

# 17 Reasons Your SaaS Company Is Not Investment Grade

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February 20<sup>th</sup>, 2019



# About SaaSOptics

Subscription Management built for growing B2B SaaS and subscription businesses.

- Billing & Collections
- Revenue Recognition
- SaaS Metrics & Analytics



550+  
Customers

\$4B+  
Managed Revenue

\$11B  
In Aggregate  
Invested Capital

Tim McCormick  
CEO



# About Founders Advisors

Founders Advisors is a merger, acquisition, and strategic advisory firm serving middle market companies. Its M&A advisors offer sell-side, buy-side, recapitalization, and divestiture/spin-off solutions for its clients. A privately held partnership founded in 2003, Founders has offices in Birmingham, Alabama, Dallas, Texas, and Houston, Texas.



**55**  
Completed Engagements Since 2012

**\$1B+**  
Total Transacted Enterprise Value From Engagements

**21%**  
Average Increase In Initial Bid To Close Value Last Year



Sales & Recapitalizations



Growth Capital



Strategic Advisory



Targeted Acquisitions



Management Buyouts

**Zane Tarence**  
*Partner & Managing Director*

**COVALENTWORKS**  
Has been acquired by  
**SPS COMMERCE**  
Sell-Side Advisor

**Predikto**  
Has been acquired by  
**United Technologies**  
Sell-Side Advisor

**Vertical SaaS Company**  
Has been acquired by  
**Diligent**  
Sell-Side Advisor

**COCONSTRUCT™**  
BUILD TOGETHER  
Has been recapitalized by  
**Serent CAPITAL**  
Financial Advisor

**TheraNest**  
Has been recapitalized by  
**GSV | GREATER SUM VENTURES**  
Financial Advisor

**SHIPT™**  
Has secured growth capital from  
**e.ventures | HMC | Harbor Management Corporation | GREYCROFT**  
Strategic Advisor

**SILICON Y'ALL**

[Silicon Y'all](#)  
2019 Summit  
October 7<sup>th</sup> – 9<sup>th</sup>

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## *Your Company Lacks Recurring Revenue So Cash Flow Is Unpredictable*

- All revenue streams are not created equal → Sum of the Parts valuation methodology
- SaaS businesses with heavy services revenue typically have compressed margins and less operating scale
  - Service revenue isn't a detractor if it is driving predictable and sticky recurring revenue
- A true single-instance, multi-tenant solution without much customization is preferred

- Growth rates are used as a proxy by many investors to determine the usefulness and viability of the solution → Product Market Fit
- Once a SaaS company has established itself and its product, its focus shifts to customer acquisition and sales
- Because of the margins associated with SaaS businesses, higher growth rates enable the business to produce significant cash flow more quickly
- How does your company compare to The Rule of 40?

- *“Neither a stellar team nor a fantastic product will redeem a bad market ” – Marc Andreessen*
- Is your end market healthy? What is the competitive landscape like?
- Generally \$1B of TAM is a market size that can excite buyers; however, if you have the ability to dominate a smaller TAM, it can be compelling to investors as well

- Investors want to acquire the #1 solution in a space, and they will pay a premium for it
- Roll-ups are accounting for much of the M&A activity in the SaaS space and driving valuations
- The only reason people go to #2 (and deeper) is because the #1 solution has already been acquired
- If you're a small company, you need to target market share in a sub-segment of the market and demonstrate that you are capturing meaningful share within a niche market

- *“Talent is the multiplier. The more energy and attention you invest in it, the greater the yield.”* — Marcus Buckingham
- Much like you try to differentiate your product in the market, are you making an effort to differentiate your company’s culture to current and prospective employees?
- Are you attracting and retaining top talent? Acqui-Hires are a key M&A driver for strategic buyers
- In the long run, employee turnover is significantly more costly than employee retention
- The real competitive advantage in any business is one word only, which is “people”

- “How do you build a defensible moat?” – Warren Buffet
- Does your company have a MOAT that protects its market position?
  - Intellectual property
  - Proprietary data
  - Differentiated delivery model
  - Brand recognition
  - Market penetration
- Weak barriers to entry make an asset less attractive to financial investors and make the build vs. buy case stronger for strategic acquirers

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*Your Company Lacks Owner-Independent Sales and Marketing Processes*

Polling Question

## *Your Company Lacks Owner-Independent Sales and Marketing Processes*

- Your sales system can't depend upon your CEO or one great salesperson
- Sales and Marketing efficiency is critical to a growing SaaS business
- Investors must see that your Sales and Marketing processes are scalable → are your processes documented?
- Performance data is key → you can't improve what you don't track
  - Pipeline conversion data
  - Sales rep performance
  - Customer acquisition cost
- What is your LTV:CAC? Does your customer acquisition model produce a return long-term?

- How much of your revenue is generated from your top 1, 3, 5 and 10 customers?
- Regardless of the relationship you have developed with your top customer(s), concentration risk will always be a value detractor (or investment disqualifier) for investors
- Aim for 3% or less average concentration per customer, with no customer accounting for more than 10% of revenue and your Top 10 customers accounting for no more than 30% of revenue

## *Your Company's Competitive Advantages Do Not Protect Its Market Share*

- A good indication of a company's competitive advantage is gross margin → can you deliver your product and service more efficiently than the competition?
  - How does your gross margin compare against your market cohort?
- What do you do better than competitors in the space?
- Price isn't a competitive advantage in the long run

## *Your Company's Brand Does Not Translate Into New Customer Acquisition*

- *“Emotional connection creates economic outcome” – Walt Disney*
- How well known is your brand to potential customers in your market?
  - Logos give credibility and clout
  - SEO and PPC domination
  - Trade show awareness
- Capterra rankings and other third party lists are important to your brand strength
- Brand category strength will directly impact your Customer Acquisition Cost → stronger brand strength leads to less CAC spend

- Are you able to continuously improve on your product to keep up with the needs of your customer?
- Is your Product Management Function world-class?
- How are you tracking product feedback and what is your product roadmap development process?
- Efficient development cycles & product update releases are key
- A lack of innovation will eventually impact customer retention
- Innovate in your functional areas as well → strategy, sales & marketing, and talent

- Every buyer will look for NPS scores (or some similar metric) during diligence
- Are you aware of how your customers feel about your product and services?
- How will your customers respond to a potential buyer's survey?
- Tracking and improving on an NPS score will give you comfort heading into that phase of diligence
  - Nice to have two years of NPS trend data

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*Your Company's Financials Aren't Buttoned Up And / Or You Can't Relate Them To Your Business Model*

Polling Question

## *Your Company's Financials Aren't Buttoned Up And / Or You Can't Relate Them To Your Business Model*

- A set of organized, accurate and believable financial statements will have more influence on a buyer than anything you say, do or promise
- Be able to articulate the unit economics of your business → how do you generate revenue, what does it cost to obtain and service that revenue, and how do you create operational scale over time?
- Understand & present a fairly burdened gross profit
- Appropriately track non-core/one-time revenue and expenses
- Create a budget or forecast for at least the next 12 months → perform annually and compare against actuals to self-assess
- Customer base metrics
  - ARR/MRR buildup
  - Retention → customer, gross, net
  - CAC and LTV

- Do you have operating leverage in the business → Are you growing revenue at a faster pace than your expense structure?
- Institutional knowledge is great, as long as it doesn't walk out the door
- Think through the most important areas of your business (dev, sales, etc.) and ensure key processes/procedures are captured in a clear and effective manner (that can also be easily and continually updated)
- Capture everything from unique workflows to how you hire/train employees
  - Operational checklists are irresistible to investors and buyers

- Organization of legal documentation → corporate docs, employee agreements (IP assignments, NDAs), and operational agreements
- Can you produce top 20 vendor & customer contracts?
  - Standardize contracts with customers and vendors → sales team doesn't have free reign to change terms
  - No "handshake" agreements
- Are you fully aware of provisions in your top customer or vendor agreements that would limit a future transaction? (Right of First Refusal, non-assignability provisions, etc.)
- Intellectual Property
  - Are you using any open source software?
  - Have your employees executed IP assignments?
- Taxes → Are you properly filing Sales & Use tax? If no, are you aware of the potential risk / exposure?

## *You Cannot Explain Why Your Company Exists And/Or Can Not Tell Its Story*

- Articulate your summary in layman's terms, with a focus on how you add value to your customers and even your customers' customers
- Create, refine, and practice your 3 minute elevator pitch
- Have a well-designed and hard-hitting 1-page executive summary
- Answer the question of why you deserve to exist as a company
- Buyers are turned off by fuzzy communicators

- Always be prepared to engage the institutional capital markets; have a well-thought out back-up plan
- Be positioned for all options:
  - Hold and continue to be a great company – need to be polished to recruit and retain the best talent
  - Raise money or take chips off the table – have your house in order in case you want or need to move quickly
  - Establish an advisory team – accountant, attorney, investment banker, and wealth manager. Don't wait too late to plan for a transaction. A well-planned exit always produces an outsized outcome

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