

Presentation

Operator

Good afternoon. My name is Hannah, and I will be your conference operator today. At this time, I would like to welcome everyone to the CRM Q1 FY '15 Earnings Conference Call. [Operator Instructions] I will now turn the call over to John Cummings, Director of Investor Relations. Sir, you may begin your conference.

John Cummings

Thanks so much, Hannah, and good afternoon, everyone, and thanks for joining us for our fiscal first quarter 2015 results conference call. Our first quarter results press release, SEC filings and a replay of today's call can be found on our website at www.salesforce.com/investor. We'll also post the highlights of today's call on Twitter at the handle @salesforce_ir.

With me on the call today are Marc Benioff, Chief Executive Officer; Keith Block, President and Vice Chairman; and Graham Smith, Chief Financial Officer. We'll start the conversation with a few prepared remarks, and then we'll turn the call over for questions.

As a reminder, our commentary today will be in non-GAAP terms. Reconciliations between our GAAP and non-GAAP results and guidance can be found in our earnings press release issued earlier today. During the call, we may offer additional metrics to provide further insight into our business or results, and this detail may or not be provided in the future. We may also reference certain unreleased services or features not yet available. We cannot guarantee the timing or availability of these services or features, so we recommend customers listening today to make purchase decisions based on services and features currently available.

The purpose of the call today is to provide you with information regarding our fiscal first quarter results. Some of our comments may contain forward-looking statements, which are subject to risks, uncertainties and assumptions. Should any of these risks and uncertainties materialize or should our assumptions prove to be incorrect, actual company results could differ materially from these forward-looking statements.

A description of risks, uncertainties and assumptions and other factors that could affect our financial results are included in our SEC filings, including our most recent report on Form 10-K, particularly under the heading Risk Factors. So with that, let me turn the call over to Marc.

Marc R. Benioff

Co-Founder, Chairman & Co-CEO

Okay, hey, thanks so much, John. I really appreciate it. And I'm absolutely delighted to be with you once again, and celebrating our 15 years of customer success here at salesforce.com. This quarter was a very important birthday for us. It gave us an opportunity to look back at how we've helped shape this new world of enterprise software, how we've grown to be the world's largest CRM company and the world's largest provider of enterprise cloud computing, and as you can see from these results, the fastest-growing top 10 software company in the world today. All in just 15 short years. It's been an exceptional journey, and we're very grateful to all of you who have been with us through this incredible 1.5 decades.

The new world of enterprise software is a world that's in the cloud, it's a world that's mobile, it's a world that's social, and it's a world that's connected. Our customers are connecting with their customers in entirely new ways. They're consistently turning to companies like Salesforce to make this customer connection. And this has driven this incredible business for us.

Whether they are looking for solutions for sales, for service, for marketing, for engagement or building custom apps, Salesforce has consistently delivered the world's best customer platform. And I'm proud of our employees, our customers and partners in what they've accomplished over the last 15 years, and I'm looking forward to our very bright future.

We're delighted this quarter to be once again chosen by Fortune Magazine as the World's Most Admired Software Company for the second year in a row, an incredible accomplishment. And earlier this year, Salesforce was recognized by Fortune as the World's 7th Place to Work -- 7th Best Place to Work. And we were Forbes Magazine Most Innovative Company in the World 3 years in a row.

And through our pioneering 1/1/1 model, we've now delivered more than 700,000 hours of community service, delivered more than \$50 million in grants and are running more than 20,000 nonprofit organizations on our service for free. Through all of this -- through all these accomplishments, nothing is more important to us than the trust and success of our customers.

This deep commitment to our customers and their success is why Salesforce delivered these exceptional results, especially now in this first quarter. Revenue grew by 37% from a year ago to more than \$1.2 billion, pretty incredible.

Deferred revenue grew by 34% year-over-year to more than \$2.3 billion. Operating cash flow grew by 67% from a year ago to more than \$470 million, and the dollar value of booked business on and off the balance sheet grew by 34% from last year's \$7.1 billion. And while we delivered world-class growth, we also grew operating margins sequentially this quarter, which is why we're able to deliver non-GAAP EPS of \$0.11, exceeding our guidance. And we'll deliver 125 to 150 basis points of operating margin improvement this year.

Given our strong financial results and pipeline of new business, we're once again raising our full fiscal year 2015 guidance by \$40 million to reach \$5.34 billion. With billions of users all over the world now using cloud services, mobile devices and social networks, the technology world has deeply changed. And Salesforce continues to lead this change in enterprise software.

Today, I run my business from my phone. I could never have imagined that just a few years ago. I don't need a PC, a laptop, a desktop to connect with my customers, employees or partners. I just need my phone. And that certainly isn't where software was a decade ago. At Salesforce, we've rebuilt all of our services under the new Salesforce1 Platform, giving our customers the ability to use phones, tablets, PCs or whatever they choose to manage and share all of their customer information.

The Salesforce1 Platform has far exceeded our wildest dreams in how it's accelerated the success of our customers, our ISVs, our developers, our administrators and their ability to be successful in this new world. And it's why our flagship Sales Cloud and Service Cloud, our ExactTarget Marketing Cloud and our platform are all leaders in the categories and growing faster than their competition.

The Sales Cloud is once again the undisputed leader in Gartner's Magic Quadrant for Sales Force Automation. In fact, we extended our lead this last year, according to Gartner, our market share and sales, now larger than the 3 next competitors combined.

Service Cloud is the clear leader in both vision and execution in Gartner's most recent Magic Quadrant for Customer Service. And with Desk.com, we're bringing our world-class customer service solutions to small businesses as well as to enterprises.

The ExactTarget Marketing Cloud doubled its market share, according to the recent Gartner report, adding more share than any other top 10 marketing vendor. And the Salesforce1 platform is the only solution rated by Forrester as a leader in every single category, platform category, and recognized leader in Gartner's first-ever Magic Quadrant for Enterprise Platforms.

Now I'm delighted to welcome our Vice Chairman and President, Keith Block, to the earnings call. And I'd like to ask Keith to introduce himself but also to give you a review of the quarter's results. We're very fortunate to bring in Keith over a year ago now. He's a member of our board and runs our distribution organization, which represents more than half of all our employees. Keith?

Keith G. Block
Co-CEO & Director

Thanks, Marc. It's great to be here. And I have to say that Salesforce is an absolutely incredible company. Over the past year, I've spent a great deal of time speaking with customers and partners all around the world, and the feedback has been overwhelmingly consistent. It's been about great vision, it's been about great products and it's been about great people.

And it's really rare to find a company whose customers and partners have such a high degree of respect and admiration on a consistent basis. And the great news is our customers and our partners, they want more from us. They want us to go deeper with them, they want us to have a more strategic relationship, they want us to help them innovatively transform their business models, they want us to help them scale their business for the future, and ultimately, at the end of the day, they want us to be their trusted advisor on their journey to connect with customers in entirely new ways. And this applies to every customer, from the smallest to the largest enterprises in the world.

Now in the quarter, we had some terrific success with companies of all sizes, across all industries, everywhere in the world, and I'd like to just share a few thoughts with you. For example, we entered into a new relationship with Manulife, one of the world's largest insurance and financial services providers. They selected the Service Cloud to create a single customer engagement platform and deliver personalized service across all their life insurance, wealth management and investment products, just a terrific story.

Meiji Yasuda Life Insurance, one of the oldest and largest insurance in Japan, we're thrilled to have that brand as part of our family. They selected Salesforce in the quarter, and this will be the first enterprise-wide cloud implementation in Japan's life insurance industry. Absolutely excited about this. They selected our Service Cloud to allow agents to close deals and service customers right from their phones. And they will also be building out their next-generation apps on Salesforce1. Very, very exciting.

In communications and media, Sky Italia selected Service Cloud, the Salesforce1 Platform, Salesforce Communities, all of which for an engine for the company's B2C communications business from call centers to self-service to partner channels.

In health care, another great brand, [indiscernible], started sales transformation with our Sales Cloud, and in the quarter, they expanded with ExactTarget Marketing Cloud, to leverage the power of social and connect directly with millions of people shopping for insurance. Many, many, many stories that we can go on to, but again, some terrific brands, some terrific stories.

And I certainly want to congratulate the team for their outstanding accomplishments in Q1, and I also want to thank our customers and our partners for their continued commitment to our collective success in futures. And I do want to say again that I'm absolutely thrilled to be part of this just outstanding organization.

So with that, I'll turn the call over to Graham.

Graham V. Smith

Former Executive Vice President

Thanks, Keith. We started fiscal 2015, as you've heard, with a really strong first quarter, growing revenue, deferred revenue and operating cash flow at more than 30% and coming in ahead of our EPS guidance. We are well positioned to deliver another year of industry-leading growth.

Let me take you through the financial highlights of our first quarter, starting with the income statement. First quarter revenue was \$1.23 billion, that's an increase of 37% and which did include an FX benefit of approximately \$6 million. Non-GAAP EPS for the first quarter was \$0.11.

On a regional basis, revenue in the Americas grew 39% to \$876 million. Revenue in Europe grew 42% in dollars and 35% in constant currency to \$231 million. And revenue in Asia Pacific increased 21% in dollars and 26% in constant currency to \$120 million. That's a nice uptick in growth after some of our recent quarters in Asia Pac.

Dollar attrition continued its slow and steady decline for the 19th consecutive quarter and remains in the high single-digits percentage range. Our non-GAAP gross and operating margins continued to reflect the

acquisition of ExactTarget last year. Gross margins were 79.5% in Q1, that's down 70 basis points from Q1 last year. And non-GAAP operating margin was 9.7%, which was down 80 basis points from Q1 last year, but actually up 280 basis points sequentially.

In the first quarter, we added more than 900 people. That's our most significant organic hiring quarter ever and brings our total headcount at the end of the quarter to just over 14,200, that's up 38% over Q1 last year.

Turning to the balance sheet, we ended the quarter with approximately \$1.5 billion in cash and marketable securities. During the quarter, we paid approximately \$280 million in principal related to conversions of our senior notes that are due in January 2015. This amount was partially offset by an approximately \$30 million deposit we received for the potential sale of 4 of our 8 lots we own in Mission Bay.

Deferred revenue ended the quarter at more than \$2.3 billion, up 34% over last year. Excluding approximately \$13 million of year-over-year FX benefit, deferred revenue increased 33%. On a sequential quarter basis, deferred revenue also had an FX benefit of approximately \$9 million. We expect Q2 deferred revenue to be approximately flat sequentially from Q1.

Approximately 68% of the value of all subscription and support-related invoices, and that includes ExactTarget, were issued with annual terms in Q1 compared with approximately 68% Q1 last year. Keep in mind, however, that our billing frequency percentage last year did not include ExactTarget. If you exclude ExactTarget from this quarter's calculation, we saw a year-over-year increase in the proportion of invoices issued with annual terms that is consistent with the fiscal 2014 average, that was around 5 percentage points improvement.

Unbilled deferred revenue or revenue that is contracted but not yet invoiced and is off the balance sheet was approximately \$4.8 billion in Q1. That's an increase of 33% over last year.

Turning to cash flow, we had an outstanding start for the year. As we talked about for some time, Q4 has historically always been our largest new business quarter and, as a result, has also become our largest renewals quarter. The seasonality of our invoicing has become more pronounced each year because of the compounding effects of the new business seasonality.

If Q4 is our largest invoicing quarter, it follows that Q1 has become our largest collections and operating cash flow quarter. So in the first quarter, operating cash flow was \$473 million, that's up 67% over last year. We anticipate our second quarter operating cash flow growth to be lower at approximately 10% year-over-year growth and continue to expect our full year operating cash flow to grow in the mid-20s percentage range year-over-year that we talked about on the call in February.

CapEx was \$60 million in the first quarter, up 11% year-over-year. CapEx as a percentage of revenue in the first quarter was 5%. That's down from 6% in Q1 last year. We continue to expect our full year CapEx to be in the range of 5% to 7% of revenue.

Free cash flow, which we define as operating cash flow less CapEx, was \$413 million in the first quarter. That's up 80% from last year.

Turning to guidance. With our solid results in the first quarter, we are delighted to be raising our full fiscal 2015 revenue outlook by \$40 million. That's a new range of \$5.3 billion to \$5.34 billion for year-over-year revenue growth of 30% to 31%. We're raising our full year non-GAAP EPS guidance to reflect the Q1 beat and now expect it to be in the range of \$0.49 to \$0.51.

And as Marc mentioned, we're still committed to increasing our full year non-GAAP operating margins by 125 to 150 basis points, but clearly, that assumes no significant M&A activity during the year. Our FY '15 non-GAAP EPS also assumes that other income and expense will continue to be a net expense and assumes a non-GAAP tax rate of 36.5%.

For Q2, we anticipate revenue in the range of \$1.285 billion to \$1.29 billion, representing year-over-year growth of approximately 34% to 35%. And we expect non-GAAP EPS in the range of \$0.11 to \$0.12. And

as a reminder, all of the underlying assumptions for our GAAP and non-GAAP guidance and a complete GAAP to non-GAAP reconciliation can be found in our earnings press release issued earlier today. So to close, Q4, the great start to the year for Salesforce, our really good solid execution across the business sets us up well to deliver another year of amazing industry-leading growth. So with that, we'll open the call up for questions.