

salesforce.com, inc. (CRM)

Alert: Acquisition in Marketing is Not a Surprise but the "Exact Target" Is

- **Acquisition of Exact Target for \$2.5B in cash** — The purchase price of \$33.75 per share represents a 53% premium to last close and, at 8x EV/LTM revenue, is a rich price. The high price and commentary on the call suggests the process was competitive and we'd expect SAP and potentially IBM were also interested. Salesforce.com will fund the acquisition with cash on hand plus a term loan to give flexibility (without tapping into longer-term liquidity).
- **Financial impact** — As we've expected for some time, any acquisition in the marketing space was going to be dilutive and this is the case for ET. Management noted \$0.16 of dilution for FY14. Assuming consensus ET revenue for 2HCY13 of \$197M and subtracting \$60-70M for deferred revenue write-down (accounting treatment that hits the first year of acquired revenue hard), this leaves roughly \$7M in cushion for the other factors including lower professional services revenue (as CRM pushes this to partners), inter-company transactions, and some cushion for potential business disruption. We believe it will be important for management to outline the impact of ET on the top-line (revenue, billings and bookings) as any obscurity will cause investors to question organic growth. We will readdress our estimates closer to the close of the transaction, which is expected to be in mid-July.
- **ET is a good fit, but not the best fit, in our view** — ET brings a suite of marketing automation products, with a core around email and a fledgling lead management system. We believe it is this lead management system that is really the strategic component and ET having only recently acquired this point (Pardot acquisition closed Oct 2012), leaves this core piece as a work in progress. Stepping back and looking at the chronology of CRM's Marketing Cloud, it is clear to us the company made a strategic error in buying adjacent assets (Buddy Media and Radian 6) before the core. By waiting for the core, CRM passed on others assets (ELOQ/MKTO) at lower valuations, leaving CRM with sub-optimal alternatives. Beyond this issue, we have always, and continue to believe that CRM is in a very good position to up-sell Marketing into its base of Sales and Service customers and with 12-24 months of focused R&D effort, ET's marketing solution can be market leading.
- **Stock view** — The shares may tread water in the near-term as investors digest this acquisition, notably the larger purchase price (\$2.5B vs. consensus view of ~\$1B). Key will be execution, where we give the benefit of the doubt to CRM, and disclosure, where CRM has set the standard for helping investors understand the impact of various factors on its growth trajectory. Assuming the company grows 25% organically in FY14, we expect the stock can work towards our \$48 price target. Beyond this, we continue to believe the company is emerging as the leader in the next-generation of "front office" applications, with marketing a key part of that and ET strengthening the CRM product portfolio.

Buy	1
Price (04 Jun 13)	US\$39.74
Target price	US\$47.75
Expected share price return	20.2%
Expected dividend yield	0.0%
Expected total return	20.2%
Market Cap	US\$23,444M

Price Performance (RIC: CRM.N, BB: CRM US)



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See Appendix A-1 for Analyst Certification, Important Disclosures and non-US research analyst disclosures.

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salesforce.com, inc.

Valuation

Our \$47.75 price target for salesforce.com is based on a 10-year discounted cash flow with a terminal value based on a 12x multiple. We are assuming revenue growth of 28% in years 3-5 and long-term (years 6-10) growth of 18%. Over the next 10 years, we also assume the company will drive 17 points of margin expansion to reach terminal margins of 30%.

Risks

Our rating is based on our belief that CRM will continue to drive above-consensus top-line growth and cash flow growth. Key risks include the inability of salesforce.com to sustain productivity while rapidly expanding its sales force, new business such as marketing and Chatter that might not materialize into sizeable businesses, increased M&A that could dilute margins and elevate execution risk, and a market premium on growth that could disappear as the risk trade reverses. If the impact on the company from any of these factors proves to be greater than we anticipate, the stock will likely have difficulty achieving our target price.

Appendix A-1

Analyst Certification

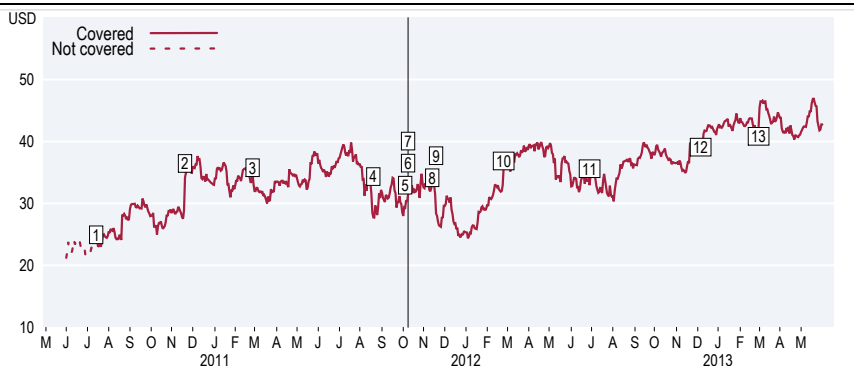
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salesforce.com, inc. (CRM)

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Analyst: Walter H Pritchard, CFA
Covered since July 14 2010



	Date	Rating	Target Price	Closing Price
1	14-Jul-10	2H	*24.50	23.93
2	19-Nov-10	2H	*31.00	34.19
3	25-Feb-11	2H	*36.25	34.71
4	19-Aug-11	2H	*33.25	27.75
5	5-Oct-11	2H	*30.50	29.31

	Date	Rating	Target Price	Closing Price
6	8-Oct-11	Stock rating system changed		
7	8-Oct-11	*2	30.50	30.24
8	14-Nov-11	*1	*39.50	33.38
9	18-Nov-11	1	*38.00	28.36
10	24-Feb-12	1	*40.75	35.91

	Date	Rating	Target Price	Closing Price
11	28-Jun-12	1	*40.50	32.95
12	6-Dec-12	1	*47.50	39.35
13	28-Feb-13	1	*47.75	42.31

* Indicates change

Rating/target price changes above reflect Eastern Standard Time

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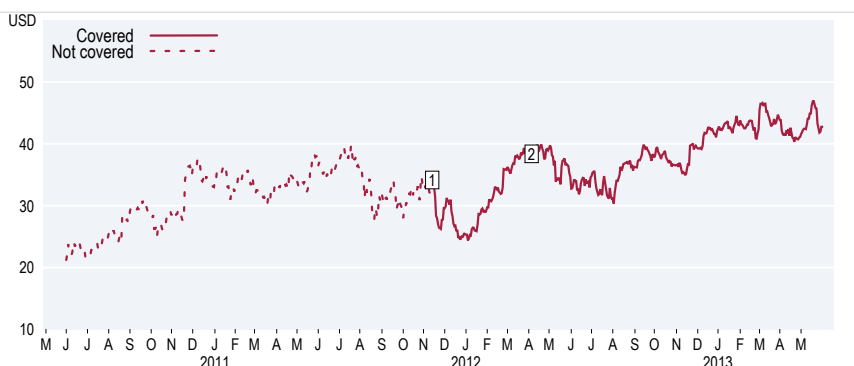
Ratings and Target Price History

Best Ideas Research

Relative Call (3 Month)

Analyst: Walter H Pritchard, CFA

Covered since July 14 2010



Date	Rating	Target Price	Closing Price
[1] 14-Nov-11	*ADD MP	-	33.38

* Indicates change

Date	Rating	Target Price	Closing Price
[2] 5-Apr-12	*REM MP	-	39.26

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12 Month Rating			Relative Rating		
Buy	Hold	Sell	Buy	Hold	Sell
48%	39%	12%	7%	87%	7%
53%	49%	43%	65%	49%	51%

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