WHITE PAPER

Introducing the Revenue-Quality Podium

Here's How Revenue Quality Drives Value for Industrial Tech and Life-Science Tools Companies

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Battery

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Introduction

Founded in 1983, Battery Ventures is a global, technology-focused investment firm with decades of experience. Although the firm is perhaps best known for its heritage in software investing, we actively invest in industrial technology and life-science tools companies, partnering with more than 80 companies in the sector globally since 2003.

Our dedicated industrial technology and life-science tools (ITLST) practice focuses on critical enabling technologies for industrial and scientific workflows, spanning software, instrumentation and sensor technologies and tech-enabled services and consumables. We partner with management teams to help them grow their businesses and create shareholder value.

While there are several well-known and frequently referenced company valuation drivers, including scale, profitability and growth, to name a few, we feel our heritage as software investors gives us a unique perspective on ***revenue-quality mix*** as a key value-creation lever for ITLST companies.

In the software world, it is widely accepted that recurring/subscription revenue is a key value driver. Software companies are often valued on a multiple of annual recurring revenue (ARR) — higher ARR generally leads to a higher valuation. This preference for recurring revenue suggests that some types of revenue are considered more valuable or ‘high-quality’ than others in determining the valuation of a business.

We think in parallel terms when evaluating current and prospective ITLST investments, focusing closely on the quality of a company’s revenue. Most of our investments have a wide range of revenue streams, ranging from product sales and recurring consumable sales to service contracts and software/data subscriptions. Our two decades of experience in partnering with ITLST companies has reinforced our thinking that the percentage of higher-quality revenue is a meaningful indicator of current value, and moreover, should serve as a key lever to help our companies increase in value over time.

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Introducing the ‘Revenue-Quality Podium’

The public companies listed below are a representative sample of those widely tracked by investors and investment bankers who follow industrial technology and life-science tools businesses.

Figure 1: ITLST Public Companies[1]

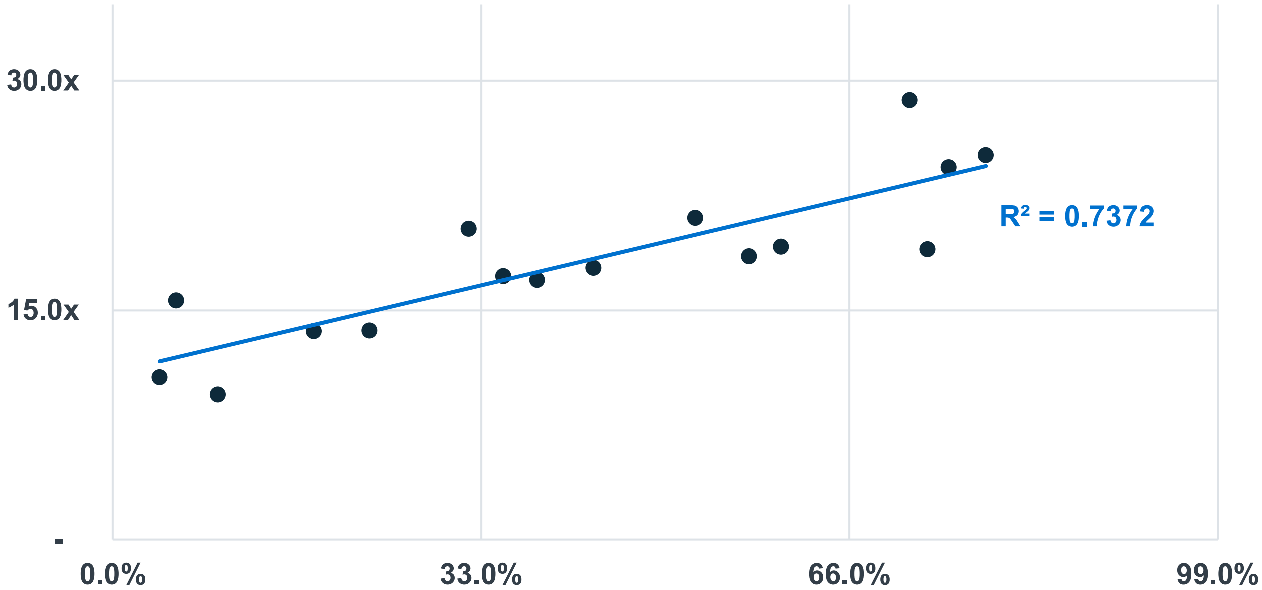
Company	% High-Quality Revenue[2]	EV/Revenue multiple	EV/EBITDA multiple
Danaher (NYS: DHR | FYE 12/31)	**78.2%**	**7.6x**	**25.1x**
Roper Technologies (NAS: ROP | FYE 12/31)	**74.9%**	**10.5x**	**24.3x**
Avantor (NYS: AVTR | FYE 12/31)	**73.0%**	**3.0x**	**19.0x**
Mesa Labs (NAS: MLAB | 03/31)	**71.4%**	**5.0x**	**28.7x**
Agilent Technologies (NYS: A | FYE 10/31)	**59.9%**	**4.6x**	**19.2x**
Veralto (NYS: VLTO | FYE 12/31)	**57.0%**	**4.5x**	**18.5x**
Trimble (NAS: TRMB | FYE 12/31)	**52.2%**	**4.3x**	**21.0x**
Fortive (NYS: FTV | FYE 12/31)	**43.1%**	**4.6x**	**17.8x**
Hexagon (STO: HEXA B | FYE 12/31)	**38.0%**	**5.3x**	**17.0x**
Honeywell (NAS: HON | FYE 12/31)	**35.0%**	**4.1x**	**17.2x**
Rockwell Automation (NYS: ROK | FYE 09/30)	**31.9%**	**3.7x**	**20.3x**
Keysight Technologies (NYS: KEYS | FYE 10/31)	**23.0%**	**3.9x**	**13.7x**
Schneider Electric (PAR: SU | FYE 12/31)	**18.0%**	**2.5x**	**13.6x**
Siemens (ETR: SIE | FYE 09/30)	**9.4%**	**1.8x**	**9.5x**
Spectris (LON: SXS | FYE 12/31)	**5.7%**	**2.6x**	**15.6x**
Sandvik (STO: SAND | FYE 12/31)	**4.2%**	**2.4x**	**10.6x**

Looking at the trading multiples, it is apparent that valuation multiples are positively correlated with revenue quality, at a statistically significant level (*$p < 0.01$*). Digging deeper, as shown in Figure 2, the R-squared value reveals that the percentage of high-quality revenue explains approximately 74% of the observed variability in the companies’ EV/EBITDA multiple. This correlation suggests that public-market investors place a premium value on companies able to demonstrate a higher percentage of more predictable revenue — whether through recurring consumables, services or software.

1. Multiple data sourced from Pitchbook on March 29, 2024 for each company’s fiscal year end.
2. High-quality revenue percentage taken from annual reports, investor presentations and/or investor press releases pertaining to the relevant period. Here, we define high-quality revenue as recurring revenue as disclosed; to the extent this was not reported, software revenue was used as a proxy.

Disclaimer: Revenue quality is one of several value-creation drivers. We do not recommend using revenue mix as a single input for defining a valuation multiple.

Figure 2: EV/EBITDA Multiple



To that end, we introduced the ***Revenue-Quality Podium*** to provide management teams, investors and industry stakeholders with an easily understandable benchmark to track value creation as companies transition to a higher share of high-quality revenue. As the graph above highlights, we see three distinct valuation clusters defined by the revenue quality mix: Bronze, Silver and Gold (just like the medals worn by athletes on an Olympic podium).

It is important to note that revenue quality is one of many qualitative and quantitative parameters that influence the specific valuation of any given business. The Revenue-Quality Podium framework is used most effectively in determining at what end of the range a company should expect to be valued relative to its specific comparable set and other key factors such as scale, organic growth rate, profitability, size and diversity of customer base and TAM, among other considerations.[4]

4. Disclaimer: Revenue quality is one of several value-creation drivers. We do not recommend using revenue mix as a single input for deriving a company’s valuation.

Case Studies

As investor preference has shifted toward businesses with higher-quality revenue, many publicly traded ITLST companies increasingly emphasize high-quality revenue growth as a key strategic priority in investor communication. Roper, Danaher and Trimble are among the companies most vocal about this focus.

Roper Technologies

Roper, based in Sarasota, Florida, designs and develops vertical software and technology-enabled products for customers in the healthcare, water, food, transportation and commercial construction markets worldwide.

Figure 3: Roper Percentage of Revenue from Software

Roper has demonstrated its strategic emphasis on recurring and reoccurring revenue throughout the company's recent annual reports and investor presentations. Likely the most robust signal emphasizing this shift is Roper's rationale for the disposal of several assets in 2021, as described in the company's 2021 annual report.

> *"These disposal activities, in the aggregate, represented a strategic shift that will have a major effect on our operations and financial results. These divestitures significantly enhance our mix of high-margin, recurring revenue businesses."*

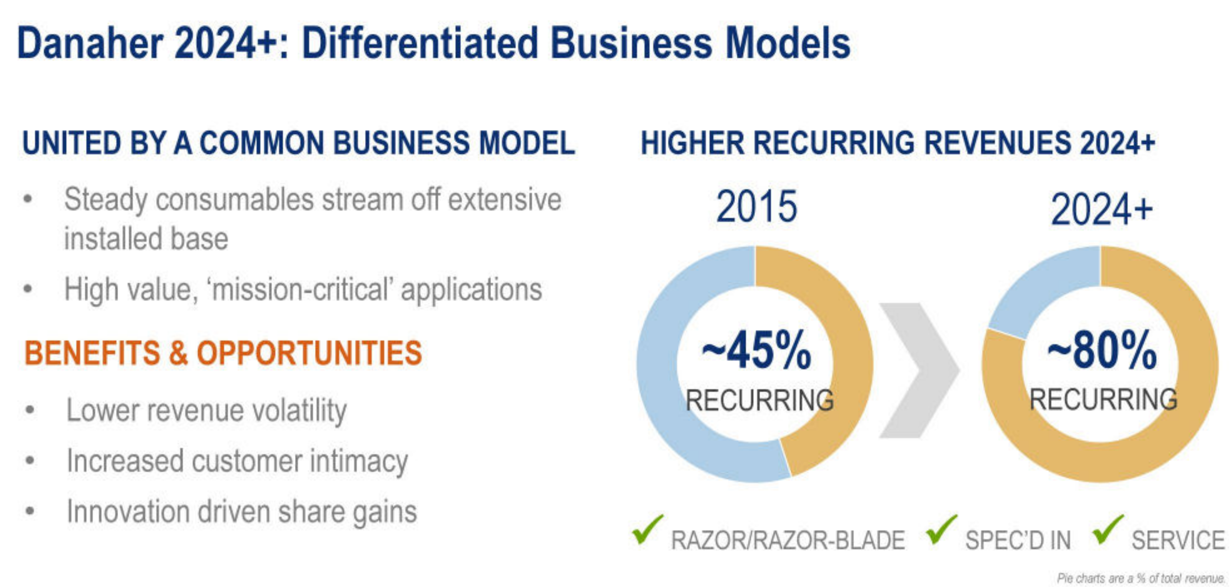
Danaher

Danaher, based in Washington, D.C., produces medical, industrial and commercial products and services globally, primarily for customers in the life-sciences and diagnostics sectors.

Figure 4: Danaher Percentage of Revenue Recurring

Among the publicly traded companies we track, Danaher is perhaps the most vocal in highlighting its focus on recurring revenue. This focus is most evident in Danaher's 2022 investor presentation, in which company leadership set a target of approximately 80% recurring revenue by 2024, which it appears on track to achieve.

Featured in Danaher's ***2022 Investor & Analyst Day*** Presentation



Trimble

Trimble, based in Westminster, Colorado, is a software, hardware and technology services company with customers across global industries, primarily in the agriculture, construction, geospatial and transportation sectors.

Figure 5: Trimble Percentage of Revenue Recurring

Similarly, Trimble notes "*a continued shift in revenue towards a more significant mix of software and recurring revenue, including subscription, maintenance and support and services revenue*" as a key strategic priority in its 2022 annual report.

The Battery Perspective

High-quality revenue is clearly linked to company valuation – evidenced both by our analysis and by the increasing strategic emphasis by leading public companies. Our ITLST team sees high-quality revenue as an important heuristic for our practice as we endeavor to provide strategic insight to our portfolio companies. More broadly, we see revenue quality, as charted through the Revenue-Quality Podium, as an important framework for all stakeholders to think about as more and more companies – public and private – increasingly pivot toward more recurring revenue streams.

To that end, we endeavor to help our companies grow their share of high-quality revenue by investing in organic initiatives, such as shifting to contractually recurring revenue models, and through inorganic initiatives, such as making add-on acquisitions that add complementary products with recurring revenue to the existing platform.

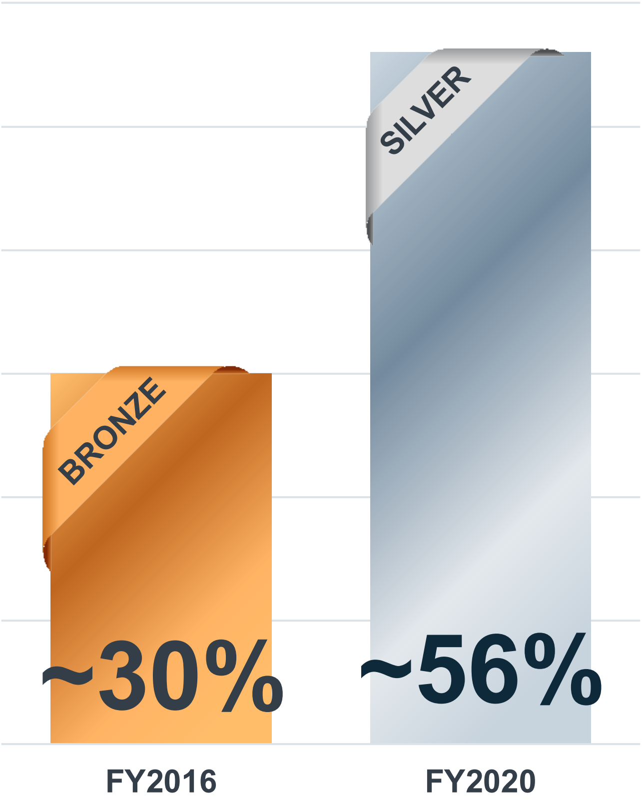
Here are three specific examples from our existing portfolio:

PST
PROCESS SENSING TECHNOLOGIES

The PST* platform started with an initial investment in Michell Instruments, a UK-based, founder-owned business that served as the starting point for a broader platform, Process Sensing Technologies (PST). At the time of our 2016 investment, the company had about 30% high-quality revenue.[5] As we supported the company through organic initiatives and seven acquisitions, **PST's share of high-quality revenue improved from Bronze to Silver over a four-year period, with approximately 56% high-quality revenue at the time of our partial exit to AEA in 2020**.

Alongside AEA, we have continued to support PST's growth strategy with an ongoing emphasis on high-quality revenue growth.

Figure 6: PST Percentage of Revenue Recurring



*Denotes a Battery portfolio company. For a complete list of investments, please visit: battery.com/list-of-all-companies/

5. High-quality revenue here defined to include revenue from services, OEMs and revenue from <$6.5k end orders.

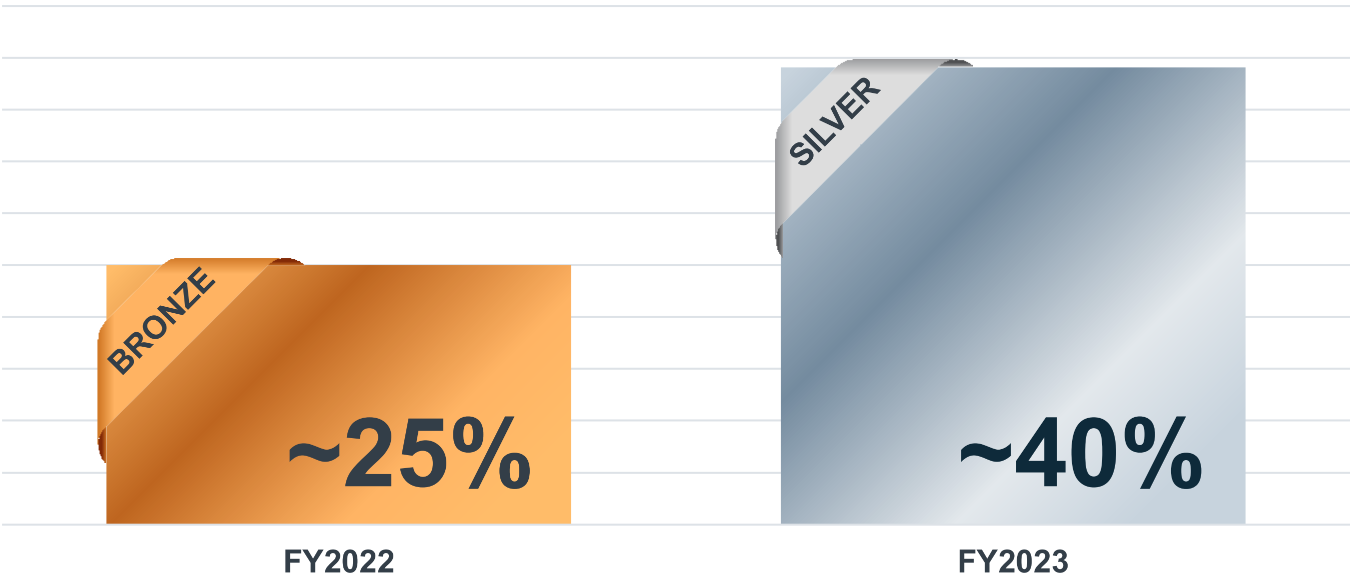
Skalar

We made our original investment in Skalar*, a second-generation, management-owned business based in the Netherlands, in March 2023, at which time the company reported approximately 25% high-quality revenue.[6] Through our partnership, Skalar has implemented several notable organic initiatives, including defining incentives for sales teams to prioritize consumables and service-contacts sales and adding dedicated account managers to emphasize contract renewals.

In addition, we supported the company's pursuit of higher-quality revenue through the acquisitions of LCTech and EST Analytical, which, at the time of acquisition, reported approximately 65% and 50% high-quality revenue, respectively.

Since our initial acquisition, **Skalar has seen high-quality revenue increase from approximately 25% to over 40% through a combination of organic and inorganic initiatives.** We are excited about the additional initiatives we have planned to continue fueling growth of high-quality revenue as we strive to transition the platform across the Revenue-Quality Podium.

Figure 7: Skalar Percentage of Revenue Recurring



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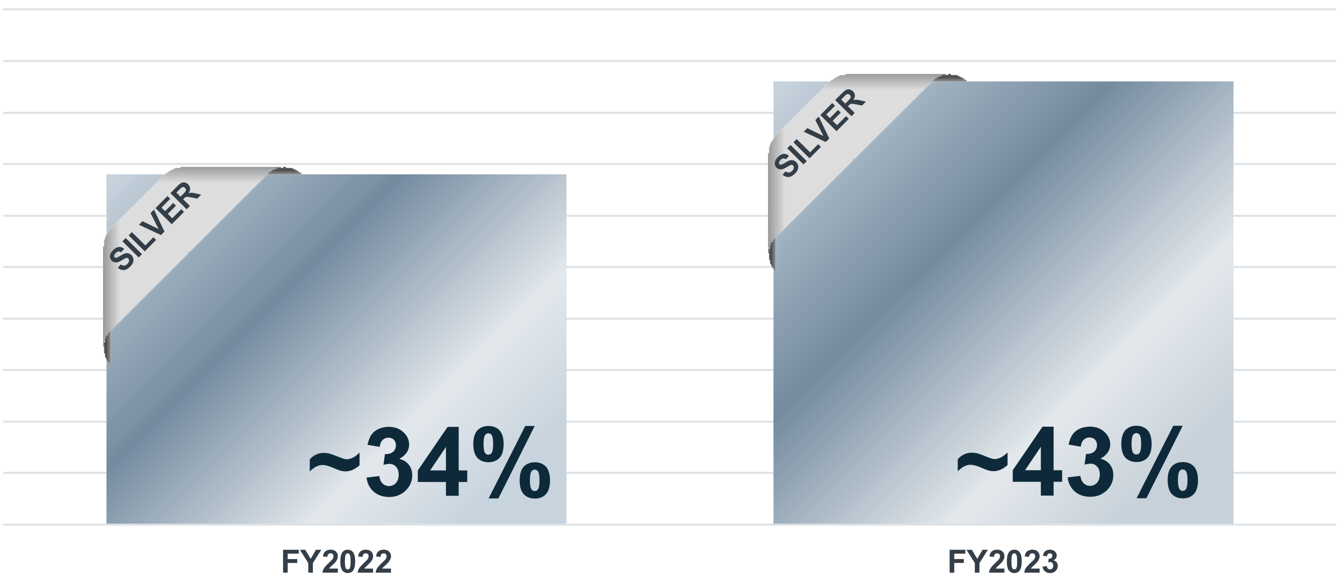
6. High-quality revenue here defined to include spares, consumables and services.

We invested in Proemion*, a German family-owned business, in November 2022 as the company was transitioning from its hardware-centric heritage to a hardware-enabled software model. Our team has helped Proemion hire key executives, including a chief revenue officer and chief financial officer, with deep enterprise software-as-a-service (SaaS) experience to help unlock customer-base analytics and to execute on a large subscription-revenue opportunity to enhance its high-quality revenue.[7]

Since our initial investment, **Proemion has grown its ARR by 30% organically and has increased the share of subscription revenue from 34% to 43%.** In addition, Proemion has signed an agreement to acquire TrendMiner NV, a complementary industrial asset analytics-software provider, which is expected to more than double the company's ARR. Alongside the Proemion team, we are excited to continue investing in strategic organic growth initiatives and executing further add-on acquisitions to increase high-quality revenue as the company scales.

Figure 8: Proemion Percentage of Revenue Recurring



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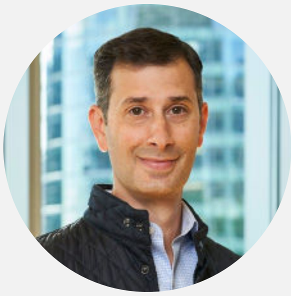
7. High-quality revenue here defined as subscription-software revenue.

Our ITLST Team

With two decades of experience working with more than 80 ITLST companies, our team is well-equipped to help scale high-quality revenue organically and inorganically. We pride ourselves on rolling up our sleeves, providing thoughtful insights and feedback informed by market trends, and leveraging technology to create value for founders, entrepreneurs and management teams.

If we can be helpful to you on your company's journey, please get in touch.

Meet the Battery Industrial Tech and Life-Science Tools Team



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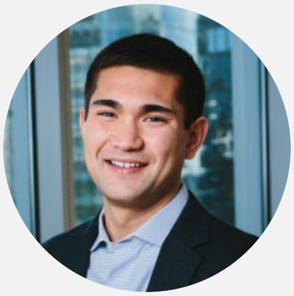

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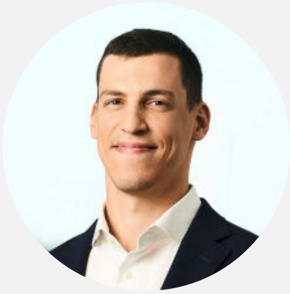

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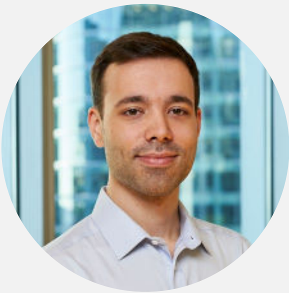

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