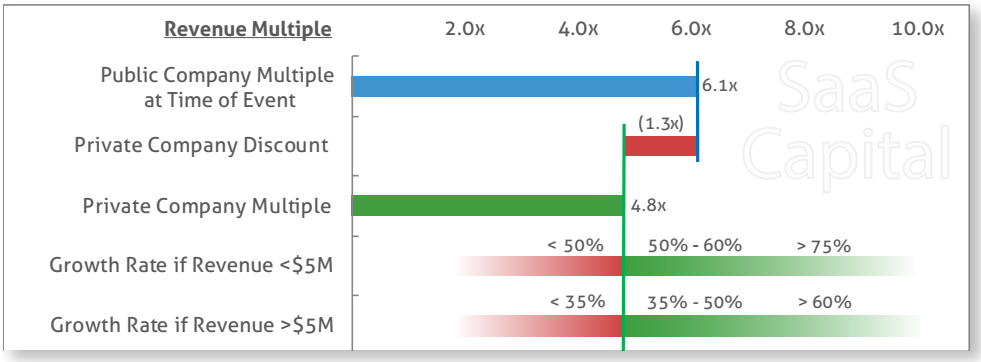
As the companies get bigger, growth rates converge, as growth is much harder to achieve. Therefore, for larger public businesses, every 5 percentage point increase in growth rate increases the valuation multiple by almost 2, which is a huge difference.

"The basis for being able to support a valuation 'growth premium' is whether your company is growing faster than its similarly-sized peers."

The premium is not that high for a 5 percentage point change in growth rate for smaller private companies, and it is also not that precise. Below, however, we attempt to parse the impact of growth on the multiple.

If your SaaS business is below $5 million in revenue, it needs to be growing at least 50% to get the average multiple of 4.8 times ARR. A premium would be justifiable for growth rates above 60% for companies of this size, and could bump the multiple up 1 to 2 times. Above 75% growth, the premium could get to 3 to 5 times or more if accompanied by a large addressable market.

For larger SaaS businesses in the $10 to $30 million range, a growth premium will become relevant above 35% revenue growth. Larger SaaS businesses growing above 50% could easily see premiums of 2 to 5 times for a total ARR multiple of 7 to 10 based on current public multiples.



For private companies raising money from VCs or PE firms, the growth imperative accounts not only for differences in valuation, but also in the likelihood of success. Slower growth SaaS businesses are difficult to get funded at any price. These businesses, and their existing investors and management, must find a way to demonstrate some organic growth that can then be leveraged with additional capital. Only then will it be worthwhile to invest the time and energy in external fundraising.

On the M&A front, the growth imperative is almost as strong. There are exceptions when a corporate buyer is looking for a very specific need that can only be filled by a single company; however, buying criteria generally revolve around growth. "I can't even take an acquisition opportunity to my CEO unless they are growing faster than we are," said an SVP in a large SaaS business growing at 29%.

Valuation Driver #2 – MARKET SIZE

How big can your business be?

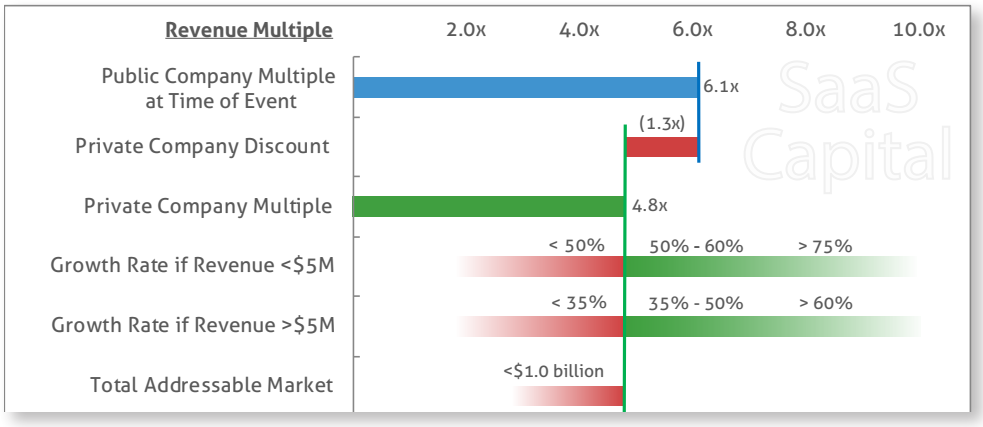
This is a key valuation battleground. Your business must be able to simply and credibly articulate it will generate large profits in the future. Keeping in mind that small businesses in small markets do not ever generate large profits, it is the size of your addressable market that establishes the upper bounds of your future cash flow and therefore your valuation.

For this reason, VCs and buyers dig deeply into the company's market size. They want to understand your "total addressable market" (TAM). In other words, if you sold all your current products to all the potential buyers of those products, how big would your company be? Investors will not pay a $50 million valuation for a SaaS business in a $100 million market. The upside is too limited.

"It is the size of your addressable market that establishes the upper bounds of your future cash flow and therefore your valuation."

In our experience, managers and owners do not do a good job framing the market-sizing discussion. This is unfortunate because as operators you are in a much better position to build the case. With a little bit of research, the management team can put together a well-organized addressable market presentation that will generally be accepted by the investor.

There is little public data connecting the size of an addressable market to a revenue multiple because TAM itself is subjective. Generally speaking, TAM enters the valuation equation on the downside if the market size is too small. For many VCs, the target minimum TAM is $1.0 billion.



Valuation Driver #3 – REVENUE RETENTION

How solid is the business you are building?

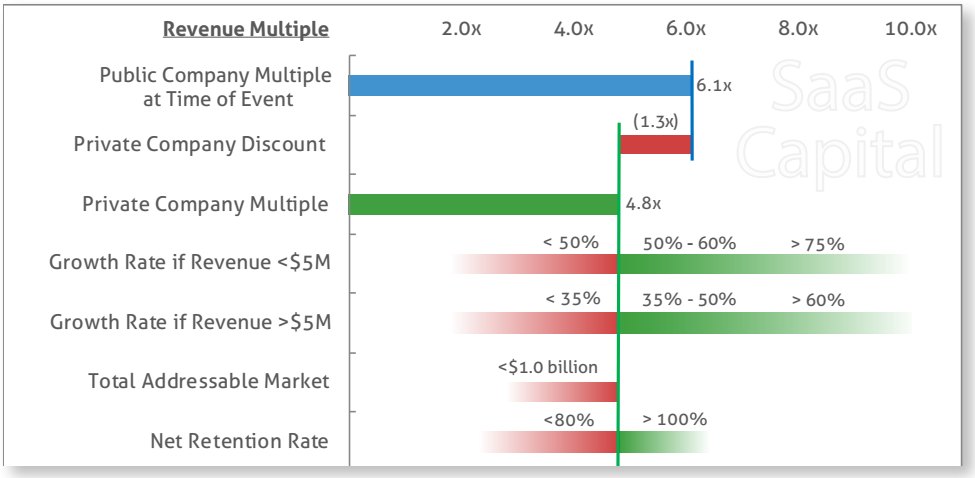
"A 1% improvement in net retention will increase the company's value by 12% over five years."

Revenue retention is a significant driver of enterprise value because it touches upon all the key factors that impact the future cash flows of a SaaS business. High retention increases the size of the addressable market, increases revenue growth, and very importantly, improves predictability which reduces perceived risk. It also improves unit economics and profitability. Retention is cumulative as well, so small differences have a large impact over time.

Our much deeper analysis on this topic, ***No Churn: Keep Customers and Improve Your SaaS Company Valuation - 2015 Update***, details the multi-factor impact of improved customer retention. Our analysis suggests that a 1% improvement in net retention will increase the company's value by 12% over five years.

In the context of the valuation framework, however, it is important to *isolate* how retention impacts valuation. The primary impact is through improved growth rate and higher revenue over time. Those factors are already incorporated into the company's valuation based on its ARR and growth premiums. However, additional value can also be generated if the retention rate is above those of its peers because high-retention businesses are less risky and have better unit economics. Buyers and investors will pay a premium for businesses they perceive as predictably losing very few customers.

From our 2016 survey data, the median net retention rate (includes cross-sell, up-sell, and price increases) for private SaaS businesses is 100%. Above that level, a premium is justifiable. How much of a premium is hard to determine because retention rates are not consistently reported in public or private valuation data. We estimate the impact at 1 to 2 times.



Valuation Driver #4 – GROSS MARGIN and REVENUE MIX

Given your business's level of revenue, how much money can you make?

Gross margin indicates the profitability level of the business per dollar of revenue when it reaches a more mature phase, and is a significant driver of valuation. Gross margin also determines how much cash a business can reinvest back into sales, marketing, and product development and, therefore, how capital efficient the business can be. For these reasons, the less direct costs required to deliver the SaaS revenue stream, the more valuable that revenue is.

"Our private company survey data indicated the typical ratio of license revenue to professional services was 4 to 1."

Our private company survey data indicated the typical ratio of license revenue to professional services was about 4 to 1 (80% to 20%). Related to the revenue mix, the overall gross margin was 84%, and the costs included in the gross margin were: professional service costs, hosting and related personnel costs, customer support, and any other direct cost associated with delivering the product.

The gross margin for public SaaS businesses is only 71% as reported in the Bessemer Cloud Index. This is not consistent with what we see on an ongoing basis. That said, if you can establish 71% as the base case gross margin in your own valuation analysis, and your gross margin is higher than that, then all the better for you.

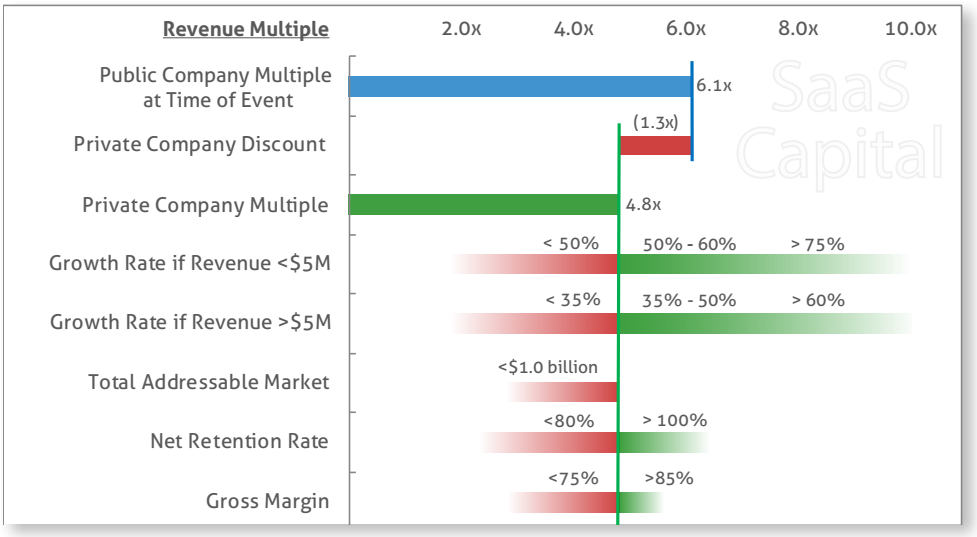
If your SaaS business is generating significantly more of its revenue from services, or has a meaningfully lower gross margin than the "norm" (i.e. your product requires a lot of third party data or services, or you have unusually high hosting costs), your revenue valuation multiple will be lower. To quantify the potential impact, it's possible to convert the ARR multiple to a gross margin multiple.

As discussed above, the average private ARR multiple is 4.8x, and the average gross margin is 84% (using SaaS Capital data), so the average gross margin multiple is 4.8/84% or 5.71 times. See the table below as an example of how to estimate the valuation impact of different gross margins.

	Avg. SaaS Co.	Low Margin SaaS Co.
Revenue	$10,000,000	$10,000,000
Gross Margin %	84%	70%
Gross Margin $s	$8,400,000	$7,000,000
Gross Margin Multiple	5.7x	5.7x
Company Valuation	$48,000,000	$40,000,000
Implied ARR Multiple	4.8	4.0

This basic approach can be used regardless of what gross margin percentage is assumed to be the base case.

An alternative approach used to account for revenue mix and gross margin is to value the different revenue streams separately. To do this, and also to run the business effectively, the services revenue and license revenue should be isolated, and so should the direct COGS needed to support each. This is a good approach for SaaS businesses that can demonstrate significant gross margin contribution from their services work.



Valuation Driver #5 – CUSTOMER ACQUISITION EFFICIENCY and UNIT ECONOMICS

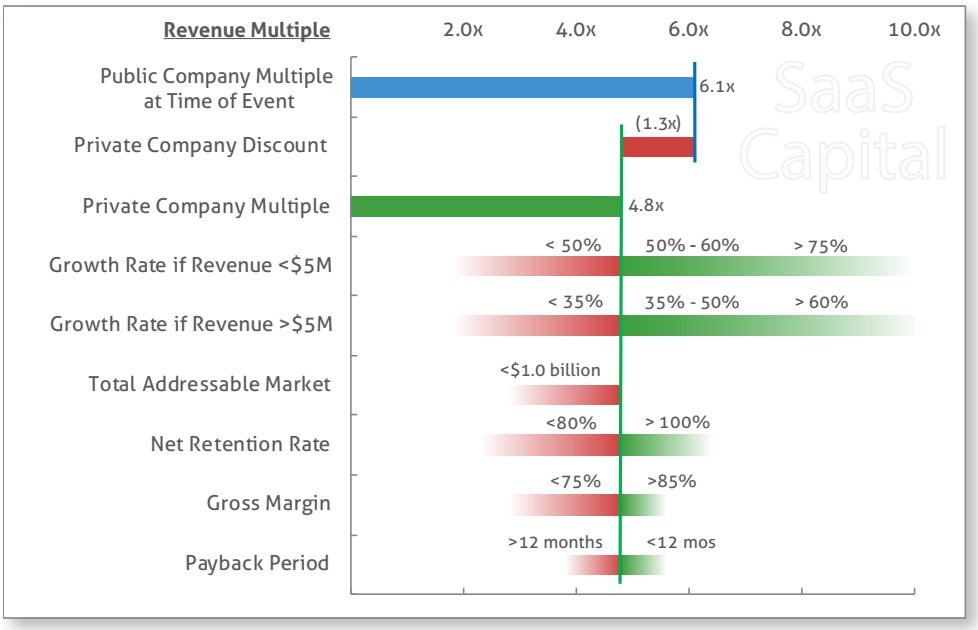
If I put a dollar in my SaaS machine, how much will I get out?

Both investors and strategic buyers are typically looking to continue growing a SaaS business by deploying more capital in sales and marketing. How efficient the business is at converting that spending into new customers is highly relevant to both projected future cash flows at maturity, and also the amount of capital it will take to grow.

Businesses with high customer acquisition costs (CAC) require more capital to grow, and thereby, diminish overall returns whether the buyer is a VC, a corporation, or a public stockholder. Your CAC Ratio (CAC/lifetime value of a customer) is also relevant to your ultimate valuation because it is the best indicator of a company's core unit economics. The better that CAC Ratio, the higher projected future cash flow, and the higher the multiple of current ARR. Retention rates and gross margins drive customer lifetime value, and those items have already been identified and benchmarked, so the main point here is isolating the acquisition costs.

"Businesses with high customer acquisition costs (CAC) require more capital to grow, and thereby, diminish overall returns."

A related metric to CAC Ratio is "payback period." How long does it take (in terms of cash), to recoup sales and implementation costs? This is actually a purer measure of capital efficiency and is becoming an increasingly important valuation driver. A less-than-one-year payback is a good target for this metric.



THE BALANCE SHEET

When getting into the final stages of valuation, the balance sheet will come into play and there will be a myriad of final "adjustments." Most of these adjustments are not specific to SaaS, and are made to account for specific sources or uses of cash, separate from ongoing operations of the business. Examples would be: a large cash balance in the bank account at closing, or a large long-term obligation that is being assumed by the buyer. Also, if accounts payable are unusually large, or accounts receivable are abnormally low, adjustments are typically made. If the company has a "normal" balance sheet relative to its peers and historical norms, then it is assumed that is the balance sheet required to support the current ARR, and no adjustments are made.

Deferred revenue is a balance sheet item relatively unique to SaaS, and we believe deserves separate consideration. Buyers will frequently argue that if they purchased ARR as a proxy for future cash flows, then deferred revenue represents cash that has already been collected and therefore not part of future cash flows and should be deducted from the price. This is wrong for two reasons:

1. If the business continues to grow or at least maintain revenue, deferred revenue will never be "repaid." It is part of the normal working capital equation of the business and is actually a positive contributor to cash flow for a growing business.
2. To satisfy the deferred revenue liability, the company merely needs to provision the service, not actually write a check as it would do for a bank loan or most other long-term liabilities. The cost to keep the servers up and running is a fraction of the amount of deferred revenue, so the future claim on the company's cash is actually much lower than what is on the balance sheet. If pressed, a fair counter you might suggest is to make a price adjustment equal to the deferred revenue balance times the cost of goods sold percentage.

OTHER VALUATION DRIVERS

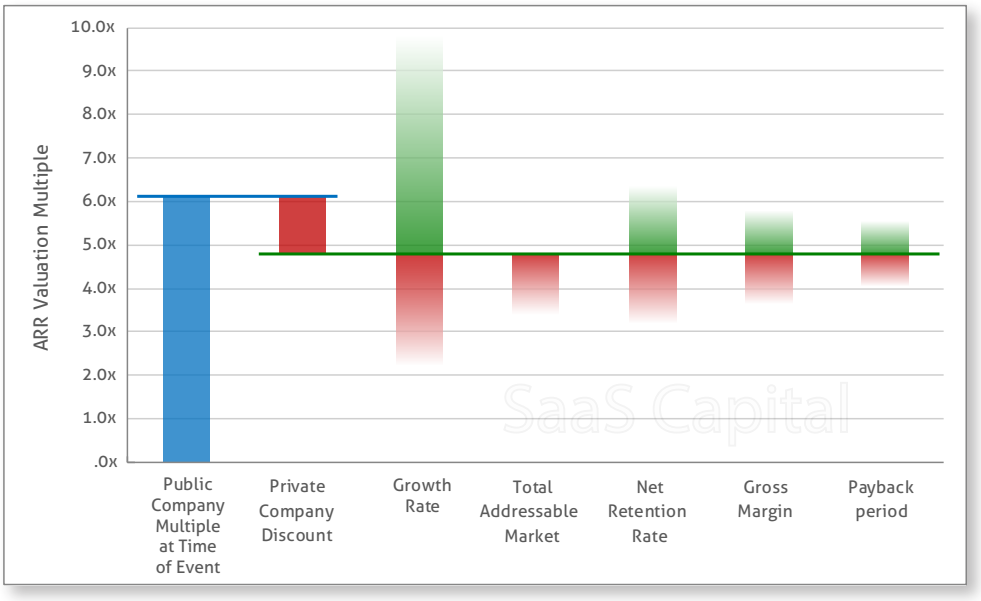
The factors listed above might make valuing a SaaS business seem more like a math exercise than it really is. In reality, there are a myriad of other factors that can impact a company's value, but they tend to be highly company specific and difficult to quantify or benchmark. Some of the other major value drivers to be aware of are:

1. Is the company a leader in its space? In the SaaS world, leaders tend to maintain and grow market share and garner a meaningful valuation premium.
2. Is the company a good strategic fit for a buyer? Beyond your SaaS company's own performance, how might it fit in with a buyer's existing business? What are the synergies? Should the buyer pay the seller for those synergies?
3. How strong (experienced) is the management team? This is particularly important when valuing an earlier-stage SaaS business when there is less clear financial data.
4. Is there a technology advantage, technology debt, or an existing claim on the intellectual property?

All of these factors, and others, can certainly impact value in a meaningful way; however, the impact is still generally within the context of an ARR multiple premium or discount. Beyond the scope of this paper is an approach for valuing less mature SaaS businesses which are sometimes acquired on a "buy vs. build" basis.

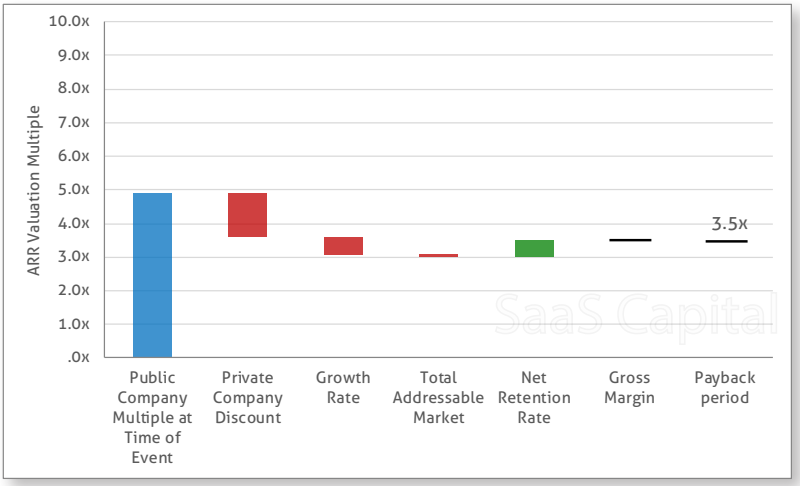
VISUAL GUIDE AND EXAMPLE VALUATIONS FROM OUR OWN PORTFOLIO

Throughout this study we've been developing the valuation framework, which begins with our public company benchmark and then builds in the appropriate valuation premiums and discounts. Below is the final framework in a visual format, followed by two actual portfolio company examples. Here is the framework, rotated for convenience.



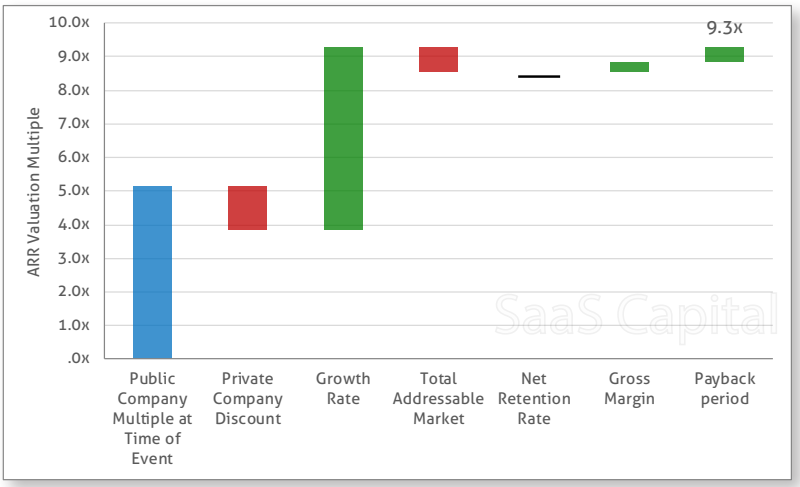
Portfolio Company #1:

- Public company market multiple at time of transaction = 4.9x
- ARR run rate = $17 million
- Growth rate = 26% (lower than mean)
- TAM = Currently serving large niche market, but larger market opportunity exists
- Net Revenue Retention Rate = 109% (very high)
- Gross Margin = 84% (average)
- Payback period = 15 months (average)
- Valuation = 3.5x from a private equity firm



Portfolio Company #2:

- Public company market multiple at time of transaction = 5.1x
- ARR run rate = $45 million (large)
- Growth rate = 230% (extremely high)
- TAM = Niche Market, potential for expansion.
- Net Retention Rate = 100% (average)
- Gross Margin = 90% (high)
- Payback period = 5 months (very high)
- Valuation = 9.3X



Obviously, we built these charts already knowing the outcome. However, a blind application of the framework would have led to a relatively tight range of expected outcomes, including the final valuation number.

Conclusion:

SaaS companies, like any other, are worth the present value of their estimated future cash flows. For SaaS businesses, however, the best proxy of future cash flows is recurring revenue, not EBITDA, and so they trade based on a multiple of that metric. Because of their smaller size and lack of liquidity, private SaaS businesses generally trade at a 1.3 times revenue multiple discount to public SaaS companies. At the publish date of this paper, an average private SaaS business was worth 4.8 times ARR. From there, the key drivers of the valuation multiple above or below the average are: growth and size of the recurring revenue, addressable market size, revenue retention, gross margins, and sales efficiency. Deviations from the mean in these metrics can swing the valuation multiple significantly and cumulatively, with revenue growth rate being the biggest value driver by far.

In understanding the basic methodology used by buyers and investors in SaaS businesses, operators and owners can better optimize and negotiate an appropriate valuation. Based on our experience, it is a myth that buyers and investors want an uneducated seller. Buyers want a reasonable and educated seller that can quickly and rationally come to a fair range on valuation. From there, the two parties may not ultimately agree on a price, but at least they will have a productive and informed conversation.

ABOUT SAAS CAPITAL

SaaS Capital is the leading provider of long-term Committed Credit Facilities to SaaS companies. Focusing exclusively on the SaaS business model, SaaS Capital delivers faster decisions, more capital, and longer commitments. SaaS businesses have used SaaS Capital's Committed Credit Facilities, instead of equity, to finance growth and create hundreds of millions of dollars in enterprise value without sacrificing significant ownership or control. Also, through its partnership with DH Capital, a boutique investment banking advisory firm, SaaS Capital can assist with M&A and capital raising services. SaaS Capital has offices in Cincinnati, New York, and Seattle.

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