WTA TECHNOLOGY MERGERS & ACQUISITIONS

MARKET VIEW

SELL-SIDE INSIGHTS:

Not all Recurring Revenue is equal

Introduction

Since joining WTA Partners in November 2023, Sean Massey has drawn on over 35 years of technology industry experience. His career has been defined by deep expertise in public sector software and IT services, spanning local and central government, education, social care, public safety, healthcare, and defence. Here, Sean explores why recurring revenue is increasingly recognised as a key driver of enterprise value and successful exit outcomes.

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"Most of our revenue is recurring" is a very common statement founders make when preparing to sell a software or IT Services business such as a managed service provider (MSP). They know it is a driver of value and attractiveness: Recurring revenue provides acquirers with forward visibility, improves forecasting accuracy, and reduces the need to resell every pound of income from scratch each financial year.

Yet seasoned buyers look deeper and examine headline Annual Recurring Revenue (ARR) through a far more critical gaze. They do not pay premium multiples simply because revenue sits in a recurring column on a spreadsheet. They look past the headline number to test its durability, margins, and whether that income will genuinely survive completion. Founders must demonstrate it is defensible and truly recurring to receive a premium valuation multiple.

Two identical ARRs but contrasting valuations

Two tech companies each report £5 million of annual recurring revenue. The first operates on multi-year contracts, demonstrates high customer retention, generates strong gross margins, maintains a diversified client base, and provides software or services embedded directly into daily operations of its customers.

The second relies on rolling annual renewals, derives half its turnover from a small number of customers, carries low-margin support obligations, and depends heavily on a handful of key staff to service contracts.

While headline ARR is identical, the risk profiles are fundamentally different. A buyer will evaluate the contractual commitment, the cost to deliver the service, and the ease with which a client could migrate to a competitor. These operational factors create substantial differences in transaction multiples.

Longevity of the customer relationship is not enough

Founders often point to long-standing clients as proof of stability. "They have been with us for ten years" is reassuring, but habitual loyalty is not legal protection. A customer that has renewed for a decade may still have the right to terminate even on thirty or ninety days' notice. A public-sector client might be bound to re-tender through an open framework. An IT Services business client may review suppliers whenever a new chief financial officer or chief technology officer is appointed.

Buyers differentiate strictly between contracted recurring revenue, rolling arrangements, repeat project income, framework allocations, usage-based fees, and ongoing maintenance. The more legally binding, the longer the period and how operationally embedded the revenue, the more confidence a buyer will place in it.

Proving retention through data

General assertions that customers are sticky will be tested thoroughly during due diligence. Buyers evaluate both gross revenue retention (GRR) and net revenue retention (NRR).

GRR measures the baseline revenue preserved from existing clients after accounting for churn, downgrades, and scope reductions. NRR incorporates expansion from upselling, cross-selling, and contractual price increases. A business with 95% GRR and 110% NRR presents an attractive starting point, proving that existing clients remain and expand over time.

However, the composition of that retention matters. Acquirers will check whether NRR growth is driven by genuine product adoption or driven by inflation-linked price rises. They will also establish whether account expansion is broad-based across the customer base or concentrated in a single large client.

Concentration changes the risk profile

Large anchor clients bring commercial credibility, but high customer concentration remains one of the fastest ways to introduce deal friction. For example, should a single customer generate 40% of revenue, buyers immediately model the downside: what happens if that client leaves; insources; is acquired or decides to negotiate an aggressive price cut?

Context determines valuation impact here. A large enterprise client on a multi-year term, integrated across multiple departments with steep switching costs, is far more defensible than an account on an annual renewal especially if the relationship hinges on a single founder connection.

Renewal timelines and operational embeddedness

Valuation risks are often absent from historical financial statements and reside instead in the renewal calendar. If a large proportion of customer contracts are scheduled for renewal within three to twelve months following deal completion, the incoming buyer inherits that exposure. Acquirers will scrutinise whether renewal discussions have commenced, whether service issues exist, and whether pricing is likely to be challenged. Maintaining a clear contract schedule detailing values, expiry dates, notice periods, and account owners reduces valuation discounts.

True enterprise value comes from operational embeddedness rather than customer familiarity.

❖ **For software businesses:** This means the application manages mission-critical workflows, integrates with core enterprise resource planning or customer relationship management systems, and stores extensive historical data.

❖ **For IT services companies: I**t means managing core infrastructure, network security, cloud backups, and daily IT estate operations. These characteristics create genuine switching barriers where replacing the provider would cause significant disruption and expense.

Margin quality and scalability

High-margin software subscriptions at 80%+ gross margin scale with minimal incremental overhead. Conversely, managed service revenue running at 35% margin or commoditised cloud licence reselling inflates top-line ARR while contributing very little real enterprise value.

Buyers actively seek out underpriced, bespoke contracts that quietly consume disproportionate senior engineering hours. If expanding ARR by £1 million requires headcount to grow at the exact same pace, acquirers will value the business more like a consultancy rather than a scalable technology platform.

Plan for the exit

Founders considering an exit within 12 to 24 months should proactively focus on ARR quality rather than headline revenue alone:

- **Contractual certainty:** Audit core client agreements and seek to extend contract lengths, eliminate ambiguous termination rights, and secure multi-year commitments.
- **Retention analytics:** Establish clean customer-level data on GRR and NRR to demonstrate genuine account retention and adoption.
- **Operational scalability:** Address unprofitable contracts and remove custom delivery bottlenecks through automation and documented processes.
- **Renewal visibility:** Maintain a granular renewal calendar showing contract values, notice windows, and account health to provide buyers with clear visibility.

In technology M&A, recurring revenue gets an exit process started. Proving that revenue is legally secure, operationally embedded, highly profitable, and scalable is what secures the value for founders.

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