Research Note

MGI Research

SaaS Valuations 2012: What Price is Right?

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Summary: Over the past twelve months, our growth-based valuation approach to Software as a Service (SaaS) companies has received significant industry recognition and use. Five public acquisitions in the SaaS space have largely confirmed our SaaS valuation model which was last published in March of 2011. During 2011 and 1Q2012 SaaS companies have largely maintained and expanded the valuation premium gap to the rest of the software sector. The acceptance of SaaS concept amongst business and IT buyers has grown meaningfully during 2011 and Q12012, while actual production use still indicates a very early stage of adoption. As the SaaS space matures, revenue growth remains the dominant valuation factor. Other SaaS valuation variables such as cash flow growth, expansion in GAAP profitability and a premium for a dominant market share are likely to become more prominent by 2014-2015. This Research Note provides updated valuation benchmarks and a revised SaaS valuation formula. We also review operating data, equity market performance and an outlook for M&A in the SaaS space.

Key Issues

- What are the correct metrics for SaaS valuations?
- How will market adoption of SaaS impact valuation multiples?
- What attributes separate top and bottom ranked SaaS companies?
- Are SaaS companies over or under-valued?
- What SaaS companies have the most efficient business model?

Software Valuation – How Much is Revenue Worth?

Since our last formal update on SaaS valuations in March of 2011, as of April 16 2012, the overall software sector valuation multiple of Enterprise Value/Revenue remained constant at 3.68 vs. 3.79 in 2011. During the same time period, the SaaS valuation multiple rose from 5.00 to 5.51 while Enterprise Software multiples eroded slightly from 3.52 to 3.24. The current study sample consists of 93 software companies including 18 SaaS firms and data on one in-progress transaction (Convio - CNVO) and excludes data on the four closed deals (RightNow Technologies, DemandTec, Taleo, SuccessFactors). We did not include DemandWare (DWRE) and GuideWire Software (GWRE) in this study for these recent IPOs lacked sufficient depth of data.

Table 1 below summarizes SaaS vs. Enterprise Software valuation multiples for various market cap classes of companies. SaaS companies continue to command significant valuation multiple premium but investor affection is not distributed evenly across market cap classes.

Table 1 - Software Valuations

Valuation: Enterprise Value / Revenue	By Market Cap Class				
Business Model	**A - LargeCap**	**B - MidCap**	**C -SmallCap**	**D - MicroCap**	**Overall**
Enterprise Software	4.42	3.88	3.07	1.20	3.24
SaaS	6.96	9.41	3.19	0.07	5.51
Average	**4.74**	**5.15**	**3.10**	**1.11**	**3.68**

Category	Market Cap
MicroCap	market cap < $100Mil
SmallCap	$100Mil < market cap < $1Bil
MidCap	$1Bil < market cap < $5Bil
LargeCap	Market cap > $5Bil

For publicly trading firms, the valuation premium for SaaS companies does not kick in until SaaS companies reach a critical mass of being at least a MidCap company. This is an indication that investors believe SaaS companies need to reach critical mass for their operating model to become attractive relative to on-premise business models. Being a small (SmallCap and MicroCap) SaaS company presents little if any advantage in the public market. Having stated that, it