

REDEYE

Nordic SaaS Report 2020

1. Introduction to the Redeye Software Team

2. Why Invest in SaaS & the Cloud

3. SaaS Companies and Economic Downturns

4. SaaS Metrics

5. Public Benchmarks

REDEYE

Redeye Software Team



Havan Hanna [Analyst]

havan.hanna@redeye.se

With a university background in both economics and computer technology, Havan has an edge in the work as an analyst in Redeye's technology team. What especially intrigues Havan every day is coming up with new investment ideas that will help him generate above market returns in the long run.



Fredrik Nilsson [Analyst]

fredrik.nilsson@redeye.se

Fredrik Nilsson is an equity analyst within Redeye's technology team. He has an MSc in Finance from University of Gothenburg and has previously worked as a tech-focused equity analyst at Remium.



Kristoffer Lindström [Analyst]

kristoffer.lindstrom@redeye.se

Kristoffer Lindström has both a BSc and an MSc in Finance. He has previously worked as a financial advisor, stockbroker and equity analyst at Swedbank. Kristoffer started to work for Redeye in early 2014, and today works as an equity analyst covering companies in the tech sector with a prime focus on Gaming and Software.



1. Introduction to the Redeye Software Team

2. Why Invest in SaaS & the Cloud

3. SaaS Companies and Economic Downturns

4. SaaS Metrics

5. Public Benchmarks

Why invest in SaaS & the Cloud

SaaS and Cloud companies provide investors the opportunity to benefit from ongoing secular growth trend, the shift from on-premise enterprise infrastructure to the Cloud. Other trends within the SaaS space that works in favor for investors are: Consumerization of IT, and the rise of the subscription economy and investors craving for recurring revenue.

The BIG one: The shift to the Cloud

The big trend that shapes the Cloud industry is the shift from on-premise software spend to Cloud. This is a secular shift that has been ongoing for many years; however, the transformation is still in the early days within some verticals. The Cloud service, with the most substantial revenue, is the application layer (SaaS).

Global Cloud Service Revenue (bn$)					
Year	'18	'19	'20E	'21E	'22E
BPaaS	41.7	43.7	46.9	50.2	53.8
PaaS	26.4	32.2	39.7	48.3	58.0
SaaS	85.7	99.5	116.0	133.0	151.1
CLd. Mng & sec.	10.5	12.0	13.8	15.7	17.6
IaaS	32.4	40.3	50.0	61.3	74.1
Total	196.7	227.8	266.4	308.5	354.6

Source: Gartner

In this report we dig deeper into:

- SaaS adoption rates by country and application vertical
- Cloud IT spending percentage
- Projected growth rates for SaaS
- Public market valuation implications

Consumerization of IT

Another trend affecting the Cloud service industry is the consumerization of IT. That means that the applications sued in work more resemble consumer tech products when it comes to usability, UX and UI. This has also led to another buying pattern within organizations as the buy decision many times have become decentralized where the end-user of the product might be the one who decides which service to use.

The rise of subscription economy

In many ways Cloud technology is the enabler of the subscription economy, but the consumer and user behavior fuel the rise of subscription even further. The subscription economy is a trend both within B2C and B2B but is extremely apparent within the software market where a focus has shifted from providing a product to an ongoing service.

Investors and recurring revenue

What can be better than always start with an almost full bucket every month? Well according to investors nothing is better than recurring revenue. The SaaS pricing model creates:

- Stability
- Predictability
- High margins
- Lower business risk

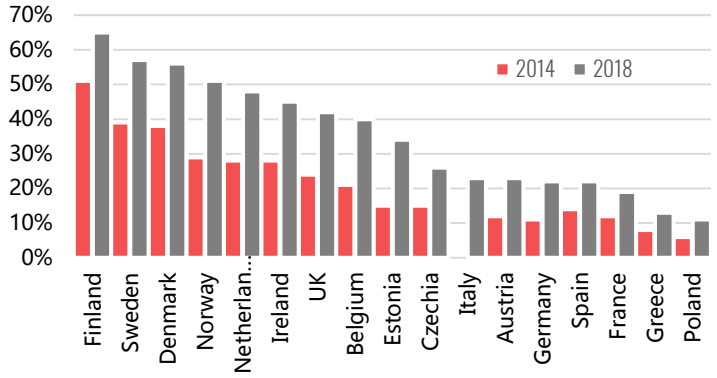
All the above factors are the reason why investors crave recurring revenue companies and price them high. In the early days of SaaS many market participants did not understand the model, with the argument that it's better to have the money in the bank today than in the future. However, it has become apparent that the Life-time-value is much higher for the same type of service when people or companies pay on a recurring basis over a long time-period. If the companies have the right type of structure on their offering there will also be significant upsell possibilities per client, which can be compared to selling a one-time license to use a software with a small support fee.

Software overview

We have gathered Cloud service market data which highlights that in many areas, the shift to the Cloud is just in its early days, the transition will continue for many years to come.

Large variations in SaaS adoption rates

Use of could computing services in Europe

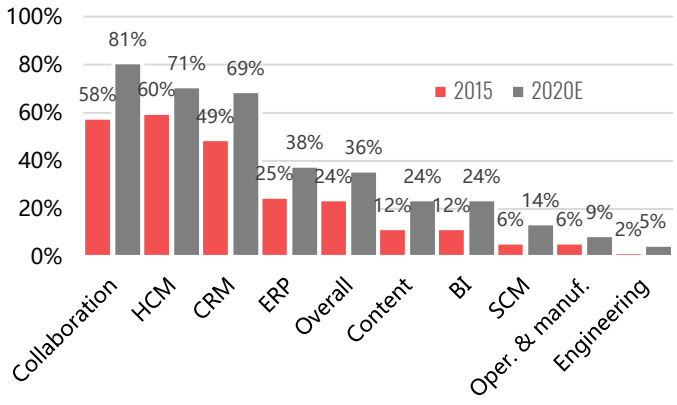


Source: Redeye Research, Eurostat

The adoption of SaaS among businesses in Europe varies substantially from country to country. The Nordic countries are frontrunners in the migration towards SaaS. All Nordic countries had a penetration rate above 50% in 2018 – twice the EU-28 average of 26%. UK, Ireland, and Benelux have rather high penetration rates of ~45%. DACH and southern Europe lagged with a penetration rate around 20%.

Interestingly, the increase in penetration from 2014 to 2018 was, on average, larger in countries with high adoption rates, widening the gap in the SaaS penetration rate even further.

Global SaaS penetration rate 2015-2020, by application



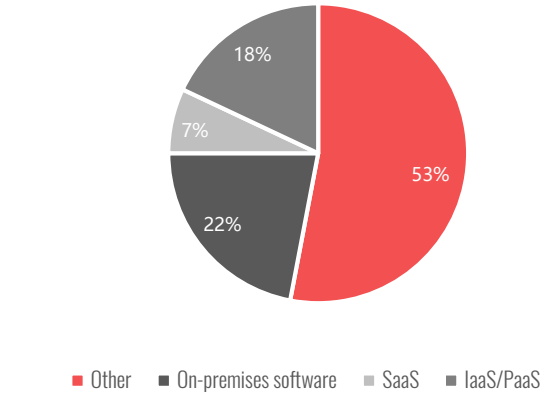
Source: Redeye Research, Statista, IDC

The difference in SaaS adoption among different types of software is even greater than the regional difference. Collaboration, Human Capital Management (HCM), and Customer Relationship Management (CRM) are estimated to have a SaaS penetration of 70-80% this year. Thus, these software segments are arguably close to reaching maturity in terms of SaaS penetration. At the bottom, with estimated SaaS adoption rates of below 10%, we find operations, manufacturing, and engineering-related software. Thus, industrial software is lagging in SaaS adoption.

Interestingly, the increase in penetration from 2015 to 2020 is, on average, expected to be larger in segments that had a high adoption level in 2015. Thus, like regarding regions, the gap between early adopters and laggards is expected to have increased since the mid-10s.

Only 25% of IT spend heading for the Cloud

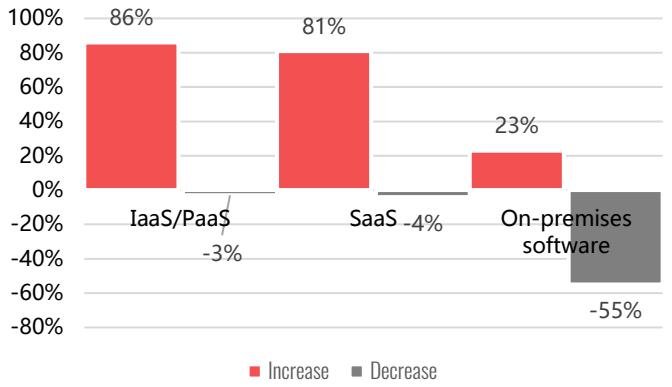
IT spend



Source: Redeye Research, Flexera 2020 State of Tech Spend

While the adoption of SaaS is significant in several regions and segments, as mentioned before, only 25% of IT spend is currently allocated to the cloud (SaaS and IaaS/PaaS), according to Flexera. For comparison, 22% of IT spend is allocated to On-premises software, suggesting that SaaS still can gain significant market shares.

Expected Change in IT Spend

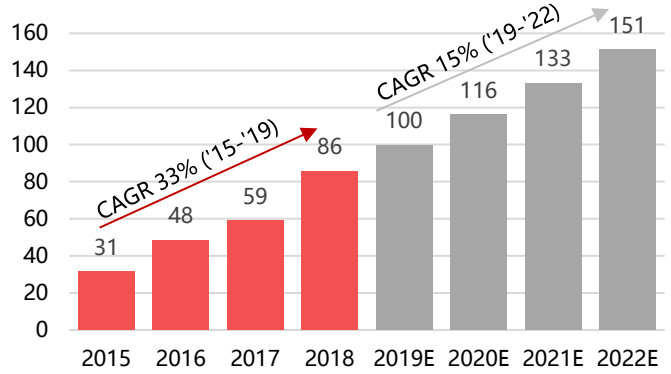


Source: Redeye Research, Flexera 2020 State of Tech Spend

The numbers show a clear trend towards IT spend moving from On-premises to cloud. ~80% of respondents expect to increase their spend on IaaS/PaaS and SaaS while ~50% expect to lower their spending on On-premise software.

Solid growth trend expected to continue

Global public cloud application services (SaaS) bn$



Source: Redeye Research, Statista, Gartner

While Gartner expects a slowdown from an impressive CAGR of 33% 2015-2019 – although, from low levels, SaaS growth is expected to remain at healthy levels, as Gartner forecasts a 15% CAGR 2019-2022.

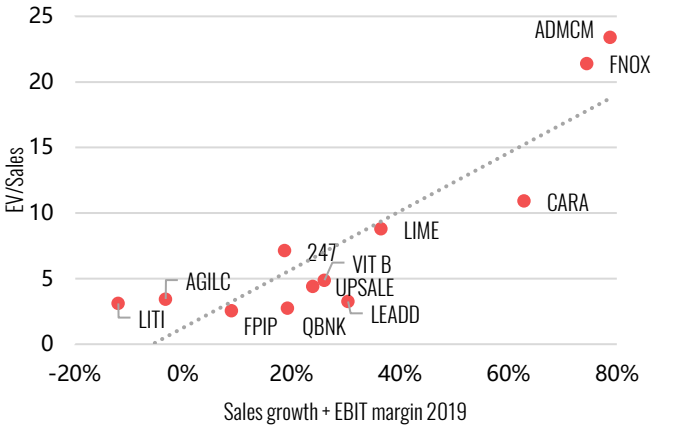
Given a current SaaS adoption of +60% in several software segments and regions, SaaS has reached a more mature state and slower – although still substantial – overall market growth seems reasonable. However, in many software segments and regions, the SaaS adoption rate is modest. As mentioned earlier, EU28 had a SaaS penetration rate of only 26% in 2018. The growth potential going forward is likely to vary substantially depending on the software segment and region.

Solid operational performance results in significant premiums

Companies that can combine high growth with decent margins or vice versa are unsurprisingly valued at high multiples, as high combined growth and margin are indicating that the company can grow its sales efficiently. Companies with a combined sales growth and EBIT margin of 40% or above are generally considered to be successful SaaS companies. However, several other important factors determine valuation—for example, company size, the share of recurring revenue, and total addressable market.

Fortnox and Admicom, among the largest companies in our comparison with a high share of recurring revenue and impressive operational performance, are trading at significant premiums relative to the rest.

EV/S vs Sales Growth + EBIT margin 2019



Source: Redeye Research, company reports

The graph above is only a snapshot of the total sales growth rate and margin, in this case, for 2019. Thus, one-off items, affecting either EBIT or sales growth, or reductions of service revenue, will tilt the numbers. For example, both Formpipe and Qbank had higher growth in recurring revenue relative to total sales growth, as their service revenue declined in 2019.

Also, the valuation of the companies is based on future sales growth and margins and not what happened in 2019. However, as many companies lack estimates and as historical sales growth in recurring revenues has a high correlation with future growth, we argue that the 2019 snapshot is interesting.

1. Introduction to the Redeye Software Team

2. Why Invest in SaaS & the Cloud

3. SaaS Companies and Economic Downturns

4. SaaS Metrics

5. Public Benchmarks

REDEYE

SaaS Companies and Economic Downturns

As of this writing we are in the midst of the corona crisis with a lot of human suffering. The outbreak has turned into a fully-fledged economic crisis as the virus containment measures affect business of all sorts. In this section, we discuss SaaS and economic downturns.

Robert Smith, CEO and founder of Vista Equity Partners famously said: **"Software contracts are better than first-lien debt".** In the coming months, this claim will certainly be put to the test. We assume that software contracts will at best be comparable to first-lien debt and should by no means be immune to economic downturns, due to the following reasons:

- Software payments terms will change significantly as fewer customers will pay cash upfront and payment terms should lengthen, impacting working capital. Accompanied by growth slowdown it will have a big impact on SaaS companies.
- Bankruptcies among SMBs are already a fact and the number is likely to increase, and this group will not be paying their software bills. Also, businesses that are effectively shut down (i.e. retailers, hotels, airlines etc.) will probably not be paying their software bills on time.
- To help customers and to reduce churn discounting will probably go up.
- More broadly, software contracts will be adjusted to reflect lower utilization rates and fewer seats.
- Usage-based models billed in arrears were gaining ground at the expense of multi-year subscription models billed upfront. The current recession will accelerate this transition, which will impact working capital and cash flow.

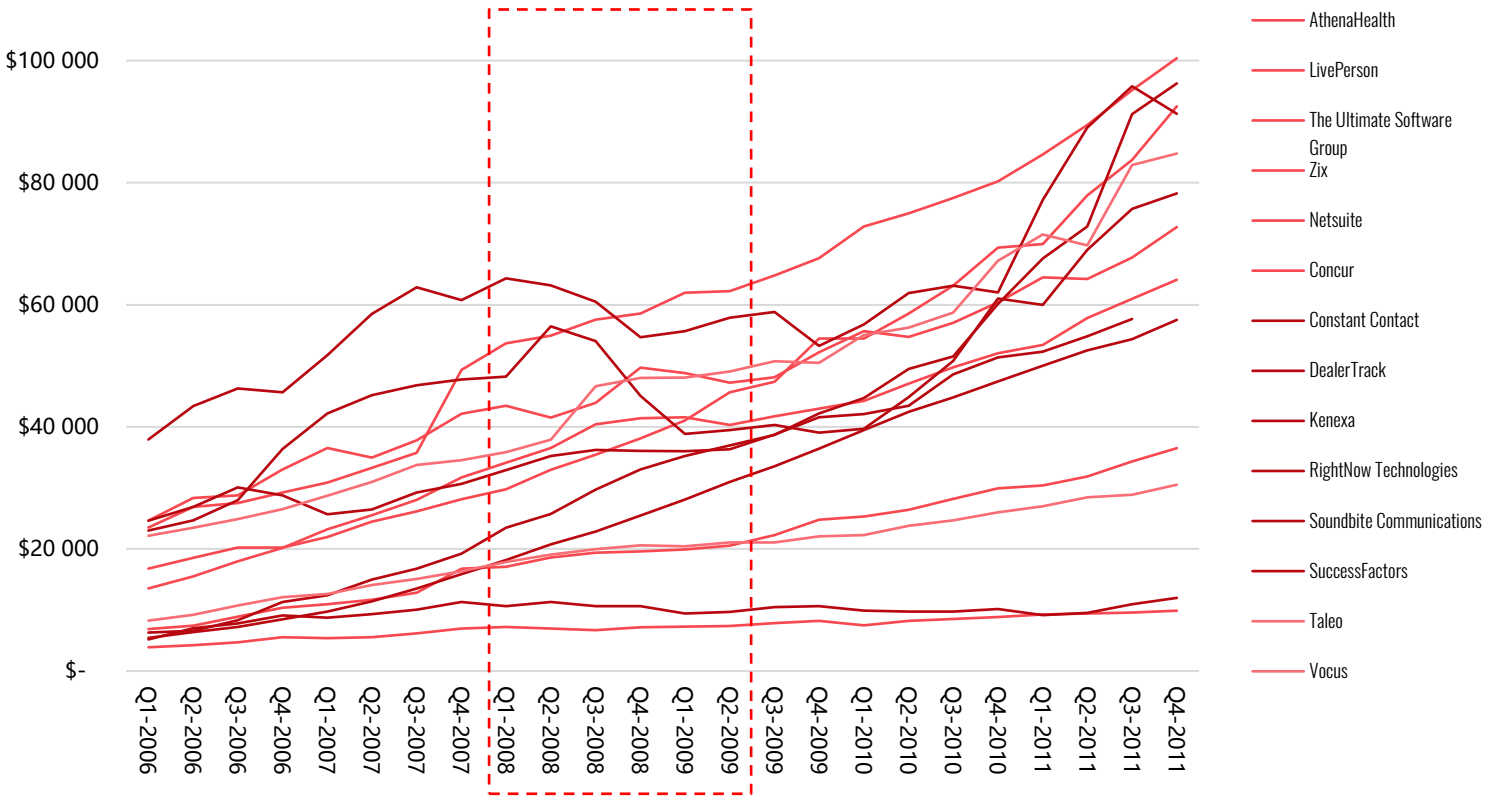
The overall impact (or cyclicality) will be a multivariate output of different variables, we highlight some of them below:

- **Customer size**: large companies (i.e. customers) will be much more resilient than SMBs.
- **Industry mix**: i.e. travel-related companies are going to be under much more pressure than companies benefiting from working from home such as SVOD, gaming etc.
- **Go to market**: a company that has a true enterprise sales motion is going to be challenged, while those that have freemium or e-commerce-like distribution models are going to be advantaged. Net revenue retention has always been one of the important software metrics — but it will be even more critical over the next months.
- **ROI**: This will differ by customer, by industry and by where each software company sits in the "stack" for each customer and industry. We will find out which software companies actually are "systems of record" without which companies cannot function.
- **Pricing model**: It is hard to frame the impact by pricing model but it will ultimately come down to utilization. Seat based, transactional and workload based pricing models should be more cyclical — one way or another.

SaaS Companies During the Global Financial Crisis

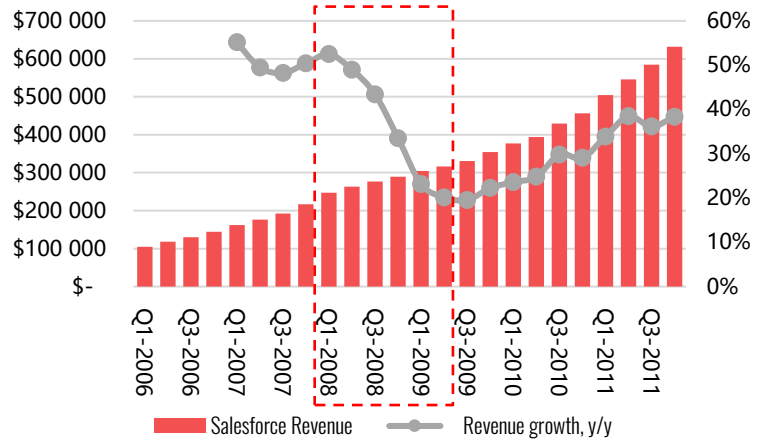
To understand how SaaS companies managed the last economic downturn, we analyzed 15 public SaaS companies' revenue growth and overall operating income for 2006 through 2011 (as of our understanding, there were 18 public SaaS companies prior to the crisis). Lastly, worldwide software spend contracted from 20% growth y/y in 2007 to 10%/-2% in 2008/2009. The chart below shows the quarterly revenue for 14 of the public SaaS companies.

Revenue for public SaaS companies during the global financial crisis (thousands), 2006-2011



Source: SaaS Capital, Redeye Research

Salesforce revenue during the global financial crisis (thousands), 2006-2011

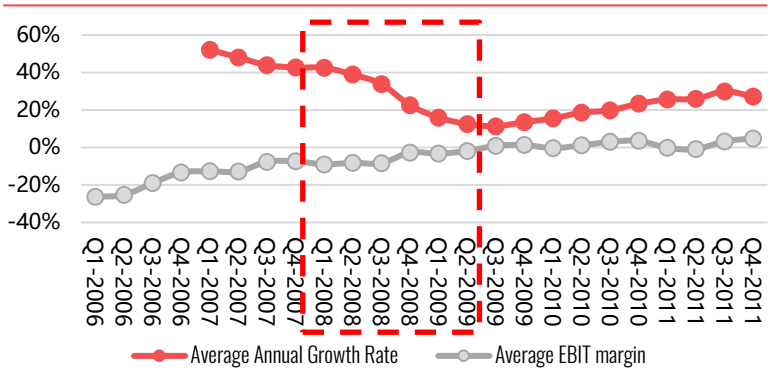


Source: SaaS Capital, Redeye Research

The chart to the left shows quarterly revenue and revenue growth for Salesforce. Numbers for Salesforce are presented in separate charts due to its relative size (was an outlier then, and really, still is). Salesforce saw its revenue growth decelerate from 44% in their January 2009 fiscal year to 21% in their January 2010 fiscal year.

There are some interesting anecdotes to see in terms of operating income, but it is hard to see the overarching trends when each number is presented separately. Instead, we highlight a chart of the average quarterly income or loss as a percent of revenue for the 14 companies (Salesforce excluded) and their aggregated average annual growth rate.

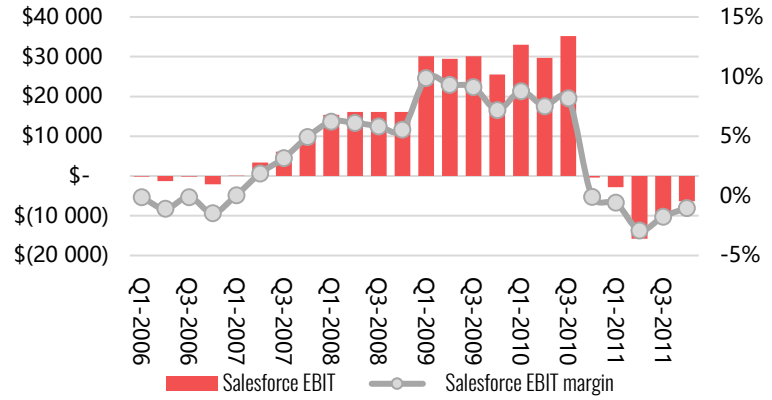
Revenue growth rate and operating margin for public SaaS companies during the global financial crisis, 2006-2011



Source: SaaS Capital, Redeye Research

The chart below shows operating income and margin for Salesforce.

Salesforce operating margin during the global financial crisis (thousands), 06-11



Source: SaaS Capital, Redeye Research

Overall, what we see is that SaaS revenue was still growing, just more slowly, and SaaS companies were becoming more efficient. As the third graph shows, the median SaaS company grew 10% in 2009 even though total software spend declined. This growth was partly driven by the adoption of SaaS from on-premise software. What's even more interesting to us, however, is the response to growth these companies took during the recession. Though growth slowed, these companies improved the efficiency of their growth (defined as operating margin), as shown in the third chart. We think that a bigger focus on existing customers and retention rates is part of the explanation (i.e. for every dollar of net revenue they earned, these companies spent less to get it). What's more, the group maintained its efficiency even when the market began to recover.

Any lessons to be learned?

Even if our purpose in analyzing SaaS companies from 2008 is not to make market predictions, or to compare 2008 to today, the last crisis seems to make one thing very clear: in a volatile market, SaaS businesses should focus on efficiency, before growth. Efficient growth is often a result of retention (i.e. gross and net) and efficient customer acquisition (i.e. CAC payback period) and management of runway/survival (i.e. cut costs, collecting receivables etc.). Lastly, when it comes to runway/survival: if a SaaS business is charging its customers annually in advance, and that business starts to shrink (i.e. faces a wave of churn), investors must be aware that its cash flow will go down much quicker than the P&L will indicate as it consumes deferred revenue, which generates no cash.

In terms of growth we think we will see revenue growth deceleration across a broad swath of software names over the next twelve months and would not be surprised to see negative revenue growth from some software companies. Also the global financial crisis was very different than the recession we are living through as the world did not "stop". Another critical difference is that software has become a much larger percentage of GDP, which "mathematically" should make software more cyclical.

To conclude, at the end of the day, there is no such thing as truly recurring revenue. Some revenue is just more recurring than other revenue.

1. Introduction to the Redeye Software Team

2. Why Invest in SaaS & the Cloud

3. SaaS Companies and Economic Downturns

4. SaaS Metrics

5. Public Benchmark

SaaS Metrics

There are many metrics to use when evaluating the strength of a SaaS business. Data on CAC, retention, and churn are crucial to look at. Public SaaS companies in the USA most often report their CAC, ARR, gross margin, and retention rates. Sadly in the Nordic's only one, Agillic (AGILIC:CHP) of the publicly listed companies report both their CAC and retention rates. We hope we will see an improvement in metric disclosure. In the tables below we explain different kinds of SaaS metrics and provide benchmarks to look at when evaluating recurring revenue business.

Key SaaS Metrics

Metric	Definition	Calculation
MRR & Implied ARR	Measurment of monthly/annual recurring revenue.	**MRR** = Number of customers * (ARPU / Month) **Implied ARR** = Actual MRR * 12
Customer Acquisition Cost (CAC)	All S&M costs for new customers.	S&M / Number of new customers
Customer Lifetime Value (CLTV)	CLTV is the net present value of the recurring profit streams of a given customer less the acquisition cost.	(ARPU * Gross margin) / Churn
Customer Acquisition Cost Payback Period	The CAC payback period is a statement in months, of the time to fully payback sales and marketing investment.	Total S&M costs last quarter / (New MRR added last quarter * Gross margin)
Customer Gross/Logo Churn	This is a percentage calculation of all customer names ("logos") that have churned over the measured time period.	Customers lost over time period / Customers at the beginning of time period
Retention	**Gross Dollar Retention:** Looks at how much of the customer ARR are kept over the measured time period. As such it's always below 100%. **Net Dollar Retention:** As above, but including upgrades. As such it's can be higher than 100% (and should be for a healthy business).	ARR – downgrades – churn / Beginning ARR (ARR + upgrades – downgrades – churn) / Beginning ARR

Source: Redeye Research

SaaS Metrics for different customer segments

	SMB	Midmarket	Enterprise
ARR growth	40-50%+	50-60%+	30-50%+
Gross Retention	70-80%	80-90%	90%+
Net Retention	80-100%	90-120%	110%+
LTV/CAC	3-5x	4-6x	4-6x
CAC Payback Period	3-6 Mos	12 Mos	18-24 Mos
Gross Margin		50-75%+	

Source: Redeye Research

Bessemer Venture Partners Efficiency Score (< $30 million ARR)



Source: Bessemer Venture Partners

1. Introduction to the Redeye Software Team

2. Why Invest in SaaS & the Cloud

3. SaaS Companies and Economic Downturns

4. SaaS Metrics

5. Public Benchmark

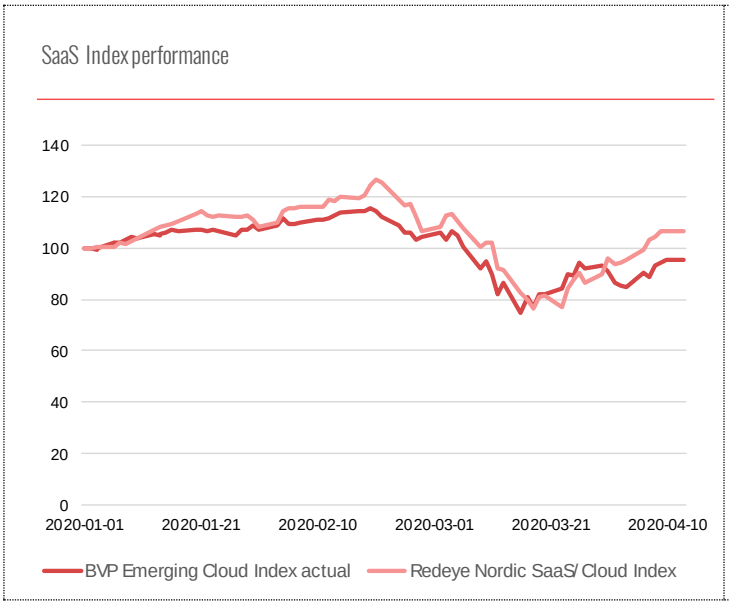
REDEYE

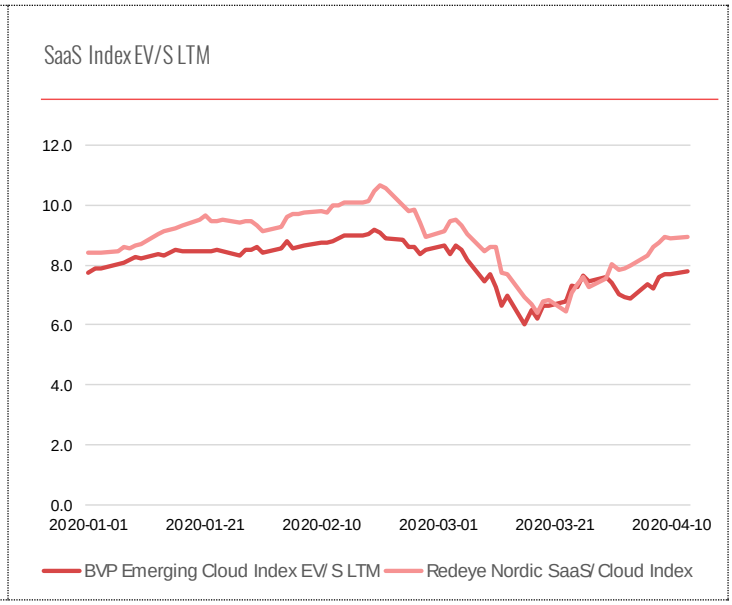
Nordic public metrics benchmarks

In this section, we present a SaaS index focused on the Nordic, named Redeye Nordic SaaS/Cloud Index. This index consists of the largest SaaS and Cloud players in the Nordics. For these companies we also present different valuation and operational metric benchmarks. Data from Bloomberg (2020-04-14)

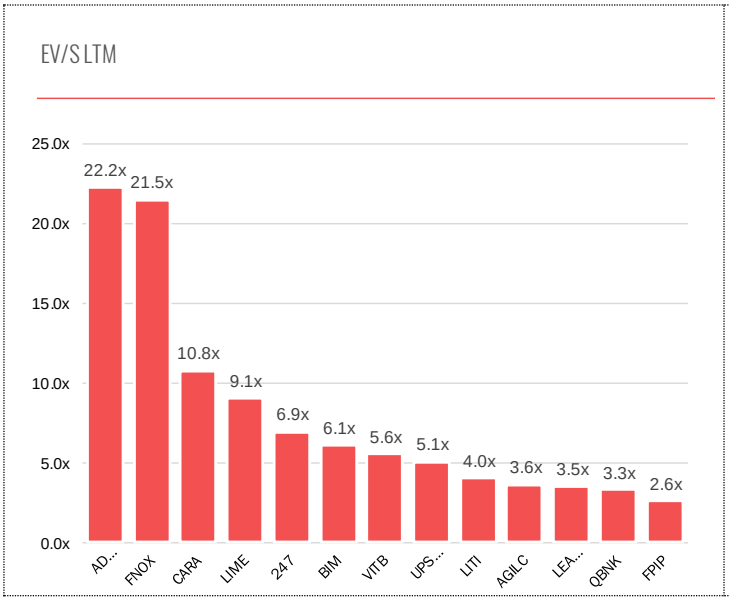
Index performance

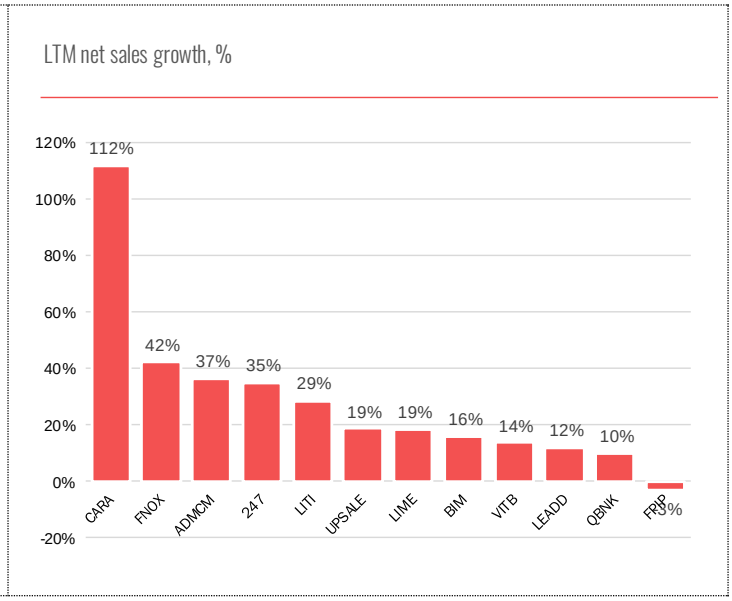
Redeye Nordic SaaS/Cloud Index (RNSC Index) consists of the largest SaaS players in the Nordics. The correlation to the board BVP Cloud Index is high. Just like almost all companies the SaaS players have taken a hit during the corona crisis. The RNSC index showed significant traction in the beginning of the year and was up 26% by the 20th of February. From the high to low level on the 23rd of March the index dropped by close to 39% but has since then rebounded. The YTD performance amounts to +5%. The EV/S (on last twelve-month basis) also dropped from a high level of close to 11.0x to a low of 6.0x. The RNSC EV/S valuation currently stands at about 8.9x.



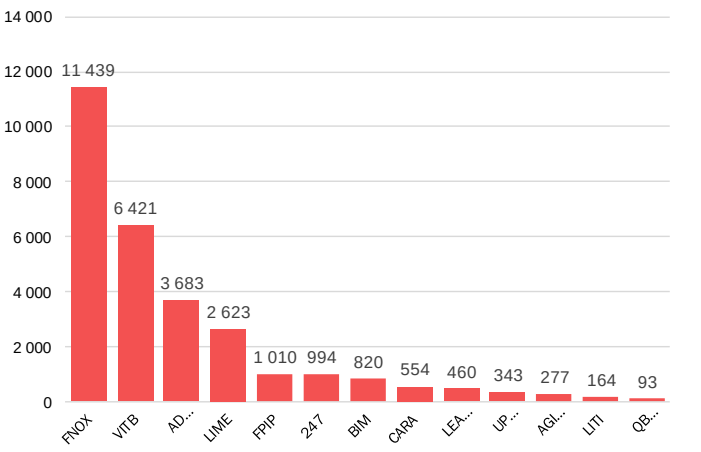


Valuation, Growth and Growth + Profit ratio

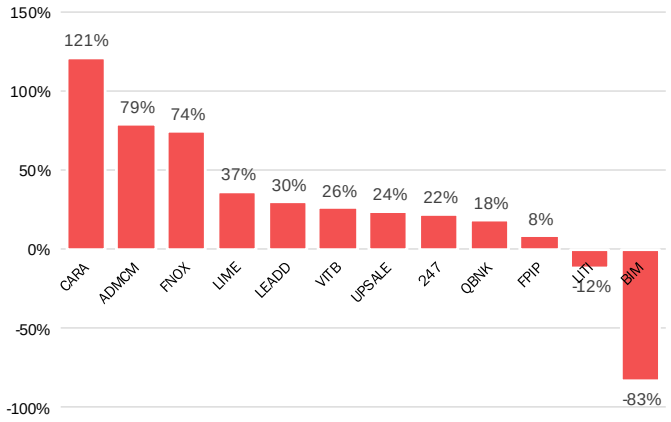




EV (mSEK)

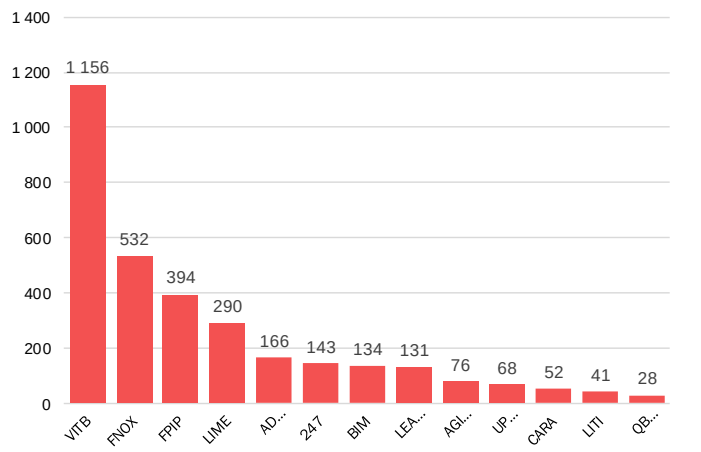


G+P ratio. %

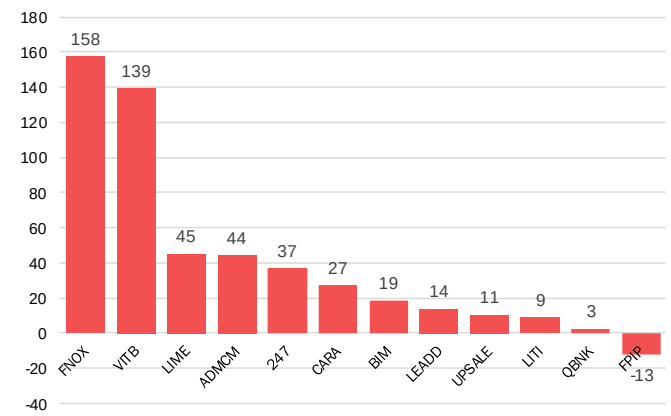


Operational metrics

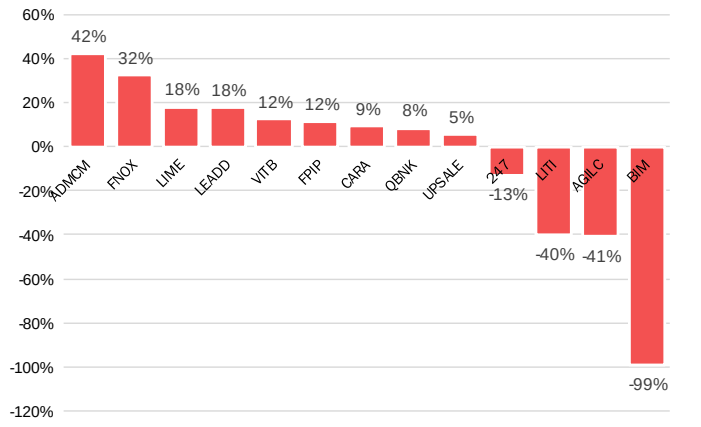
LTM net sales (mSEK)



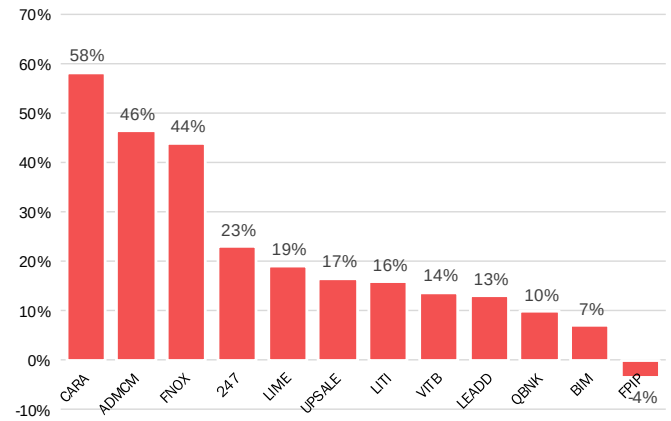
LTM net add sales (mSEK)



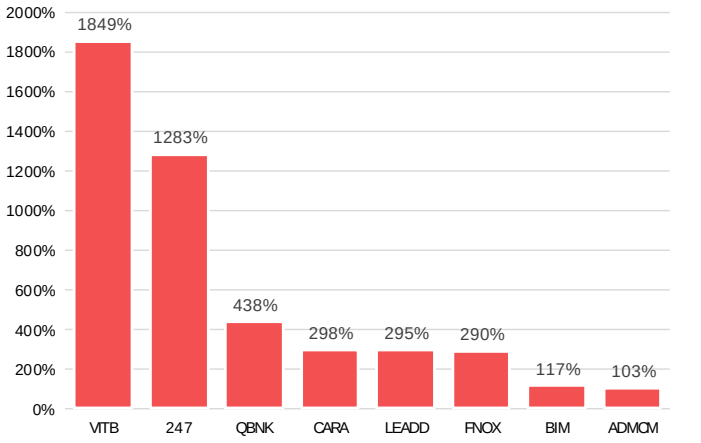
LTM EBIT-m



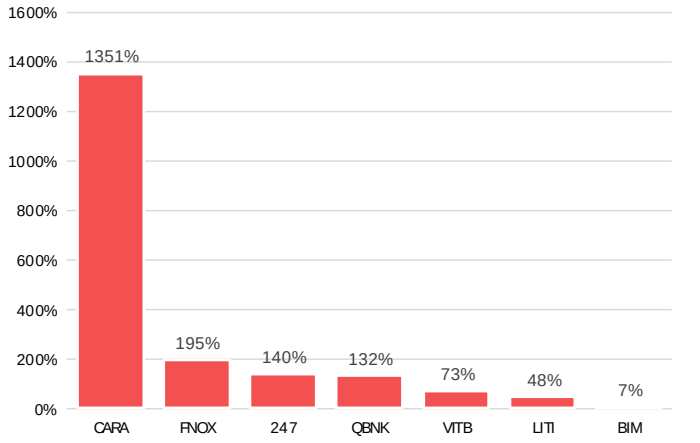
Growth efficiency, %



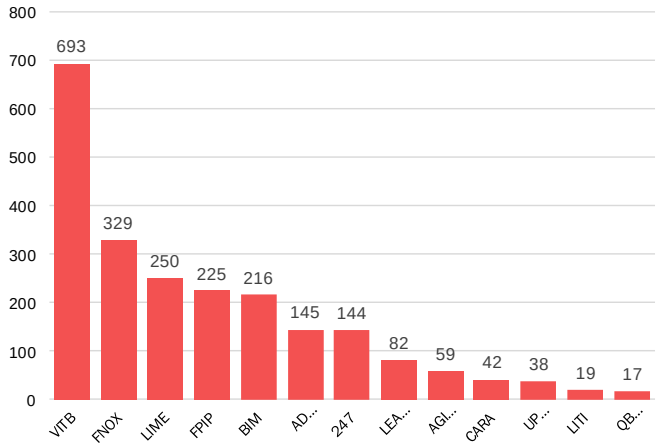
CSS LTM



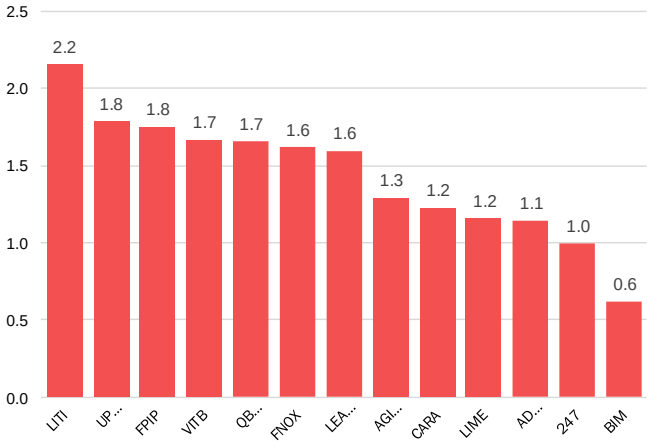
Marginal CSS LTM



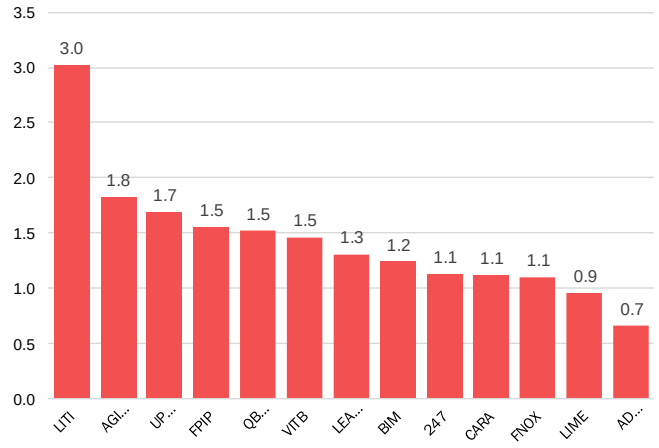
Current nr of employees



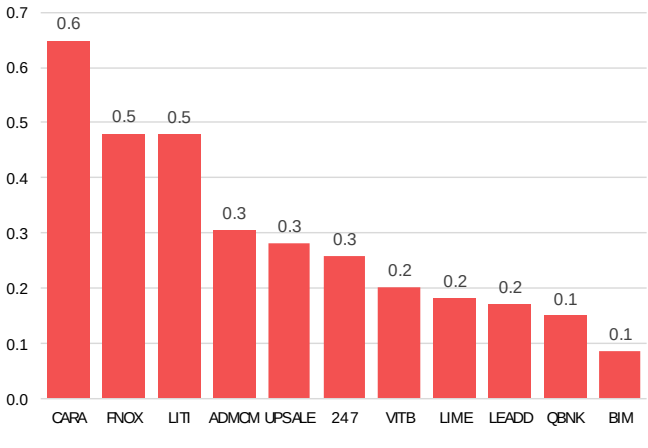
Net sales per emply. (LTM) (mSEK)



OPEX per emply. (LTM) (mSEK)



Net add in sales per emply. (LTM) (mSEK)



Glossary and calculations:

- LTM – Last Twelve Months
- EV/S – Enterprise Value to annual net sales
- G+P ratio – Growth in percentage and EBIT margin in percentage combined.
- Sales growth – Net sales growth on an annual basis, in percentage
- Net add sales – Increase in net sales on an absolute basis in million SEK
- EBIT-m – Earnings Before Interest and Taxes (EBIT) as a percentage of sales (margin)
- Growth Efficiency – Calculated LTM OPEX by Net add in sales. Meaning the OPEX required to grow sales
- CSS – Cash Conversion Score, net sales divided by Capital Employed
- Marginal CSS – CSS based on the net add in sales and the increased Capital Employed during the timeframe



Redeye – Research powered investment banking

Follow the technology and life science sectors at www.redeye.se

Mäster Samuelsgatan 42, 10tr, Box 7141, 103 87 Stockholm

t 46(0)8-545 013 30 f +46(0)8-54501349 e info@redeye.se w redeye.se