

The SaaS Glossary

The Fundamentals

THE ARR FUNNEL

REVENUE RECOGNITION

CATEGORIZING SPEND



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NAVIGATE

The Metrics

GROWTH & LOGO RETENTION

REVENUE RETENTION

ARR PER CUSTOMER

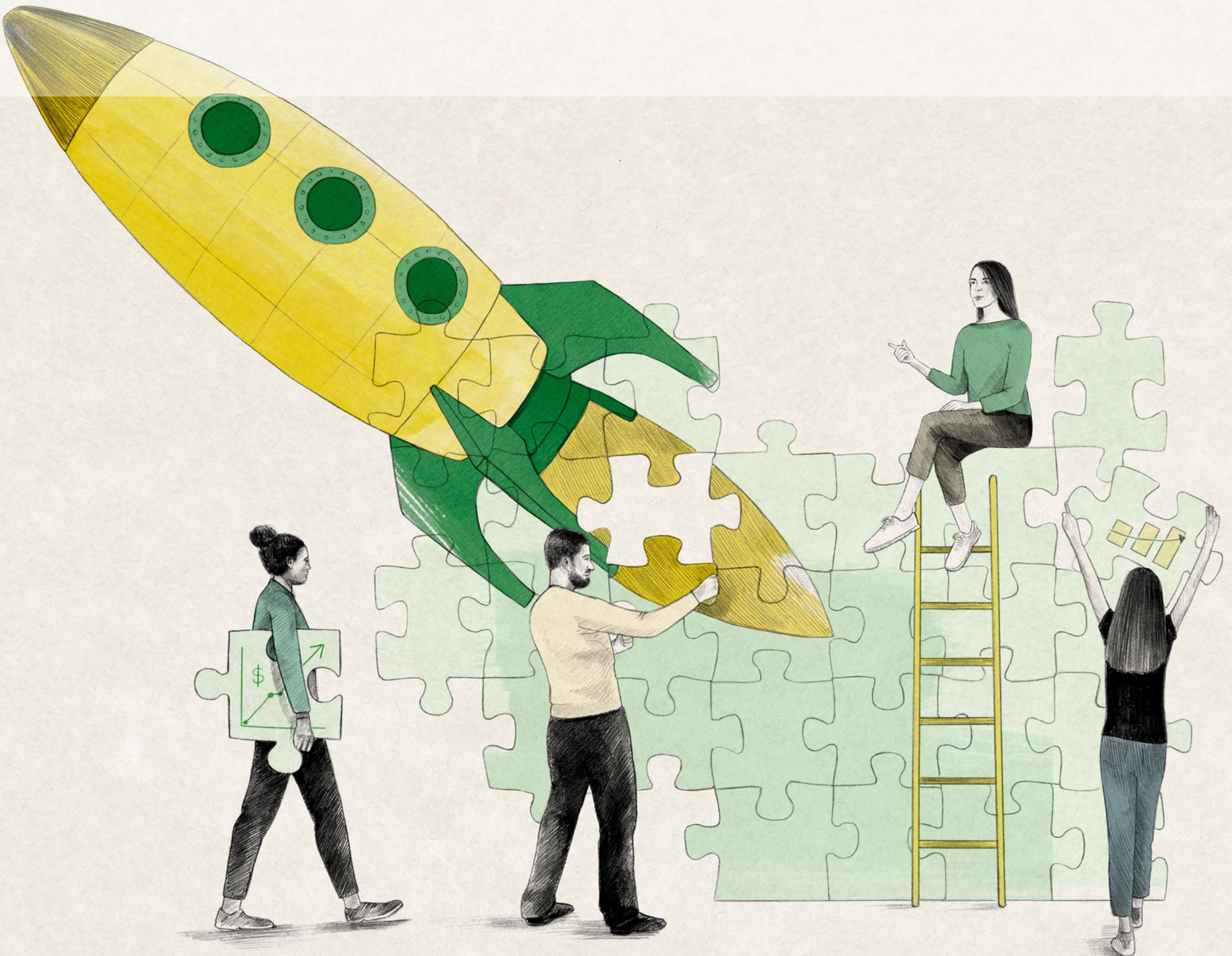
LTV & CAC

RULE OF 40

BURN RATE

MAGIC NUMBER

HEADCOUNT EFFICIENCY



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How to Use This Guide

Every year, we publish our cornerstone report on what growth and efficiency looks like across our portfolio of enterprise SaaS companies. However, the different terms and metrics used to describe SaaS business performance are often confusing and not well-documented. We often get questions from even established founders and finance teams on the best ways to calculate a certain metric.

We are excited to share this glossary of common SaaS terms and metrics as a companion tool to our annual Growth & Efficiency report. This is not intended to be a definitive guide to SaaS accounting. Rather, we hope to share some best practices and common approaches we often see companies use to most cleanly define and track these metrics on an ongoing basis. We also believe this is a topic that will only benefit from increased knowledge sharing and welcome any additional considerations or best practices you may have.

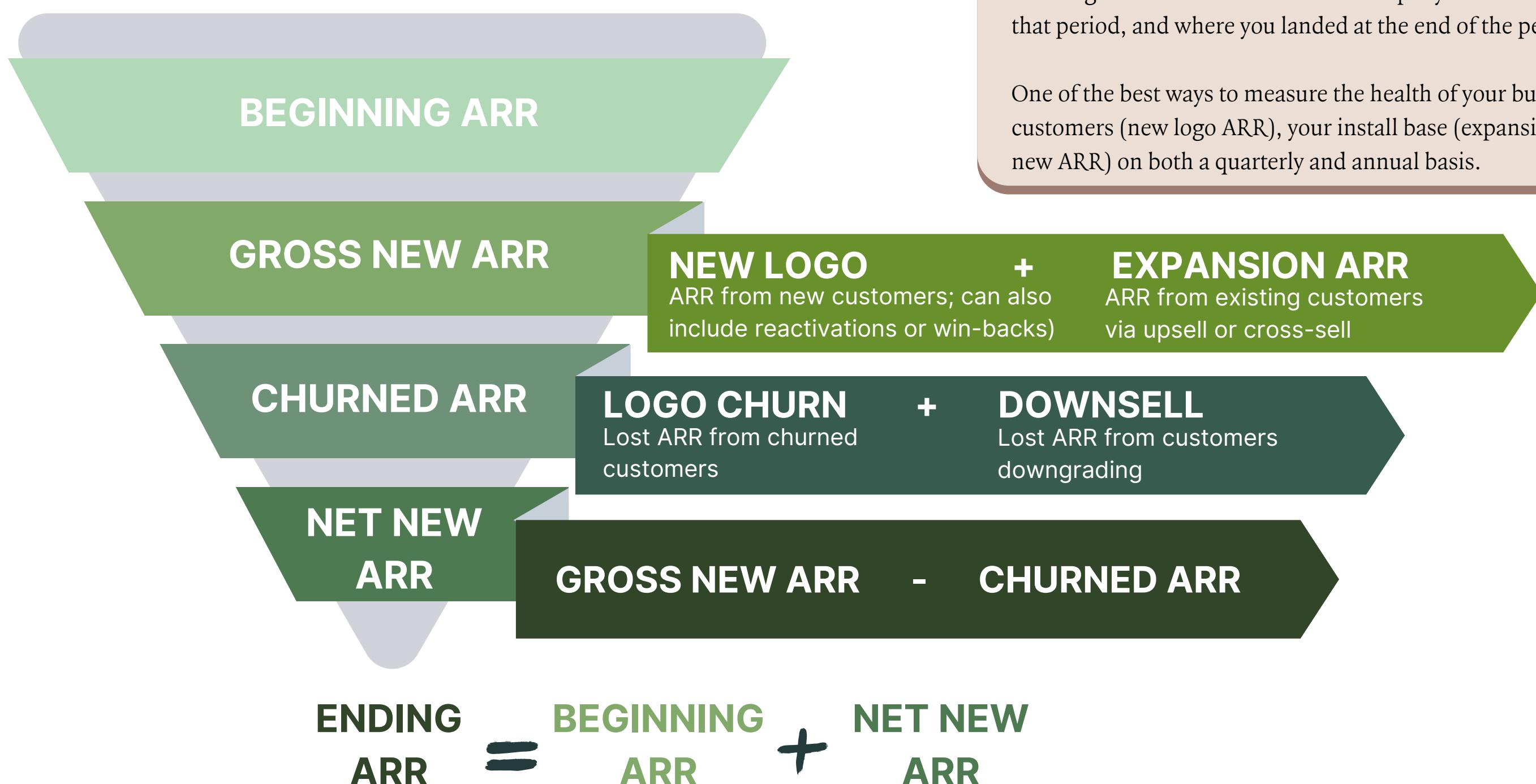
[Access our Growth & Efficiency materials](#)



The Fundamentals

The ARR Funnel

Note: This same funnel can also be built out for CARR (contracted annual recurring revenue) which takes into account signed (but not live) contracts



Because of the recurring nature of SaaS businesses, it can be challenging to see how well a company is actually doing. An ARR waterfall is one of the fundamental building blocks of SaaS financial planning, allowing us to understand where a company is at the beginning of period, the puts and takes of ARR in that period, and where you landed at the end of the period.

One of the best ways to measure the health of your business is to look at what happened with new customers (new logo ARR), your install base (expansion, churn rate), and the sum of all the above (net new ARR) on both a quarterly and annual basis.



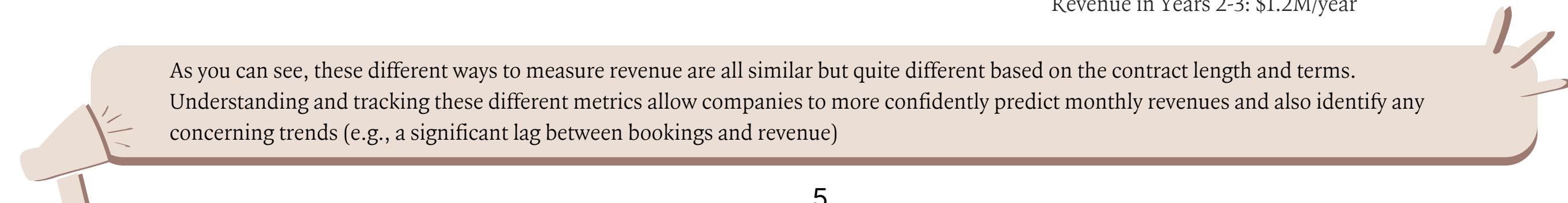
Download our
[ARR funnel template](#)

The Fundamentals

SaaS Revenue Recognition

	Definition	Example
BOOKINGS	Dollar value from any customer agreements to spend money with you (usually with an executed contract)	A 2.5-year contract where Year 1: \$600K, Year 2: \$1.2M, Year 3: \$1.2M Contract is signed on Jan 1st with a time to live of 6 months and an upfront payment of \$600K
BILLINGS	Amount invoiced that is due for payment	Bookings on Jan 1st: \$3M
ACV / TCV	Annual contract value (ACV): Value of a contract over an annual (12-month) period Total contract value (TCV): Total value of the contract which can be shorter or longer than the 12-month period	Billings on Jan 1st: \$600K \$100K/month starting in Year 2 ACV: \$1.2M per year (3M / 2.5 years) TCV: \$3M
CARR	Contracted annual recurring revenue refers to the subscription revenue of all signed contracts (including customers not yet live)	CARR: \$1.2M per year
MRR / ARR	Annual recurring revenue (ARR) is the annualized, recurring value of the contract that is live and being recognized as revenue. $MRR = ARR / 12$	MRR on Jan 1st: \$0 \$100K in MRR starting in Month 7, ARR = \$1.2M
REVENUE	Dollar value of money that is recognized once services are delivered (per GAAP accounting policy)	Revenue on Jan 1st: \$0 Revenue in Year 1: \$600K (\$10K/month starting in Month 7) Revenue in Years 2-3: \$1.2M/year

Revenue Realization



The Fundamentals

SaaS Revenue Recognition



Common Questions

Which topline metrics should I be tracking?

The metrics most suitable for your tracking will depend on your business model and other factors like scale. For example, certain metrics will make more sense for earlier vs. later stage companies. We often see earlier stage companies tracking both CARR and ARR since this can give the company and investors a holistic view of future revenue. Conversely, revenue becomes more important as companies scale and approach IPO readiness. However, if asked to pick the most important topline metric to track - we always recommend companies track both ARR and revenue as these metrics give the best sense of actual realized revenue.

What's the difference between deferred revenue, backlog, remaining performance obligations, and ARR?

These terms are often used interchangeably but are actually quite different. Deferred revenue refers to the dollars current customers have pre-paid for services to be delivered (these are recorded on the Balance Sheet). Once these services are rendered, the dollars become recognized as revenue. Backlog is the remaining value of contracted services that customers have not yet paid for. Together, deferred revenue + backlog = RPO (remaining performance obligations). On the other hand, ARR is an annualized value for contracted services so typically RPO will be greater than ARR for growing businesses.

What's the difference between ACV, TCV, and ARR?

Annual contract value (ACV) refers to the value of a contract over an annual (12-month) period, whereas total contract value (TCV) is the total value of the contract and can be shorter or longer than the 12-month period. TCV will also include non-recurring revenue such as one-time charges and professional services. While ARR and ACV will often be the same for a single customer, total ARR and ACV will be quite different as you think about customers with different lengths of multi-year contracts. For example, if we have Customer A with a 1-year \$100K contract and Customer B with a 2-year \$75K/year contract, Year 1 ARR is \$175K and Year 1 ACV is \$87.5K.

How should I track ARR for multi-year contracts? What about customer discounts or promotions?

If there is a ramp in multi-year contracts (i.e. Year 1 is \$1M, Year 2 is \$3M, Year 3 is \$5M), the best practice we've seen in the portfolio is to log ARR at \$1M for the first year (rather than an average of \$3M across each year) to take into account any potential uncertainties in getting to the \$5M. We have also seen companies log the first year ARR and the future ARR gets credited into the projected future year growth, so that when budgeting we can account for existing contracts expected to ramp up.

Many SaaS businesses will offer discounts to incentivize customers. The best practice is to account for any discounts when calculating ARR; for example, if a customer is receiving a 20% discount on an annual contract of \$100K, the ARR recognized should be \$80K. Similarly, a 6-month free trial offered as part of an annual contract should not be included in ARR calculations.

The Fundamentals

Categorizing Spend

Cost of Goods Sold

Typical Costs

- Hosting and infrastructure (e.g., servers, connectivity, security software, user hosting*)
- Third party fees (e.g., credit card / processing fees)
- Deployment / implementation resources
- Affiliate partner payouts
- Professional services
- Customer support
- Overhead (e.g., rent / facilities, office supplies)

Where you allocate certain line items across spend will be dependent on each company's business model.

For example, it may make sense for a company that has a Customer Success team that focuses more on implementation and customer support to allocate this team in COGS, whereas for other companies where Customer Success handles renewal / expansions, this team may roll up to Sales & marketing expenses. Similarly, user hosting costs can be found in either COGS or S&M. However, it is important to note that these changes will impact gross margin and any large accounting changes should have a justifiable reason.

Operating Expenses

Both people (onshore and offshore) and non-people related spend should be included in below functions

Sales & Marketing

- Quota-carrying reps (AEs, BDR/SDRs, sales managers, etc.)
- Marketing (communications, PR, demand gen, events)
- Customer success*
- Agency partnerships
- Sales enablement / revenue operations
- Account management
- User hosting*

General & Administrative

- People / HR (Operations, Recruiting, L&D)
- Finance
- Legal / Compliance
- IT
- Executive team
- Analytics

Research & Development

- Engineering
- Engineering operations
- Product design / management
- Quality assurance / testing
- Product support
- Data operations

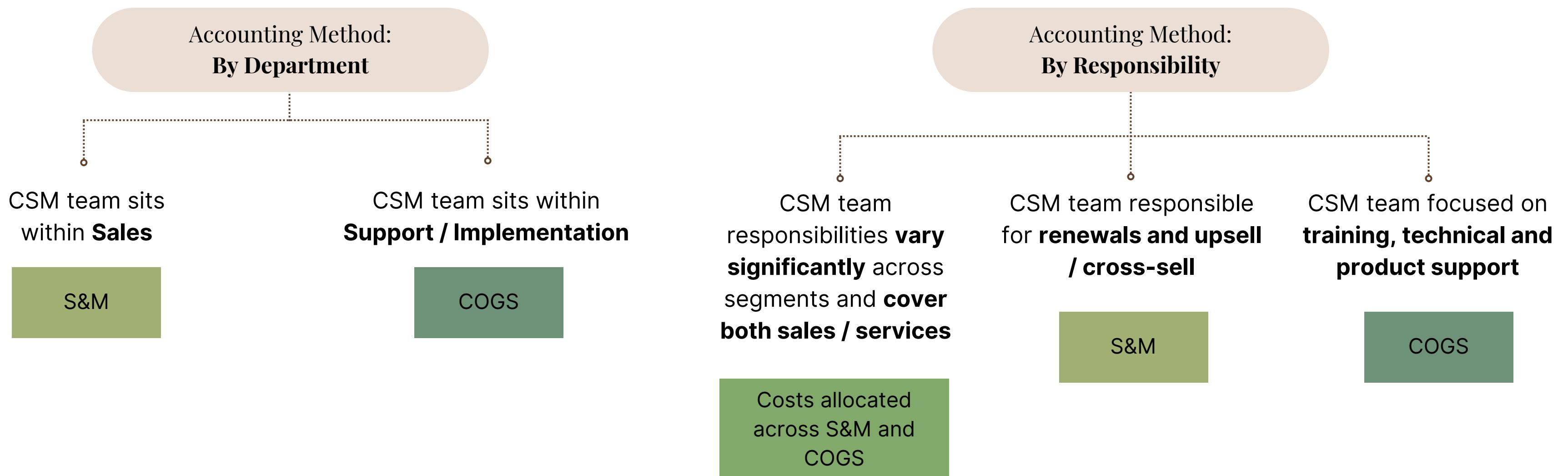
Note: Under GAAP accounting policies, stock-based compensation is recognized as a non-cash expense on the income statement. Thus, just like wages stock-based compensation (SBC) is allocated to the relevant line items across COGs (i.e. direct labor) and Operating Expenses (i.e. SBC for R&D engineers, etc.)

The Fundamentals

Categorizing Spend: A Deep Dive on Customer Success

Where should Customer Success be allocated?

The CSM team is one of many accounting line items that can quickly become nuanced across different companies and business models. While there is not a straightforward answer for where to allocate CSM between COGS and Sales & Marketing, below is a framework we often see portfolio companies use to make this decision.



The Metrics

Growth & Logo Retention

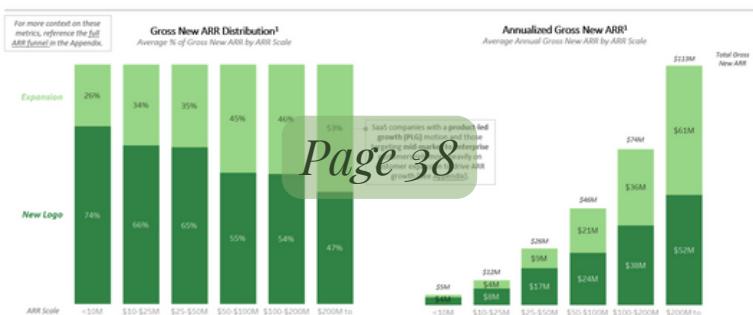
Metric	Definition	Considerations
YoY ARR Growth <i>%, Annual</i>	$\left(\frac{\text{Year 2 ARR}}{\text{Year 1 ARR}} - 1 \right) \times 100$	<p>One of the most important metrics to track, ARR growth looks at the difference between current and last year ARR. The drivers of ARR growth are also important to understand — both in terms of size and quality of customers, as well as variation by sales motion.</p>
Gross Logo Retention <i>%, Annual or Quarterly</i>	$\left(1 - \frac{\text{Churned Customers}}{\text{Beginning Customers}} \right) \times 100$	<p>Logo retention indicates the percentage of customers a business retains over a period of time. For a SaaS business, logo retention indicates the percentage of customers who renewed their accounts out of those due for renewal in a specific period.</p>

Relevant Pages in Growth & Efficiency Report

Topline Health | ARR Growth
After reaching the \$10M ARR threshold, enterprise SaaS companies with top performance in ARR growth typically grow 2.0x-2.5x year over year until ~\$100M ARR, followed by 1.3x-1.5x until IPO. The public companies in this dataset typically IPO'd within 4-6 years after hitting \$10M ARR.



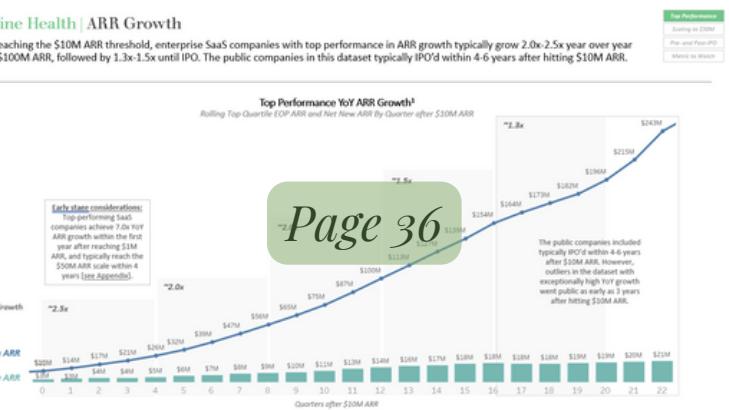
Topline Health | Drivers of ARR Growth
New logos are the primary driver of ARR growth until enterprise SaaS companies reach ~\$200M ARR, when upsell and cross-sell motions scale and expansion begins to make up >50% of gross new ARR.



Download our ARR and customer funnel template

The Metrics

Attainment

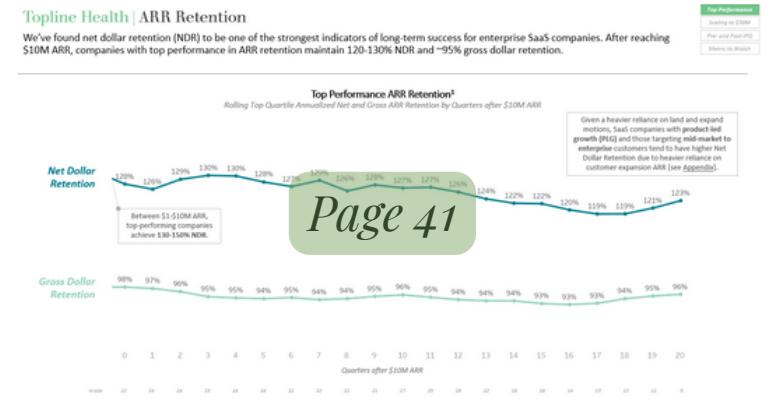
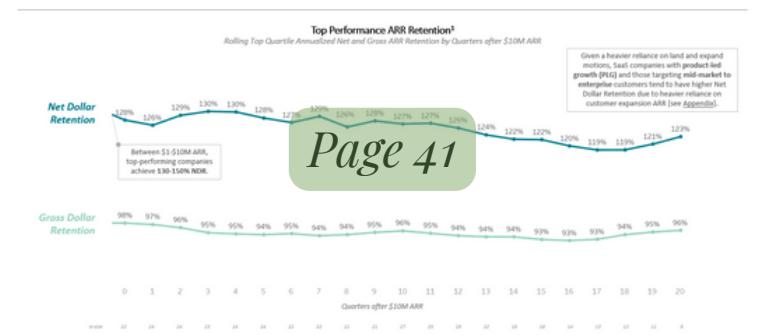
Metric	Definition	Considerations	<u>Relevant Pages in Growth & Efficiency Report</u>
Topline Attainment <i>%, Annual or Quarterly</i>	<u>Current Quarter Net New ARR</u> Net New ARR Forecast	<p>One of the most important measures of both topline health as well as business predictability is topline attainment, which measures the actual dollars achieved each quarter against the original plan set at the beginning of the year.</p> <p>We typically recommend looking at the attainment metric on a <u>cumulative incremental</u> basis rather than within a standalone quarter which can often be impacted by seasonal fluctuations. For example, Q2 topline attainment should be viewed as Q1 + Q2 (1H) attainment, or in other words the net new ARR generated in Q2 - beginning of year ARR.</p>	 <p>Topline Health ARR Growth After reaching the \$10M ARR threshold, enterprise SaaS companies with top performance in ARR growth typically grow 2.0x-2.5x year over year until ~\$100M ARR, followed by 1.3x-1.5x until IPO. The public companies in this dataset typically IPO'd within 4-6 years after hitting \$10M ARR.</p> <p>Top Performance Growth in 2009 Pre- and Post-IPO Arrive to market</p> <p>Page 36</p>



Download our ARR and customer funnel template

The Metrics

Revenue Retention (1 of 2)

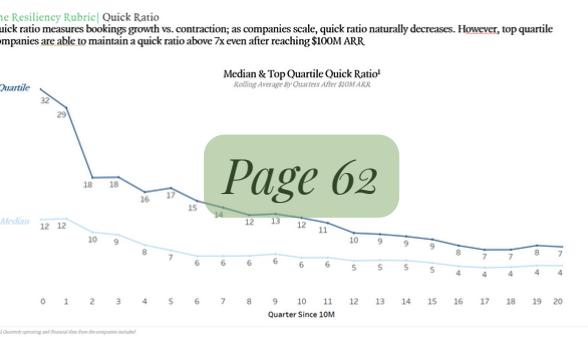
Metric	Definition	Considerations	<u>Relevant Pages in Growth & Efficiency Report</u>
Gross Dollar Retention <i>%, Annual or Quarterly</i>	$1 - \frac{\text{Churn} + \text{Downsell}}{\text{Average of Beginning ARR} + \text{Ending ARR}}$	<p>Recurring revenue is the engine of SaaS businesses. Gross dollar retention assesses dollars lost from your existing customer base via churn or downgrades. We typically see companies use beginning ARR as the denominator or the average of beginning and ending ARR to smooth out any inconsistencies across quarters (recommended approach). For certain businesses (e.g., companies where predominant upsell/downsell motion is seats organically expanding or contracting), looking at only logo churn may be the right metric.</p>	
Net Dollar Retention <i>%, Annual or Quarterly</i>	Annualized Net Retention: $1 + \frac{\text{Expansion} - \text{Downsell} - \text{Churn}}{\text{Average of Beginning ARR} + \text{Ending ARR}}$ LTM Customer Cohort Retention: <p>Looking at the trailing twelve months, the exact same cohort of customers are evaluated from the year prior to identify total expansion net of churn and attrition to calculate a retention figure</p>	<p>We believe net retention is arguably the most important gauge of business health for software companies and the efficiency of their revenue generation. Net dollar retention specifically accounts for expansion, downsell, and churn which renders it a robust measure of both product strength and customer success motions. There are a number of different ways to calculate net retention, including annual net retention, annualized quarterly retention, and customer cohort analysis. We typically use annualized-quarterly net retention to better capture quarter-over-quarter changes, which is particularly important when companies are smaller in scale and greater variation in net retention (%) is driven by a smaller denominator. Especially when looking at inconsistent periods, we will use the average of BOP and EOP ARR in the denominator. To understand net retention specific to a company or customer cohort, we recommend a cohort analysis of retention.</p>	

The Metrics

Revenue Retention (2 of 2)

Metric	Definition	Considerations
Quick Ratio Ratio	$\frac{\text{New logo + expansion ARR}}{\text{Churn + downsell ARR}}$	<p>The SaaS quick ratio measures the growth of recurring revenue over a certain period in comparison to the contraction. Not all growth is equal, so it is important to maintain a higher quick ratio which implies that your growth is healthy and efficient.</p> <p>Generally, the "optimum" SaaS quick ratio is around 4x.</p>

Relevant Pages in Growth & Efficiency Report



The Metrics

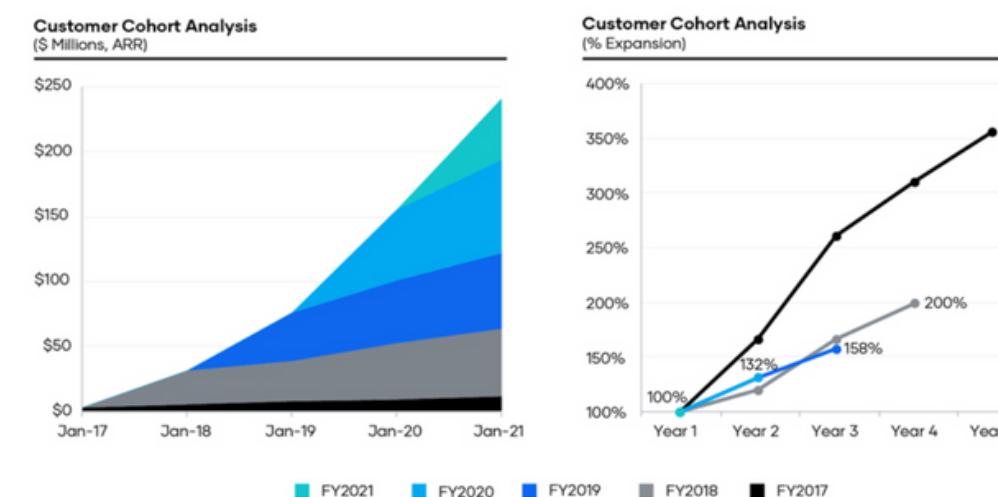
A Deep Dive on Net Dollar Retention

WHAT'S THE BEST WAY TO CALCULATE NET DOLLAR RETENTION?

There are typically two approaches to look at annual retention figures, which have different considerations. We typically recommend companies track both in order to get a sense of holistic net retention for an isolated period of time as well as insight into customer behavior over time.

LTM CUSTOMER COHORT EXPANSION

- From the same quarter one year prior, a certain number of customers / subscribers are selected
- Looking at the trailing twelve months, the exact same group of customers are evaluated from the year prior to identify the total expansion net of churn and attrition to calculate a retention figure



Example Cohort Analysis From Hashicorp S-1 Filing

ANNUALIZED QUARTERLY EXPANSION VS. CHURN / DOWNSELL

- Based on a specific quarter, ARR generated through expansion of existing customers is taken, subtracted by the churn/downsell ARR within that quarter (the "net expansion")
- "Net expansion" is taken over beginning ARR (or sometimes average of beginning and ending ARR) for that quarter to reflect a quarterly net retention
- The quarterly net retention figure is multiplied by 4 to reflect an annualized net retention figure (typically indexed to 100%)

The Metrics

Unit Economics: LTV & CAC

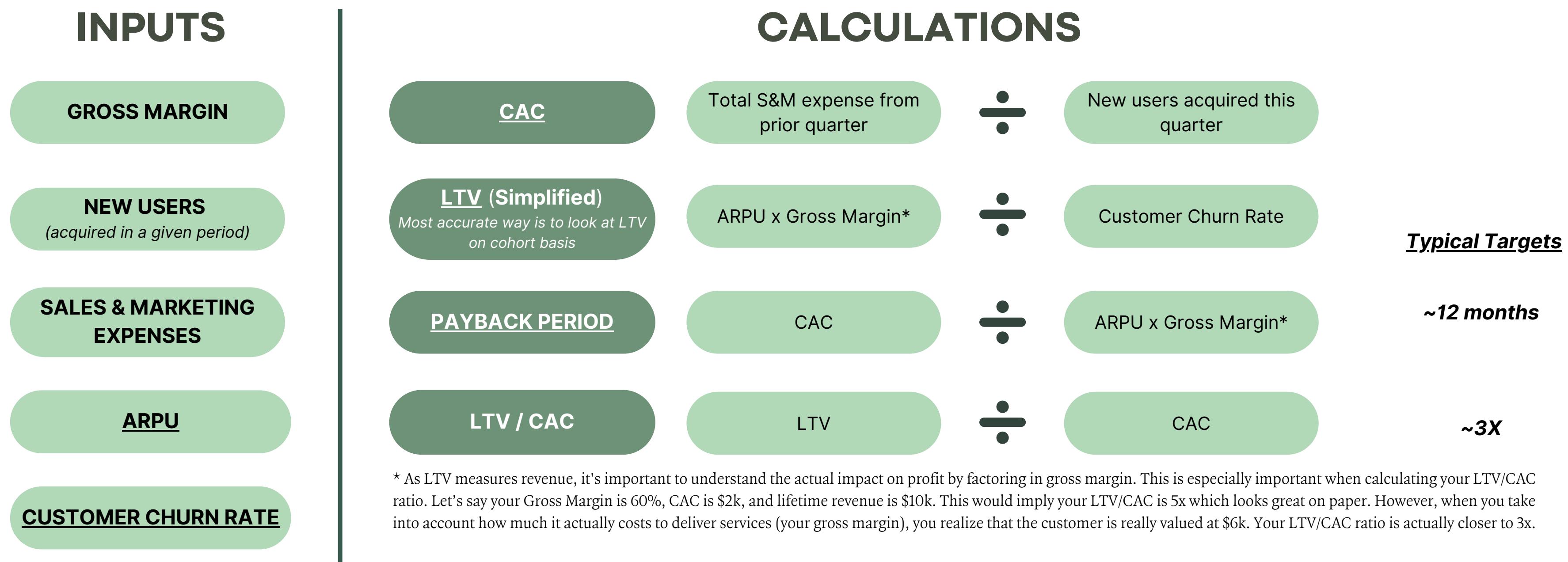
Metric	Definition	Considerations	<u>Relevant Pages in Growth & Efficiency Report</u>
CAC <i>\$, Annual or Quarterly</i>	$\frac{\text{S\&M Expense}}{\text{Gross New Customers}}$	<p>For any business, you want to make sure you are earning more customers than the amount paid to acquire them. There are many flavors of CAC - the most common being blended vs. paid CAC. While blended CAC looks at all types of channels including non-direct like content marketing, paid CAC looks at only total acquisition cost via paid channels.</p> <p>For companies with a longer sales cycle, we've also seen some companies use a "time-adjusted CAC" calculation where you offset the CAC as needed by the sales cycle (i.e. use S&M expense from -1Q) and just make sure to consistently track each quarter in addition to regular CAC.</p>	<p><small>Unit Economics LTV / CAC by Scale SaaS companies typically see a LTV/CAC ratio of 4-7x depending on scale and a median CAC payback of 20-30 months</small></p>
Payback Period <i>Usually in # of months</i>	$\frac{\text{CAC}}{\text{ARPU} \times \text{Gross Margin}}$	Payback period calculates the number of months needed to pay back any customer acquisition costs - effectively showing your break-even point. Either ARPU or MRR can be used when calculating payback period.	
Customer Lifetime Value <i>\$</i>	$\frac{\text{ARPU} \times \text{Gross Margin}}{\text{Customer Churn Rate}}$	LTV is a key measure of unit economics that allows us to make sure that the profit we are getting from a customer over their lifetime (LTV) is greater than the cost to acquire a customer (CAC). The formula shown on the left is the simplest way to calculate LTV. However, there are many flavors of this calculation specific to your business (e.g., if you have long customer lifetime values and negative churn, etc.) so LTV is a formula we often see being tailored to the company's model and customer profile. The most accurate way will be to look at customer LTV on a cohort basis.	

The Metrics

Unit Economics: LTV & CAC

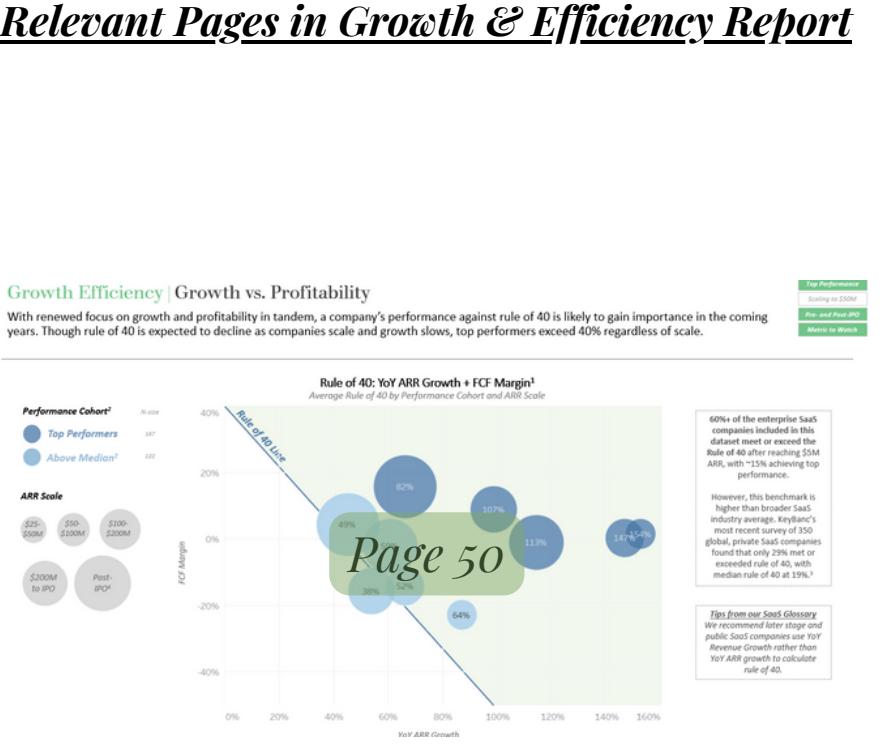
How should I calculate my LTV / CAC?

LTV / CAC is a great metric that gives insight into a company's unit economics. However, the calculation will often be very dependent on the company's business model, customers, and finance model. Below is an example of a simplified approach that we like to use when calculating LTV and CAC for a given quarter:



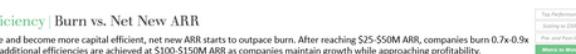
The Metrics

Rule of 40

Metric	Definition	Considerations	<u>Relevant Pages in Growth & Efficiency Report</u>
Rule of 40 <i>%, Quarterly or Annual</i>	Revenue Growth % + FCF Margin %	<p>The Rule of 40 is a rule of thumb that measures your tradeoff between growth and profitability; a high-performing SaaS company should generally meet or exceed 40%. Both revenue and ARR growth can be used for Rule of 40, but revenue is most commonly used. While either FCF or EBITDA margin can be used in the Rule of 40 calculation, we typically prefer to use FCF as it is ultimately what drives value for all companies. There can be variability in FCF Q/Q so EBITDA is another important profitability metric that can be used as a proxy. FCF is defined as cash flow from operations less capital expenditures.</p> <p>We typically only begin to place real weight against this metric for companies with at least ~\$25M in topline.</p>	

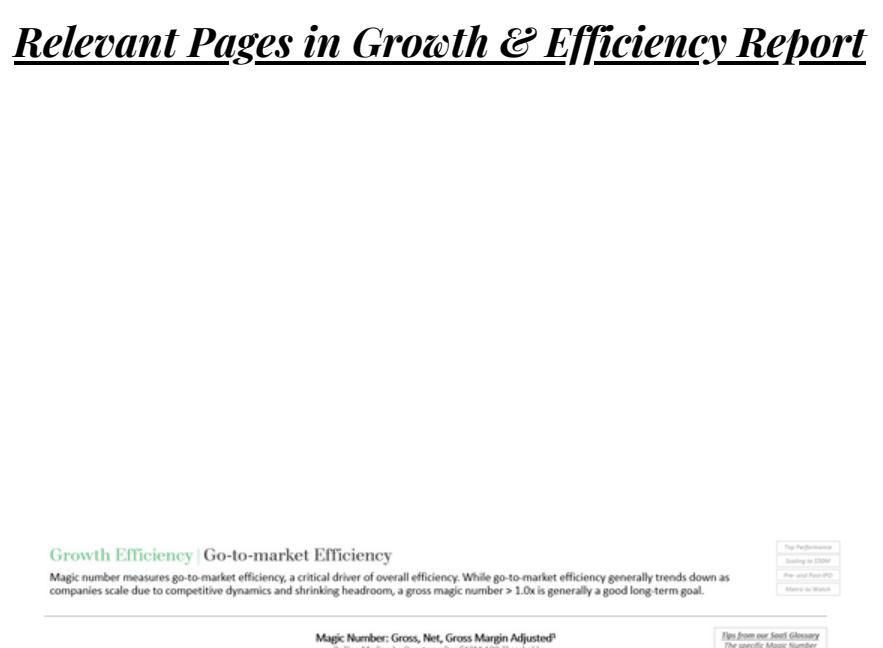
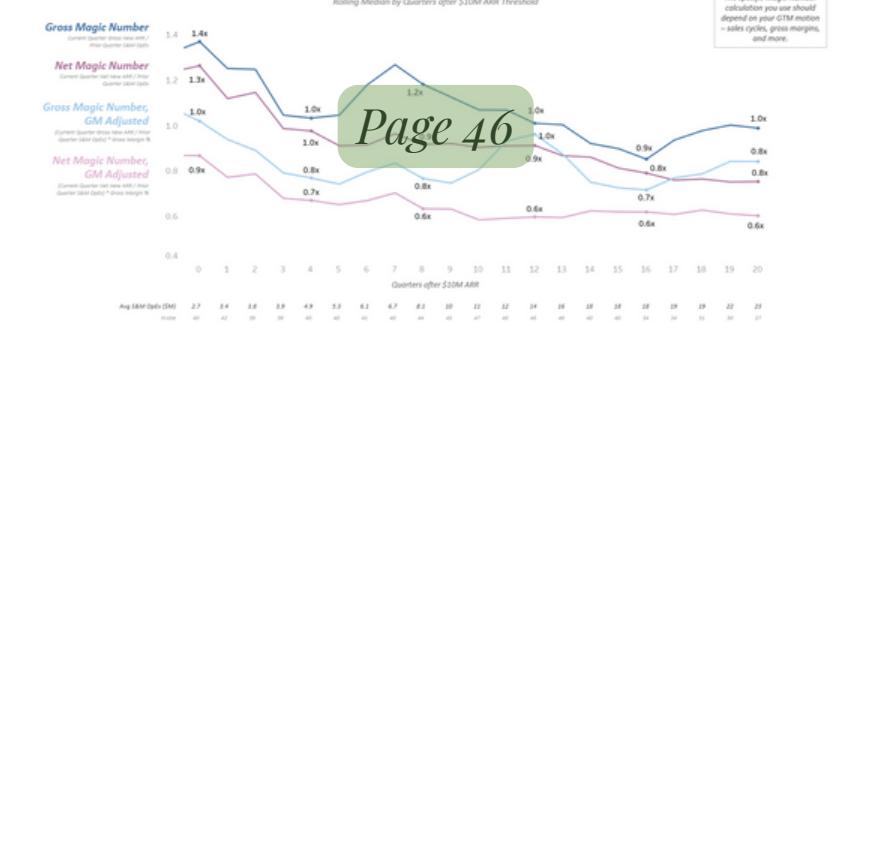
The Metrics

Burn Rate

Metric	Definition	Considerations	<u>Relevant Pages in Growth & Efficiency Report</u>
Burn Multiple <i>Ratio</i>	<u>Net Burn</u> Net New ARR	Burn multiple is one of many ways to measure capital efficiency - a metric that becomes increasingly important in the current environment. Other ways to look at this include the hype ratio (capital raised / ARR) or efficiency score (net new ARR / net burn). We prefer the burn multiple because the metric focuses on how much is being burned to generate each incremental dollar of ARR. We typically use FCF as the burn metric, but EBITDA and operating income can also be used as a proxy. A burn multiple under 1.5x is generally a great goal for companies to strive toward that are experiencing strong growth.	 Page 64
Cash Runway <i>Usually in months or years</i>	<u>Cash Balance</u> Annualized FCF	Visibility into cash flow is critical for any business. Runway defines how long your business can keep operating given available capital and current pace of burn. Tracking runway (usually in terms of months or years) allows leaders to keep an eye on burn rate and understand when cash infusions are next needed.	 Page 51

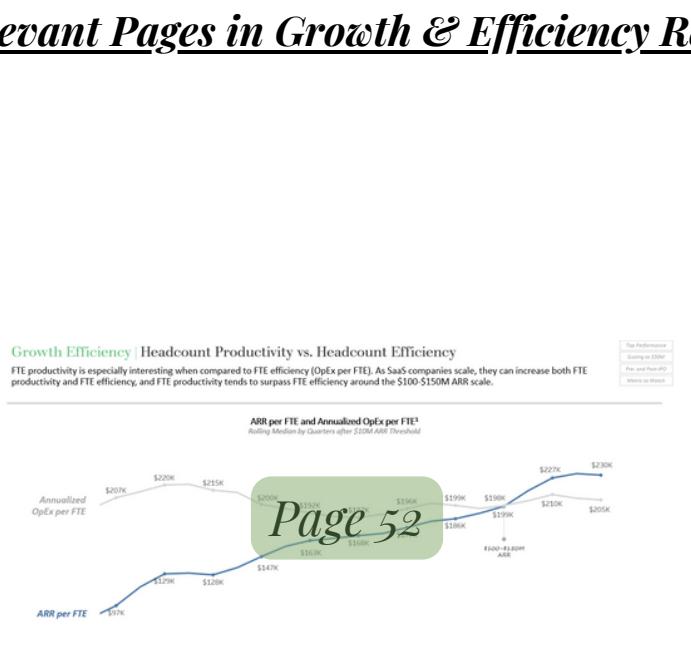
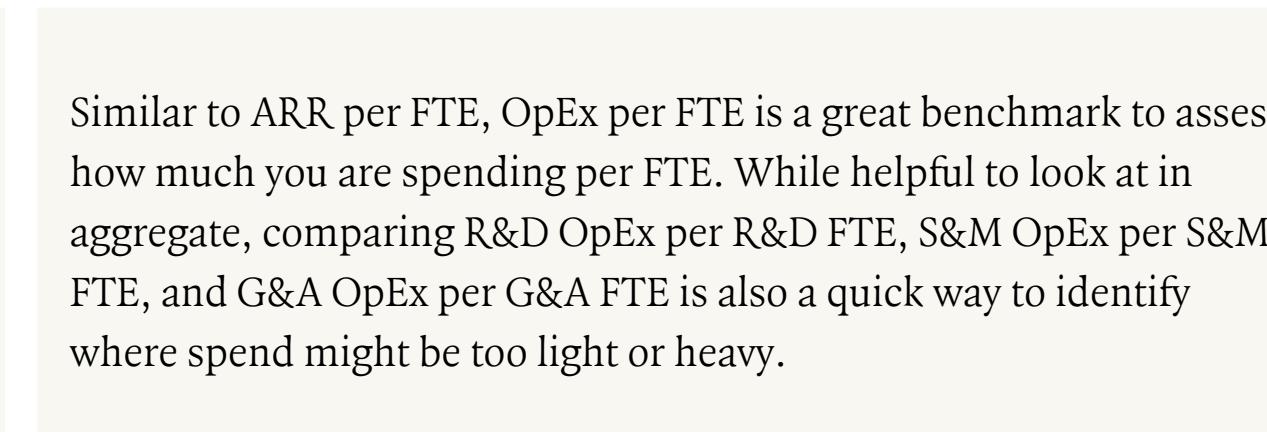
The Metrics

Magic Number

Metric	Definition	Considerations	<u>Relevant Pages in Growth & Efficiency Report</u>
Gross Magic Number <i>Ratio</i>	$\frac{\text{Current Quarter Gross New ARR}}{\text{S&M Expense}}$	The “magic” of this metric lies in its ability to measure revenue generation against sales & marketing spend while accounting for the lag of a typical sales cycle in order to understand the efficiency of sales and marketing spend and teams at a more nuanced level. Timing used in the calculation may differ based on the length of your sales cycle (e.g., some companies may use last quarter or an average of past 2 quarters S&M) and it may also make sense to track magic number across different customer segments (e.g., SMB vs enterprise) if sales cycles are drastically different.	
Net Magic Number <i>Ratio</i>	$\frac{\text{Current Quarter Net New ARR}}{\text{S&M Expense}}$	While there are four ‘flavors’ of Magic Number (Gross and Net, each with or without a Gross Margin adjustment) ⁵ , we typically find Net Magic Number to be the cleanest and most comprehensive view. Similar to gross magic number, net magic number looks at the impact of your sales and marketing spend against net new ARR (inclusive of expansion / upsell). Gross and Net Magic Number calculations can be multiplied by a company’s gross margin % as well which will take into account the payback required to fully break even and helps normalize when comparing magic number benchmarks across different companies.	

The Metrics

FTE Productivity

Metric	Definition	Considerations	<u>Relevant Pages in Growth & Efficiency Report</u>
ARR per FTE \$, Quarterly or Annual	$\frac{\text{Ending ARR}}{\text{Total FTEs}}$	ARR per FTE is another measure of efficiency to look at how much ARR is being generated per full-time employee and is an effective gauge of whether you are burning too much compared to employee productivity or have an opportunity to invest further.	
OpEx per FTE \$, Quarterly or Annual	$\frac{\text{Total OpEx}}{\text{Total FTEs}}$	Similar to ARR per FTE, OpEx per FTE is a great benchmark to assess how much you are spending per FTE. While helpful to look at in aggregate, comparing R&D OpEx per R&D FTE, S&M OpEx per S&M FTE, and G&A OpEx per G&A FTE is also a quick way to identify where spend might be too light or heavy.	
Productivity Ratio Ratio	$\frac{\text{ARR per FTE}}{\text{OpEx per FTE}}$	The productivity ratio is a metric that looks at the total average revenue generated per FTE in comparison to the total employee expenditures. Generally, companies should aim to achieve a productivity ratio greater than 1x.	