SaaS Capital Insights

In the first quarter of each year, SaaS Capital conducts a survey of B2B SaaS company metrics. This year's study marked our 9th annual survey, and, with over 1,400 private B2B SaaS companies responding this year, it is the largest survey of its kind and continues to grow every year. This year, for the first time, we asked several questions on funding sources, amounts raised, and cash balances to study capital efficiency and runway among private SaaS companies. It also needs to be explicitly stated that this data was collected in early 2020 and is based on 2019 performance metrics and data, before the impact of the COVID-19 pandemic. Benchmarking comparisons should be made to the same time period for your company.

PRIVATE SAAS COMPANY FUNDING, RUNWAY, AND CAPITAL EFFICIENCY BENCHMARKING

This year in our annual survey of private B2B SaaS companies, for the first time, we asked several questions on funding sources and amounts raised to learn more about capital efficiency and cash balances to better understand runway. Runway considerations, in particular, became very relevant with the arrival of the novel Coronavirus COVID-19 and the resulting economic shutdowns. The goal of asking these new questions was to be able to answer the following:

- When do companies raise equity?
- How much money do they raise?
- How much runway do companies maintain?

Lastly, we wanted to analyze the correlation between the data on capital formation and business performance. The core tenet behind raising outside capital[1] is that it will help you grow faster than you otherwise could have, increasing the value of your business more and/or in a shorter period of time. At odds with this tenet is the obvious dilution to a founding team's ownership percentage from selling equity to an investor.

We know from previous research on private SaaS company growth rates that venture capital-backed companies are growing faster than bootstrapped companies (causal relationship notwithstanding), but are they growing fast enough to offset the dilutive impact of raising equity? Said another way:

Is there a way to handicap the advantage from the extra funding of raising equity to compare performance in an apples-to-apples manner between VC-backed and bootstrapped companies?

The survey question was specifically worded: "What is the primary type of equity financing your company has used? (If significant, include convertible debt here)". So it is possible, even likely, that companies have used multiple sources of equity financing, but the data presented in the sections below are based on the source of the most dollars raised.

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1 While we asked about the use of debt and equity in the survey, in this report we only analyze the impact of equity capital.

When do companies raise equity?

Twenty-four percent of companies responding to the survey never raise equity at all, and another twenty-three percent primarily raise equity only from angel investors. Thirty-one percent of companies raise the majority of funds from traditional venture capitalists, while fifteen percent are private equity funded and five percent are primarily funded by strategic investors.

In terms of timing, figure 1 shows that 40% of companies are bootstrapped at founding, and another 40% start with angel backing. Venture funding really begins to proliferate about the time that SaaS companies turn four years old. The percent of companies backed by VCs grows from 21% in year 3 to 32% in year five. From the survey data we have found that the average time to get to $1 million in ARR is about 4 years for VC-backed companies and 6 years for bootstrapped companies. Combining these data points, it appears that the run rate revenue threshold to attract institutional equity investors is about $1 million in ARR.

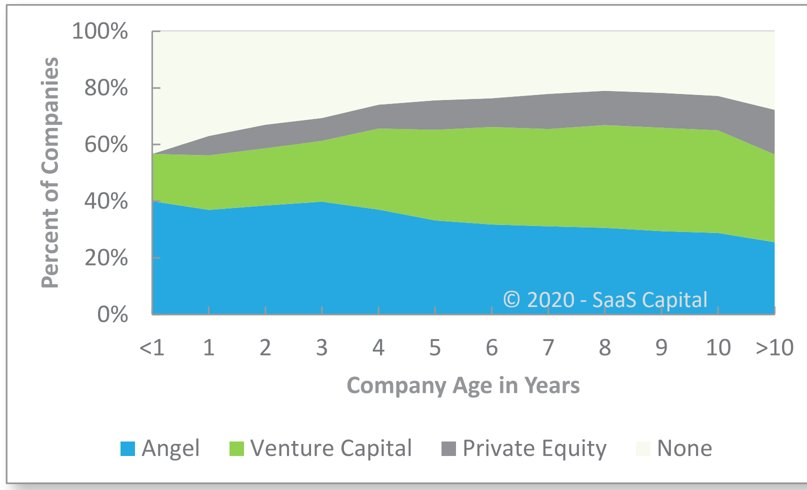
The percent of companies using outside capital peaks at about year eight, with 79% of all companies. Very interestingly, starting about then, the percent of companies that primarily financed through angel investors and VCs begins to decline. The percent of companies that primarily use PE dollars or are bootstrapped expands. Our hypothesis is that it is at this point – years eight through ten – when early-stage equity investors begin seeking an exit for their portfolio companies in order to return liquidity to their limited partners. There are simply fewer companies of this age now, and more of the remaining companies are still bootstrapped.

The last comment on Figure 1 is that, despite what has seemed like a gold rush of private equity interest into the SaaS industry over the last several years, only 12% of companies in the survey report primarily being funded from that source.

Figure 2 examines the same data by revenue stage, instead of by company age. Our premise that VCs get more heavily involved post-$1 million in ARR is supported by this chart, as we see the percent of companies funded by VC expand significantly at the $1 million ARR mark.

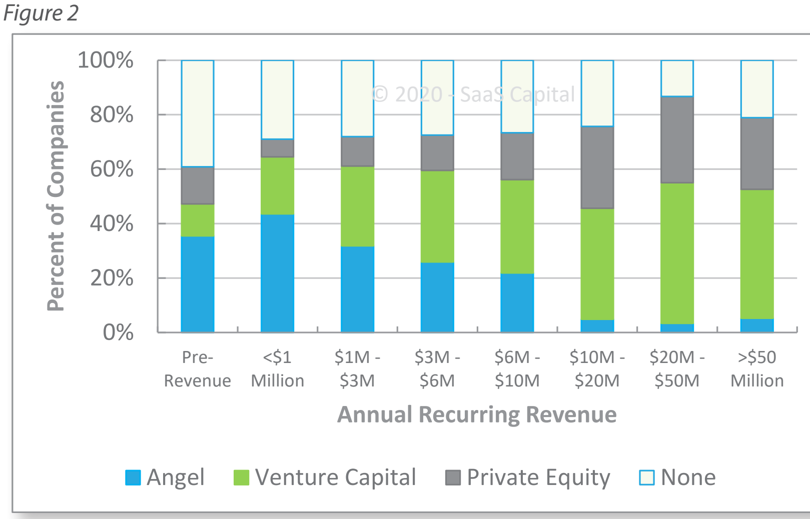
Up to $10 million in ARR, approximately 25% of companies are bootstrapped. Above $10 million of ARR is where private equity becomes a more significant source of funding. This is consistent with SaaS Capital's anecdotal experience.

Figure 1



"The average time to get to $1 million in ARR is about 4 years for VC-backed companies and 6 years for bootstrapped companies. The run rate revenue threshold to attract institutional equity investors is about $1 million in ARR. "

Figure 2

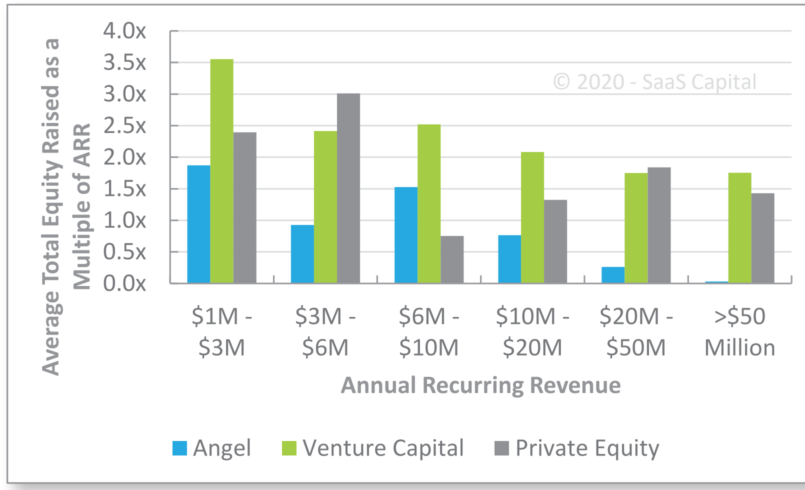


How much money do companies raise?

The median angel funding invested in pre-revenue companies and companies with less than $1 million in ARR is $660,000. The median amount of venture capital funding for that same group is $3 million, although it should be reiterated that VCs get much more heavily involved post-$1 million ARR.

For companies with revenue greater than $1 million ARR, the average (which we specifically use here instead of median to illustrate the effect of outliers to the high end) of total equity raised, regardless of source, is surprisingly no more than about 2.5 times a company's annual recurring run rate revenue. The average amounts raised, by source and ARR, are presented in Figure 3.

Figure 3



A reminder that in Figure 3, the columns show ***total funding from all sources***, but are separated by ***primary source*** of funding. For example, to benchmark a business that has $5 million ARR and has raised two angel rounds for $500,000 each and a $5 million Series A from a venture capital firm, you would compare solely against the green column in the $3-6 million ARR grouping. You would not add the blue (Angel) and green (VCs) bars in the chart together; the green bar already shows ***total*** funding amount from all sources. In our example, at a total funding of 1.2x ARR ($6 million raised / $5 million ARR), the majority of which came from VCs, your company is far below the average amount of 2.45x ARR for peer companies.

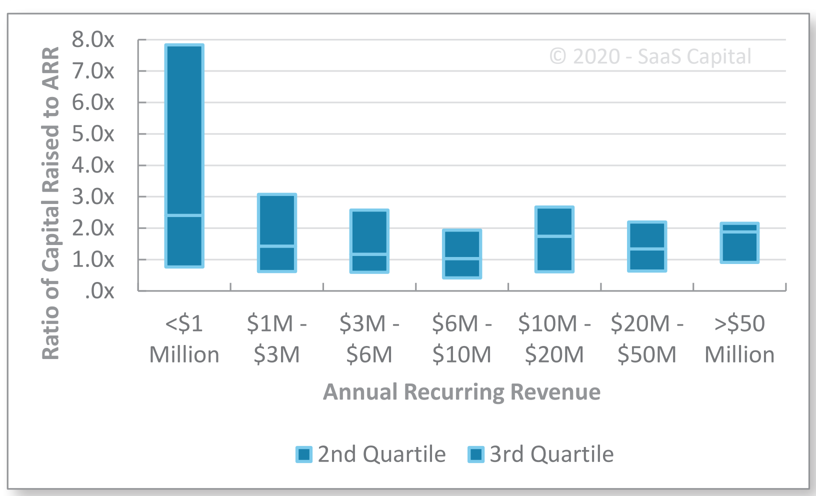
The overwhelming majority of angel funding is less than 1 times ARR. Venture funding only tops 2.5 times ARR in the very early stage, when ARR is relatively small.

We were surprised to see that even private equity funding, which is typically structured as partial or full recapitalizations or buyouts, averages between 1.0 and 2.0 times ARR for more established companies. This is perhaps due to two possibilities:

1. Private equity firms really are investing only 1 to 2 times ARR, meaning that they are buying companies far below the median private valuation level in Q4 2020 of around five or six times ARR, or
2. Survey respondents did a good job following the specific instructions of the question, which was "How much capital has your company ***deployed*** to reach its current ARR." A very literal reading of the question is that it is asking for how much primary capital has been raised and spent towards the goal of growing revenue, and an astute respondent would not include secondary capital used to buy out existing shareholders. We will clarify the question in the next survey.

Whatever the explanation, for those that raise outside equity, the average SaaS company raises between 1.0x and 2.5x ARR, with that amount decreasing as a company scales. Figure 4 shows the quartile distribution of amounts of capital raised by ARR. The two blue sections combined in each column show the 2nd and 3rd quartiles, the middle 50%, of amounts of capital raised as a multiple of revenue. The light blue line is the median amount for each ARR grouping. The top quartile is very high (~30 times ARR) and not very useful for benchmarking without other supporting data, so it is not shown. The lowest quartile essentially goes to 0.0x, as some companies only raised nominal amounts. The key takeaway here is that, for companies with more than $1 million of ARR, 75% have raised less than 3 times ARR, and more than half have raised less than 2 times ARR.

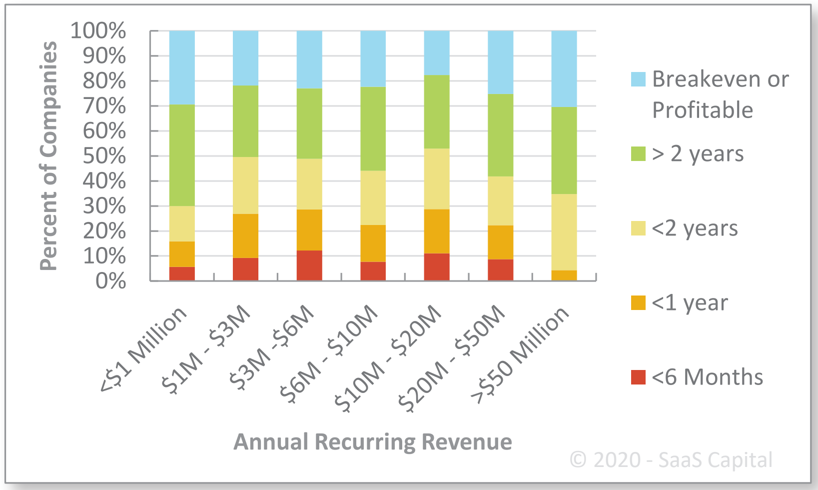
Figure 4



Coincidentally, while working on this research piece, we spoke with a private equity investor who specifically mentioned that one of his firm's required criteria is "invested capital to-date of less than one times ARR."

A question that comes up in conversation somewhat frequently is whether a company's customer acquisition cost (CAC) drives the amount of capital it raises. The thinking goes that the higher a CAC, the more capital a company must raise to fund the sales and marketing costs to support revenue growth. We found that there is no correlation between CAC and the amount of equity raised.

Figure 5



How much runway do companies have?

Looking at companies that have raised equity, Figure 5 shows that 50% are either profitable, breakeven, or have runway for at least 2 years. Another 25% of companies have less than 1 year of runway. Only a small number, less than 10%, have less than six months of runway.

Below is a summary table of burn rates as a percent of revenue for equity-funded companies compared to those of bootstrapped companies, sorted by ARR. Negative numbers indicate profitability.

Table 1

Annual Burn Rate as a Percent of ARR							
	<$1 Million	$1M-3M	$3M-$6M	$6M-$10M	$10M-$20M	$20M-$50M	>$50 Million
Average Burn Rate - VC-backed	48%	47%	38%	26%	24%	15%	18%
Median Burn Rate - VC-backed	0%	11%	5%	8%	13%	2%	24%
Median Burn Rate - Bootstrapped	0%	-2%	-5%	-1%	-9%	-10%	-11%

A reminder that this survey data was collected in Q1 2020 and based on performance data for 2019, before any impact from the COVID-19 pandemic. We will again be completing our survey in early 2021 and will update all of the data and research then to understand how SaaS companies were impacted, and how they adjusted to the economic fallout of the pandemic shutdowns.

Can we weight a company's performance by its capital efficiency?

Lastly, we wanted to investigate if there is a direct correlation between the amount of capital raised and company performance. The value proposition of raising outside capital is that it will help you grow faster than you otherwise could have, increase the value of your business in a shorter period of time, and ultimately, increase your wealth faster and/or more than otherwise possible. The cost is the dilution to a founding team's ownership percentage from selling equity to an investor. The goal is that the value creation made with the extra cash outweighs the value lost through dilution. Said another way, the venture capital sales pitch is that you will own a smaller piece of a much larger pie.

Without knowing far more detail around valuation, liquidation preferences, and participation rights, we can't complete a company-by-company analysis, but below we propose a methodology for adjusting a company's performance metrics by the amount of equity it has raised in order to compare it to its bootstrapped peers, or itself on a bootstrapped-adjusted basis.

The "Rule of 40" is a benchmark proposed by a private equity investor who stated he would only invest in companies for which growth rate plus profitability margin was greater than 40. This rule of thumb is a great shorthand way to determine a company's performance against its peer group.

While growth plus profitability (GPP) of at least 40 is one investor's benchmark for an investable company, the actual peer benchmarks are generally lower, which makes sense since an investor is presumably looking for better-than-average companies. Figure 6 shows the median GPP of bootstrapped companies from the survey, categorized by ARR ranges.

Before we even get to the adjustment, we were surprised to see that the median GPP of VC-backed companies is lower than its bootstrapped peers. Figure 7 compares the two groups.

Venture capital-backed companies are growing at a median rate of 43%, while bootstrapped companies are growing at a median annual rate of 26%[2]. However, the burn rate differential of VC-backed companies, 15% of revenue versus +11% profitability for bootstrapped companies, far outweighs the growth rate differential, resulting in lower GPP medians before even adjusting for the capital raised (and spent) to get to this point. A last interesting point on the chart above is that bootstrapped companies tend to maintain a steady level of GPP as they grow, around 35%, while VC-backed companies' GPP declines as ARR increases. Both types of companies are combating the same [daunting math of growth rates](), but it appears bootstrapped companies respond by increasing profitability, while VC-backed companies maintain or increase their spending.

To adjust the GPP of venture-backed companies to an "as-bootstrapped" basis, we weight (divide) the GPP by the multiples of ARR that the company has raised. There is no adjustment for companies who have raised less than 1 times ARR, and we netted out current cash on-hand, to account for companies that may have just raised an equity round, and have not yet deployed the capital into growth initiatives.

Since we use the multiple of ARR raised, the resulting downward adjustments deltas – the difference between the green dots and gray dots in Figure 8 for each revenue category – mirror the data in Figures 3 and 4, with larger adjustments for larger multiples of ARR raised. This is to say, somewhat obviously, the more capital the company has raised relative to its ARR, the more the GPP is adjusted. Early-stage companies raise more as a multiple of ARR than later-stage companies, so they are adjusted more.

Figure 6

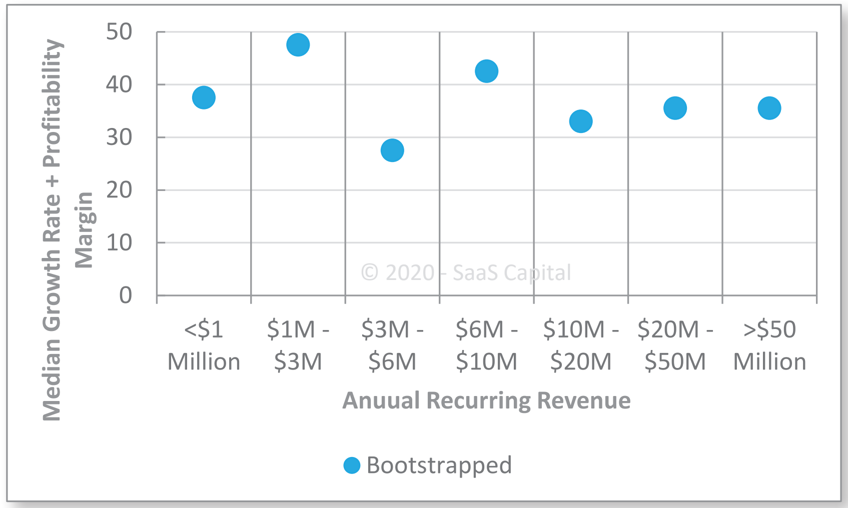


Figure 7

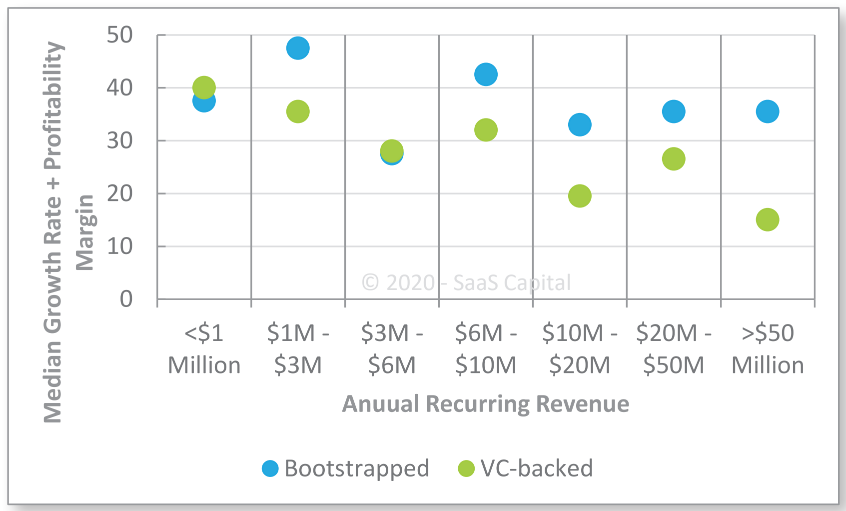
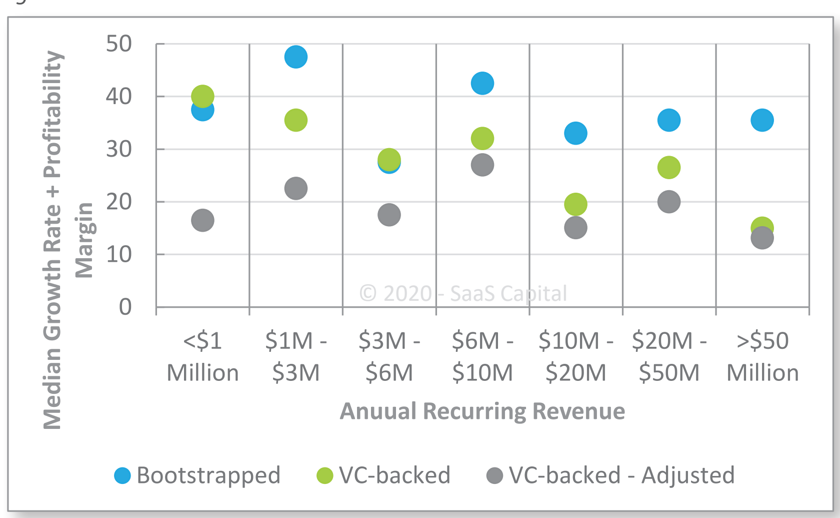


Figure 8



2 No causal relationship is implied here; venture capitalists likely invest in companies that are already showing signs of great success.

The end result is fascinating:

> ***Now on an as-bootstrapped adjusted basis, the adjusted GPP of VC-backed companies is fairly consistent through the company life cycle, but instead of around 35%, VC-backed companies have adjusted-GPP levels of between 15 and 20%, about half of their unfunded peers.***

This shows that the added spending from outside investment does not result in a growth rate increase to even reach parity with unfunded companies on a GPP basis, let alone surpass them. And when adjusting the GPP for how much capital was raised and spent, this contrast is even more significant.

One important caveat to this analysis is that it focuses solely on the GPP score, which puts equal weight on growth and profitability. PE investors may weight those two metrics equally, but VC investors typically weight growth over profitability, particularly early in a company's life. But as stated at the beginning of the section, the GPP is a good shorthand metric for company health, so it is a good starting place. We will explore other performance metrics and capital formation in future research.

Conclusion and Summary of Findings

This was the first year that we asked questions around capital formation. The data and analysis above is yet another way to compare your business to that of your peers. The benchmarking data presented here are helpful to understand where you differ from others and confirm that those variations are intentional. The surprising result from this research was that venture-backed companies have lower GPP scores than bootstrapped companies. This is an area we will explore in greater depth in future research. A summary of the key findings are:

- 24% of companies surveyed are bootstrapped.
- Venture capital becomes a more significant source of funding around $1 million in annual recurring revenue (ARR), which is typically about year four or five of a company's life.
- Looking at companies and their funding by age, the percent of the total that are bootstrapped steadily declines for the first eight years of a company's life as more and more companies raise outside capital. This trend reverses around year eight, however. Our hypothesis is that this is driven in part by the finite life of venture capital funds and the need for investors to liquidate investments, leaving fewer companies remaining of this age, more of which are bootstrapped.
- Private equity is much more common in companies with $10 million in ARR and above.
- There is no correlation between customer acquisition cost (CAC) and the amount of equity raised.
- Most companies raise relatively modest amounts of capital. The median amount of equity raised for companies with ARR over $1 million is 1.3 x ARR.
- Regarding handicapping equity investments to compare performance against bootstrapped companies, the median Growth Rate Plus Profitability (GPP or the "Rule of 40") metric for venture-backed companies is lower (28) than that of bootstrapped companies (37) before any adjustments. VC-backed companies are growing faster (43%) than bootstrapped companies (26%), but their higher burn rate (15% of revenue, versus 11% profitability for bootstrapped companies) more than offsets the growth rate advantage, resulting in a GPP score lower than that of the bootstrapped companies. Handicapping for the equity raised would lower the metric further. From a Rule of 40 perspective, and it is only one view on performance, the data show that bootstrapped companies are performing better than VC-backed companies even before taking the dilution into consideration.

It is worth repeating that the data was reported in February 2020 before the impact of the COVID-19 pandemic. At the time of publishing, Q4 2020, through our discussions with SaaS companies and monitoring of the overall environment, we have seen that financing, M&A, and strategic activities have rebounded soundly from Q2. We plan to update our benchmarking data on all topics with new data on 2020 performance as soon as we conduct our next survey in early 2021.

About SaaS Capital

SaaS Capital is the leading provider of growth debt designed explicitly for B2B SaaS companies. SaaS Capital's growth debt is structured to provide a significant source of committed funding, deployment flexibility, and lower overall cost of capital, all while avoiding the loss of control and dilution associated with selling equity. SaaS Capital was the first to offer lending alternatives to SaaS businesses based on their future recurring revenue. Since 2007, SaaS Capital has deployed $209.5 million in growth debt to deliver better outcomes for 65+ clients, resulting in $753 million in total enterprise value created.

Benefits of SaaS Capital's unique, SaaS-focused approach:

- **Higher advance rates** - Capital availability is based on a multiple of your monthly recurring revenue (MRR) – typically 4x to 7x MRR
- **Capital availability that grows with your business** - The amount of capital that you can draw increases automatically as your revenue grows
- **Long-term source of capital** - The capital is drawn down over 2 years under the committed line of credit, and then either renewed, or repaid over the following 3 to 4 years
- **Efficient use of capital** - Capital is drawn down only as your business needs it, thereby reducing your interest expense
- **Flexibility -** No balance sheet covenants or cash reserve requirements

SaaS Capital is best able to assist companies with the following attributes:

- Sell a SaaS-based solution
- Seeking $2M to $10M in growth capital
- $250,000, or above, in MRR
- Have a minimum of 85% retention
- Registered and principally banked in the U.S., Canada, or UK
- Revenue growth above 15% per year

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- Venture Backed
- Profitable
- Billing your customers monthly

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1311 VINE STREET | CINCINNATI, OH, 45202
7900 E GREENLAKE DRIVE NE, SUITE 206 | SEATTLE, WA 98103
WWW.SAAS-CAPITAL.COM

ROB BELCHER | MANAGING DIRECTOR | RBELCHER@SAAS-CAPITAL.COM | 303-870-9529
STEVE JAFFEE | MANAGING DIRECTOR | SJAFFEE@SAAS-CAPITAL.COM | 614-506-2770