Why You Should Buy Okta

David Gardner | January 19, 2018 | Buy Recommendation

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

DAVID GARDNER'S JANUARY 2018 RECOMMENDATION:

*Since 2002, Motley Fool co-founder **David Gardner** (TMFSpiffyPop) has beaten the S&P 500 by 373.8 percentage points for Stock Advisor members. David, a native of Washington, D.C., graduated as a Morehead Scholar from the University of North Carolina at Chapel Hill in 1988.*

See Why David Likes Okta

You know the drill: Your password must be at least eight characters long, containing an uppercase and lowercase letter, a number, and a symbol. As organizations have grown more conscious of security, it has put a drag on productivity and the quality of our digital lives. Decent passwords are hard to remember, and our professional lives may require us to know dozens of them, some of which must regularly change. People tend to reuse familiar ones, or write them down in insecure places. My recommendation this month, **Okta** (NASDAQ: OKTA), helps make businesses more secure and more productive by streamlining individuals' digital access. It manages passwords, but it also does far more than that. And that's made it the leader in a fast-growing industry.

OKTA IN 1 MINUTE

What It Does

Okta uses cloud-based software to manage companies' digital access rights, making work simpler for employees and helping employers keep track of who's who on their networks.

Company Guide

- **Industry:** IT Services
- **Asset Class:** Large
- **Region:** US
- **Price on June 21, 2020:** $ 199.19

Key Data

- **Headquarters:** San Francisco, CA, US
- **Sector:** Technology
- **Market Cap:** $3B

Add OKTA to Your Favorites

Okta is a pioneer in what is called identity and access management (IAM), and consulting firm **Gartner** (NYSE: IT) ranks it as a leader — one that's executing on its vision better than a handful of rival leaders like **Microsoft** (NASDAQ: MSFT), **Oracle** (NYSE: ORCL), and **IBM** (NYSE: IBM).

The company's cloud-based software-as-a-service (SaaS) platform works by creating a secure identity profile of an individual, which can then be matched against whatever kind of digital rights and access they require. That means employees don't have to wrangle with dozens of passwords, of course, but IT managers can also seamlessly control any number of other policies and credentials. That includes everything from what personal mobile devices are given access to a corporate network to what physical locations are considered secure. Companies can set central policies governing what VPN settings are used for corporate travelers, or set rules for clients and collaborators who need network access. Okta can make sure that data and identities are managed in compliance with regulations like the Health Insurance Portability and Accountability Act (HIPAA). Profiles are centralized and easy to change as employees come and go, or policies are changed companywide.

Moreover, these secure identities and policies can be seamlessly integrated into third-party applications. To make it easier, Okta has "pre-integrated" thousands of cloud-based services, so employees are securely linked at the touch of a button. While some of its competitors also do this, we think Okta's pure focus on IAM is an advantage. The company is agnostic about the services its clients are using, whether it's **Salesforce.com** (NYSE: CRM), **Amazon** Web Services (NASDAQ: AMZN), **Zendesk** (NYSE: ZEN), **Workday** (NASDAQ: WDAY), NetSuite, Google Apps, Office 365, or over 5,000 other applications. Competitors like Microsoft and Oracle, on the other hand, may have a bias toward their own additional software and services.

Okta has a rare appeal to companies: It makes business both more secure *and* easier to conduct. Firewalls, anti-virus, and other conventional cybersecurity are a necessary part of business, but unwitting employees are often the weak link in even the most robust security plan. Okta goes a long way toward addressing that.

See Why You Should Invest in Okta Now

Right now, identity and access management is a fractured industry that's growing very quickly. Some market research suggests the sector could reach over $20 billion in annual spending by 2022. Despite its leadership position, Okta represents only a tiny fraction of that total. But it has been expanding quickly, from $41 million in revenue in 2015 to $231 million over the past 12 months. That should continue to rise quickly: Gartner estimates that 80% of organizations will use access management software by 2019, up from 55% in 2017.

For now, most of Okta's revenue is from business-to-business applications, but there is another large business-to-consumer opportunity — particularly around e-commerce — that I believe the market is overlooking. Okta acquired Stormpath last year in part to advance its tools for customer identity and access management (CIAM). The appeal to retailers is huge: By creating secure profiles of customers, it can offer a safer shopping experience, more robust marketing, and ultimately a better reputation. Gartner suggests cloud-based access management will be the majority access/delivery model for online purchases by 2021, up from less than 20% today.

Okta recognizes this opportunity, and it recognizes that existing clients can be cross-sold its growing range of services. Thus it has been investing heavily in sales and marketing. As of the most recent quarter, the company had 3,950 customers, up 36% from the prior year. And 603 of those customers spend $100,000 or more a year on the platform. That growth has come at the price of a negative operating margin, net cash burn, and significant net losses. But over time, I expect the company to reverse that. In the next three to five years, I believe, we'll see the company drastically improve margins and achieve positive cash flow while continuing to grow revenue at a brisk pace — 35% annually or better.

We'll also be backing a winning team led by Okta's founders, Todd McKinnon and Frederic Kerrest, now respectively CEO and COO. Both are former Salesforce.com executives who had a hand in building what is perhaps the world's most successful SaaS company. With a combined 9.6% stake in Okta, they are committed to doing it again. I think it's worth getting behind this pair and investing in a better way to improve our digital lives.

Recent Price: **$26.78** | Website: **Okta investor relations** | Market Cap: **$2.7 billion**

Risk Tolerance

Okta isn't yet profitable, and it is richly valued even on a price-to-sales basis. Thus, we're counting on robust top-line growth as well as improving margins. If the company falls short, or if the entire SaaS sector sees valuations fall, Okta's share price will suffer. In addition, Okta (and its rivals) are taking on a lot of responsibility for enterprise security. Someone who hacked into Okta's permissions could cause untold damage. For that reason, the company is meticulous about its system and the background of its employees. But a breach would be very bad for business.

Risk Rating: Okta scores 12 out of 25

Dividend

The company does not pay a dividend and is unlikely to do so in the foreseeable future.

Time Frame

Because Okta is still investing heavily in its sales and marketing, it could be a few years before it shows the margin strength that I think is coming. Be patient and stay the course for at least three to five years.

Tom's Recommendation: Buy Paycom Software.

Karl Thiel contributed to this report.

This stock is priced at about $27 at the time of our recommendation. We think it has great potential and is a good buy anywhere around this price. Consider buying in thirds (making three purchases over time) to get a potentially better average price.

See Tom's Recommendation »

Ready to follow our recommendation?

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Buy OKTA

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