Value scorecard driver: The importance of Net Dollar Retention

Our Technology M&A team has developed a proprietary value scorecard tool where we look at relevant drivers that help assess businesses’ value. This quarter, we explore the importance of recurring revenue for software businesses.

Why should we care about recurring revenue and net dollar retention?

Having recurring revenue streams is one of the key reasons that make software subscription businesses attractive. But in this regard not all software businesses are created equal. This makes retention the most objective metric to point to the recurring nature of a software business.

There are several ways to assess customer attrition, whether it’s renewal rate, logo retention or gross or net dollar retention (NDR). In this Recap, we will focus on NDR, which contains a lot of information in a single metric.

Customer retention can be seen as a critical measure for the health of software businesses since these models are heavily dependent on the fact that customers keep coming back. This is particularly true for SaaS businesses, where the business model typically revolves around subscription, licensing or usage-based pricing.

We define NDR as the opening-period recurring revenue less churn (including downgrades) plus expansion revenue divided by the opening-period recurring revenue. It tells you for a given cohort how much of the revenue was churned in a period and whether you were able to offset that through the expansion in revenues from existing customers.

The last part is important: if your expansion revenue is covering your churn, it suggests, at least in the near term, the business could see no new customers and still grow. This really demonstrates the power of a company’s business model.

Given current economic headwinds, this metric may indicate if a business will be able to weather the storm, as customers tighten their belts and clamp down on spending or consolidate their vendor groups.

Strong net dollar retention as a metric can be a significant value driver, but why should it matter to you operationally?

- Customer churn is expensive. Loss of existing customers – which initially required investment of time, energy, and resources – impedes overall growth of a business and hurts overall return on invested capital.

- The cost of acquisition is higher than the cost of retention. Studies have shown that acquiring new clients can be at least five times more expensive than keeping existing ones. Furthermore, the odds of cross-selling to a new customer are usually better than a coin flip, while salespeople tend to close only 1 of every 10 prospects.1

- NDR enables more accurate forecasting. SaaS revenue can be readily modelled using historical customer behaviour. Higher retention allows more visibility and reliability into forecasted financials.

What does net dollar retention mean for value?

The simple answer is that investors place high importance on the NDR metric. It encompasses many of the important value drivers in a single metric. If your NDR is great, chances are your revenue growth is quite strong, recurring revenues make up a fairly large portion of the business and you have an efficient sales function. Studies tell us that you should aim to have an NDR of at least 100% (i.e., your expansion revenue is offsetting your churn), but for top-quartile performance and for additional value, 120% or higher should be the goal.

How to improve customer retention?

- Gain deeper insights with customer health scores. Implementing and applying a customer health metric allow business owners to look under the hood and determine whether a customer is at risk of churning and how high that risk is. Using a system of metrics, looking at things like usage, also allows management to build rankings across the customer base and focus their resources on key customers.

- Perform a churn analysis. Churn analysis is the process of using data to understand why your customers have stopped using your product or service. This type of analysis enables management to identify customer journey pain points and opens avenues to improve NDR.

Want to learn more about evaluating your business with our proprietary Value Scorecard? Contact one of our team members.

1 Invescro Customer Acquisition Retention - November 11, 2022
Some of our recent deals include:

- **StepUp**, has been sold to **XTEL** backed by **KANTAR** and **SilverTree**
  
- **Metro** has been acquired by A technology company that operates leading stock exchanges and serves capital markets globally
  
- **VERDAZO** has been acquired by **Vela Software**
  
- **3vGEOMATICS** has been acquired by **rfm MEASUREMENT**

- **refresh FINANCIAL** has been acquired by **Borrowell**
  
- **Wellness Checkpoint** has been acquired by **Carebook**
  
- **filefacets**, has well-integrated property rights and assets for
  
- **Fresenius vitruvi SOFTWARE** received a strategic investment from **AFL**

*Ernst and Young Orenda Corporate Finance Inc.*
Video Series

Programmed for Success

EY’s Technology M&A practice has recently launched a new video series, Programmed for Success.

The 5-part series hosted by EY’s Canadian Technology M&A Leader, Sid Nair, interviews industry thought leaders from inside and outside of the firm. The series focuses on key considerations, risks and opportunities that should be considered prior to a sale of a technology business.

Watch along as Sid Nair explores the key considerations when selling your technology business with industry thought leaders.

Watch Episodes 1 - 5

Join the conversation #BetterWorkingWorld
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Q4 2022 Transactions(1)

Dec 22, 2022: Reliance Strategic Business Ventures Limited acquired a stake in Exyn Technologies Inc., developer of a software modular system which enable drones / robots to navigate difficult terrains without GPS or other navigation technologies, for a transaction value of $25 million. The transaction represents an enterprise value of 24.8x revenue.

Dec 19, 2022: Enghouse Systems Ltd. announced the acquisition of Gumu Corporation, a provider of cloud-based enterprise video technology which can analyze live and asynchronous video at scale, for an approximate transaction value of $18 million. The transaction represents an enterprise value of 0.8x revenue.

Dec 16, 2022: Dropbox, Inc. (NasdaqGS: DBX) acquired KingStreetLabs, LLC / FormSwift, a developer of a cloud-based platform designed to help businesses build, edit, approve, share, and print custom personalized documents, for a transaction value of $95 million.

Dec 12, 2022: Thoma Bravo LP, announced the acquisition of Coupa Software Incorporated, a provider of cloud-based business spend management platform that unifies processes across supply chain, procurement, and finance functions, for an approximate transaction value of $8.3 billion. The transaction represents an enterprise value of 10.2x revenue.

Dec 12, 2022*: Vector Health Laboratories Ltd. acquired Get a Head Inc., an operator of a mental health and training SaaS platform, for a transaction value of $12.4 million.

Dec 08, 2022: Chewy, Inc. (NYSE: CHWY) acquired Petabyte Technology Inc., a provider of a SaaS-based practice management software to manage veterinary clinics and hospitals, for a transaction value of $43.4 million.

Dec08, 2022: 7GC & Co. Holdings Inc. (NASDAQ: VII) announced a merger with Banzai International, Inc., which offers end-to-end video engagement solution that provides a fast, intuitive, and powerful platform of marketing tools, in a SPAC deal at a pro-forma enterprise value of $380 million.

Dec 05, 2022: Keywords Studios plc (AIM: KWS) acquired Helpshift, Inc., a developer of a market leading proprietary software-as-a-service (“SaaS”) customer support automation tool, for a transaction value of $75.0 million*. *Includes earnouts of $15 million.

Nov 18, 2022: Fidelity National Financial, Inc. (NYSE: FNF), acquired TitlePoint Resource Center, a developer of platform that enables searches for detailed property information, images of documents and maps from hundreds of counties across the US, for a transaction value of $225 million.

Nov 17, 2022: PTC Inc. (NasdaqGS: PTC) announced the acquisition of ServiceMax, Inc., a provider of cloud-native, asset-centric field service management (FSM) software, for an approximate transaction value of $1.46 billion.

Nov 17, 2022: Dunamu Global Co., Ltd. announced the acquisition of Tilia LLC, which operates a payment platform for the metaverse economy and provides an all-in-one solution to manage payments, issue virtual tokens, and manage in-game purchase, for a transaction value of $9.8 million. The transaction represents an enterprise value of 10.1x revenue.

Nov 11, 2022*: Thomson Reuters Corporation (TSX: TRI) announced the acquisition of SurePrep, LLC, provider of tax automation software, helping accounting firms increase productivity and profitability while promoting a completely digital tax workflow, for a transaction value of $500 million.

Nov 07, 2022: Arsenal Capital Partners acquired a stake in Certara, Inc., a provider of software products and technology-enabled services to customers for bio-simulation in drug discovery, preclinical and clinical research, regulatory submissions, and market access, for an approximate transaction value of $449 million. The acquisition represents an enterprise value of 7.7x revenue and 26.3x EBITDA.

Nov 03, 2022*: Pinetree Capital Ltd. and L6 Holdings Inc. acquired a minority stake in Quorum Information Technologies Inc., a SaaS software and services company providing essential software solutions for vehicle dealerships, for a transaction value of $2.5 million. The transaction represents an enterprise value of 1.6x revenue and 21.1x EBITDA.

Nov 03, 2022: Issuer Direct Corporation (NYSEAM: ISDR) acquired iNewsWire.com LLC, a media and marketing communications technology company that provides press release distribution, media databases, media monitoring, and newsrooms, for a transaction value of $44.0 million. The transaction represents an enterprise value of 4.4x revenue.

Nov 01, 2022: Cinven acquired TaxACT Inc., a provider of digital, do-it-yourself (“DIY”) tax filing assistance software and services, for a transaction value of $720 million.

Nov 01, 2022: Voya Financial (NYSE: VOYA) announced the acquisition of Benefitfocus, Inc., a cloud-based benefits administration technology company that serves employers, health plans and brokers in the US, for a transaction value of $570.0 million. The transaction represents an enterprise value of 2.3x revenue and 70.2x EBITDA.
Select Q4 2022 Transactions

Oct 31, 2022*: Corel Corporation announced the acquisition of Nitro Software Limited, a developer of Nitro productivity platform that provides PDF productivity, simple to qualified eSignatures, powerful APIs and integrations, document generation, and industry leading analytics, for a transaction value of $377.1 million.

Oct 27, 2022: NIC Inc. announced the acquisition of Rapid Financial Solutions, LLC, a provider of secure payment platform with card issuance and digital disbursement capabilities, for a transaction value of $68 million.

Oct 27, 2022: Thoma Bravo LP, announced the acquisition of UserTesting, Inc., an operator of a software-as-a-service (SaaS) platform that enables organizations to know experiences of people as they engage with products, designs, apps, processes, concepts, or brands in the US, the UK and internationally, for an approximate transaction value of $1.3 billion. The transaction represents an enterprise value of 6.0x revenue.

Oct 27, 2022: Alphabet Inc. acquired Alter, an artificial intelligence (AI) avatar start-up that helps creators and brands express their virtual identity using 3D avatars through smartphones, for a transaction value of $100.0 million.

Oct 19, 2022*: Volaris Group Inc. acquired Situational Intelligence solutions of Cognyte Software Ltd., which comprises a software that empowers enterprises and governments to manage security operations, for a transaction value of $82.5 million*. 

Oct 19, 2022: Alarm.com Inc., acquired a majority-stake in Noonlight, Inc., a developer of connected safety and event management platform that enables new applications and provides enhanced emergency response capabilities, for a transaction value of $31.9 million.

Oct 11, 2022*: WELL Health Technologies Corp. (TSX: WELL) acquired Cloud Practice Inc. and three clinics of CloudMD, which comprises of cloud-based electronic medical records and practice management software of Cloud Practice Inc. and 3 primary care clinics of CloudMD, for a transaction value of $4.2 million.

Oct 11, 2022: Thoma Bravo LP, announced the acquisition of ForgeRock, Inc., operator of a digital identity platform that delivers enterprise-grade identity solutions at scale for customers, employees, and connected devices, for an approximate transaction value of $2.4 billion. The transaction represents an enterprise value of 11.1x revenue.

Oct 11, 2022: Roblox Corporation (NYSE: RBLX) acquired Byfron Technologies, LLC, operates as a developer of anti-cheat software for games, for a transaction value of $19.0 million.

Oct 04, 2022*: Velodyne Lidar, Inc. (NasdaqGS: VLDR) acquired Bluecity.ai, a provider of artificial intelligence software services that include lidar-based solutions solving safety, traffic, and infrastructure issues, for a transaction value of $11.7 million.
Both deal values and deal volumes have declined in Q4 2022 compared to Q4 2021 levels.

Public company multiples have steadily declined in 2022, subsequent to the highs observed throughout 2021.

Revenue transaction multiples have remained volatile while some categories have shown an increase when compared to Q4 2021.

EBITDA transaction multiples have remained volatile while about half of the categories have shown an increase when compared to Q4 2021.
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