How to value your bootstrapped SaaS business

✓ The basic math behind a bootstrapped SaaS valuation

✓ Calculating long-term value with SaaS multipliers

✓ Getting to a whole number you're happy with and other valuation considerations you should know

✓ How to know if it's the right time to sell

SURESWIFT CAPITAL

The short story on SaaS valuation is that the market determines the value of your business.

In other words, your company's value is the point where what you're willing to sell for, and what a buyer is willing to pay meet. Selling a business is really similar to selling a house in that way.

As a founder, you obviously want to sell for the highest number possible, and a buyer wants to buy for the lowest reasonable number possible. But there's a sweet spot where the founder gets a dream exit — not just a good number, but also a good outcome for their customers and team — and the buyer gets a fair price. With 30+ acquisitions under our belts, and ongoing relationships with many of our founders, we're confident that we know a thing or two about that.

How do you come up with a value range that covers that sweet spot?

Keep reading to find out.

PART 1

The basic math behind a bootstrapped SaaS business's value

If you're looking for the most basic method of valuation, there are two simple formulas most buyers (and sellers) use as a starting point to determine the value of a SaaS business.

SDE-Based SaaS Valuation Formula
(Most common)

Seller's Discretionary Earnings (SDE) x a Multiplier
= Your Approximate SaaS Value

Revenue-Based Valuation Formula
(Less common)

Revenue x a Multiplier
= Your Approximate SaaS Value

Let’s dive into SDE a bit more, and then we’ll look at cases where revenue might be used for valuation instead.

What is SDE, and how do you calculate it for your SaaS business?

SDE is a metric you’ll want to be familiar with if you’re considering selling your SaaS.

If you follow the stock market at all, you’re probably already familiar with EBITDA (Earnings before interest, taxes, depreciation and amortization).

It’s often reported in public companies’ quarterly earnings releases, and it’s one of the methods investors and financial analysts use to measure a company’s operational performance regardless of differences in things like industry, country, or region. It’s also sometimes used as a valuation method for big SaaS businesses with multiple employees and multi-million ARR stats.

SDE is similar to EBITDA in that it tries to remove taxes and non-cash expenses. It differs in that it also removes costs related to a founder’s dual role as both the owner and the operator of the business.

That’s useful for estimating how much a bootstrapped SaaS business is worth, because typically the founder works both on and in the business, and SDE accounts for that dual role. That means the founder’s salary, as well as expenses like personal health insurance that usually come out of the company’s profit and cash flow get added back in.

These kinds of expenses benefit the current owner, and typically don’t get passed on to a new owner (at least in the same form), so they’re considered “discretionary.” In other words, they aren’t essential to operating the business.

Not sure if an expense is discretionary?

Here's a quick checklist:

✓ It benefits the owner (like health insurance)

✓ It doesn't benefit the business (like advertising) or the employees (like hourly wages for a contract developer)

✓ It's documented on your tax returns and P&Ls

Taxes also get added back into SDE because a new owner will likely have a different tax cost/structure, particularly if they're operating multiple businesses.

And finally, adjustments are made for one-time, non-essential expenses. For example, let's say you've been in business for two years. In your first year, you hired a lawyer to help you set up an LLC, register your business, and draft contracts and IP transfer for a part-time developer and a couple other contractors. These legal fees are non-recurring, and would get added back into your SDE.

So —

Business profit before taxes
\+ founder(s) salary
\+ founder(s) benefits
\+ depreciation
\+ adjustments for any other non-essential expenses

= SDE

It’s important to note that your SDE will be calculated and verified using your tax returns and P&L’s, so you need to have your financial records in order.

If you’ve been in business for more than 3 years, expect to share the last 3 years. If you’ve been in business for less than 3 years, expect to share the full financial history of the business. (Here’s a more complete list of what you’ll want to have done if you’re serious about preparing your business for an exit.)

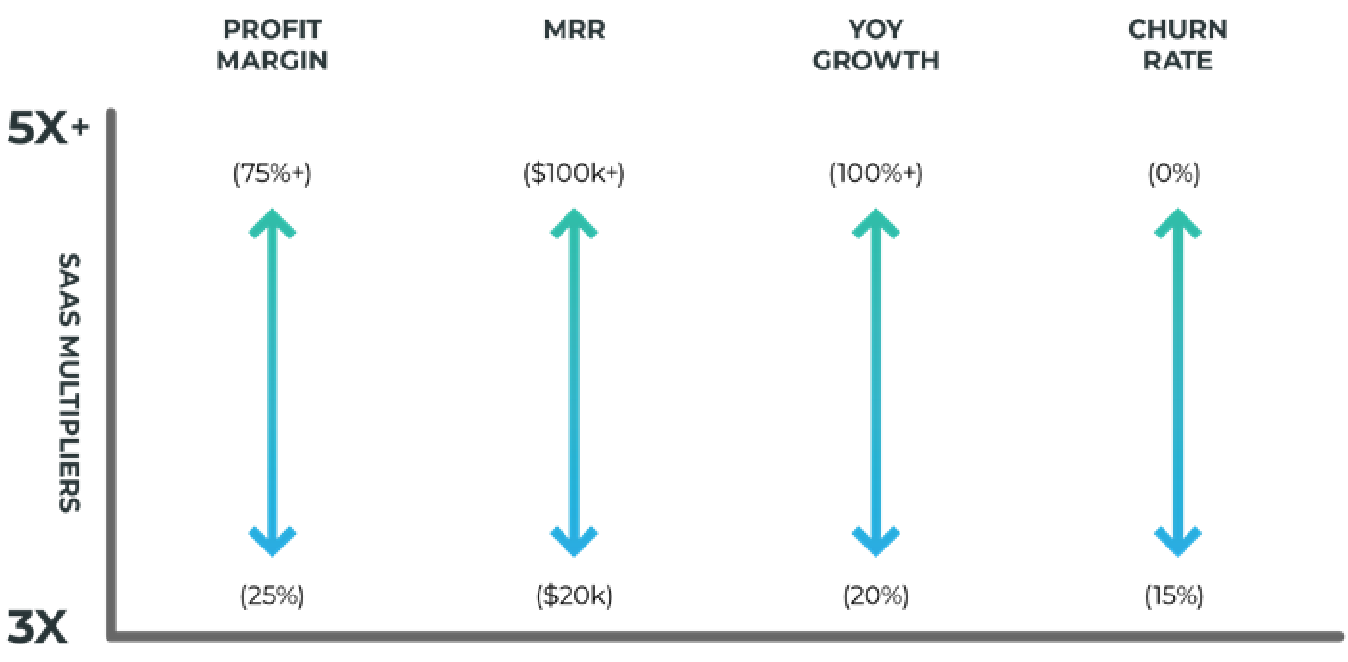
PART 2

Getting to long-term value with SDE multipliers

Getting back to the original formula for valuing a bootstrapped SaaS business using SDE — it's time to look at the multiplier part of the equation. If SDE is an attempt to measure how much cash a business can bring in to a new owner, the multiplier is a measure of the business's long-term potential value.

For smaller, bootstrapped SaaS businesses (that are profitable and growing) those multipliers tend to range between 3x and 5x.

Businesses with higher profit margins, MRR, TAM (Total Addressable Market) and YoY growth rates, and lower customer and revenue churn will have multiples on the higher end of that range.



On the outside of that range, a lower multiplier can come into effect if the business is flat, or declining. Or multipliers could spike past 5x if your YoY growth is insane, or in a strategic acquisition (more on those in a moment).

> However your current math works out, be careful that your margins and growth rate take into account your current reality. Sure, in theory any business has the potential to double in size in the next year. It also has the potential to lose half or all of its customers in the next year.

A note on revenue-based valuations for SaaS companies

If a company is in the very early stages when it's acquired, or it's growing more than 50% YoY, it may make more sense to do a revenue-based valuation since there's not a stable history to look at with SDE.

It's also worth noting that different buyers can put vastly different valuations on a business. Smart buyers aren't just buying history, they're also buying what they think they can help the business become in the future.

There's going to be a big difference in the 'fair' price between buyers that might bring very different goals, assets, and strategic direction to a given business. One oversimplified way to look at this is that some buyers are 'strategic' and some are 'financial.'

'Strategic' buyers may be able to get more long-term value (and therefore be willing to pay a higher price) because there's a good fit with other ways they're already making money and/or serving customers.

That's why 'strategic' buyers might put a purely revenue-based or even technology-based valuation on a company. But these types of buyers also typically only want to buy bigger companies, so they don't usually come into play with smaller SaaS deals.

A purely revenue-based valuation also indicates that the buyer will radically change the operations and cost structure of the business they're acquiring, so they ignore the current ops and cost structure.

At SureSwift, we're mostly a financial buyer — that's why we price primarily based on earnings and use the SDE method — and we look to extend on the strengths of bootstrapped SaaS companies by keeping and growing the teams who have made the company successful. We think we're pretty good at operating companies and extending growth, which means we can pay (a bit) more for companies we feel confident about growing.

PART 3

Going past the formula: Getting to a whole number, and a sale you'll be happy with.

Figuring out your SDE takes some legwork (and paperwork) but it's a pretty straightforward way to get a range of what your business could be worth.

The bad news is that while this is a great way to pencil things out and gauge potential offers, there isn't a single, simple formula that can tell you exactly what your business is worth.

And most buyers are going to look beyond your SDE number anyways to make sure you're not gaming it by under-investing in the company to make things look better on paper.
At the end of the day, the business is worth what you're willing to sell it for, and what a buyer is willing to pay for it. And as we just covered, every potential buyer will value it differently, because they'll have different values, capabilities and goals.

> So SDE is a good place to start for a ballpark, but you'll want to come up with a whole number that will make you feel good about a sale, and you'll want to think about what kind of buyer you want to work with, too.

Here are a few things you should consider when it comes to evaluating buyers and potential deals.

Is the buyer offering cash, or does the deal need to be financed?

SaaS is a hot ticket right now, and there are a lot of people trying to get into the acquisitions business in this segment. Unfortunately, those people don't always have the experience or the capital to close a deal.

If you're truly interested in an exit and want the process to be as low-stress and seamless as possible, you want to work with a cash buyer who has experience closing deals. Baremetrics is just one recent example of a SaaS business where **the deal went south because the potential buyer couldn't secure financing**.

Finding yourself in a situation like this one is not only stressful and disappointing, but it can also be costly. Preparing your business for an exit usually means you'll spend on accounting and legal services, in addition to investing your own valuable time. So do everything you can to ensure that time and money doesn't go to waste, and exercise some extra caution and vetting with any non-cash offers.

What do other founders say about the buyer?

Just like you should be cautious with non-cash buyers, you also want to be careful with first-time buyers. Everyone in acquisitions has a first deal. And we can tell you from experience that no matter how good intentions are on both sides, the first deal just isn't as smooth as the tenth or the thirtieth. If the buyer has experience, that's great. Talk to other founders who've sold to them and find out what the process was like.

We always put founders in our sales pipeline in touch with founders who've sold to us in the past, and any other buyer should be willing to do the same.

Is the buyer offering you a full, or partial exit?

Any buyer who knows their stuff is going to ask for a transition period as part of the sales agreement. We typically ask founders to work with us for 3-6 months to fully onboard their product and their team. After that, they have cash in hand, and the freedom to work on whatever they want to.

How easy are you to replace?

Another thing to consider is how easily replaceable you are as the founder. Your business is going to have a lot more appeal (read: offers) if a new owner can easily replace what you do in the business.

That means things like documenting important workflows and processes, building with a simple, well-known tech stack, and having well structured support and sales that can easily be handed over to someone else, among other things. If the business can't run without you, work on that before selling. You'll get a better deal, and the sales process will be a lot easier for everyone involved.

What opportunities is the buyer offering for your business and your team (if you have one)?

Another hard-to-measure, but important thing to consider is what a buyer will do with your business. Are they a competitor who will dissolve the brand you've built, and lay off people you might have worked with for years? Or will they grow your brand, add resources to the product, and have a seat for those people?

We believe wholeheartedly in giving founders dream exits. But we've closed several deals where we weren't the highest bidder, but the founder chose us because we offered cash, a full exit, and better opportunities for the business and the team. So we know those intangibles have real value to good founders.

Your list of intangibles might be different, but it's worth thinking through not just what you want to get out of a deal financially, but also what the sales experience will be like, and what you want the future of your business to look like with a new owner. The right deal is the one you feel good about on all three counts.

PART 4

How do you know it's the right time to sell your SaaS?

The answer to this one is pretty simple: If it's the right time for you to sell, then yes, it's a good time.

The economics for bootstrapped SaaS acquisitions haven't shifted all that much, even as the greater economy is showing a lot of volatility and uncertainty in 2020-2021. Some of the more speculative buyers we were seeing in previous years have slowed down or disappeared from the scene, but the valuation multipliers we're discussing with founders interested in our hold-and-grow approach haven't changed.

The bottom line is selling is a decision that really comes down to you. There will never be a perfect time to sell, but there is a right time for you. Almost every business owner we talk to sells for one of three reasons (or sometimes a combo).

1) They have multiple projects going, and they want to focus on one and sell the others. We're expecting to hear this even more over the next couple of years since some small SaaS companies that had great MRR and were running almost on autopilot are taking a lot more time and attention to run this year.

"It got to a point where we knew it was time. With other simultaneous ventures, I hadn't been able to spend as much time on it as I would have liked over the last year or so. It made sense to explore finding a home with a team that could move it forward.

- **Ade Olonoh,** Founder of Jell

Read our full interview with Ade →

2) They've hit a growth or risk ceiling, and they want an exit to secure their personal financial future while taking some time to think about a next project.

"Reaching our goals, although thrilling, shifted our risk level to an uncomfortable height where we suddenly felt that we had something to lose. I noticed that we were no longer making smart business decisions, but decisions rooted more in comfort and safety.

- **Danielle Simpson,** Co-Founder of Feedback Panda

Read our full interview with Danielle →

3) They’re ready to make a big life change (kids, marriage, moving, etc) and taking some of the risk out of the equation just feels like the right move for them, right now.

“A couple of years in, my personal situation changed in a way that it made sense to think about selling at least one of the two products. The risk was also getting bigger — the bigger the businesses got, the more I had to lose.

- Moritz Dausinger, Founder of Docparser and Mailparser

Read our full interview with Moritz →

Thanks for reading! Have questions about selling your bootstrapped SaaS business?

Schedule 15 minutes to chat with our Head of Acquisitions, Chris Reedy.

Schedule a call now →

*Everything you need to know about how to value a bootstrapped SaaS from the basic formulas to getting to a whole number you're happy with via **@SureSwiftCap.***

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