

Salesforce.com

Tim Beyers | January 21, 2009

CURRENT PRICE: [CRM](#) \$ 188.34 ↑ \$ 2.79 (1.5%)

Why Buy:

- Top dog and first mover in online CRM is also an emerging juggernaut in corporate cloud computing.
- Salesforce outperforms even Google in turning research and development investments into returns for shareholders.
- High P/E ratio masks a reasonable free cash flow valuation.

What It Does

Salesforce.com provides online customer relationship management tools.

Key Company Data

Headquarters: San Francisco, Calif.

Website: www.salesforce.com

CAPS Rating: 1 Star (14.79 out of 100)

Sign of a Breaker: Top Dog and First Mover

Market Cap: \$3,431.9

Cash/Debt: \$601.5 / \$1.8

Revenue (TTM): \$1,004

Earnings (TTM): \$37.1

Revenue (2005-07): \$309.9 / \$497.1 / \$748.7

Earnings (2005-07): \$28.5 / \$0.5 / \$18.4

Recent Price: \$28.13

Data as of 1/16/09
Dollar amounts in millions except recent price.

In 1999, a successful Oracle software engineer stood up at a rally and announced the death of software.

Marc Benioff was leading a PR stunt -- maybe the best in Silicon Valley history -- but his real mission was the launch of **Salesforce.com** ([NYSE: CRM](#)) as an alternative for customer relationship management. Benioff is no less a rebel today, and Salesforce is now a budding cloud computing powerhouse positioned to host every bit of corporate data that connects to the Web -- and disrupt Microsoft, SAP, and even Oracle on the way to multibagger returns.

Developers, Developers, Developers, Developers

Expect Benioff to pull it off. Not because of his mouth, though it's big, or because of his talent, though he is a master salesman -- but because of his network. He has tens of thousands of developers invested in the success of his company.

CRM is the software that lets businesses monitor their interactions with customers and prospects. Much like inventory management helps companies track parts, CRM helps them track deals.

It's big business -- and Salesforce makes it even easier by putting everything online and making it accessible through an ordinary browser. The company sells monthly subscriptions to more than 50,000 corporate clients who access its servers. Renting makes sense to these customers, who would rather save money upfront by allowing Salesforce to own the data centers. Those who use Oracle, SAP, and Microsoft aren't so lucky. Not only do they have to buy expensive hardware, but they also need the expertise to maintain it.

In that sense, Salesforce is a classic cloud computing company like Google and peer NetSuite. It delivers functionality over the Web that you'd ordinarily install on a PC or server.

Cash in the Cloud

And there's more to the story: Salesforce wants to be the warehouse for companies that put their data online. As Oracle has been for on-site business software, Salesforce wants to be for Web-based business software.

The idea seemed silly a few years ago. Heck, it seemed silly to me, and I once used Salesforce to track customer references for a PR client. I couldn't imagine a Web page substituting for a robust, customized, in-house system. But then came new languages and frameworks to bridge the gap between PC client and Web server. Browsers became more fully featured. We began to see the Web not as a playground but a platform, as Salesforce's customer base shows:

Scroll left/right to view wide tables

	FY 2006	FY 2007	FY 2008	TTM
Net Paying Customers	20,500	29,800	41,000	51,800
Growth	47%	45.4%	37.6%	36%
TTM through 10/31/08. Source: Salesforce.				

I see three factors behind this outsized growth. First is cost and simplicity. It's much easier to get started with Salesforce than to customize Oracle and its Siebel CRM system, making it a great fit for growing but small to mid-sized businesses that are still establishing an IT infrastructure.

Second, the technology has improved. Adobe's Air platform makes Salesforce available as a desktop application, so users can enter data when they're not connected to the Web and then synchronize when they jump back online.

Third, Salesforce is open. Both Google's App Engine and Amazon's Web Services can connect to Salesforce, which makes it easier for developers to create software to access and manipulate data within the system. More applications means more reasons to buy Salesforce -- a virtuous cycle that should continue to fuel growth.

Valuation and Risks

Success doesn't come cheap, however, and bears will tell you that Salesforce is far too expensive to own. They point to its 100-plus price-to-earnings ratio as proof. But if you look at cash flow, Salesforce's valuation is far less intimidating:

Scroll left/right to view wide tables

	FY 2006	FY 2007	FY 2008	TTM
Cash From Operations	\$95.9	\$111.2	\$204.3	\$234.8
Capex	\$23.4	\$22.1	\$43.6	\$57.2
Stock-Based Compensation	\$3.4	\$39.2	\$55.2	\$71.8
Free Cash Flow	\$69.1	\$49.9	\$105.5	\$105.8
Free Cash Flow Per Share	\$0.63	\$0.44	\$0.88	\$0.87
Amounts in millions except free cash flow per share. TTM through 10/31/08. Source: Capital IQ.				

Salesforce trades for 38 times the three-year median of my most conservative estimate of free cash flow per share, pricey but justifiable for a cash gusher with network effects.

But Salesforce isn't without risks. Anything connected to the Web can be hacked, and Salesforce has been. Security is a priority, but any serious hack would damage our interests as investors. Salesforce also has nearly as many competitors as it does partners. Benioff and his team need to be extremely efficient to win. Fortunately, they are -- even more efficient than Google. Over the past year, Salesforce spent just \$0.09 of R&D to produce a new dollar of revenue. Google, by contrast, spent \$0.13 for the same return.

Were any of these trends to reverse -- were a competitor to force outsized R&D expense for little return, were security problems to become common, were management to develop a severe case of stupid when it comes to capital allocation -- I'd probably recommend you sell. But there's no reason to believe the trends will reverse. Low-cost cloud computing is an efficient, secure alternative for cash-strapped IT buyers, and Salesforce should be able to capitalize.

Foolish Bottom Line

Salesforce offers price momentum -- the stock has been a sound market-beater since September -- along with visionary leadership, and a strong market position. It's the perfect Rule Breaker for troubled times.

Tim has stock and options positions in Google and owns shares of Oracle.

For more, join us on the [RBS: Salesforce.com](#) discussion board.



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Market data provided by FactSet and Web Financial Group.