Buy Okta

David Gardner | April 20, 2018 | Buy Recommendation

CURRENT PRICE: OKTA $ 200.72 ↑ $ 1.53 (0.8%)

"Identity and access management" may not be the sexiest-sounding business, but **Okta** (NASDAQ: OKTA) sure makes it look good. Since we first recommended this stock in January, it's up more than 40% to around $42 while the broader market has declined.

Not much has changed at Okta since then, apart from another strong quarterly report. But that's fine with us. Okta's exact place in the business world can be tricky to pin down, but the service it provides is valuable: It makes it easy for its clients to control which employees can access which parts of their network, covering everything from legacy internal systems to new third-party cloud apps, and it doesn't require those clients to change anything faster than they need.

If you didn't buy the first time, don't worry. Okta is doing exciting work behind the scenes, and buying shares today will put you ahead of the curve.

High Oktane

For most of its short tenure — it went public just a year ago — Okta's stock has tracked pretty closely with the S&P 500. It's only been in the past few months that the company's story has found traction on Wall Street. Investors' slow-building enthusiasm may stem from the difficulty of describing its business. Is it a cloud-based alternative to old-school directory-based credentialing? Is it focused on enterprises looking to improve their internal efficiency? Or is it really about improving customer experience? Is it a security company? It's a little of each, and where you focus can change your perception of Okta's opportunity.

Back in January, we homed in on Okta's ability to improve security. And that's definitely an important part of the business. Rather than making firewalls to keep intruders out, Okta focuses on the way that employees sometimes (unwittingly) let them in through back doors. By establishing a single, secure identity for employees, the company allows a single

WHAT IT DOES

Okta provides identity solutions for enterprises, small and medium-sized businesses, and other organizations, allowing them to securely integrate internal and third-party cloud applications.

WHY YOU SHOULD BUY

- Okta recently reported another strong quarter, with important customer additions and positive operating cash flow.
- The company has a significant, and largely untapped, opportunity in customer identity and access management.
- It continues to expand relationships with existing customers, while its leadership position makes it a top consideration for prospective clients.

BUYER'S GUIDE

- **Industry:** Software
- **Size:** Mid Cap
- **Region:** Global
- **Risk:** 12 out of 25

KEY DATA

- **Headquarters:** San Francisco, Calif.
- **Website:** Okta investor relations
- **Market Cap:** $4.4 billion
- **Cash/Debt:** $230 million / $0
- **Revenue (TTM):** $260 million

sign-on and a centralized place from which to manage credentials, permissions, and company policies.

Okta doesn't replace traditional cybersecurity systems, it makes them work better. At a recent investors conference, company co-founder and CFO Frederic Kerrest described the integration of Okta and a firewall from **Palo Alto Networks** (NYSE: PANW):

- **Earnings (TTM):** ($114 million)
- **Revenue (2015/'16/'17):** $41 million / $86 million / $160 million
- **Earnings (2015/'16/'17):** ($59 million) / ($76 million) / ($83 million)
- **Recent Price:** $42

> *"So for example, I can now see that Keith is coming through to my firewall, and it looks like he's coming from a place he never comes from. And it looks like he's going to access some resources he never accesses, and it's 2 a.m. on Sunday morning. That might not be Keith. Let me go tell my identity management system about that. We'll put Keith in the penalty box."*

That capability is a big selling point to some companies. But in truth, customers typically come to Okta looking for much less.

For example, a mid-sized business — say, 1,000 to 5,000 employees — may approach Okta looking to better manage its IT infrastructure. It probably already has a basic directory of employees that it uses to control access to its internal database and reporting system. But it wants employees to be able to seamlessly access multiple systems with features like multifactor authentication and life-cycle management, making it easy to move employees on and off teams with different credentials — or in and out of the company altogether.

After that, customers come back to Okta looking for new capabilities — like the ability to integrate third-party cloud apps or analyze individuals' access patterns, or allow users selective use of APIs (application program interfaces) for hybrid cloud applications. In short, Okta makes it easy to improve basic functions and then makes it even easier to add advanced functions.

It's a classic "land and expand" strategy, and it explains why Okta had a net dollar retention rate — the amount existing customers spend with the company, even after any turnover — of 121% over the past year. It also explains why Okta is growing revenue far faster than its rivals in identity and access management. As of its most recent quarter, Okta had over 4,350 customers, 691 of which spend over $100,000 a year. Look for those figures to keep rising rapidly.

They Haven't Forgotten About You

Yet that's the enterprise side of the business. And while enterprise is responsible for the bulk of the company's revenue today, protecting the customers those companies serve may ultimately be the bigger opportunity. It is "underestimated and underappreciated," according to Kerrest, who talks about an addressable market of $15 billion or more.

Many companies implicitly offer their customers online security — just think of the number of password-protected services you use. But getting serious about this protection means knowing customers are who they say they are, offering multifactor authentication, and more. This is particularly critical to companies in businesses where identity and security are important, like banking, health care, insurance, and air travel.

Those aren't random examples, by the way. Last quarter, Okta landed **JetBlue Airways** (NASDAQ: JBLU) as a customer identity client, while a major upsell to Farmers Insurance Group also focused on customer identity. It also added **Fidelity National Financial** (NYSE: FNF) in the quarter, and it counts a number of health service providers among its clients.

Okta is still just scratching the surface on the customer side, but that didn't stop it from growing revenue 62% in fiscal 2018 (which ended Jan. 31). The company is still tracking well ahead of the 35% annual pace we expect it to maintain over the next three to five years. Moreover, while it is still not profitable, operating cash flow ticked over into the positive territory in the most recent quarter. While that number may fluctuate, the company's fairly modest capital expenditure requirements (it expects to spend $15 million this year only because it is expanding office space) means that it will be generating positive free cash flow long before it turns a profit.

Risks and When We'd Sell

Back in January, we noted that Okta's stock was "richly valued even on a price-to-sales basis," even though the company was not yet profitable. It's about 40% more richly valued now. On one hand, that's an argument for why traditional valuation metrics don't always work for high-quality, fast-growing companies. Nevertheless, this adds to the pressure on the company to continue adding new customers and sell additional services to existing ones.

Okta is a clear industry leader, but it does have many competitors — including large companies like **Microsoft** (NASDAQ: MSFT), **Oracle** (NYSE: ORCL), and **IBM** (NYSE: IBM). These rivals still don't match the flexibility or independence of Okta, but they're watching over the company's shoulder. If we see the company losing market share or pricing power, that's a sign that its dominance may be waning.

The Foolish Bottom Line

Before they founded the company, Kerrest and Todd McKinnon (now the CEO) spent years at **Saleforce.com** (NYSE: CRM), the first enterprise cloud company to reach $10 billion in annual sales (and arguably the first cloud company at all). Much like their former boss, Salesforce founder Marc Benioff, McKinnon and Kerrest realized that to achieve their ambitions, they'd have to build something new and independent. They're off to a great start, but we think there's much more to come.

Karl Thiel contributed to this report.

Choose What You Want to Do With This Stock

By adding OKTA to your Favorites, you will be notified whenever our team recommends buying *or selling* OKTA.

Ready to follow our recommendation?

Add OKTA to Favorites

Buy OKTA

Teresa Kersten is an employee of LinkedIn and is a member of The Motley Fool's board of directors. LinkedIn is owned by Microsoft. The Motley Fool owns shares of Okta and Oracle. The Motley Fool is short shares of IBM and has the following options: short June 2018 $52 calls on Oracle and long January 2020 $30 calls on Oracle. The Motley Fool has a disclosure policy.

Important Reminder! Access all of David Gardner's top stock recommendations

In less than 60 seconds, you can DOUBLE the amount of stock picks you currently receive from David Gardner! You see, *Motley Fool Stock Advisor* is not the **only** place where David shares his top stocks. David's also the lead advisor for *Motley Fool Rule Breakers* -- the highly sought after growth-investing newsletter he founded in 2004. Click here to access a special offer -- and instantly upgrade your membership to include the market-thumping stock ideas of BOTH *Motley Fool Stock Advisor* and *Motley Fool Rule Breakers*.

|
| | |