

Software &amp; Services

## Salesforce.com, Inc. (CRM)

**RATING**  
**HOLD**
**PRICE TARGET**  
**NA**
**PRICE**  
**\$181.10**
**52-WEEK RANGE**  
**\$115.29 - \$195.72**

## COVID Hits CRM Sales, Guidance on Wrong Side of Growth + Profitability Profile

The COVID-driven macro impacted CRM as much, if not more, than expected, as 1QF'21 revenue and billings only modestly outperformed and EPS was negatively impacted by one-time charges. COVID hurt sales in Q1 and caused management to trim revenue growth guidance to the high single digits in 4QF'21. We were more perplexed by the lack of operating margin leverage we have seen accompany sales slowdowns at other SaaS peers as guidance suggests an \$0.08 EPS reduction when excluding \$0.06 in one-time COVID expenses. May sales trends are more encouraging and there were pockets of positivity like Commerce Cloud, but we remain HOLD rated as we believe the significant revenue growth deceleration combined with the lack of operating leverage create an unfavorable profile over the intermediate term.

**1Q revenue of \$4.865B came in ahead of our \$4.832B estimate while EPS of \$0.70 was inline with our estimates.** Total revenue increased 30.2% Y/Y, which includes the impacts from tableau and Salesforce.org, driven by higher subscription revenue.

**Metrics continue to rise on inorganic contributions.** Current RPO increased 23% Y/Y, with tableau and Salesforce.org contributing around 5pts of that growth, leading to total RPO of \$29.3B, or 18% Y/Y growth organically.

**COVID-19 impacts 1Q bottom line but pipeline remains strong for the remainder of FY21.** The company incurred approximately \$0.16 worth of EPS expense related to pandemic in the 1Q.

**FY21 guidance lowered.** Given the uncertainties surrounding the COVID-19 pandemic, management has decided to lower its FY21 revenue guidance from \$21B - \$21.1B, to \$20B, and its EPS guidance from \$3.16 - \$3.18 to \$2.93 - \$2.95.

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### KEY DATA

<b>Market Cap (MM)</b>	<b>\$162,883.5</b>
Price [05/28/2020]	\$181.10
52-Week Range	\$115.29 - \$195.72
Shares Outstanding	899.41
Avg. Daily Volume	6,470,758.5
Total Debt/Cap.	13.58%

### ESTIMATES

<b>FY (Jan)</b>	<b>2019A</b>	<b>2020A</b>	<b>2021E</b>
<b>EPS</b>			
Q1	0.74A	0.93A	0.70A
Q2	0.71A	0.66A	0.67E
Previous	—	—	0.74E
Q3	0.61A	0.75A	0.77E
Previous	—	—	0.78E
Q4	0.70A	0.66A	0.80E
Previous	—	—	0.82E
Year	2.75A	3.19A	2.95E
Previous	—	—	3.05E
Growth	103.9%	16.0%	(7.6)%
P/E	65.8x	56.8x	61.5x

### Rev. (MM)(\$)

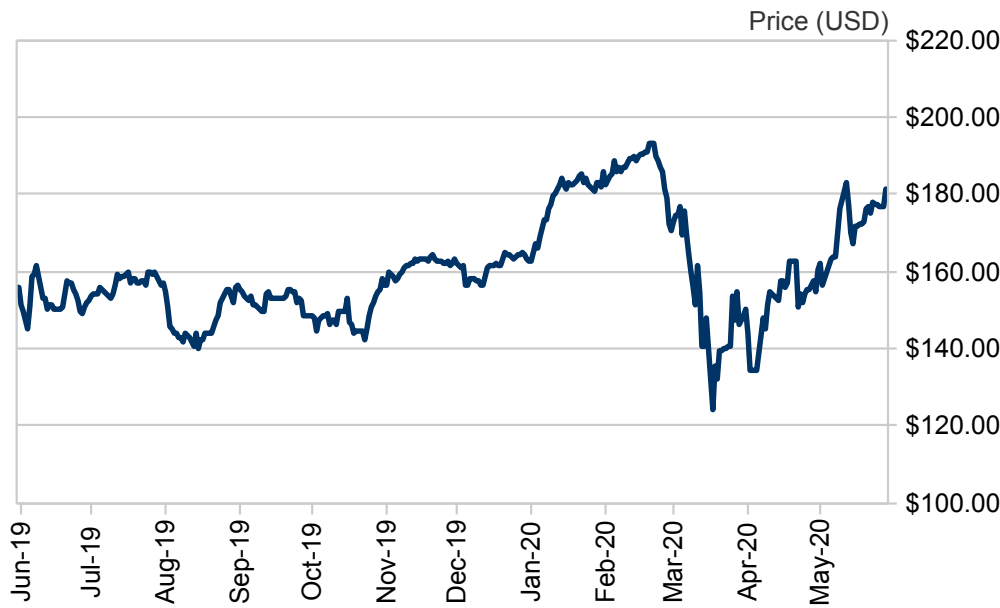
Year	13,282.0A	17,098.0A	19,993.5E
Previous	—	—	20,252.8E
Growth Rev	26.7%	28.7%	16.9%

### Op. Margin

Year	17.1%A	17.8%A	16.9%E
Previous	—	—	17.6%E

At a Glance

PRICE PERFORMANCE



KEY DATA

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**1Q revenue of \$4.865B came in ahead of our \$4.832B estimate while EPS of \$0.70 was inline with our estimates.** Total revenue increased 30.2% Y/Y, which includes the impacts from tableau and Salesforce.org, driven by higher subscription revenue. Subscription gross margin of 83.5%, contracted 10bps Y/Y. Operating expenses were 5.% higher than modeled, driven by 2/3 higher S&M and 1/3 R&D spend. Operating margin decreased 520bps Y/Y to 13.1% and were also below of our 17% estimate. The inline EPS was a result of approximately \$0.16 of pandemic related one-time charges (excluding the pulled forward termination fees), or a 350bps headwind to operating margins including the termination fees. Operating cash flow decreased \$106mm Y/Y to \$1.86B, mainly from lower deferred revenue, as customer payments were delayed due to shelter in place orders as well as some temporary financial flexibility granted to some customers that were affected by the pandemic.

**Metrics continue to rise on inorganic contributions.** Current RPO increased 23% Y/Y, with tableau and Salesforce.org contributing around 5pts of that growth, leading to total RPO of \$29.3B, or 18% Y/Y growth organically. Billings increased 20.2% Y/Y versus +24.7% in 1Q20 while deferred revenue grew 20.1% Y/Y versus +22.3% in 1Q20. Growth in the company's Sales Cloud improved from the low of +11.2% Y/Y in 1Q20 to +16%, though growing only 12% Y/Y when excluding contributions from Salesforce.org. Service Cloud growth improved to +22.7%Y/Y or +20.7% Y/Y when excluding contributions from ClickSoftware and Salesforce.org, compared to +20.3%Y/Y in 1Q20. Marketing Cloud growth remains strong at +27.3% Y/Y or +23.3%Y/Y when excluding contributions from Salesforce.org.

**COVID-19 impacts 1Q bottom line but pipeline looks strong for the remainder of FY21.** The company incurred approximately \$0.16 worth of EPS expense related to pandemic in the 1Q. This breaks down to approximately \$140mm related to the one-time commission guarantee paid to the company's sales team, a \$25mm charge for lease impairment due to subleasing and vacating offices, along with a \$20mm donation of PP&E and cash grants. We have excluded the \$65mm in cancelation charges for all their physical events canceled in FY21 from this \$0.16 calculation because we view these charges as purely a timing difference. However, these one-time charges were partially offset by approximately \$75mm in savings related to canceled T&E due to shelter in place orders. This all equates to an approximate \$175mm in 1Q pandemic related impact. Management noted that their pipeline remains strong going into both the 2Q21 and 2H21, as their cloud solution are more relevant than ever, especially work.com. Recent conversations with customers continue to revolve around digital transformations, with many companies taking a digital first policy going forward. Customer are now looking past the pandemic and to what the "new-normal" will look like after the pandemic disruptions have ceased, with expectations for the increased frequency of remote work.

**FY21 guidance lowered.** Given the uncertainties surround the COVID-19 pandemic, management has decided to lower its FY21 revenue guidance from \$21B - \$21.1B, to \$20B, and EPS guidance from \$3.16 - \$3.18 to \$2.93 - \$2.95. Although revenue attrition slowed Y/Y in the 1Q, FY21 guidance assumes revenue attrition accelerates to less than 10% from less than 9% in 4Q20 as well as expectations for few new business wins throughout the year. The \$0.23 drop in EPS guidance at the midpoint represents an approximate \$0.08 decrease in EPS guidance that will be incurred over the remainder of the year, excluding the \$0.15 worth of one-time pandemic related expenses in the 1Q. The company has also decided they will reassess their FY24 revenue goal from the previously stated range of \$34B - \$35B and will give an updated goal during their upcoming analyst day. However, management is pleased with their current pipeline and expects a recovery in IT spending at the beginning of FY22 or sooner. 2Q21 revenue guidance was set to \$4.89B - \$4.9B, below consensus estimates of \$5.04B at the midpoint. Management set EPS guidance to \$0.66 - \$0.67, which is also below the consensus estimate of \$0.74 at the midpoint.

**Figure 1 - Salesforce.com Variance Analysis**

	Y/Y Change			Q/Q Change			Estimate vs Actual		
	1Q20	1Q21	% Change	4Q20	1Q21	% Change	1Q21E	1Q21	% Change
Subscription revenue	3,496,000	4,575,000	30.9%	4,563,000	4,575,000	0.3%	4,555,000	4,575,000	0.4%
Professional revenue	241,000	290,000	20.3%	288,000	290,000	0.7%	277,150	290,000	4.6%
<b>Total revenue</b>	<b>3,737,000</b>	<b>4,865,000</b>	<b>30.2%</b>	<b>4,851,000</b>	<b>4,865,000</b>	<b>0.3%</b>	<b>4,832,150</b>	<b>4,865,000</b>	<b>0.7%</b>
<b>Cost of Revenue</b>									
Subscription revenue	574,000	755,000	31.5%	702,000	755,000	7.5%	706,025	755,000	6.9%
Professional revenue	236,000	288,000	22.0%	297,000	288,000	-3.0%	271,607	288,000	6.0%
<b>Total Cost of Revenues</b>	<b>810,000</b>	<b>1,043,000</b>	<b>28.8%</b>	<b>999,000</b>	<b>1,043,000</b>	<b>4.4%</b>	<b>977,632</b>	<b>1,043,000</b>	<b>6.7%</b>
<b>Gross Profit</b>	<b>2,927,000</b>	<b>3,822,000</b>	<b>30.6%</b>	<b>3,852,000</b>	<b>3,822,000</b>	<b>-0.8%</b>	<b>3,854,518</b>	<b>3,822,000</b>	<b>-0.8%</b>
<i>Gross Margins</i>	<i>78.3%</i>	<i>78.6%</i>		<i>79.4%</i>	<i>78.6%</i>		<i>79.8%</i>	<i>78.6%</i>	
<b>Operating Expenses</b>									
R&D	473,000	693,000	46.5%	669,000	693,000	3.6%	652,340	693,000	6.2%
Sales & Marketing	1,452,000	2,055,000	41.5%	2,009,000	2,055,000	2.3%	1,957,021	2,055,000	5.0%
G&A	320,000	439,000	37.2%	429,000	439,000	2.3%	425,229	439,000	3.2%
<b>Total Operating Expenses</b>	<b>2,245,000</b>	<b>3,187,000</b>	<b>42.0%</b>	<b>3,107,000</b>	<b>3,187,000</b>	<b>2.6%</b>	<b>3,034,590</b>	<b>3,187,000</b>	<b>5.0%</b>
Non- GAAP Operating Income (Loss)	682,000	635,000	-6.9%	745,000	635,000	-14.8%	819,928	635,000	-22.6%
<i>Non-GAAP Operating Margins</i>	<i>18.2%</i>	<i>13.1%</i>		<i>15.4%</i>	<i>13.1%</i>		<i>17.0%</i>	<i>13.1%</i>	
GAAP & Non-cash charges	472,000	775,000	64.2%	781,000	775,000	-0.8%	825,000	775,000	-6.1%
<b>GAAP Operating Income</b>	<b>210,000</b>	<b>(140,000)</b>	<b>-166.7%</b>	<b>(36,000)</b>	<b>(140,000)</b>	<b>288.9%</b>	<b>(5,072)</b>	<b>(140,000)</b>	<b>2660.1%</b>
<i>GAAP Operating Margins</i>	<i>5.6%</i>	<i>-2.9%</i>		<i>-0.7%</i>	<i>-2.9%</i>		<i>-0.1%</i>	<i>-2.9%</i>	
Interest & Other Income (Expense)	272,000	187,000	-31.3%	32,000	187,000	484.4%	10,000	187,000	1770.0%
Non-GAAP Income before Taxes	954,000	822,000	-13.8%	777,000	822,000	5.8%	829,928	822,000	-1.0%
Income Tax	215,000	181,000	-15.8%	175,000	181,000	3.4%	186,734	181,000	-3.1%
<b>Non-GAAP Net Income</b>	<b>739,000</b>	<b>641,000</b>	<b>-13.3%</b>	<b>602,000</b>	<b>641,000</b>	<b>6.5%</b>	<b>643,194</b>	<b>641,000</b>	<b>-0.3%</b>
GAAP Income before Taxes	482,000	47,000	-90.2%	(4,000)	47,000	-1275.0%	4,928	47,000	853.8%
Income Tax	90,000	(52,000)	-157.8%	244,000	(52,000)	-121.3%	3,548	(52,000)	-1565.6%
<b>GAAP Net Income</b>	<b>392,000</b>	<b>99,000</b>	<b>-74.7%</b>	<b>(248,000)</b>	<b>99,000</b>	<b>-139.9%</b>	<b>1,380</b>	<b>99,000</b>	<b>7075.0%</b>
<b>Non- GAAP EPS</b>	<b>\$ 0.93</b>	<b>\$ 0.70</b>	<b>-24.7%</b>	<b>\$ 0.66</b>	<b>\$ 0.70</b>	<b>6.2%</b>	<b>\$ 0.70</b>	<b>\$ 0.70</b>	<b>0.5%</b>
<b>GAAP EPS</b>	<b>\$ 0.51</b>	<b>\$ 0.11</b>		<b>\$ (0.28)</b>	<b>\$ 0.11</b>		<b>\$ 0.00</b>	<b>\$ 0.11</b>	
Basic Shares Outstanding	771,000	896,000		889,000	896,000		894,000	896,000	
Diluted Shares Outstanding	793,000	913,000		911,000	913,000		921,000	913,000	

Source: Company reports and Needham &amp; Co estimates

### VALUATION (PRICE TARGET: NA)

Although we at Needham do not assign price targets for Hold rated stocks, we frame CRM's current valuation relative to its recent past. Today, the company is trading at 5.3x EV/FY18 total revenue, 28x EV/TTM operating cash flow, 21x EV/FY18 operating cash flow, 35x EV/TTM FCF, or 28x EV/FY18 FCF. We believe these metrics are in line with other comparable 20% organic revenue growth names with low-teens operating income. We also believe the company's 1.33:1 EV/FY FCF:Revenue growth rate valuation ratio is at the mean of its recent three-year valuation and also near the mean of other profitable SaaS companies.

### RISKS TO TARGET

Risks: 1) Macroeconomic weakness could weaken renewals and delay sales cycles; 2) Increasing competition could impact new and renewal pricing; 3) Recent acquisitions could distract management and impact execution around core business; 4) Unknown adoption rates of new products.

Rating and Price Target History for: Salesforce.com, Inc. (CRM) as of 05-28-2020



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I, Scott Berg hereby certify that the views expressed in this research report accurately reflect my personal views about the subject company (ies) and its (their) securities. I, also certify that I, have not been, and will not be receiving direct or indirect compensation in exchange for expressing the specific recommendation(s) in this report.

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<b>Buy</b>	67	26
<b>Hold</b>	29	4
<b>Underperform</b>	1	0
<b>Rating Suspended</b>	< 1	100
<b>Restricted</b>	< 1	0

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The research analyst and research associate have received compensation based upon various factors, including quality of research, investor client feedback, and the Firm's overall revenues, which includes investment banking revenues for the following: Salesforce.com, Inc.

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