Valuation of SaaS vs. On-Premise License Software

November 2014

FIREPOWER CAPITAL

LOWER MID-MARKET INSIGHTS

Recurring revenues dramatically drive valuations up

No one would contest that investors pay more for businesses that generate recurring revenues, but nowhere is that truism more starkly evident than in the software industry. The transition from on-premise licenses to Software-as-a-Service (SaaS) over the past decade or so is not only remarkable in the amount of shareholder value it has unlocked, but also in how much difference selecting the right business model can make.

We here make conclusions based on US data from research firm *Software Equity Group LLC* to quantitatively support the strategic advice we give to our Canadian prospects and clients alike, regardless of their sector. This is particularly relevant in the context of them considering a potential exit in the coming years, and as they devise their strategic roadmaps to get there.

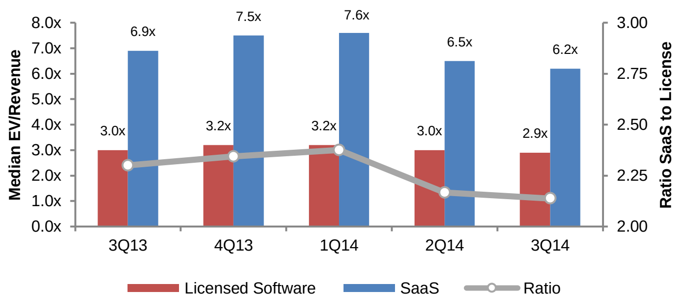
How big is the valuation gap, really?

Simply put, SaaS businesses are 2.0-3.5 times more valuable than on-premise license software firms. As shown by the grey line in the first two charts to the right, for publicly traded firms over the past five quarters, the ratio of median enterprise value (EV) to revenue and the EV to EBITDA multiples of SaaS firms vs. on-premise license firms were generally within that range, but peaked above 4.0 and bottomed at 1.7.

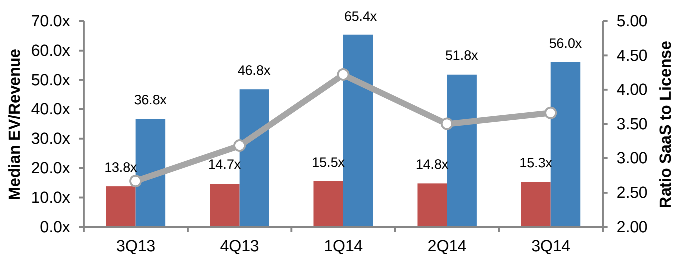
The third chart to the right shows that ratio holding steady in the 1.8-1.9 range for M&A transactions for which data is available. While the gap is lower in an M&A context (which indeed captures a more relevant set of circumstances for our readers), the discrepancy is still very much there.

This valuation gap is as clear as it gets in terms of evidence of what investors value—there is little doubt that any privately-held business (not just software) that can grow and defend a customer base that generates recurring revenues will be rewarded with higher valuations down the road if it chooses to explore a potential company sale.

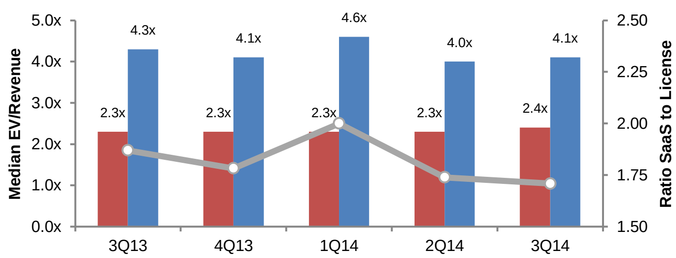
Median EV/Revenue Multiples for Public Companies



Median EV/EBITDA Multiples for Public Companies



Median EV/Revenue Multiples in M&A Exits

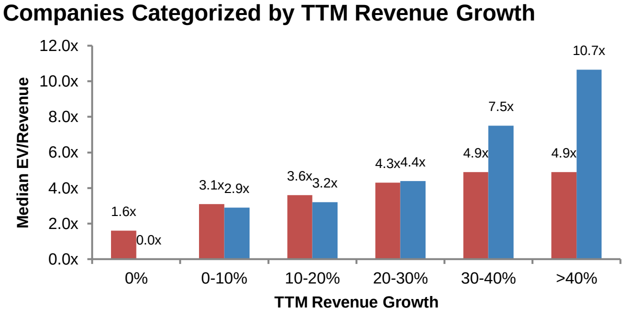


Intuitively, it still seems like a big gap. Are there other drivers of value behind the 'SaaS' label?

Correct. And the answer is not SaaS businesses being more profitable. Rather, it's high revenue growth that is rewarded, and it so happens that SaaS businesses on average grow far faster (25.8% TTM revenue growth) than on-premise license software firms (8.0% TTM revenue growth). At the high end of the spectrum, the valuations are truly eye-popping: SaaS businesses with more than 40% TTM revenue growth command a 10.7x multiple on average, and explain nearly all of the gap between revenue models.

The last chart in the bottom right corner shows this in more detail: valuations clearly increase as a function of TTM revenue growth, when they are plotted against one another. Not surprisingly, the 'lift' applies to both SaaS and on-premise license, but accelerates greatly for SaaS.

Median EV/Revenue Multiples of Public Software Companies Categorized by TTM Revenue Growth



So, does it mean that privately-held software firms should convert all revenues to recurring and grow as fast as possible at all cost?

There is no question that a dollar of SaaS revenues is worth more than a dollar of non-recurring revenues. However, it is also self-evident that not all businesses lend themselves to recurring contracts, so our conclusion to the first part of the question above is "whenever possible".

The second part of the question is far less ambiguous. Revenue growth is all that matters, in terms of exit values, for only a rarified set of private companies, primarily VC-backed ones. For the vast majority of privately-held firms, profitability is more important, and should be a strategic focus especially ahead of a company sale.

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Who are we?

FirePower Capital is Canada's entrepreneurial investment bank. We focus exclusively on advising private lower mid-market companies in Canada on their strategic M&A and non-dilutive capital financing transactions.

We formed the firm in 2012 because **we believe that private lower mid-market companies in Canada should have access to the sophisticated transactional advisory services that are typically reserved for much larger companies.**

The need proved to be real: we are now one of the largest independent firms in Canada. As of May 2015, we are managing **10 active sell- and buy-side mandates worth an estimated $98 million, and 9 financing assignments worth $26 million**.

Our team of 16 dealmakers are smart, passionate and driven by a fierce determination to not only succeed, but exceed our clients' expectations. **We love what we do, we are good at it, and our clients love us for it.**

What do we do?

Our **Mergers & Acquisitions Practice** understands the difficulties and complexities around the decision and process of selling or buying a business. Typical transaction sizes range from $5 to $50 million, and span most industries except for resources and life sciences. We deliver on the full spectrum of M&A transactions:

- Sell-side
- Buy-side
- Asset sales & purchases
- Cross-border
- Hostile acquisition or defense
- Spin-offs and other corporate restructurings

Our **Capital Advisory Practice** provides objective transactional advice and seamless execution capabilities to our clients with respect to non-dilutive capital financings. Typical transaction sizes range from $1 to $30 million, and span most industries except for resources and life sciences. We have extensive experience raising debt capital for most situations:

- Growth
- Leveraged buyouts
- Turnarounds & special situations
- Acquisitions
- Refinancing
- Shareholder events, e.g. dividend recaps or management buyouts

Why work with FirePower?

We're not typical Bay Street guys: We have made it our mission to excel in the lower mid-market, and not be 'tempted' by the larger, headline-grabbing deals. That means developing a deep understanding of how to overcome the challenges unique to this segment.

Our track record is extensive: During our short history, our team has already built a reputation for crafting deals the market has never seen before, providing expert transactional advice and getting deals closed.

We do things differently: We have built FirePower like a start-up, not a traditional advisory firm. We rely heavily on new technologies to produce competitive tension between buyers or investors, and thus create multiple options for our clients.

We put our money where our mouth is: Most of our compensation is based on closing a deal that works for our clients. We are aligned with them: we succeed only if our clients succeed.

We have a global reach, but nurture deep Canadian roots: Exposing a deal to hundreds of buyers or investors worldwide is easier than ever, but doing it intelligently is still difficult, time-consuming and extremely complex. A strong network of relationships at home in Canada helps us balance our global efforts.

Our track record (recent sample transactions)

CONFIDENTIAL

Sale of Majority Stake
$5,002,000

The undersigned acted as the exclusive advisors to the Sellers

FIREPOWER CAPITAL

Nautilus Explorer

Subordinated Debt
US$3,000,000

The undersigned acted as the exclusive advisors to the Company

FIREPOWER CAPITAL

CONFIDENTIAL

Senior & Subordinated Debt for Management Buy-Out
$16,000,000

The undersigned acted as the exclusive advisors to the Company

FIREPOWER CAPITAL

KINGSMAN RESOURCES

Reverse Takeover
$28,200,000

Contagious Gaming

TELOS

The undersigned acted as the special advisors to the Company

FIREPOWER CAPITAL

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