Tech Insights #371
The Rule of X

Mergers & acquisitions
Corporate finance advisory
Capital raising
12 May 2025

Clare Capital

Overview

The 'Rule of X' is emerging as a modern adaptation of the widely recognised 'Rule of 40' for SaaS businesses, offering an updated approach to assess performance. The Rule of 40 is a benchmark where the sum of a company's revenue growth rate and free cash flow margin should equal or exceed 40%. Developed by Bessemer Venture Partners (BVP), the Rule of X adopts a more nuanced evaluation, emphasising growth over profitability.

The tables below show how the Rule of X and Rule of 40 are calculated for selected US-listed cloud companies, along with average values for the top, middle, and bottom 28 companies (by EV / NTM revenue) out of a group of 84 US-listed cloud companies.

Rule of X = (annual revenue growth x multiplier) + free cash flow margin

vs

Rule of 40 = annual revenue growth + free cash flow margin

Rule of X: BVP good, better, best framework	
Best	~70%
Better	~50%
Good	~40%

Selected company	Revenue growth (LTM)	FCF margin (LTM)	Rule of 40	Rule of X multiplier	Rule of X	EV / NTM revenue
Autodesk	13%	22%	35%	2.0	48%	9.5x
Gitlab	32%	(15%)	17%	2.0	49%	9.3x
Smartsheet	19%	20%	39%	2.0	57%	5.7x
Braze	28%	1%	29%	2.0	58%	5.7x
Zoom Communications	3%	37%	40%	2.0	43%	3.8x
Sprout Social	22%	6%	27%	2.0	49%	3.7x

All companies (n=84)	Revenue growth (LTM)	FCF margin (LTM)	Rule of 40	Rule of X multiplier	Rule of X	EV / NTM revenue
Top 28 companies (average)	24%	20%	44%	2.0	67%	11.0x
Middle 28 companies (average)	17%	18%	35%	2.0	51%	6.2x
Bottom 28 companies (average)	11%	12%	23%	2.0	33%	2.8x
Average	**17%**	**16%**	**34%**	**2.0**	**51%**	**6.6x**

Note: FCF = Free cash flow, EV = Enterprise value, LTM = Last 12 months, NTM = Next 12 months.

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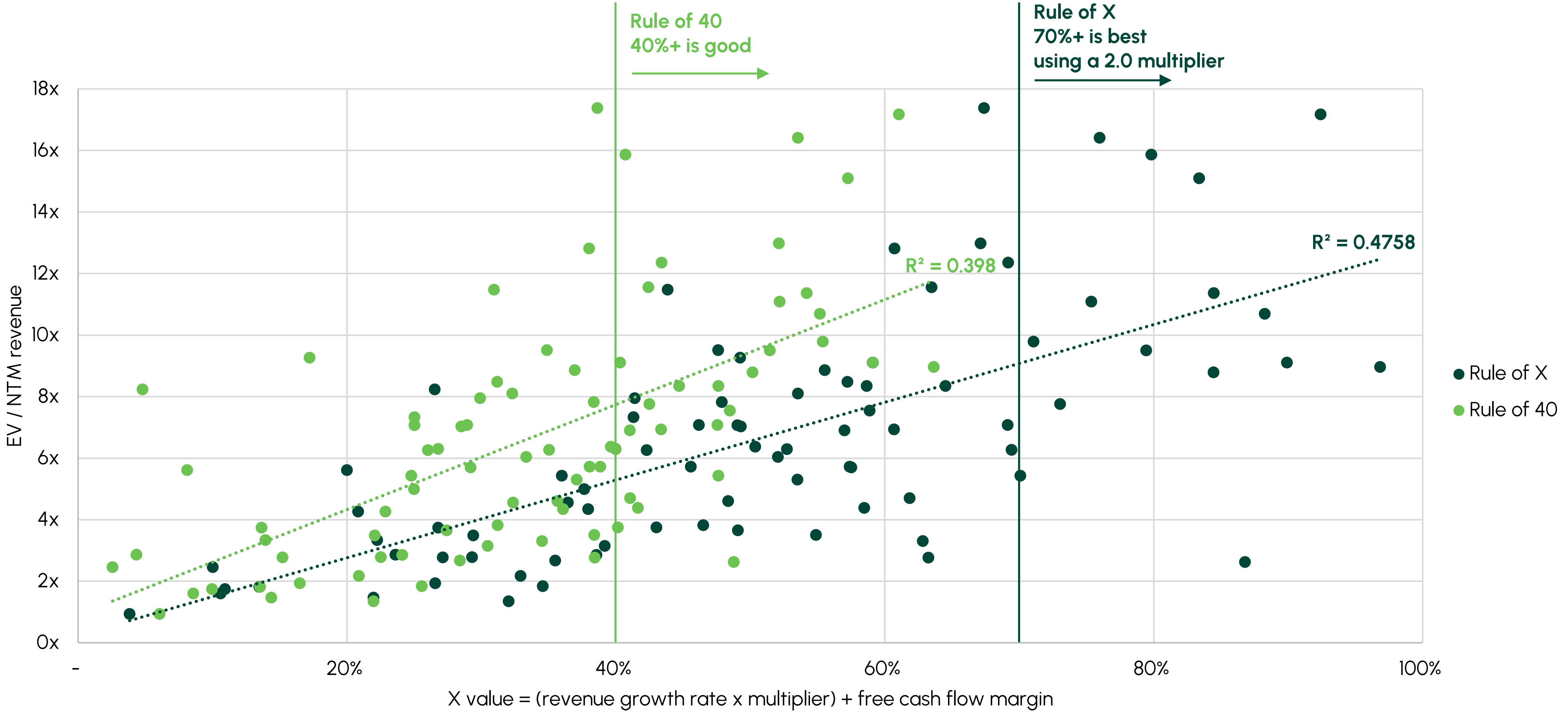
Comparing the correlation of the Rule of X against the Rule of 40 as at 31 December 2024

Calculating the Rule of X by applying a 2.0 multiplier to the LTM revenue growth of US-listed cloud companies resulted in a higher R^2 correlation compared to using no multiplier (i.e. the Rule of 40) as at 31 December 2024. However, it should also be noted that both correlations are below 0.5, and performing the same analysis for different historical periods shows this relationship can (and does) move around over time.



Note: We have removed certain outliers from the calculations: where revenue growth is above 100%, the revenue multiple is above 40x, or the Rule of 40 is negative.