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Increasing the value of your SaaS business
with robust ARR

Annual Recurring Revenue (ARR) is a key metric for SaaS businesses. Potential investors like to see a strong ARR as a measure of continued sustainable growth, and it's a vital component to an exit strategy.

One of the main ways to value a software business is as a multiple of the ARR (i.e. 3 x ARR, or 5 x ARR). If a business can show a good level of ARR, it can command a weighty multiple when it comes to valuation. A typical multiple would be 3-4, but with good ARR we've seen businesses attract a multiples of 10, 11 or 12 – a significant boost to the overall valuation.

If you're a SaaS business which is getting ready for sale, one of the jobs at the top of your list should be an ARR health-check. In this article we have a look at how to carry out that check and get the best possible value for your business.

Which revenue is included in ARR?

ARR represents the predictable and annualised revenue that your business expects to generate from its subscription contracts. Ideally your pricing will have a fixed element so you can point to the same amount recurring each year.

If you have pricing that is usage based, it may not be considered 'true' ARR.

Can you 'repackage' any revenue?

You can think laterally about ARR. Do you have any revenue that could be 'repackaged' as recurring subscription revenue?

See if you can encourage customers to switch from monthly plans to annual plans to give a greater level of certainty to your ARR figure. You can do that by offering customers a discount on longer contracts to incentivise them to make the switch.

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What is your churn rate?

Purchasers and investors will scrutinise how many of your clients renew each year. The higher the renewal percentage, the more ARR you really have.

With that in mind, it's worth investing in your client care and the renewal process. You can look after your customers with comprehensive onboarding, regular check-ins, helpful support, and ongoing communication.

Think about auto-renewal

When it comes to the renewal process, make it as easy as possible for your customers. One way to do that is to include auto-renewal in your contracts.

The language in the contract must be clear and unambiguous for this clause to be enforceable. The clause itself must be 'fair' and the concept of fairness is a bit prickly from a legal perspective. You need to give your customers certain information about the length of the contract and how to cancel the subscription (among other things).

To make sure that your auto-renewal clauses are enforceable, ask a lawyer to draft them for you.

Are price increases included?

Have you got price increases baked in to the subscription model? If you don't, this will devalue your ARR, due to the impact of inflation. The value of your contracts will erode with time, unless you increase their price in line with, or preferably beyond, the rate of inflation.

One common pitfall here is neglecting price increases in multi-year contracts. You need a clause in those contracts that allows for year-on-year price increases, not just at renewal. Again, that clause must be clear and fair to be enforceable.

Consolidate one set of Ts&Cs

Purchasers and investors like 'universality' when it comes to contracts. That means that they want to see all customers on the same versions of your Terms and Conditions, not lots of different ones.

In order to achieve that, you must be robust with any customer who wants to use their own Ts&Cs and you need to keep amendments to your Ts&Cs to a minimum.

From time to time you will also need to update your standard Ts&Cs, and you'll need to include a clause in there that allows you to do that.

Managing your ARR through your contracts

All of these issues that impact your ARR can be managed through your contracts. In order to give you the best chance of a higher multiple at valuation, your contracts will need to be robust, clear and fair, and they need to cover these nuanced points adequately.

If you'd like help in drafting or updating your contracts, please speak to one of the commercial experts at Roxburgh Milkins.

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