

Salesforce.com

Tim Beyers | December 21, 2011

CURRENT PRICE: [CRM](#) \$ 188.34 ↑ \$ 2.79 (1.5%) CwàG! Ýí B~ÅÖG'ÅññÅññ ìN ï

Skeptics are laying into **Salesforce.com** ([NYSE: CRM](#)) again. The company best known for selling and delivering customer relationship management, or CRM, software via the Web is taking a beating for adopting a new mantra.

"We were born cloud, and now we've been reborn social," Salesforce founder and chief executive Marc Benioff proclaimed at the company's annual Dreamforce conference this summer. Benioff is betting that business computing will become more collaborative, and that embedding social media with business systems is the best combination for enabling collaborative work. The rise of the "social enterprise," Benioff calls it. He's hawking a new Twitter-like system called Chatter that's designed as an add-on for the core Salesforce environment.

Critics howled. But their beef is more about valuation than vision. They don't dispute the idea on its merits; they just doubt that Salesforce can beat aggressive competitors and achieve sustained profitability. A Cowen & Co. analyst has just downgraded the stock on competitive fears as I write this.

There's just one problem: When it comes to defying skeptics, few can match Benioff's record. Salesforce's stock has nearly tripled since I first recommended it almost three years ago, and I'm happy to recommend it a second time today. Whether it's the cloud or social business, this company's potential is still soaring.

Valuation as Validation

We'll discuss valuation in a bit, but first, here are the numbers that matter most to our thesis: \$16 billion and \$440 billion. That's the market cap of Salesforce versus the combined market caps of Microsoft, Oracle, and SAP.

If Benioff is right that social media is driving demand for Web-based business software — and I believe he is — then this ratio is going to shift dramatically and, in the process, deliver multi-bagger returns to Salesforce shareholders.

How big are we talking? If Salesforce's revenue and deferred revenue continue growing 25% to 40% annualized, and if developers continue to commit code to the platform, history says this disruptive stock will one day be worth at least \$100 billion in market cap.

Salesforce trades for what most will say is an outrageous 74 times forward earnings. The stock also trades for 59 times enterprise value when compared to free cash flow, a sharp contrast to three years ago. Here's why the valuation doesn't concern me: High valuations are often the market's way of identifying excellence.

Think of Apple after the introduction of the iPod in late 2001. Buying shares at that time would have cost you 78 to 124 times earnings. Today, the same slice of Apple will cost you just 14 times earnings. Which buy sounds better? Give yourself a pat on the back — and a 40-bagger — if you answered the former.

WHAT IT DOES:

Salesforce.com provides online software for managing customer-facing business operations.

WHY BUY:

- The top dog and first mover in online customer relationship management is now also the first mover in social business.
- Visionary CEO has created evangelists for the company and the platform.
- Valuation and outperformance speak to the size of the company's advantage.

KEY DATA:

- Headquarters: San Francisco, Calif.
- Website: www.salesforce.com
- Sign of a Breaker: Top Dog, First Mover
- CAPS Rating: 1 star (14 out of 100)
- Market Cap: \$14,560
- Cash/Debt: \$646 / \$543
- Revenue (TTM): \$2,092
- Earnings (TTM): (\$3)
- Revenue (2009/'10/'11): \$1,077 / \$1,306 / \$1,657
- Earnings (2009/'10/'11): (\$43) / (\$81) / (\$64)
- **Recent Price: \$107.06**

Data as of 12/16/11. Dollar amounts in millions except recent price.

To be fair, this isn't always true. Hundreds of awful businesses were purchased at extreme valuations during the dot-com bubble. But bad bets aren't as prevalent today, while well-positioned businesses are still commanding a premium. Take Salesforce peer SuccessFactors, which SAP recently purchased for \$3.4 billion, or about 250 times next year's earnings estimate. Investors are clearly willing to pay more for Salesforce than they're paying right now.

The 7-Year Stretch

Benioff is the key to our admiration for Salesforce and to this recommendation. He's a Breaker's Breaker not just because of his vision, but also because he's proved it in battle.

In 2004, *Fortune* noted that market leader Siebel Systems was going after Salesforce's clients with an on-demand suite of its own. IBM and SAP were also preparing Web-based alternatives. "The question is whether — as the industry catches on and copycats multiply — Benioff can actually dominate the vision of the future he so convincingly paints," the magazine's Daniel Roth wrote.

Seven years later, Salesforce's annual revenue has multiplied 21 times over — from \$96 million to \$2.1 billion as of the quarter ending in October. Investors from those days have enjoyed a seven-bagger. And competitors? Siebel no longer leads anything; instead, it's a subsidiary of Oracle. SAP is still trying to compete, but Big Blue is now a tacit partner with a product for integrating Salesforce with other types of business software.

No one should be surprised by IBM's change of heart. Like a firebrand preacher, Benioff has spent a decade convincing the world that the Web will one day become the primary mechanism for delivering software.

Risks and When We'd Sell

Benioff and his team have to outperform in order to achieve the premium we're banking on. Specifically, Salesforce has to publish regular, concrete metrics that prove the company's social media experiment is paying off.

Talent is key to this and other goals. On the acquisitions side, the company has a surprisingly good track record for keeping executive talent brought over in deals. And on the recruiting side, several of the smartest people I used to work with in my past life as a PR and marketing consultant have gone to work for Benioff. Most describe the culture he's created as one of high performance that mixes in a healthy and even a Rule Breaking dose of philanthropy.

Should necessary metrics fail to materialize, or talent start to flow outward rather than inward, we'd reevaluate our position and perhaps sell.

The Foolish Bottom Line

We Rule Breakers delight in companies the market doesn't get. It's not that we enjoy being contrarian for its own sake; that's simply where the opportunity is. We love where Marc Benioff has led his company up to now, and we want to be on board when Salesforce reaches its next destination.

See the team's and David and Tom Gardner's holdings [here](#). The Motley Fool owns shares of Apple, IBM, Microsoft, and Oracle.



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Market data provided by FactSet and Web Financial Group.