

19 September 2013 | 8 pages

Application Software (GICS) | Application Software (Citi)
North America | United States

salesforce.com, inc. (CRM)

Alert: Marketing Cloud Remains Clear Incremental Opportunity, Execution the Key

- **Connections 2013** – We spent two days at Connections 2013, ExactTarget's user conference. Salesforce.com had analyst session at the conference, which had 6,000 attendees, up significantly over 4,000 last year.
- **Framing the marketing opportunity** – CFO Graham Smith showed statistics on the total addressable market in customer relationship management to highlight Marketing as 1) perennially underestimated in size and 2) growing significantly faster than Sales or Service (21% forecasted CAGR vs. 13-14% for core businesses). Anecdotal conversations with customers and partners suggest that digital marketing penetration is still relatively low, even at many B2C businesses.
- **No hard data points on synergies as yet** – ET had 10-11K customers, compared to salesforce.com's well over 100K, so the cross sell opportunity of ET into the CRM base is significant. Management pointed to qualitative metrics on revenue synergies, focusing on the quality of introductions of ET in new accounts (i.e. new access to higher-level decision makers).
- **Distribution constrained** – ET CEO Scott Dorsey believes the company had underhired in the 2012 timeframe, leading to distribution constraints. At the time of acquisition, ET had 400 account executives, leading to situations where key enterprise prospects had 1/10 of an FTE's coverage. salesforce is seeking to expand this number significantly through organic hiring of new reps, repurposing Buddy Media and Radian6 reps, and by tapping the mother ship for account leads.
- **The suite opportunity** – ET has had a historical focus on e-mail, but the company had made acquisitions over time to broaden its focus to multiple channels. Our conversations with companies at the conference confirms management's suggestion that a) the market today is highly silo'ed and b) that companies want to consolidate on a single platform. This could be a significant driver of organic revenue growth at ET, which seems to have the best bundle of multichannel assets.
- **Pardot is stepping into the enterprise opportunity** – Pardot co-founder Adam Blitzer acknowledged that Pardot historically did not focus on the enterprise due to its bootstrap focus. This led to gaps in enterprise capabilities (R&D investment choices as well as legal resources to craft agreements). But recent product announcements such as asset permissions and custom object integration have closed some of these gaps, and the company has started closing some large wins.

(continued on 2nd page)

Buy	1
Price (19 Sep 13)	US\$53.25
Target price	US\$50.00
Expected share price return	-6.1%
Expected dividend yield	0.0%
Expected total return	-6.1%
Market Cap	US\$31,414M

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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- **Product direction hints at ambitions for Big Data warehouse** – ET plans to continue to focus on its Fuel platform, which will be the basis for the Marketing Cloud going forward. Fuel has the ability to ingest significant amounts of customer data including clickstreams, purchase histories, and more. At the conference, ET announced Contact Builder and Journey Builder products, apps that enable Fuel to better analyze and run campaigns using the data resident in Fuel.
- **Integration, product rationalization needs to take place** – Pardot is increasing its integration with Force.com to reduce the amount of data that needs to be passed back and forth, and ultimately may be re-written on Force.com. Both steps should be significant differentiators over other marketing automation products, which will still rely on congested API call traffic to facilitate that integration. There is clear overlap between elements of ET's solution and Buddy Media and Radian6, but we were unable to get clarity on how these products will be rationalized.
- **Foreshadowing expansion into e-commerce?** – In the TAM discussion, Smith showed e-commerce as another pillar of the CRM market, as defined by Gartner. When asked, Smith denied having any plans to enter this market, but we believe salesforce's increasing push into B2C via ET as well as market moves by other key CRM players – Oracle (acquired ATG) and SAP (acquired Hybris) – make this move an inevitability for a company that plans to own the front office suite of applications.

salesforce.com, inc.

Valuation

Our \$50 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 30% in years 3-5 and long-term (years 6-10) growth of 20%. Over the next 10 years, we also assume the company will drive 18 points of margin expansion to reach terminal margins of 27%.

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

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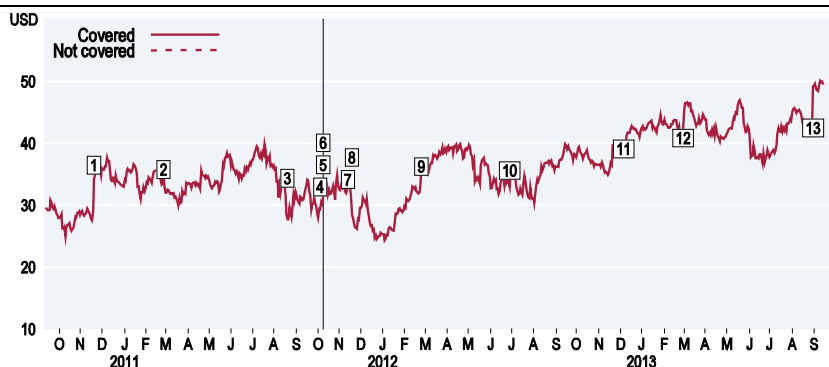
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salesforce.com, inc. (CRM)

Ratings and Target Price History

Fundamental Research

Analyst: Walter H Pritchard, CFA



Date	Rating	Target Price	Closing Price
1 19-Nov-10	2H	*\$31.00	34.19
2 25-Feb-11	2H	*\$36.25	34.71
3 19-Aug-11	2H	*\$33.25	27.75
4 5-Oct-11	2H	*\$30.50	29.31
5 8-Oct-11	Stock rating system changed		

Date	Rating	Target Price	Closing Price
6 8-Oct-11	*2	30.50	30.24
7 14-Nov-11	*1	*\$39.50	33.38
8 18-Nov-11	1	*\$38.00	28.36
9 24-Feb-12	1	*\$40.75	35.91
10 28-Jun-12	1	*\$40.50	32.95

Date	Rating	Target Price	Closing Price
11 6-Dec-12	1	*\$47.50	39.35
12 28-Feb-13	1	*\$47.75	42.31
13 30-Aug-13	1	*\$50.00	49.13

* Indicates change

Rating/target price changes above reflect Eastern Standard Time

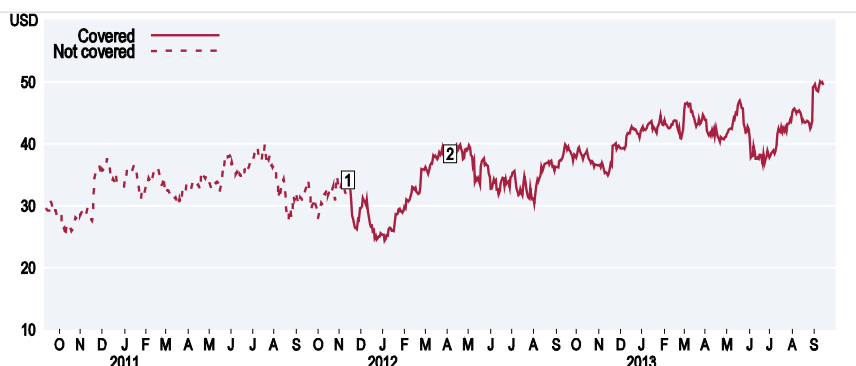
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Ratings and Target Price History

Best Ideas Research

Relative Call (3 Month)

Analyst: Walter H Pritchard, CFA



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

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

* Indicates change

Rating/target price changes above reflect Eastern Standard Time

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Data current as of 30 Jun 2013

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% of companies in each rating category that are investment banking clients

12 Month Rating			Relative Rating		
Buy	Hold	Sell	Buy	Hold	Sell
48%	40%	12%	6%	88%	6%
53%	50%	45%	58%	51%	49%

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