

# Salesforce Firing On All Cylinders

## Client Briefing Note

4 June 2018



# Performance Highlights

- Reported an impressive quarter – another in a long string of robust quarters.
- No signs of decelerating top-line growth despite surpassing \$12bn ARR.
- Benefiting from sustained tailwinds in IT spending, fueled largely by a push for digital transformation, data analytics and AI.
- Organic growth of 20% complemented by a steady stream of M&A.

## Putting Salesforce's Latest Results into Perspective

Salesforce grew revenues by 25% YoY in Q1 FY19, consistent with its remarkable historical performance. The company generated double-digit growth in all relevant metrics, exceeded analyst expectations and its previous guidance, and raised its outlook for future performance across the board. Growth is showing no signs of decelerating, despite the company surpassing \$12bn in ARR.

The latest results build on exceptional momentum from fiscal 2018, which was a record year for Salesforce, and from Q4 '18, which was the company's best quarter ever. In 2017, Salesforce managed to increase its CRM market share by more percentage points than the rest of the top 20 vendors combined.

## What is Driving Outperformance?

### 1) Structural Growth

Salesforce is benefiting from strong tailwinds in IT spending, fueled largely by a push for digital transformation, data analytics and AI. Sales Cloud remains the company's largest line of business with about 34% of corporate subscription and support revenue this past quarter. The company's ability to execute within that space, and to grow at a 16% rate, suggests that it is gaining market share. And it is probably also a testament to the rapid acceptance of solutions with Sales Cloud based on Einstein AI, Salesforce's catch-all brand for the intelligence layer underlying the platform.

### 2) Acquisitions

The company's 20% organic growth is complemented by a steady stream of M&A. Most recently Salesforce closed its acquisition of MuleSoft which will converge into Salesforce Integration Cloud. The company's current year guidance of 24-25% YoY growth includes \$315 million from MuleSoft.

### 3) International Expansion

Salesforce still has a substantial unfulfilled business opportunity outside the US. This past quarter, revenues in Europe jumped 48% (31% on a constant currency basis) to c. 20% of the total. Management believes that such a percentage growth leaves significant room for further upside.

# Outlook

## The Drive to \$20 Billion ARR

A consistent message from the management team is that Salesforce aims to surpass \$20 billion in revenue faster than any other software company in history. At the current trajectory of organic and acquisitive growth, this milestone could be reached by 2022 as Salesforce transforms itself from a “system of engagement” to a “system of intelligence” and, ultimately, a “system of systems”.

## Bolt-On Acquisitions

Salesforce uses M&A to reshape or bolster its strategic direction. The company entered the business intelligence market following the acquisition of EdgeSpring, while the RelateIQ acquisition led to a major rethink of the company’s core Sales Cloud and its small-business strategy. Equally, the acquisitions of Pardot and ExactTarget signalled Salesforce’s foray into marketing automation.

Salesforce’s first acquisition of 2018 was Attic Labs, which was incorporated it into Quip – the document collaboration platform Salesforce bought in 2016 for \$750 million. Attic Labs’ tech will extend Quip’s ability to connect live data sources and facilitate collaboration.

In March Salesforce acquired long-time partner CloudCraze, a leading B2B ecommerce platform. Similar to quote-to-cash company SteelBrick, which Salesforce acquired in 2015 for \$360 million, CloudCraze too has been built natively on the Salesforce platform.

Meanwhile, through the \$6.5 billion acquisition of MuleSoft, Salesforce now provides one of the world’s leading platforms for building application networks that connect enterprise apps, data and devices across any cloud or on-premise, regardless of whether they connect with Salesforce or not.

### Be smart:

- With MuleSoft, Salesforce will be able to reach data trapped in isolated systems, regardless of whether they connect with Salesforce or not, and make it available to Einstein.
- Adobe's acquisition of Magento may lead to a countervailing acquisition by Salesforce.

## Impact on Profitability

Even though the company is not optimizing for this, GAAP operating margins increased to more than 6% this quarter compared to breakeven last year, primarily due to a disproportionately smaller impact from sales and marketing expenses. Looking ahead, the company expects year-over-year non-GAAP operating margin improvement to be flat to +25 bps, including c. 125 bps headwind from MuleSoft. This means that, even with the temporary impact of some of the more transitional issues one would expect with an M&A integration and deal cost, Salesforce still has an operating margin yield of approximately 24%.

# What's Next?

Firstly, the road to \$20 billion ARR will most likely take Salesforce beyond the strict confines of B2B. Management has long been signaling that they view every B2B company as becoming a B2B2C company. Marketing and Commerce Cloud, with its most recent revenue jump following the Demandware acquisition, is now 15% of total Salesforce revenues and it is reasonable to imagine it will continue to exert a positive impact on reported top line growth well into the future. Building on that, CloudCraze extends Salesforce into B2B, B2C and even B2B2C models. This TAM expansion may well be complemented by further acquisitions e.g. in the area of content management.

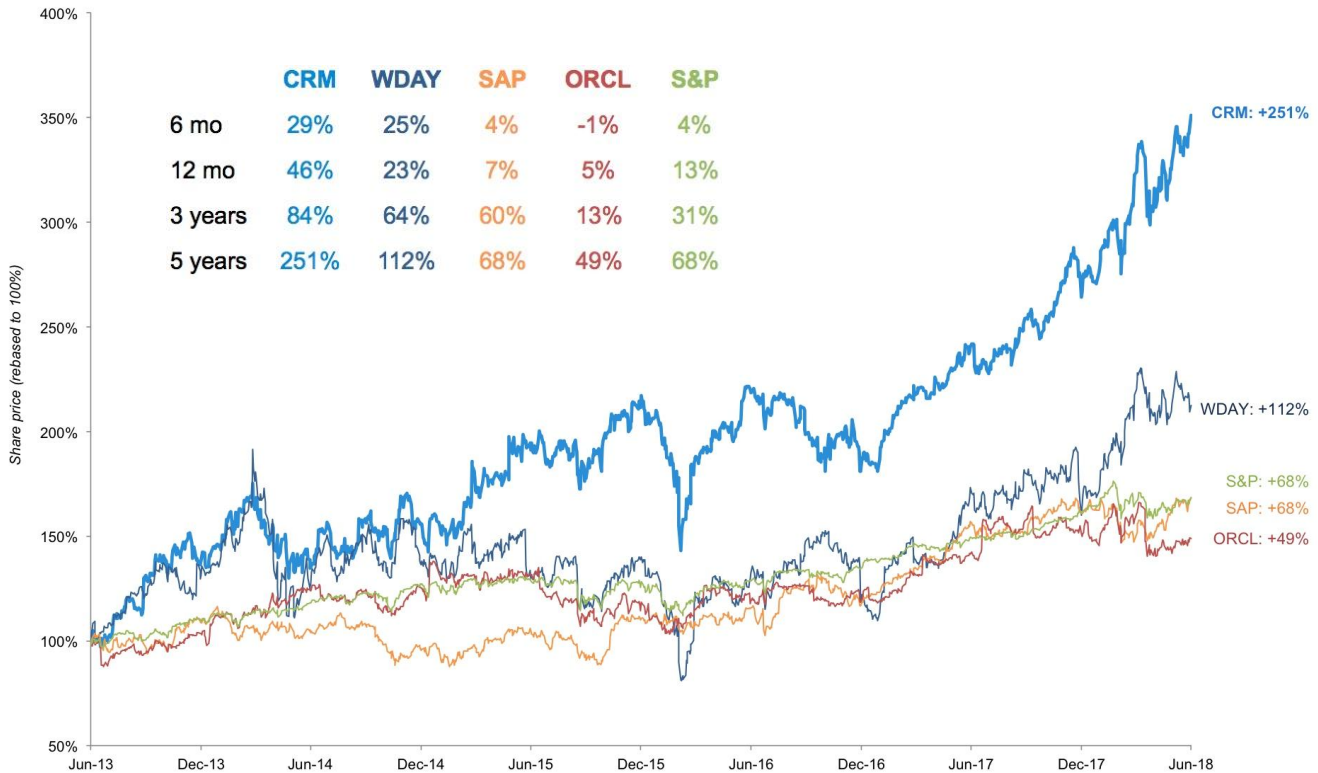
Secondly, Salesforce was one of the pioneers of the “ecosystem” approach. That business unit achieved growth of 36% last quarter. Fostering a symbiotic relationship with all of the companies that exist on its platform is an area in which Salesforce truly excels. The addition of Mulesoft to its product line will further enhance Salesforce’s ability to achieve outsize growth both in its core platform and across its other revenue streams.

Lastly, it is worth noting that MuleSoft’s on-premise installation capabilities do not mark a shift towards hybrid cloud for the company. Unlike some of its competitors, Salesforce’s core platform is still 100% public cloud and on-premise deployments are the necessary exception driven by the reality of many legacy architectures.

Salesforce delivered yet another remarkable quarter, outperforming expectations and delivering double-digit growth across segments and geographies. With a lofty valuation and its share price at an all-time high, markets certainly expect this performance to continue.

# Key Figures

## Share Price Performance vs. Peers



## Selected Financials

### Disaggregation of Revenue

#### Subscription and support revenue by cloud service offering (in millions):

	Three Months Ended April 30,	
	2018	2017 (as adjusted)*
Sales Cloud	\$ 965	\$ 830
Service Cloud	848	656
Salesforce Platform and Other	575	424
Marketing and Commerce Cloud	422	299
	<b>\$ 2,810</b>	<b>\$ 2,209</b>

#### Total revenues by geography (in millions):

	Three Months Ended April 30,	
	2018	2017 (as adjusted)*
Americas	\$ 2,101	\$ 1,765
Europe	606	409
Asia Pacific	299	223
	<b>\$ 3,006</b>	<b>\$ 2,397</b>

#### Total revenues by geography as a percentage of total revenues:

	Three Months Ended April 30,	
	2018	2017 (as adjusted)*
Americas	70%	74%
Europe	20	17
Asia Pacific	10	9
	<b>100%</b>	<b>100%</b>

Source: Salesforce 1Q2019 8-K

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