

US Software Sector

Best proxy to benign interest-rate environment

The anticipation that the US's tightening cycle is over has sent the US tech sector share performance to new highs. US software and cloud computing sectors have recorded rapid growth over the past 20 years, driven by enterprise digitization demand. The software sector contributes about 38% of US tech sector market cap in 2023. According to Gartner, global IT spending grew by 3% YoY to US\$4.5tn in 2022, of which software/IT services spending accounted for 18/29% (2020: 16/27%). Within the SaaS software sub-sector, we continue to favour the long-term growth prospect of the respective vertical leaders, such as Salesforce and ServiceNow, given their up-selling/cross-selling potential, global expansion opportunities, and their enlarged TAM with the acceleration of world-wide enterprise digitization.

- **Robust economy boosted demand and operating leverage amplified sector profitability.** The US software sector stock performance was up by over 50% in 2023, on the back of improving fundamentals and anticipation of interest rates entering a benign environment. Software sector revenue growth gradually reaccelerated in 2023, recovering on an easier base. Leading companies continue to improve operating efficiency to deliver a healthier ROE. For 2024, we expect software revenue growth to remain resilient in the US as the US and global economy navigate the downturn cycle. We estimate Salesforce/ServiceNow to deliver a total revenue CAGR of 11/20% over FY24-26E. We also expect further room for software companies to enhance their operating efficiency, especially on the selling and marketing front. We forecast Salesforce S&M expense ratio to decline from 43% in FY23 to 34% in FY26E, driving its overall non-GAAP OPM to improve from 22.5% in FY23 to 34.9% in FY26E. We forecast Salesforce/ServiceNow to deliver non-GAAP operating income CAGR of 28/25% over FY24-26E.
- **Demand outlook remains solid for software & IT services.** The software sector is the largest contributor to the US tech sector market cap. Gartner expects global software & IT services spending will grow by 13.7/14.1% YoY to US\$2.3/2.6tn in FY23/24E. Cloud computing is one of the fastest-growing sub-sectors. Gartner expects global cloud computing market size to grow by 22/24% YoY to US\$482/598bn in 2023/2024E. It also expects the SaaS market size to increase by 17/19% YoY to US\$195/232bn and account for 41/39% of the global cloud market in 2023/2024E.
- **Initiate coverage of Salesforce and ServiceNow at BUY.** We continue to recommend sector leaders, after the sector has experienced a bull-run and expectations on interest rate cuts evolve. For Salesforce, we like 1) its unparalleled leadership in global CRM market; 2) ample room to enhance operating efficiency and drive profitable growth; and 3) its current valuation (20x FY24E EV/EBITDA), offering a 42% discount to the sector average. For ServiceNow, we are positive on 1) its leadership in global ITSM (IT Service Management) market; 2) solid revenue growth outlook due to up-selling and cross-selling opportunities beyond ITSM; and 3) solid financial profile thanks to its adherence to the Rule of 50 (i.e. total revenue growth + free cash flow margin > 50%), outperforming other peers.

Valuation Table

Company	Ticker	Rating	Mkt Cap		TP (LC)	Upside/Downside	EV/EBITDA		EV/Sales	
			(US\$ mn)				FY24E	FY25E	FY24E	FY25E
Salesforce	CRM US	BUY	270,982	329.3		18%	19.8	18.0	7.9	7.1
ServiceNow	NOW US	BUY	157,735	897.8		17%	41.2	32.6	14.2	11.8

Source: Company data, CMBIGM estimates

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US Software Sector

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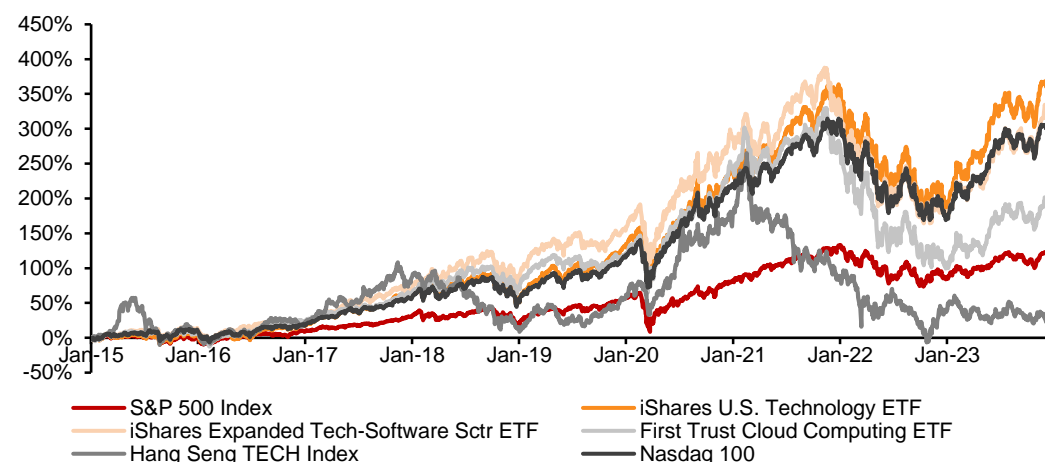
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US software sector: overview

US software and cloud sectors experienced strong rallies from 2015 to 2023, up 343% and 216% respectively versus the S&P 500 index (+132%). Investor concern on global economy and softening demand for software solutions caused a drawdown of 42% for US Software Sector ETF (IGV US) in 2022. Nonetheless, driven by the companies' initiatives to enhance operating efficiency and to refuel revenue growth, as well as interest rate cut expectations in 4Q23, the software sector delivered a strong rebound of 58% in 2023.

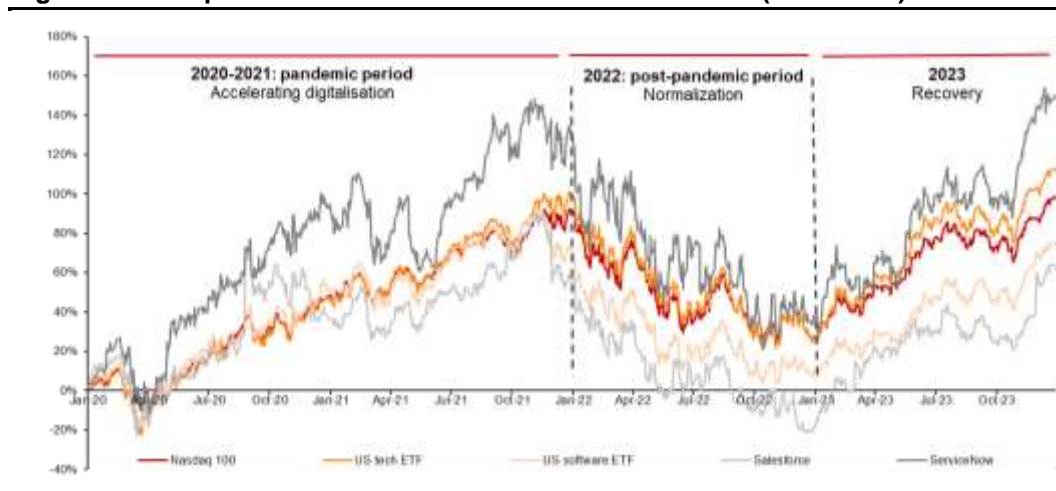
Figure 1: Price performance of US tech and software index (2015-2023)



Source: Company data, CMBIGM

Over the past three years, the US tech and software sector went through almost two cycles. During the pandemic (2020-2021), private- and public-sector enterprise digitization process accelerated, supporting software companies' results and stock price performance during 2020-2021. In 2022, high inflation dampened business expenditure sentiment, and a high base led to the sector's under-performance. The aggressive investment during 2020-2021 also further eroded the companies' margin in 2022. As a result, the software sector dropped over 40% in 2022. In 2023, companies started to focus on operating efficiency improvement and exploring more revenue growth potentials, on the back of gradually improving fundamentals and anticipation of interest rate cuts in 4Q23, which led the sector back into a strong bull run.

Figure 2: Price performance of US tech and software index (2020-2023)



Source: Bloomberg, CMBIGM

The average forward 1-year PE of the US software sector is currently at 47.3x, which is a 7% premium to the historical average (44.0x, since 2020) and has risen to a level close to average + 1SD (49.4x PE).

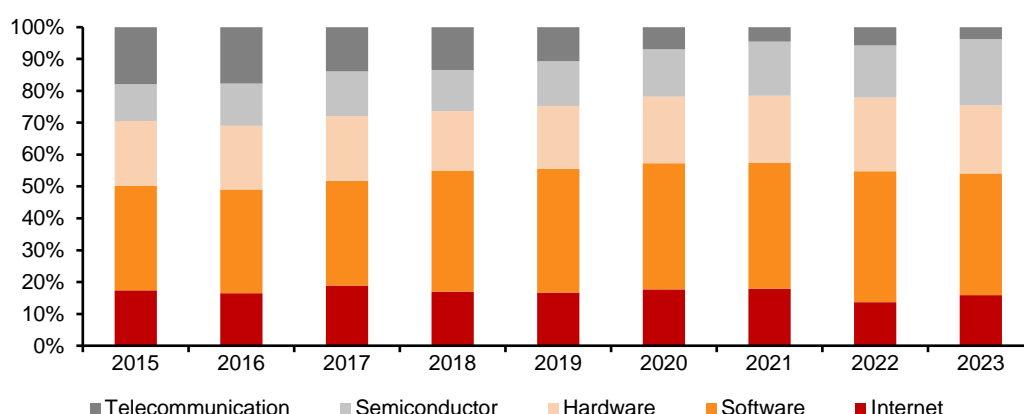
Figure 3: US software: forward 1-year PE band



Source: Bloomberg, CMBIGM

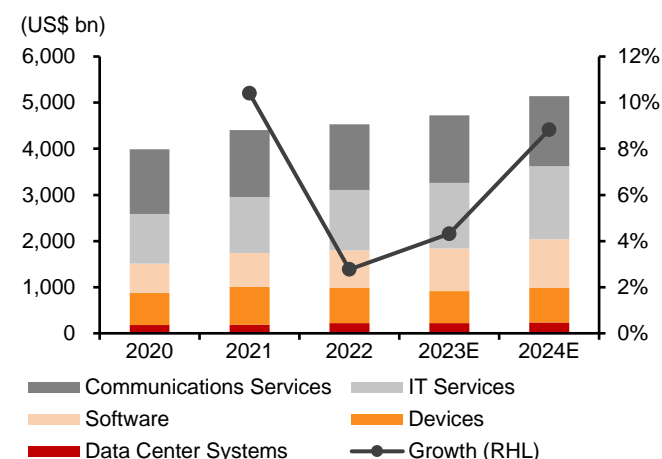
The software sector is the largest contributor to the US tech sector market cap. Its market cap contribution to the sector rose from 33% in 2015 to 38% in 2023.

Figure 4: Market cap composition of US tech sector

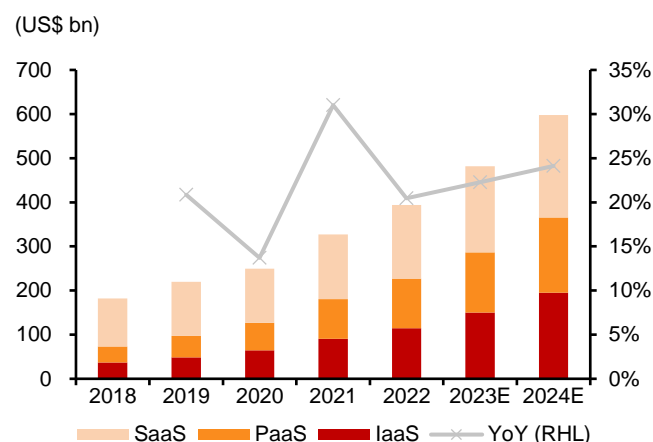


Source: Company data, CMBIGM

According to Gartner, global IT spending grew by 3% YoY to US\$4.5tn in 2022, of which software/IT services spending increased by 11/8% YoY and accounted for 18/29% (2020: 16/27%). Gartner expects global software & IT services spending will grow by 13.7/14.1% YoY to US\$2.3/2.6tn in FY23/24E. Cloud computing is one of the fastest-growing segments within the software sector. Gartner expects global cloud computing market size to grow by 22/24% YoY to US\$482/598bn in 2023/2024E. It also expects the SaaS market size to increase by 17/19% YoY to US\$195/232bn and account for 41/39% of the global cloud market in 2023/2024E.

Figure 5: Worldwide IT spending

Source: Gartner, CMBIGM

Figure 6: Worldwide cloud computing spending

Source: Gartner, CMBIGM

Among the 18 leading US SaaS companies we select, 10/15 of them have recorded an annualized absolute return of over 20/10% since their IPO, and 15 of them have outperformed the S&P 500, supported by the increasing global demand for digital solutions and the strong business growth. Driven by the revenue growth recovery and margin improvement, several SaaS companies delivered a strong rebound YTD.

SaaS companies with strong revenue growth outlook and free cash flow margin outperformed in 2023. The average return of companies which met the Rule of 40 (i.e. total revenue growth + free cash flow margin > 40%) was 74% in 2023, significantly higher than the average return of those which did not meet the Rule of 40 (33%).

Figure 7: Price performance of US SaaS companies

Company	Ticker	Market cap (US\$m)	Annualized absolute return			Relative return (vs. S&P 500)			Rev Growth + FCF Margin
			IPO-2023	2020-2023	2023	IPO-2023	2020-2023	2023	FY22
Oracle	ORCL US	293,035	22%	21%	31%	14%	10%	7%	35%
Adobe	ADBE US	271,605	29%	16%	77%	21%	6%	53%	54%
Salesforce	CRM US	263,228	23%	13%	98%	16%	3%	74%	38%
SAP	SAP US	194,767	10%	5%	52%	3%	-5%	28%	26%
Intuit	INTU US	171,265	20%	25%	62%	12%	15%	38%	61%
ServiceNow	NOW US	149,482	34%	26%	82%	22%	16%	58%	53%
Workday	WDAY US	74,492	17%	14%	65%	5%	4%	41%	42%
CrowdStrike	CRWD US	68,045	38%	50%	142%	27%	40%	118%	85%
Atlassian	TEAM US	61,160	31%	19%	85%	19%	8%	61%	50%
Autodesk	ADSK US	51,862	16%	7%	30%	7%	-3%	6%	55%
Datadog	DDOG US	40,412	31%	34%	65%	20%	24%	41%	84%
HubSpot	HUBS US	28,253	38%	38%	101%	28%	28%	77%	44%
Zoom	ZM US	21,450	3%	1%	6%	-8%	-9%	-18%	34%
Okta	OKTA US	13,854	22%	-6%	32%	11%	-16%	8%	47%
Twilio	TWLO US	13,254	14%	-6%	55%	2%	-16%	31%	26%
Docusign	DOCU US	12,960	7%	-5%	7%	-3%	-16%	-17%	36%
Five9	FIVN US	5,643	27%	5%	16%	17%	-6%	-8%	32%
Ring Central	RNG US	3,099	6%	-33%	-4%	-4%	-43%	-28%	30%

Source: Company data, Bloomberg, CMBIGM

Figure 8: SaaS: valuation comparison

Companies	Ticker	Price (Local)	2023E	EV/Sales (x) 2024E	2025E	2023E	EV/EBITDA (x) 2024E	2025E	Rev CAGR 22-25E
CRM									
Salesforce	CRM US	279.9	NA	7.9	7.1	NA	19.8	18.0	11%
HubSpot	HUBS US	588.7	13.5	11.5	9.6	75.1	61.7	47.8	21%
Five9	FIVN US	77.2	6.4	5.5	4.6	36.1	31.1	23.9	17%
ITSM									
ServiceNow	NOW US	769.4	17.3	14.2	11.8	54.7	41.2	32.6	22%
Atlassian	TEAM US	247.8	15.2	12.6	10.1	70.9	58.4	49.8	21%
Security									
CrowdStrike	CRWD US	290.3	22.2	17.2	13.8	90.0	66.5	48.5	30%
Okta	OKTA US	84.8	6.2	5.6	4.9	na	na	24.4	15%
Datadog	DDOG US	124.0	18.8	15.3	12.2	79.3	66.2	48.8	25%
ERP									
SAP	SAP US	173.7	6.8	6.3	5.6	25.4	23.4	17.7	8%
Oracle	ORCL US	114.6	7.5	6.9	6.3	15.3	13.7	12.4	8%
Collaboration									
Twilio	TWLO US	71.9	2.5	2.3	2.0	15.8	15.4	13.4	9%
Ring Central	RNG US	34.9	2.1	1.9	1.8	9.4	7.7	7.6	10%
Zoom	ZM US	67.7	3.4	3.3	3.1	8.3	8.2	8.0	3%
Average			10.2	8.5	7.1	43.7	34.5	27.2	

Source: Bloomberg, CMBIGM

Note: data are as of 26 Jan 2024

The US software sector has developed a comprehensive SaaS ecosystem, due to the rising demand for cloud-based solutions and the continuous cloud migration of enterprise solutions in the past several years. In each SaaS vertical, our selected key companies are presented in the table below.

Figure 9: SaaS: company overview

Company	Ticker	Overview
CRM (customer relationship management)		
Salesforce	CRM US	Salesforce operates as a cloud-based software company. The company develops CRM software and applications focused on sales, customer service, marketing automation, analytics, and application development.
HubSpot	HUBS US	HubSpot provides a cloud-based CRM platform. The company's CRM platform, comprised of marketing, sales, service, content management system, and operations hub, features integrated applications, tools, and a native payment solution.
Five9	FIVN US	Five9 provides cloud contact center software. The company offers real-time and historical reporting, recording, quality monitoring, workforce, and customer relationship management integrations.
ITSM (IT service management)		
ServiceNow	NOW US	ServiceNow provides enterprise IT management software. The company designs, develops, and markets a cloud computing platform to help companies manage digital workflows for enterprise operations
Atlassian	TEAM US	Atlassian designs and develops enterprise software platform for project management, collaboration, issue tracking, integration, deployment, and support services.
New Relic	NEWR US	New Relic provides cloud-based application performance management solutions for cloud and data center applications. The company offers a solution including real user, application, and availability monitoring features that enable developers and operations teams to manage web application performance in real-time.
Security		
CrowdStrike	CRWD US	CrowdStrike provides cybersecurity products and services to stop breaches. The company offers cloud-delivered protection across endpoints, cloud workloads, identity and data, and leading threat intelligence, managed security services, IT operations management, threat hunting, Zero Trust identity protection, and log management.

Okta OKTA US Okta develops internet applications software. The company offers automated user management, integration, mobile identification, multifactor authentication, and reporting software.

Datadog DDOG US Datadog offers cloud-based monitoring and analytics platform which integrates and automates infrastructure monitoring, application performance monitoring, and log management for real-time observability of customers. Datadog operates worldwide.

ERP (enterprise resource planning)

SAP SAP US The company develops ERP software solutions that includes programs for all core business areas, such as procurement, production, materials management, sales, marketing, finance, and human resources (HR).

Oracle ORCL US Oracle supplies software for enterprise information management. The company offers databases and relational servers, application development and decision support tools, and enterprise business applications. It helps companies and organizations of all sizes and industries run their businesses profitably, adapt continuously, and grow sustainably.

Collaboration

Twilio TWLO US Twilio offers cloud computing platforms that allow web developers to integrate phone calls, Internet protocol voice communications, and text messages into web, mobile, and phone applications.

Ring Central RNG US RingCentral provides cloud-based business communications solutions. The company enables communication via voice, text, video and web conferencing, and fax on multiple devices, including smartphones, tablets, and computers.

Zoom ZM US Zoom operates as a communications technology company. The company offers an easy-to-use communication platform and solutions for video meetings, phone calls, whiteboarding, and annotation for users to connect with anyone from anywhere.

Source: Company data, CMBIGM

Figure 10: Top holdings of major US tech sector funds

Fidelity Select Software & IT Svcs Port					ARK Innovation ETF				
AUM (US\$bn)					AUM (US\$bn)				
10.669					6.038				
Top Holding	Company	Market value (US\$mn)	% of Portfolio (3Q23)	% of Portfolio (3Q22)	Top Holding	Company	Market value (US\$mn)	% of Portfolio (3Q23)	% of Portfolio (3Q22)
1	Microsoft	2,493	23.4%	24.8%	1	Coinbase	547	9.1%	4.2%
2	Adobe	813	7.7%	5.8%	2	Tesla	524	8.7%	9.1%
3	Salesforce Inc	648	6.1%	4.9%	3	Zoom Video	480	8.0%	9.4%
4	Alphabet Inc	324	3.0%	3.0%	4	Roku	471	7.8%	6.6%
5	Intuit	318	3.0%	1.3%	5	UiPath Inc	426	7.1%	4.6%
6	Oracle	285	2.7%	1.9%	6	Block	303	5.0%	4.7%
7	Workday	276	2.6%	1.6%	7	Roblox	271	4.5%	3.8%
8	Autodesk	266	2.5%	2.5%	8	DraftKings Inc	255	4.2%	3.3%
9	Palo Alto	262	2.5%	2.8%	9	Twilio	246	4.1%	4.4%
10	Cognizant	220	2.1%	2.3%	10	Unity	209	3.5%	3.2%
T. Rowe Price Science & Tech Adv					Janus Henderson Global Technology and Innovation Fund				
AUM (US\$bn)					AUM (US\$bn)				
6.975					4.939				
Top Holding	Company	Market value (US\$mn)	% of Portfolio (3Q23)	% of Portfolio (3Q22)	Top Holding	Company	Market value (US\$mn)	% of Portfolio (3Q23)	% of Portfolio (3Q22)
1	Microsoft Corp	721	10.41%	9.05%	1	Microsoft Corp	536	10.9%	12.8%
2	Alphabet Inc	573	8.28%	9.33%	2	NVIDIA Corp	384	7.8%	/
3	NVIDIA Corp	508	7.33%	4.64%	3	Apple	295	6.0%	6.0%
4	Salesforce Inc	376	5.43%	8.69%	4	Meta	222	4.5%	/
5	Amazon	300	4.34%	8.03%	5	TSMC	220	4.5%	3.7%
6	QUALCOMM	271	3.92%	2.68%	6	Workday Inc	216	4.4%	4.0%
7	Accenture PLC	250	3.60%	3.51%	7	Alphabet	187	3.8%	3.6%
8	Zalando SE	212	3.07%	3.41%	8	Adobe	181	3.7%	/
9	Texas Instru.	196	2.83%	/	9	ASML	173	3.5%	5.8%
10	AMD	177	2.55%	2.49%	10	Lam Research	171	3.5%	2.8%

Source: Company data, CMBIGM

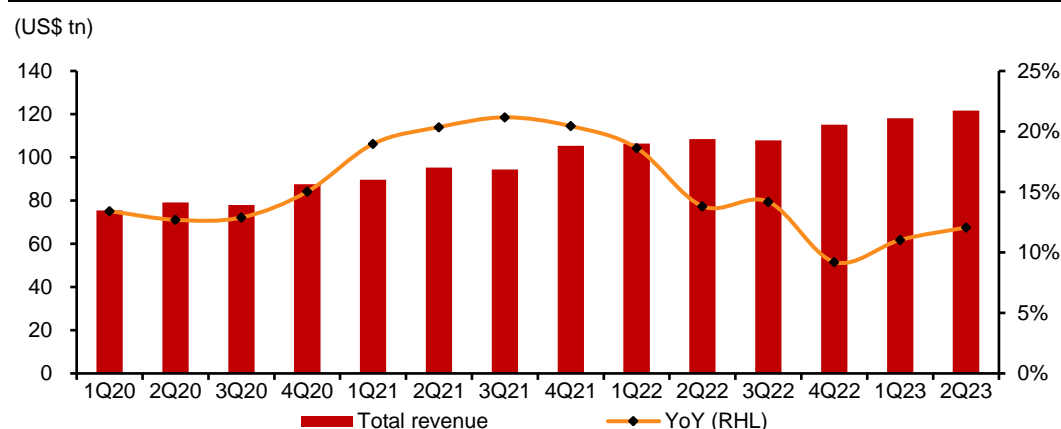
Revenue growth recovery and improving margin in 2023

We summarize and analyse the quarterly financial performance of the top 50 US-listed software companies (by market cap). We note that US software sector revenue growth began to reaccelerate and the operating margin also improved in 2023, which in our view supported the stock price rally YTD.

After the deceleration of total revenue growth amid global macro headwinds in 2022, US software revenue growth gradually reaccelerated in 2023 on an easier base. Based on our estimate, total revenue was up by 12% YoY to US\$121.6bn in 2Q23 (4Q22/1Q23: +9/11% YoY).

For FY24E, we expect software revenue growth to remain resilient as the US and global economy navigate the downturn cycle. We estimate Salesforce total revenue to grow by 11% in FY25E and ServiceNow total revenue to increase by 21% in FY24E.

Figure 11: US software: total revenue growth trend

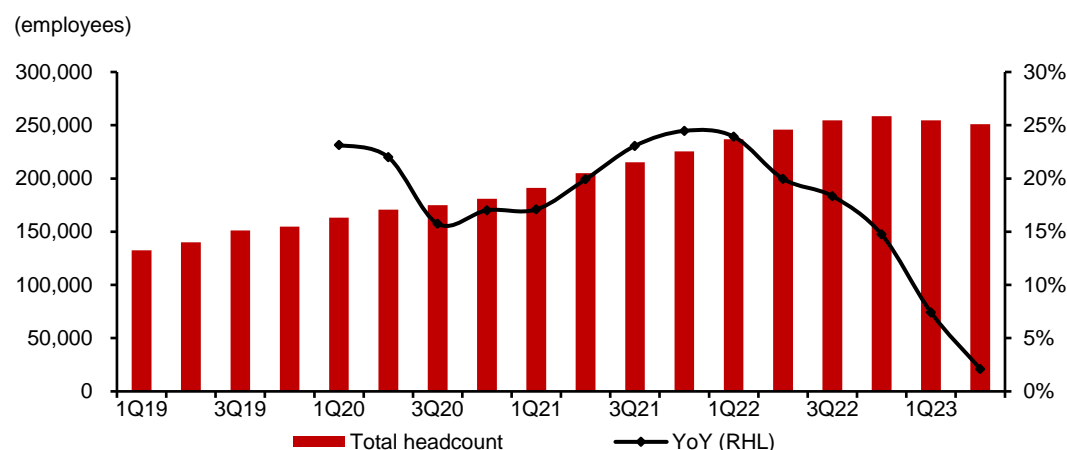


Source: Company data, CMBIGM

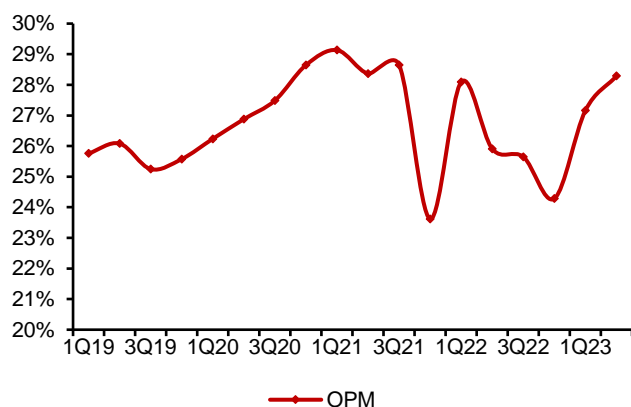
Note: Our universe of US software companies includes top 50 US listed software companies by market cap

Besides, since the end of 2023, several software companies improved their operating efficiency through reducing headcount, controlling expenses and optimizing workforce, etc. Total headcount growth reached a 3-year low at merely 2% YoY in 2Q23. This has unleashed operating leverage of software companies. The sector OPM rose by 2.4/1.1ppt YoY/QoQ to 28.3% in 2Q23. Total operating income was up 22.4% YoY in 2Q23.

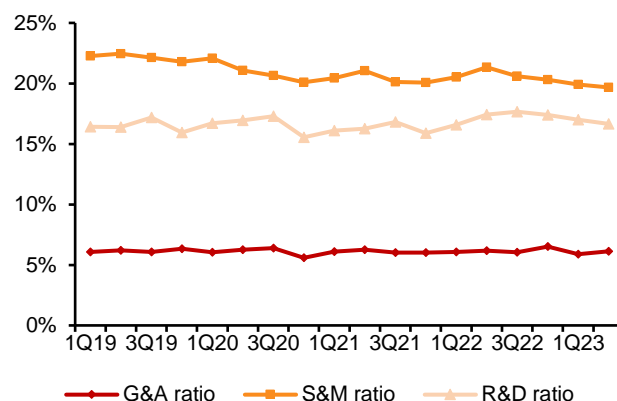
Looking ahead, we see further room for software companies to enhance their operating efficiency, especially on the selling and marketing front. We forecast Salesforce S&M expense ratio to decline from 43.1% in FY23 to 34.0% in FY26E, driving overall non-GAAP OPM to improve from 22.5% in FY23 to 34.9% in FY26E.

Figure 12: US software: total headcount

Source: Company data, CMBIGM

Figure 13: US software: OPM trend

Source: Company data, CMBIGM

Figure 14: US software: operating expenses trend

Source: Company data, CMBIGM

Generative AI to boost long-term business growth

With the rapid development of LLM and generative AI, SaaS companies actively invested in AI and launched new AI solutions in 2023. Given their long-term investment in R&D and tech infrastructure, software companies are well-positioned to capture the AI opportunities, which may enlarge their monetization potential or improve operating efficiency.

Figure 15: SaaS company: generative AI development

Company	Ticker	AI & LLM development
Oracle	ORCL US	Oracle's has a multi-tier strategy focused on AI, and has taken on rival cloud providers with its OCI Supercluster, and extensive addition of generative AI assistants to its Fusion and Netsuite: 1) provide a robust infrastructure for training and serving models at scale through partnership with NVIDIA; 2) enable new generative AI services and business functions through partnership with Cohere; 3) embed generative AI from Cohere into its Fusion, NetSuite, and Oracle's vertical SaaS portfolio to create solutions that provide organizations with the full power of generative AI.
Adobe	ADBE US	Released new generative AI models: Firefly Image 2 Model, Firefly Vector Model, and Firefly Design Model. Adobe's AI-powered advancements for Document Cloud, GenAI and Firefly are built into its flagship applications, signifying an AI-focused approach towards its products.
Salesforce	CRM US	1) In June 2023, Salesforce announced AI Cloud. AI Cloud is built for CRM – supercharging customer experiences and company productivity by bringing together AI, data, analytics, and automation to provide trusted, open, real-time generative AI that is enterprise ready; 2) In Sep 2023, Salesforce announced a rebrand of its Einstein 1 Data Cloud and new capabilities for the Einstein generative AI assistant for CRM.

SAP	SAP US	1) Newly launched SAP Ariba Category Management solution will leverage generative AI to help procurement professionals build extensive and effective category strategies faster; 2) announced Joule, a natural-language, generative AI copilot that will transform the way business runs; 3) announced investments in three major generative AI players: Anthropic, Cohere, and Aleph Alpha.
Intuit	INTU US	Intuit is launching a generative AI software tool for its full set of financial, tax, and accounting software. Over the coming months, Intuit will roll out its Intuit Assist software across all of its software products, including TurboTax, Credit Karma, QuickBooks, and Mailchimp. Intuit plans to make the tools available to all users without any additional charge.
ServiceNow	NOW US	Working on new generative AI models that are not trained on public data available on the internet, but are tailored explicitly to understanding some of the exact problems that enterprises have and trying to address those problems. The company will not sell the language models but to sell the ability to leverage the ServiceNow platform to create end-to-end digital transformations which involve generative AI.
Workday	WDAY US	Workday has launched a series of HCM and Adaptive Planning update along with generative AI tools for enterprises, managers and developers recently. It has announced AI Marketplace to help customers easily discover and deploy industry-leading AI and ML solutions
Atlassian	TEAM US	Developing some AI-powered features such as Jira Work Management, Confluence Smart Links, and Trello Smart Cards. Atlassian's AI initiatives are aimed at enhancing team productivity, automating repetitive tasks, and providing actionable insights to improve decision-making. The introduction of AI into their suite of products is a natural progression from their focus on collaboration and efficiency.
Autodesk	ADSK US	Autodesk announced Maya Assist, an AI tool that it has developed with Microsoft. The product aims to allow artists to automatically manipulate scenes using natural language text prompts directly in Maya. For example, you can ask to copy an object, increase its size by 25%, or add a camera and aim it anywhere.
CrowdStrike	CRWD US	Unveiled its new generative AI cybersecurity analyst tool, dubbed Charlotte AI, which enables Falcon platform users with varying levels of security expertise to ask questions using natural language prompts.
Datadog	DDOG US	Announced the launch of Bits, a new generative AI-based assistant that learns from customers' observability data and helps engineers resolve application issues in real time.
HubSpot	HUBS US	Announced a comprehensive AI strategy HubSpot AI. The purpose of HubSpot AI is to make it easier for marketers and salespeople to do their jobs, and the company has access to a number of different types of content to help train their models.
Zoom	ZM US	1) Announced its new AI Companion, a suite of generative AI (GAI) tools available at no additional cost to paid Zoom subscribers; 2) unveiled Zoom IQ, which is zoom's first GAI features, in June 2023; 3) will gradually release a "significant expansion" of upgraded GAI features in the coming months.
Okta	OKTA US	Announced a series of features and functionalities across the company's two core products, all powered by Okta AI. A new product is Identify Threat Protection, to provide real-time detection and remediation for identity-based threats.
Twilio	TWLO US	Unveiled Customer AI, a set of capabilities woven throughout all of Twilio's products that couples the power of large language models (LLMs) with real-time customer data flowing through Twilio's Customer Engagement Platform.

Source: Company data, CMBIGM

Industry risks

Slower-than-expected interest rate cuts cause valuation to decline

We see the benign interest rate environment further boost the US software sector valuation YTD. However, if the interest rate cuts are slower than market expectation or the magnitude of interest rate cuts is lower-than-expected, the overall sector valuation may decline.

Adverse economic condition leads to tightening software budget

Enterprise digitalisation demand is closely tied to the macro environment and employment. If the global economy condition is worse than expected, software sector revenue and earnings growth may slow down.

Intensifying competition

US software sector is competitive and the technology evolves rapidly. Intensifying competition may lead to margin erosion.

Salesforce (CRM US)

Driving quality earnings growth

Initiate at BUY. Salesforce is a leading CRM company, taking a global CRM market share of 23.0% in 2022. The company offers a comprehensive CRM solution which unites sales, service, marketing, commerce and IT teams to create a complete view of customers. The solution allows enterprises to be more productive and responsive to customer demand and market opportunities. The company has established strong moats across its product offerings, customer base and S&M capabilities. Amid macro headwinds, Salesforce has gradually entered a new cycle to drive more profitable growth. We estimate non-GAAP operating income to increase by a CAGR of 28% over FY24-26E. Initiate coverage on Salesforce with a BUY rating and target price of US\$329.3 (based on 24x FY24 EV/EBITDA).

- Multiple engines to drive durable growth.** Salesforce has established three key pillars to drive durable revenue growth: 1) land and expand: 82% of incremental ARR (annual recurring revenue) was from installed base in FY23 (FY21: 77%) and 96% of total ARR was from customers with multi-cloud adoption in FY23 (FY21: 93%); 2) industry solutions: Compared to the core offerings, the Industry Clouds have 30% higher ASPs. In FY23, the ARR of industry clouds reached US\$3.8bn, which accounted for c.12% of total revenue; and 3) geographic expansion: Salesforce international ARR represented only 12% of the international TAM in 2022, while its North America ARR represented 17% of the North America TAM.
- Strong leadership in expanding global CRM market.** According to Gartner, global TAM of CRM is expected to grow at a CAGR of 13% over 2022-2026E and reach US\$298bn in 2026E, with the sales/service/digital/platform/data cloud each accounting for 11/18/25/19/28% of the TAM in 2026. The digital cloud market (marketing & commerce) may deliver the fastest growth over 2022-2026E (CAGR: 16%), followed by sales/service cloud (CAGR: 14/14%). Leveraging its diversified service offerings, Salesforce is well-positioned to capture the market opportunities in the global CRM market, in our view. Salesforce has established a strong leadership in the global CRM market, with a market share of 23% in 2022, significantly higher than that of other players in the market.
- Balancing growth and profitability.** We forecast Salesforce's total revenue to grow at a CAGR of 11.0% over FY24-26E and reach US\$42.9bn in FY26E, driven by its land-and-expand strategy, expansion in global reach and industry cloud growth. Looking ahead, the company will focus more on balancing profitability and revenue growth. It aims to bring its S&M expense ratio down to below 35% by FY26E (FY23: 43.1%) via increasing self-service and partner-led sales, improving sales representative productivity and executing its land-and-expand strategy. We estimate its non-GAAP operating income to increase by a CAGR of 28% over FY24-26E, with OPM expanding from 22.5% in FY23 to 34.9% in FY26E.

Earnings Summary

(YE 31 Jan)	FY22A	FY23A	FY24E	FY25E	FY26E
Revenue (US\$ mn)	26,492	31,352	34,998	38,938	42,919
YoY growth (%)	24.7	18.3	11.6	11.3	10.2
Adjusted net profit (US\$ mn)	4,659.0	5,224.0	8,168.4	9,623.8	11,438.9
EPS (Adjusted) (US\$)	4.88	5.27	8.23	9.70	11.53
Consensus EPS (US\$)	4.88	5.27	8.20	9.67	11.13
P/S (x)	10.1	8.5	7.6	6.9	6.2
P/E (x)	163.9	813.1	72.9	58.1	47.8

Source: Company data, Bloomberg, CMBIGM estimates

BUY

Target Price **US\$329.30**
 Up/Downside **17.6%**
 Current Price **US\$279.94**

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Stock Data

Mkt Cap (US\$ mn)	267,342.7
Avg 3 mths t/o (US\$ mn)	1,403.4
52w High/Low (US\$)	280.88/161.62
Total Issued Shares (mn)	955.0
Source: FactSet	

Shareholding Structure

The Vanguard Group	8.2%
BlackRock	7.1%

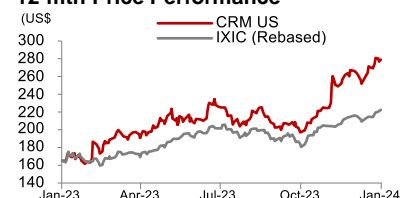
Source: Company data

Share Performance

	Absolute	Relative
1-mth	5.2%	2.6%
3-mth	42.6%	16.3%
6-mth	24.1%	13.4%

Source: FactSet

12-mth Price Performance



Source: FactSet

Salesforce: investment thesis

Strong leadership in expanding global CRM market

Salesforce has established a strong leadership in the global CRM market, with a market share of 23% in 2022 (versus Microsoft/Oracle/SAP/Adobe: 5.7/4.8/4.6/3.6%). Salesforce offers a comprehensive CRM solution which unites sales, service, marketing, commerce and IT teams to create a complete view of customers. The solution allows enterprises to be more productive, efficient and responsive to customer demand and market opportunities. The company has established strong moats across its product offerings, customer base and S&M capabilities. The macro impact on global IT budget has been largely priced in. Salesforce has gradually entered a new cycle to drive more profitable growth, which further eases investor concern on Salesforce's heavy investment in S&M and relatively low margin versus peers. We initiate coverage on Salesforce with a BUY rating and target price of US\$329.3 (based on 24x FY24E EV/EBITDA).

Multiple engines to drive durable growth

Salesforce has established three key pillars to drive durable revenue growth and expand in the growing addressable market across all service offerings. 1) The land and expand strategy: Salesforce has a strong track record of "land and expand". Customers which made their initial purchase in FY07 grew their average ARR contribution by 47.7 times and the cloud count to 5.8 (vs. 1.2 cloud in FY07) in FY23. 82% of incremental ARR was from the installed base in FY23 (FY21: 77%) and 96% of total ARR was from customers with multi-cloud adoption in FY23 (FY21: 93%). 2) Industry solutions: Salesforce offers innovative and customized solutions to industry customers, such as financial services, healthcare and life sciences. Compared to the core offerings, the Industry Clouds have 30% higher ASPs. In FY23, the ARR of industry clouds reached US\$3.8bn, which accounted for c.12% of total revenue. 3) Geographic expansion: Salesforce has enormous room to increase its penetration in the international market. The company's international ARR represented 12% of the international TAM in 2022, while the company's North America ARR represented 17% of the North America TAM.

Global CRM TAM to reach US\$298bn in FY26E

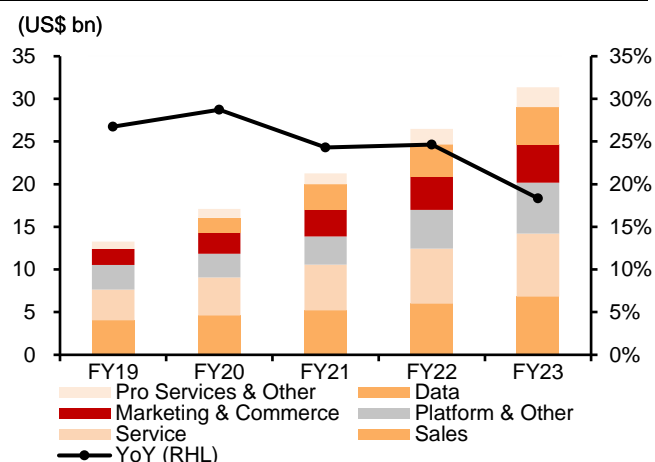
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Focus on profitable growth

We forecast Salesforce's total revenue to grow at a CAGR of 11.0% over FY24-26E and reach US\$42.9bn in FY26E, driven by its land-and-expand strategy, expansion in global reach and its industry cloud growth. Looking ahead, the company will also focus more on enhancing operating margin to balance profitability and revenue growth. It aims to manage its S&M expense ratio down to below 35% by FY26E (FY23: 43.1%) via increasing self-service and partner-led sales, improving sales representative productivity and executing its land-and-expand strategy. We expect S&M expense ratio to decline from 43% in FY23 to 36/35/34% in FY24/25/26E. Salesforce also expects to save G&A expenses through workflow automation and hybrid workforce strategy. We forecast G&A expenses ratio to decline from 11% in FY23 to 10% in FY26E. We estimate non-GAAP operating income to increase by a CAGR of 28% over FY24-26E, with OPM expanding from 22.5% in FY23 to 34.9% in FY26E.

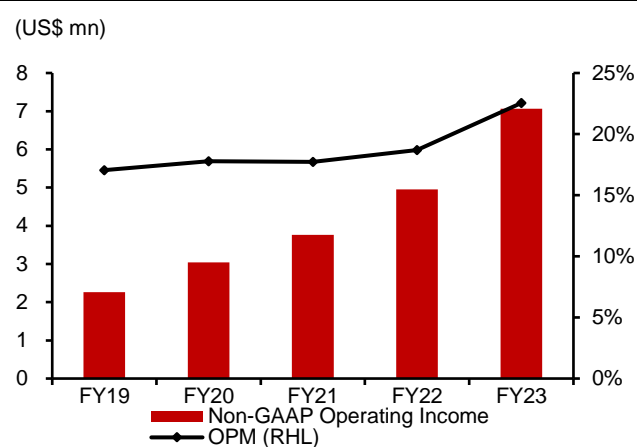
Salesforce: focus charts

Figure 16: Salesforce: total revenue trend



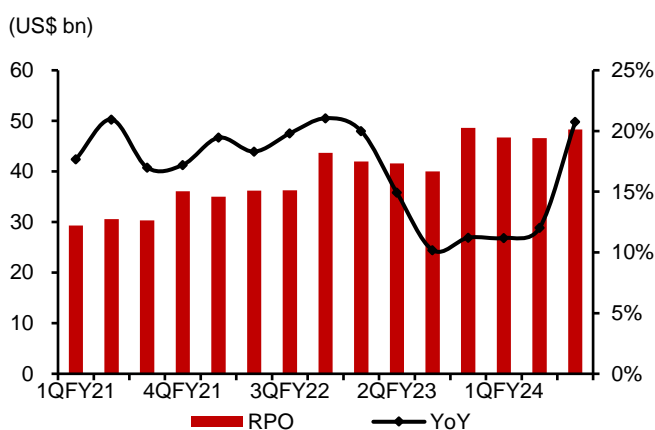
Source: Company data, CMBIGM

Figure 17: Salesforce: non-GAAP OP trend



Source: Company data, CMBIGM

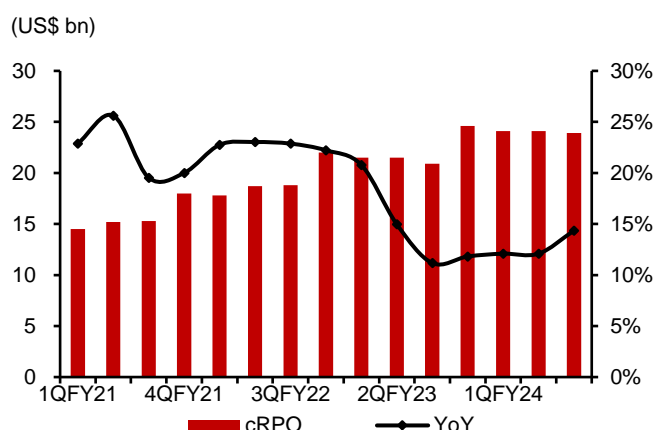
Figure 18: Salesforce: RPO trend



Source: Company data, CMBIGM

Note: RPO – remaining performance obligations

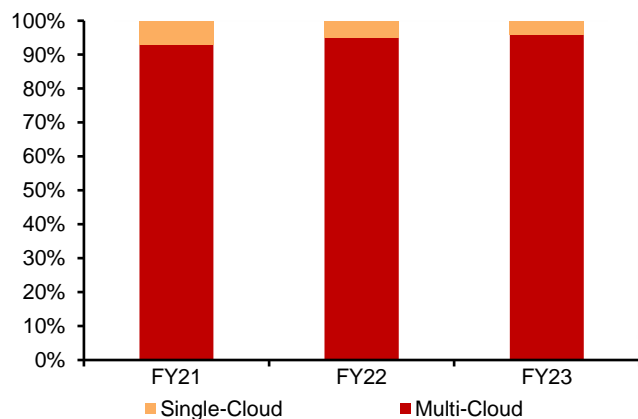
Figure 19: Salesforce: cRPO trend



Source: Company data, CMBIGM

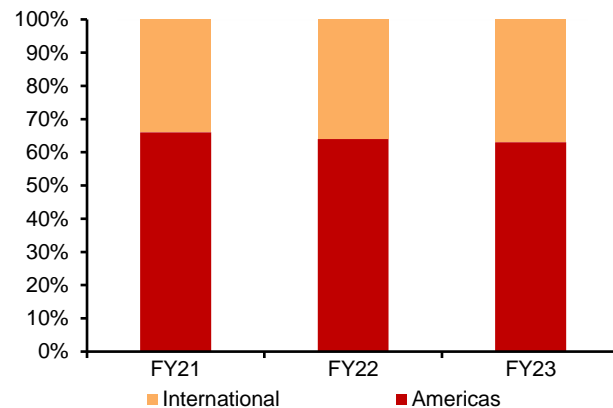
Note: cRPO – current remaining performance obligations

Figure 20: Salesforce ARR mix: cloud adoption



Source: Company data, CMBIGM

Figure 21: Salesforce ARR mix: regional breakdown



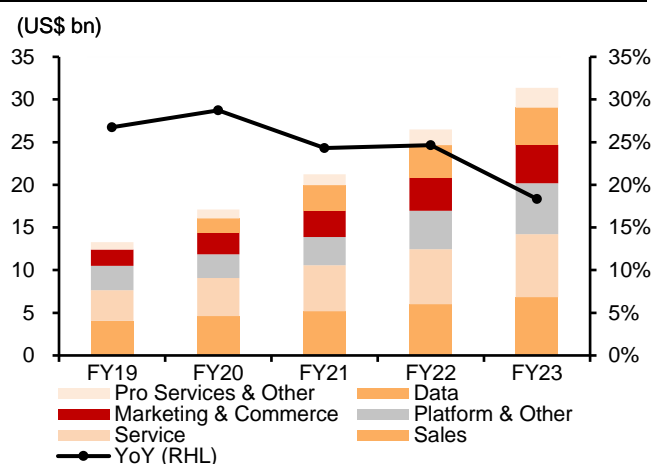
Source: Company data, CMBIGM

Salesforce: company overview

Founded in 1999, Salesforce is a leading customer relationship management (CRM) company, with a global market share of 23.0% in 2022 (per IDC). Based on its Customer 360 platform, Salesforce offers a comprehensive CRM solution which unites sales, service, marketing, commerce and IT teams by connecting data across systems and devices to create a complete view of customers. The solution allows enterprises to be more productive, efficient and responsive to customer demand and market opportunities. Salesforce sells its solutions to business worldwide based on the subscription model. Americas/Europe/APAC & other each accounted for 68/23/9% of total revenue in FY23.

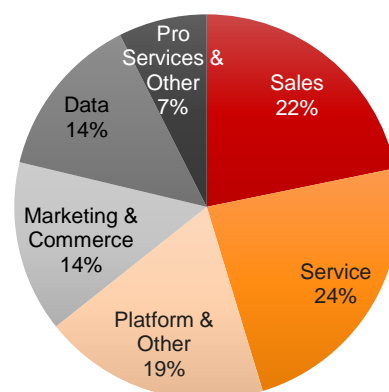
Salesforce Customer 360 mainly comprises the following. **1) Sales cloud (22% of FY23 revenue):** Sales offering enables sales team to automate the entire sales process from leads to opportunities to billing. **2) Service cloud (24% of FY23 revenue):** Service offering allows enterprises to serve clients in a trusted, personalized and efficient way. The offerings connect service agents with customers across multiple channels. **3) Platform and other (19% of FY23 revenue):** Platform offering is a platform that allows enterprises to build business apps on an efficient and low-cost basis. The segment also includes Slack offerings, which is a digital hub that connects employees, customers, partners and systems. **4) Marketing and commerce cloud (14% of FY23 revenue):** Marketing offerings enable companies to plan and optimize their marketing activities across multiple channels; Commerce offerings allow companies to unify their shopping experience across platforms. **5) Data cloud (14% of FY23 revenue):** Analytics offering (including Tableau) provides an end-to-end analytics tool to serve a board spectrum of enterprise uses cases; Integration offering (including MuleSoft) connects data from different systems in the enterprise to deliver connected experience.

Figure 22: Salesforce: total revenue trend



Source: Company data, CMBIGM

Figure 23: Salesforce: revenue breakdown (FY23)



Source: Company data, CMBIGM

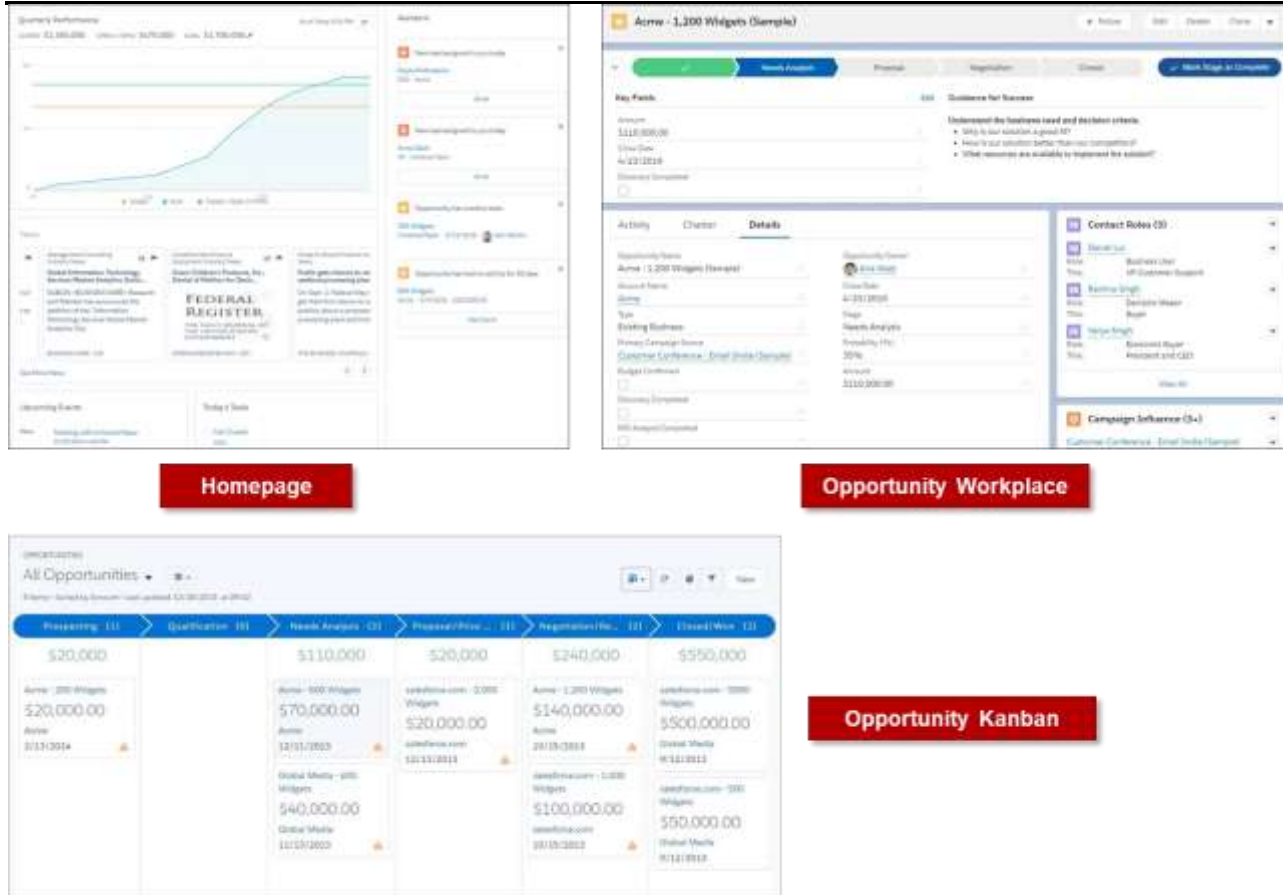
Figure 24: Salesforce: product offerings

Segment	Intro	Pricing	Adds-on/Applications
Sales	Foundation product of the sales segment. It can be used for sales activity management, lead management, account & opportunity management, forecast management, pipeline management, reports & dashboards, sales workflow & process automation, quoting & contract approvals, collaboration & optimization	Starter: US\$25 per user/month Professional: US\$80 per user /month Enterprise: US\$165 per user/month Unlimited: US\$330/month	Sales Engagement Enablement Partner Relationship Management Sales AI Sales Analytics
Service	A customer service platform that helps businesses manage and resolve customer inquiries and issues. It provides tools for case management, knowledge base, omni-channel support, automation, and analytics, enabling companies to deliver exceptional customer service experiences.	Starter: US\$25 per user/month Professional: US\$80 per user/month Enterprise: US\$165 per user/month Unlimited: US\$330/month	Customer Service AI Self-Service Experience Contact Center Field Service Digital Engagement (live chat)
Marketing	The marketing cloud enables companies to plan, personalize and optimize one-to-one customer marketing journeys, including interactions across email, mobile, social, web, Web3 and connected products.	Data Cloud Starter: US\$108,000/org/year	Data Cloud For Marketing Marketing Cloud Advertising Marketing Cloud Personalization Marketing Cloud Engagement
Commerce	Commerce offering empowers brands to unify the shopping experience across many points of commerce, including mobile, web, social and store	B2B Commerce Starter/Growth: 1/2% GMV B2C Commerce Starter/Growth/Plus: 1/2/3% GMV D2C Commerce: 1% GMV	Storefront Templates Composable Storefronts Headless Commerce Order Management
Data	1) Analytics, powered by Tableau, offers customers intelligent analytics capabilities to better see and understand their business data; 2) Integration, powered by MuleSoft, makes it easy to connect data from any system to deliver truly connected experiences.	Tableau Viewer: US\$15/user/month Tableau Explorer: US\$42/user/month Tableau Creator: US\$75/user/month	Analytics: Tableau Integration: MuleSoft
Platform and other	1) Platform: an easy, flexible platform that enables companies of all sizes, locations and industries to build business apps that bring them closer to their customers, with drag-and-drop tools that boost efficiency. 2) Slack: a system of engagement that digitally connects employees, customers, partners and systems with every application and every workflow.	Starter: US\$25 per user/month Plus: US\$100 per user/month	Platform
		Pro: US\$7.5 per user/month Business+: US\$12.5 per user/month Enterprise Grid: customize	Slack
Industry Verticals	Industry vertical service offerings are suited to meet the needs of customers in specific industries, such as financial services, healthcare and life sciences, manufacturing and more.	Starter - Enterprise: US\$250/user/month Starter - Unlimited: US\$425/user/month Growth - Enterprise: US\$325/user/month Growth - Unlimited: US\$500/user/month	Financial Services Cloud
		Sales: US\$250/user/month Service: US\$250/user/month Sales + Service: US\$275/user/month	Manufacturing Cloud
		Growth: US\$300/month Advanced: US\$450/month	Communication Cloud

Source: Company data, CMBIGM

Salesforce CRM offers a one-stop platform for enterprises to manage relationships with customers, help teams collaborate internally and externally, track important business metrics, communicate via different channels and explore business opportunities. Salesforce Homepage features several CRM tools to enhance the efficiency of the sales team. Other key features include Opportunity Workspace (display leads that are qualified to buy and the sales team can work on) and Opportunity Kanban (visualization tool to review deals organized by each stage in the pipeline).

Figure 25: Salesforce CRM interface



Source: Company data, CMBIGM

Salesforce: key milestones

Organic growth based on product innovations (1999-2009): During 1999-2009, Salesforce mainly drove organic business growth through its own product innovations. Salesforce has been one of the first tech companies to adopt the SaaS business model in the global IT marketplace. The company launched the industry's first on-demand application sForce 2.0 in 2003. Since then, Salesforce has followed the guideline of "no software" and continued to diversify its cloud product offerings. In 2005, Salesforce launched its AppExchange service, a PaaS platform which offers 3rd-party developers a cloud platform to develop their own applications. It enables customers to easily build and install apps on Salesforce's architecture. In 2009, Salesforce extended its SaaS offerings to Service Cloud, bringing customer service and support automation features to the market.

Stepping up acquisition to enrich product offerings and drive business growth (2010-2020): Moving into the 2010s, Salesforce began to step up acquisition in addition to its own product innovations, to driven business growth. Salesforce acquired 1) Heroku in 2010 to enhance its PaaS capability; 2) Radian6 in 2011 and ExactTarget in 2013 to supercharge the power of Marketing Cloud; 3) Demandware, an e-commerce platform, in 2016 to introduce its Commerce Cloud; 4) MuleSoft in 2018 and Tableau in 2019 to extend its SaaS offerings upon data cloud solutions. By 2020, Salesforce had built a comprehensive CRM platform, with four SaaS solutions (Sales/marketing/commerce/data clouds) based on a PaaS solution (Platform cloud).

Balancing growth and margin (2021 onwards): We see Salesforce entering a new period of balancing growth and profitability. There has been heightening concern about Salesforce's heavy investment in S&M and low personnel productivity since 2021. In response to the concern, Salesforce announced a restructuring plan (c.10% reduction of workforce and office space selection) in Jan 2023 to reduce operating costs and improve operating margins. The company expects its non-GAAP OPM to improve to c.30% in FY24E (FY23: 22.5%). We expect Salesforce to advance its ongoing commitment to profitable growth going forward.

Figure 26: Salesforce: product innovation



Source: Company data, CMBIGM

Three growth pillars to drive durable growth

Salesforce has established three key pillars to drive durable revenue growth and expand in the growing addressable market across all service offerings, namely: 1) land and expand strategy; 2) industry solutions; and 3) geographic expansion.

Figure 27: Salesforce: growth pillars

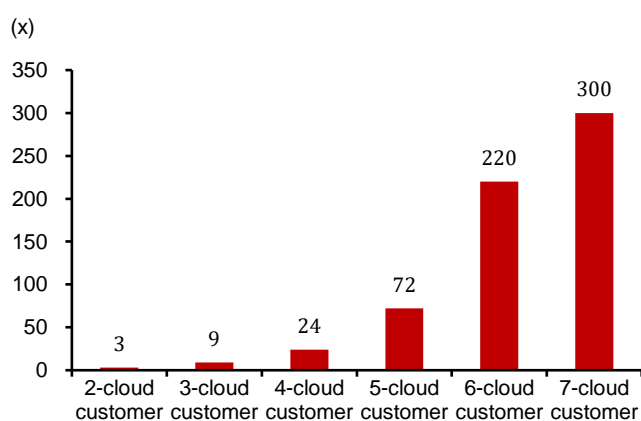


Source: Company data, CMBIGM

Land and expand strategy

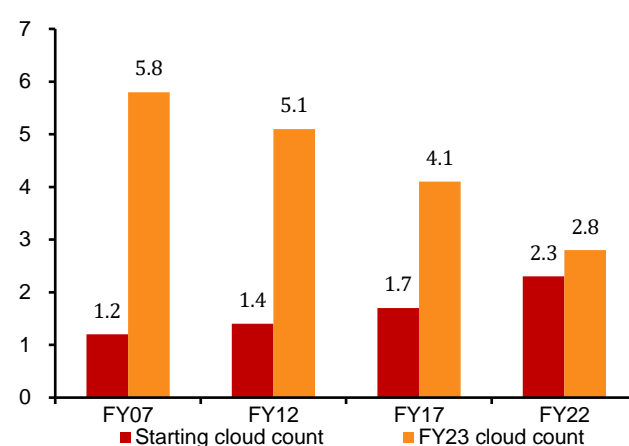
Salesforce has a strong track record of land and expand. Customers which made their initial purchase in FY07 grew their ARR contribution by 47.7 times and the cloud count to 5.8 (vs. 1.2 cloud in FY07) in FY23. The land and expand strategy helps increase customer ARR contribution, reduce the attrition rate and enhance sales efficiency. Average ARR of customers with 7 clouds is c.300 times higher than that of single-cloud customers, and the attrition rate of 7-cloud customers is also the lowest. Customers with 4+ clouds represented 20% of total customers but accounted for c.85% of total ARR in FY23.

Figure 28: Salesforce: average ARR per customer vs single-cloud customer



Source: Company data, CMBIGM

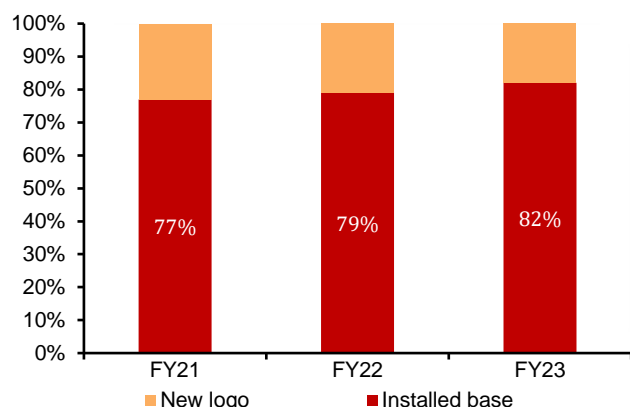
Figure 29: Salesforce: average number of clouds adopted by customers



Source: Company data, CMBIGM

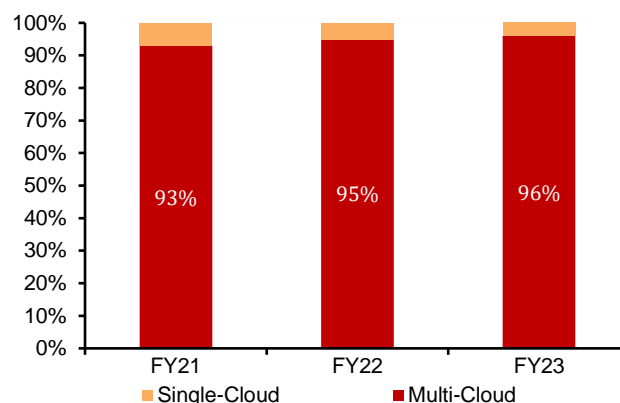
As Salesforce executes its land-and-expand strategy, 82% of incremental ARR was from the installed base in FY23 (FY21: 77%) and 96% of total ARR was from customers with multi-cloud adoption in FY23 (FY21: 93%).

Figure 30: Salesforce: % of incremental ARR



Source: Company data, CMBIGM

Figure 31: Salesforce: % of ARR



Source: Company data, CMBIGM

Industry Cloud

Besides standardized SaaS products, Salesforce also offers innovative and customized solutions to industry customers based on customer needs in the specific industries, such as financial services, healthcare and life sciences. Compared to the core offerings, the Industry Clouds have 30% higher ASPs and 2ppt lower attrition rate, and attract 45% customer new logos. In FY23, the ARR of industry clouds reached US\$3.8bn, which accounted for c.12% of total revenue.

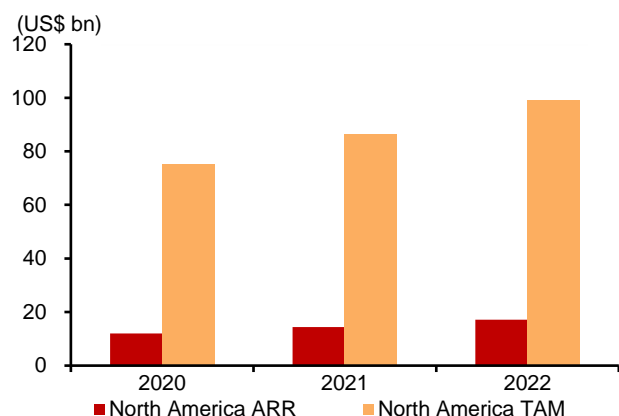
Figure 32: Salesforce: industry cloud solutions



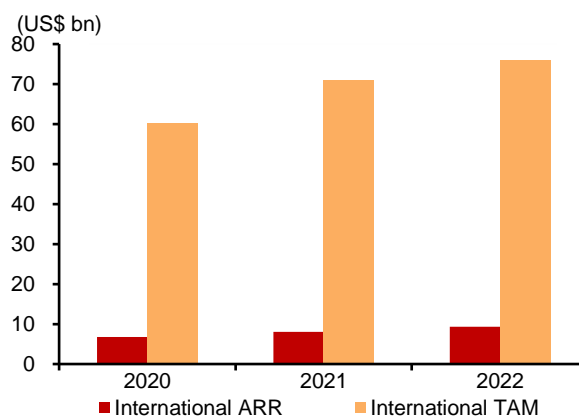
Source: Company data, CMBIGM

International strategy

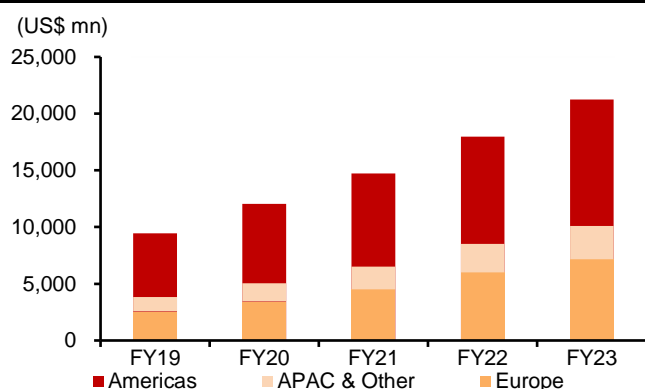
Salesforce continues to expand its go-to-market capabilities in the global market, primarily through the company's direct sales force and indirect distribution channels. We believe Salesforce has enormous room to increase its penetration in the international market. The company's international ARR represented 12% of the international TAM in 2022, while the company's North America ARR represented 17% of the North America TAM.

Figure 33: Salesforce: North America ARR vs TAM

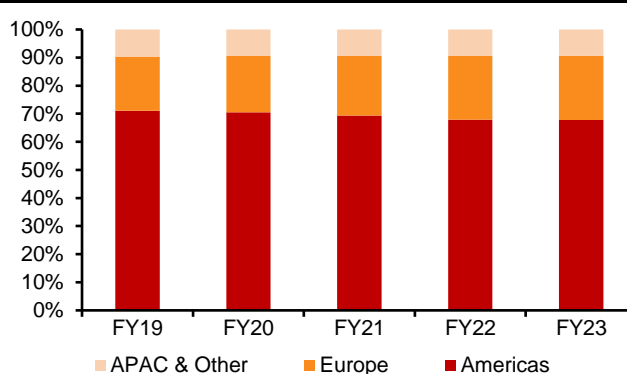
Source: Company data, CMBIGM

Figure 34: Salesforce: International ARR vs TAM

Source: Company data, CMBIGM

Figure 35: Salesforce: revenue mix by region

Source: Company data, CMBIGM

Figure 36: Salesforce: revenue mix by region (in %)

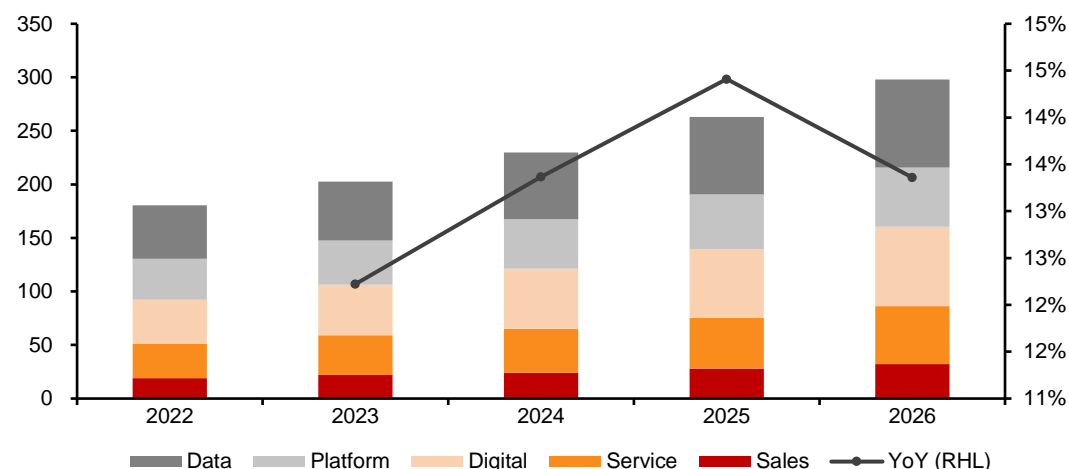
Source: Company data, CMBIGM

Global CRM: TAM to reach US\$298bn in FY26E

According to Gartner, global TAM of CRM is expected to grow at a CAGR of 13% over 2022-2026E and reach US\$298bn in 2026E, with the sales/service/digital/platform/data cloud each accounting for 11/18/25/19/28% of the TAM in 2026. The digital cloud market (marketing & commerce) may deliver the fastest growth over 2022-2026E (CAGR: 16%), followed by sales/service cloud (CAGR: 14/14%). Leveraging its diversified service offerings, Salesforce is well-positioned to capture the market opportunities in the global CRM market, in our view.

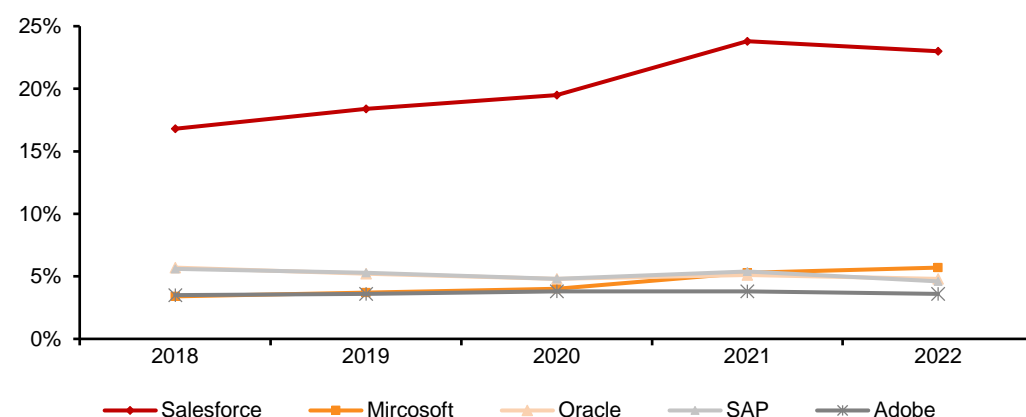
Figure 37: Global: CRM total addressable market

(US\$ bn)



Source: Gartner, CMBIGM

Salesforce has established a strong leadership in the global CRM market, with a market share of 23% in 2022, significantly higher than that of other players in the market. With enriched product offerings, improving go-to-market capabilities and rising global presence, Salesforce also increased its market share from 16.8% in 2018 to 23.0% in 2022.

Figure 38: Worldwide CRM market share

Source: IDC, CMBIGM

Salesforce has also been recognized as a leader in Gartner Sales Force Automation Magic Quadrant for 16 consecutive years, mainly due to its comprehensive product offerings, strong business track record, and successful global customer deployment in a wide range of industries.

Figure 39: Magic Quadrant for Sales Force Automation Platforms



Source: Gartner, CMBIGM

Per Gartner survey, Salesforce was acknowledged by its customers for its: 1) innovation capabilities: Salesforce continues to innovate to provide customers with advanced solutions; 2) deep market understanding: Salesforce integrates different modules and features to enable customers to capture the latest market trends; and 3) strong sales strategy: Salesforce has a strong direct sales team to provide customers with the top-notch service quality. That said, Gartner also noted several weaknesses in Salesforce offerings, such as high pricing and confusing product strategy.

Figure 40: Sales Force Automation Vendors: a comparison

Company	Strength	Weakness
Salesforce	<p>1) Innovation: continuous innovation, with newly-added Slack-based SFA module and sales training features to its current offerings</p> <p>2) Market understanding: ability to tie the future of digital buying and selling into its SFA offerings; it released subscription management and commerce cloud integrated within the Sales Cloud module</p> <p>3) Sales strategy: strong sales strategy aimed at supporting self-service and product-led growth motions</p>	<p>1) Pricing execution: heightening concern with costs and Salesforce not accommodating pricing sensitivities or demanding additional spend for further value realization.</p> <p>2) Product strategy: rising confusion about Salesforce's product offerings, with many unsure of differences between Sales Cloud and vertical industry solutions that include Sales Cloud components.</p> <p>3) Account and contact management: Building account and contact scoring models depend on the procurement of Salesforce's Marketing Cloud Account Engagement product (formerly Pardot), other add-on products.</p>

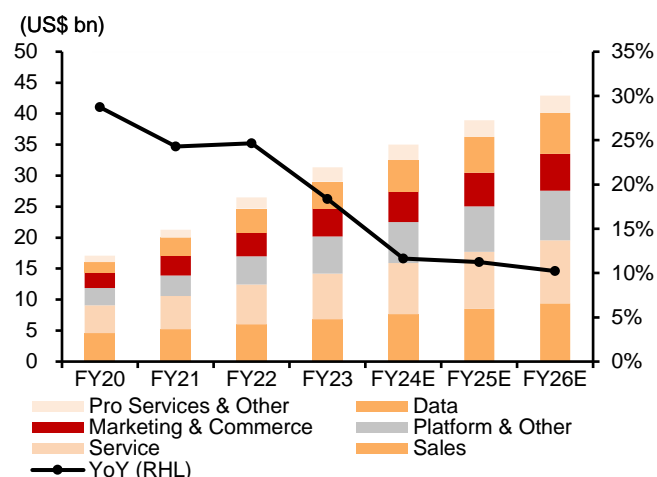
Microsoft	<p>1) Market strategy: continue to expand on embedding the Microsoft Office ecosystem of products into the Dynamics 365 Sales product and vice versa</p> <p>2) Activity management: has improved its conversation intelligence features, a part of activity management, with an included timeline slicer</p> <p>3) Marketing execution: consistently among the most shortlisted SFA vendors</p>	<p>1) PRM: PRM capabilities are limited. It does not allow native Dynamics 365 Sales support for content distribution channels via its partner portal capabilities. It often requires the use of Microsoft Office products and Azure. Microsoft also often relies on a third-party ISV to fulfill these needs.</p> <p>2) Roadmap Communication: Sales organizations looking for a firm roadmap and vision, should press Microsoft for more concrete features and releases.</p> <p>3) Product strategy: released Viva Sales as an additional productivity product, but planned to market this product as part of its Viva product line versus augmenting and restricting this to the Dynamics 365 Sales product only.</p>
Oracle	<p>1) Marketing understanding: offers some important features that improve the seller experience by automating routine data entry</p> <p>2) Market strategy: offers functions tailored for a range of verticals including automotive, CPG, financial services, high tech, manufacturing and utilities.</p> <p>3) Sales forecasting: the forecasting features included in Oracle Sales scored well above-average</p>	<p>1) Sales strategy: lacks a comprehensive Oracle Sales strategy specifically for SMB customers, deferring this segment to the NetSuite product</p> <p>2) ISV marketplace: Oracle does not have a robust, third-party application ecosystem for sales-specific applications and lacks prebuilt integrations to some common sales technology add-ons</p> <p>3) Activity management: it does not natively support integration with Google email and calendar; besides, conversation intelligence is not native but supported via add-on from a third-party CTI solution</p>
SAP	<p>1) Marketing understanding: Its added ML capabilities support the identification of potential opportunities and leads, as well as the building of strong customer relationships throughout a sales cycle.</p> <p>2) Embedded CRM technology: SAP CX solutions work with the SAP ERP ecosystem, HR solutions and other SAP products. It supports a CRM- and ERP-connected journey.</p> <p>3) Collaboration through teams: introduced Microsoft Teams integration, guided selling via Teams and the execution of sales workflows within the embedded application.</p>	<p>1) Product functionality: some of SAP clients said that the vendor is not delivering the business value they want from their sales technology implementations</p> <p>2) UI and UX: specific functionality and customizations are often difficult to add, UI and UX releases are delivered more slowly</p> <p>3) Differentiation: SAP's SFA capabilities are less differentiated in innovation</p>
HubSpot	<p>1) Content Tacking for sellers: Users can take advantage of HubSpot's deep marketing technology footprint and sales enablement features, such as buyer engagement analytics on content open and dwell time.</p> <p>2) Flexible sales revenue models: Sales Hub Enterprise edition can easily support multiple revenue models at once</p> <p>3) Customization-Enabled: Sales Hub Enterprise edition can easily support multiple revenue models at once</p>	<p>1) Market strategy: HubSpot lags most vendors on its ability to successfully communicate its product to B2B, B2C and indirect channel sales needs.</p> <p>2) Vertical Strategy: does not have an approach to tackling specific vertical use cases, nor does it intend to go into vertical markets.</p> <p>3) Partner Relationship Management: It does not have a module to support indirect selling, and it lacks understanding of indirect selling needs, often deferring such work to its partner program for custom-built solutions.</p>

Source: Gartner, CMBIGM

Salesforce: financial forecast and valuation

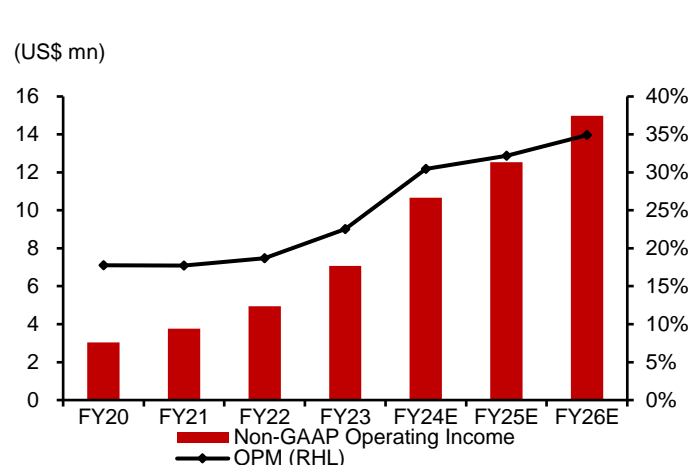
We forecast total revenue to grow at a CAGR of 11.0% over FY24-26E and reach US\$42.9bn in FY26E, mainly attributable to its land-and-expand strategy, expansion in global reach and its industry cloud growth. Looking ahead, the company will also focus more on enhancing operating margin to balance profitability and revenue growth. We estimate non-GAAP operating income to increase by a CAGR of 28% over FY24-26E, with OPM expanding from 22.5% in FY23 to 34.9% in FY26E.

Figure 41: Salesforce: total revenue trend



Source: Company data, CMBIGM estimates

Figure 42: Salesforce: non-GAAP operating income



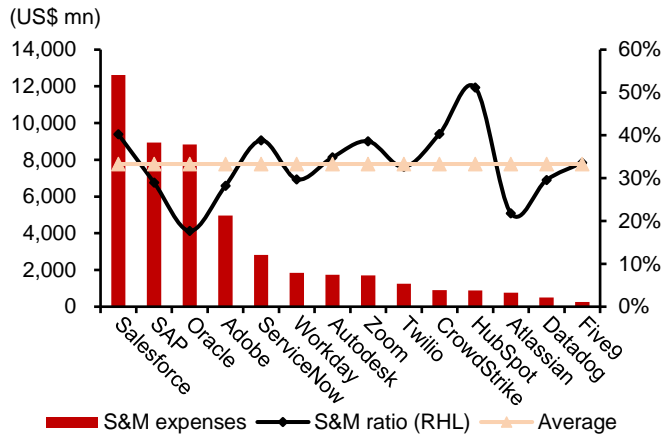
Source: Company data, CMBIGM estimates

Figure 43: Salesforce: financial forecast

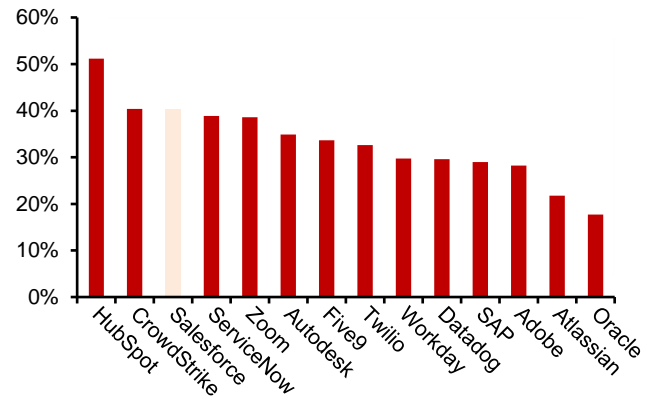
(US\$ bn)	FY21	FY22	FY23	FY24E	FY25E	FY26E
Total revenue	21.3	26.5	31.4	35.0	38.9	42.9
YoY	24.3%	24.7%	18.3%	11.6%	11.3%	10.2%
Subscription & Support	20.0	24.7	29.0	32.5	36.3	40.1
YoY	24.5%	23.4%	17.7%	12.1%	11.5%	10.6%
Sales	5.2	6.0	6.8	7.7	8.5	9.4
YoY	12.9%	15.4%	14.1%	12.0%	11.4%	10.5%
Service	5.4	6.5	7.4	8.3	9.2	10.2
YoY	20.4%	20.4%	13.8%	12.0%	11.4%	10.5%
Platform & Other	3.3	4.5	6.0	6.6	7.3	8.0
YoY	19.3%	35.6%	32.3%	11.0%	10.5%	9.6%
Marketing & Commerce	3.1	3.9	4.5	5.0	5.4	5.9
YoY	25.0%	24.5%	15.7%	10.0%	9.5%	8.7%
Data	3.0	3.8	4.3	5.0	5.8	6.6
YoY	75.0%	28.2%	14.7%	16.0%	15.2%	14.0%
Professional Services & Other	1.3	1.8	2.3	2.5	2.7	2.8
YoY	20.9%	43.8%	27.0%	6.0%	8.0%	5.0%
Gross profit margin	74.4%	73.5%	73.3%	73.9%	74.4%	75.0%
S&M expense ratio	45.5%	44.7%	43.1%	36.0%	35.0%	34.0%
R&D expense ratio	16.9%	16.9%	16.1%	14.0%	14.0%	14.0%
G&A expense ratio	9.8%	9.8%	10.8%	10.0%	9.8%	9.7%
Non-GAAP OPM	17.7%	18.7%	22.5%	30.5%	32.2%	34.9%
Non-GAAP operating income	3.8	5.0	7.1	10.7	12.5	15.0
Non-GAAP net income margin	21.6%	17.6%	16.7%	23.3%	24.7%	26.7%
Non-GAAP net income	4.6	4.7	5.2	8.2	9.6	11.4

Source: Company data, CMBIGM estimates

Salesforce's margin was under pressure due to heavy investment in its go-to-market capability. Total S&M expenses were US\$13.5bn in FY23 and were significantly higher than the other SaaS platforms at its scale. Its S&M expense ratio was 43.1% in FY23, which was also above the sector average.

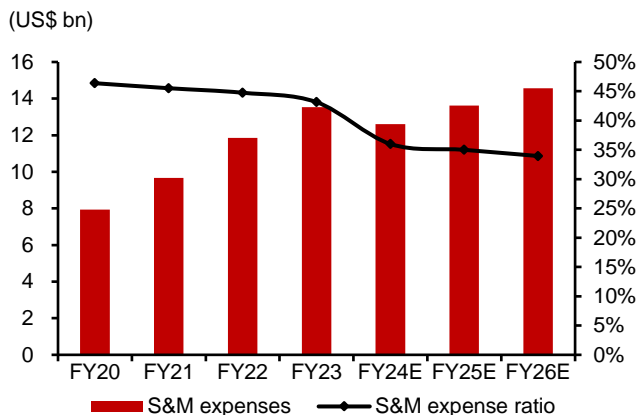
Figure 44: S&M expenses comparison (2022)

Source: Company data, CMBIGM

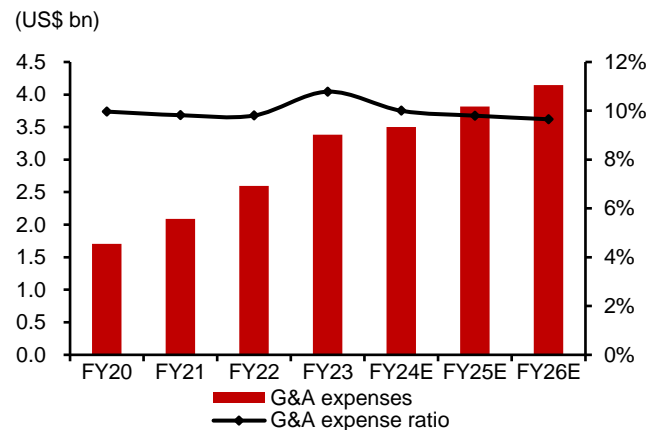
Figure 45: S&M expense ratio comparison (2022)

Source: Company data, CMBIGM

The company aims to manage its S&M expense ratio down to below 35% by FY26E (FY23: 43.1%) via increasing self-service and partner-led sales, improving sales representative productivity and executing its land-and-expand strategy. We expect its S&M expense ratio to decline from 43% in FY23 to 36/35/34% in FY24/25/26E. Salesforce also expects to save G&A expenses through workflow automation and hybrid workforce strategy. We forecast G&A expense ratio to decline from 11% in FY23 to 10% in FY26E.

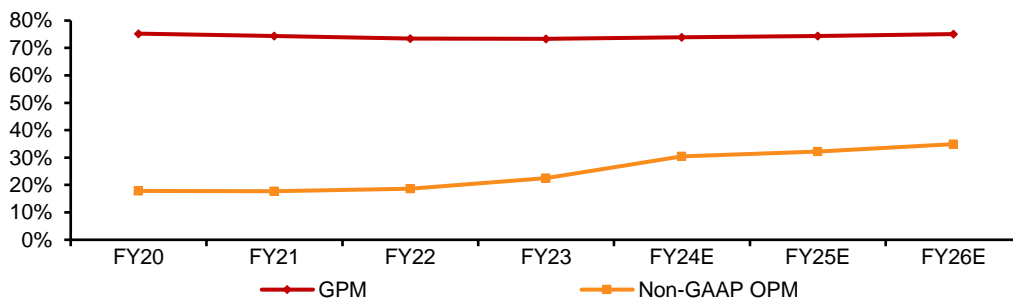
Figure 46: Salesforce: S&M expense ratio

Source: Company data, CMBIGM estimates

Figure 47: Salesforce: G&A expense ratio

Source: Company data, CMBIGM estimates

As Salesforce completes its restructuring plan to enhance operating efficiency by FY24, we forecast non-GAAP operating margin to increase by 10ppt YoY to 30.5% in FY24E. Salesforce will focus more on driving profitable growth in the future.

Figure 48: Salesforce: margin

Source: Company data, CMBIGM estimates

Valuation and risks

We value Salesforce at US\$328.3bn (US\$329.3 per share) based on 24x FY24E EV/EBITDA. Our target EV/EBITDA is at a discount to the sector average (34x), given Salesforce earnings growth has entered a more mature stage.

Figure 49: Salesforce: target valuation

EV/EBITDA Valuation (US\$mn)	FY24E
Adjusted EBITDA	13,123
Target FY24E EV/EBITDA	24.0
Target EV	314,956
Net cash	13,368
Target equity valuation	328,324
Valuation per share (USD)	329.3

Source: Company data, CMBIGM estimates

Figure 50: SaaS: valuation comparison

Companies	Ticker	Price (Local)	2023E	EV/Sales (x) 2024E	2025E	2023E	EV/EBITDA (x) 2024E	2025E	Rev CAGR 22-25E
CRM									
Salesforce	CRM US	279.9	NA	7.9	7.1	NA	19.8	18.0	11%
HubSpot	HUBS US	588.7	13.5	11.5	9.6	75.1	61.7	47.8	21%
Five9	FIVN US	77.2	6.4	5.5	4.6	36.1	31.1	23.9	17%
ITSM									
ServiceNow	NOW US	769.4	17.3	14.2	11.8	54.7	41.2	32.6	22%
Atlassian	TEAM US	247.8	15.2	12.6	10.1	70.9	58.4	49.8	21%
Security									
CrowdStrike	CRWD US	290.3	22.2	17.2	13.8	90.0	66.5	48.5	30%
Okta	OKTA US	84.8	6.2	5.6	4.9	na	na	24.4	15%
Datadog	DDOG US	124.0	18.8	15.3	12.2	79.3	66.2	48.8	25%
ERP									
SAP	SAP US	173.7	6.8	6.3	5.6	25.4	23.4	17.7	8%
Oracle	ORCL US	114.6	7.5	6.9	6.3	15.3	13.7	12.4	8%
Collaboration									
Twilio	TWLO US	71.9	2.5	2.3	2.0	15.8	15.4	13.4	9%
Ring Central	RNG US	34.9	2.1	1.9	1.8	9.4	7.7	7.6	10%
Zoom	ZM US	67.7	3.4	3.3	3.1	8.3	8.2	8.0	3%
Average			10.2	8.5	7.1	43.7	34.5	27.2	

Source: Bloomberg, CMBIGM

Note: data are as of 26 Jan 2024

Risks: Intensified competitive environment from hyperscalers and other SaaS providers, deceleration of RPO and revenue growth on adverse economic conditions, and increased privacy concerns and restrictions on cross-border data transfers.

Appendix

Figure 51: Salesforce: management profile

Name	Position	Prior experience
Marc Benioff	Chair of the Board, CEO and co-Founder	Has served as Chief Executive Officer since 2001. Mr. Benioff was named Innovator of the Decade by Forbes and recognized as one of the World's 50 Greatest Leaders by Fortune and 10 Best-Performing CEOs by Harvard Business Review. Mr. Benioff received his B.S. in Business Administration from the University of Southern California, where he also serves on the Board of Trustees.
Parker Harris	Director, Chief Technology Officer and co-Founder	Has served as a Director since August 2018 and as Chief Technology Officer since September 2016. Mr. Harris co-founded Salesforce in February 1999 and has served in senior technical positions since inception, including Executive Vice President, Technology from December 2004 to February 2013. Prior to Salesforce, Mr. Harris co-founded Left Coast Software, a Java consulting firm, and served as its Vice President from October 1996 to February 1999. Mr. Harris received his B.A. in English Literature from Middlebury College.
Miguel Milano	President and Chief Revenue Officer	Rejoins Salesforce after having successfully led Salesforce international sales organizations across Asia-Pacific; Europe, Middle East, and Africa (EMEA); and Latin America from 2011–2020. Most recently, he served as co-owner and Chief Revenue Officer for Celonis, leading the sales, customer success, and partner organizations. Miguel holds a B.S. and M.S.E. in electrical engineering from the Polytechnic University of Catalonia and an MBA from Sloan School of Management at the Massachusetts Institute of Technology.
Brian Millham	President and Chief Operating Officer	Has served as President and Chief Operating Officer since August 2022. Mr. Millham has been with Salesforce since its inception in 1999, most recently serving as Chief Customer Success Officer and Chief Operating Officer, Global Distribution from February 2022 to August 2022. Mr. Millham served in various leadership roles in business development, account management and sales. Mr. Millham received his B.A. from the University of California, Berkeley.
Amy Weaver	President and Chief Financial Officer	Has served as President and Chief Financial Officer since February 2021. Prior to this, she served as President and Chief Legal Officer from January 2020 to January 2021, President, Legal & Corporate Affairs and General Counsel from February 2017 to January 2020, Executive Vice President and General Counsel from July 2015 to February 2017 and Senior Vice President and General Counsel from October 2013 to July 2015. Ms. Weaver received her B.A. in Political Science from Wellesley College and J.D. from Harvard Law School.

Source: Company data, CMBIGM

Financial Summary

INCOME STATEMENT	2021A	2022A	2023A	2024E	2025E	2026E
YE 31 Jan (US\$ mn)						
Revenue	21,252	26,492	31,352	34,998	38,938	42,919
Cost of goods sold	(5,438)	(7,026)	(8,360)	(9,143)	(9,970)	(10,724)
Gross profit	15,814	19,466	22,992	25,855	28,968	32,194
Operating expenses	(15,359)	(18,918)	(21,962)	(20,999)	(22,895)	(24,722)
Selling expense	(9,674)	(11,855)	(13,526)	(12,599)	(13,628)	(14,571)
Admin expense	(2,087)	(2,598)	(3,381)	(3,500)	(3,816)	(4,143)
R&D expense	(3,598)	(4,465)	(5,055)	(4,900)	(5,451)	(6,009)
Operating profit	455	548	1,030	4,856	6,072	7,472
Other expense	(64)	(227)	(131)	175	195	215
Other gains/(losses)	2,170	1,211	(239)	(267)	(297)	(429)
Pre-tax profit	2,561	1,532	660	4,764	5,970	7,257
Income tax	1,511	(88)	(452)	(953)	(1,194)	(1,451)
After tax profit	4,072	1,444	208	3,811	4,776	5,806
Net profit	4,072	1,444	208	3,811	4,776	5,806
Adjusted net profit	4,580	4,659	5,224	8,168	9,624	11,439

BALANCE SHEET	2021A	2022A	2023A	2024E	2025E	2026E
YE 31 Jan (US\$ mn)						
Current assets	21,889	22,850	26,395	33,510	42,772	52,967
Cash & equivalents	6,195	5,464	7,016	13,368	21,865	31,382
Account receivables	7,786	9,739	10,755	11,405	12,055	12,623
Prepayment	991	1,120	1,356	1,468	1,585	1,694
Financial assets at FVTPL	5,771	5,073	5,492	5,492	5,492	5,492
Other current assets	1,146	1,454	1,776	1,776	1,776	1,776
Non-current assets	44,412	72,359	72,454	72,503	72,759	73,172
PP&E	2,459	2,815	3,702	4,257	4,866	5,527
Deferred income tax	0	2,623	2,800	2,800	2,800	2,800
Investment in JVs & assos	3,909	4,784	4,672	4,672	4,672	4,672
Intangibles	4,114	8,978	7,125	6,620	6,266	6,018
Goodwill	26,318	47,937	48,568	48,568	48,568	48,568
Other non-current assets	7,612	5,222	5,587	5,587	5,587	5,587
Total assets	66,301	95,209	98,849	106,013	115,531	126,139
Current liabilities	17,732	21,788	25,891	26,409	27,997	28,936
Account payables	4,355	5,356	6,486	6,881	7,278	7,594
Other current liabilities	4	4	1,182	1,182	1,182	1,182
Lease liabilities	766	800	847	847	847	847
Contract liabilities	12,607	15,628	17,376	17,499	18,690	19,313
Non-current liabilities	7,076	15,290	14,599	14,599	14,599	14,599
Long-term borrowings	2,669	10,592	9,419	9,419	9,419	9,419
Other non-current liabilities	4,407	4,698	5,180	5,180	5,180	5,180
Total liabilities	24,808	37,078	40,490	41,008	42,596	43,535
Share capital	1	1	1	1	1	1
Capital surplus	35,601	50,919	55,047	57,882	61,036	64,898
Retained earnings	5,933	7,377	7,585	11,396	16,172	21,978
Other reserves	(42)	(166)	(4,274)	(4,274)	(4,274)	(4,274)
Total shareholders equity	41,493	58,131	58,359	65,005	72,935	82,604
Total equity and liabilities	66,301	95,209	98,849	106,013	115,531	126,139

CASH FLOW	2021A	2022A	2023A	2024E	2025E	2026E
YE 31 Jan (US\$ mn)						
Operating						
Profit before taxation	2,561	1,532	660	4,764	5,970	7,257
Depreciation & amortization	2,846	3,298	3,786	2,458	2,350	2,292
Tax paid	1,511	(88)	(452)	(953)	(1,194)	(1,451)
Change in working capital	(5,365)	(2,869)	(1,830)	(245)	822	261
Others	3,248	4,127	4,947	2,835	3,154	3,863
Net cash from operations	4,801	6,000	7,111	8,859	11,102	12,222
Investing						
Capital expenditure	(710)	(717)	(798)	(875)	(973)	(1,073)
Acquisition of subsidiaries/ investments	(1,281)	(14,876)	(439)	0	0	0
Net proceeds from disposal of short-term investments	(1,962)	(1,495)	(3,006)	0	0	0
Others	(18)	2,552	2,254	(1,632)	(1,632)	(1,632)
Net cash from investing	(3,971)	(14,536)	(1,989)	(2,507)	(2,605)	(2,705)
Financing						
Net borrowings	(24)	6,705	(4)	0	0	0
Share repurchases	0	0	(4,000)	0	0	0
Others	1,218	1,133	442	0	0	0
Net cash from financing	1,194	7,838	(3,562)	0	0	0
Net change in cash						
Cash at the beginning of the year	4,145	6,195	5,464	7,016	13,368	21,865
Exchange difference	26	(33)	(8)	0	0	0
Cash at the end of the year	6,195	5,464	7,016	13,368	21,865	31,382

Source: Company data, CMBIGM estimates. Note: The calculation of net cash includes financial assets.

ServiceNow (NOW US)

Riding on global digitalisation trend

Initiate at BUY. ServiceNow is a one-stop platform that offers a comprehensive set of SaaS solutions to facilitate digitalisation of all enterprise workflows, including IT, customer, employee, and creator workflows. ServiceNow is well-positioned to benefit from the secular tailwind of digital transformation, given its unparalleled leadership in the global ITSM market and expanding digital solutions that could meet various digitalisation demand. We see key growth opportunities including workflow and market expansion to drive total revenue/non-GAAP net income CAGRs of 20/26% over 2024-2026E. We value ServiceNow at US\$897.8 per share based on 50x 2024E EV/EBITDA. Initiate at BUY.

- **Riding on the secular trend of digitalisation.** Global enterprises' investment in digital transformation is expected to grow at a CAGR of 16% over 2024-2026E and reached US\$3.4tn in 2026E, according to IDC. ServiceNow has established strong leadership in the ITSM market (2021 ITSM revenue was over 3 times that of its closest competitor), the TAM of which is expected to grow at a CAGR of 15% over 2021-2025E and reach US\$81bn in 2025E, per Gartner. In addition, ServiceNow has been expanding its workflows to other areas that are essential to enterprise digital transformation, such as customer, employee, and creator workflows. For these non-tech workflows, the TAM is expected to reach US\$139bn in 2025E per Gartner and ServiceNow estimate, representing a CAGR of 13% over 2021-2025E.
- **Strong growth engine built on the land-and-expand strategy.** The company has accumulated 1,897 customers with over US\$1mn ACV in 4Q23, covering over 80% of the Fortune 500 companies. ServiceNow's customers exhibit strong loyalty, with an over 95% renewal rate and 2/3 of the existing customer spending incremental dollars with ServiceNow in 2022. This provides ServiceNow with substantial opportunities to up-sell and cross-sell its products. Overall, the company targets its subscription revenue to deliver a CAGR of 21% over 2024-2026E and reach US\$15.3bn in 2026E, driven by workflows/market/client base expansion.
- **Robust business model to deliver strong ROE.** ServiceNow has a solid financial profile through adhering to its Rule of 50 (i.e. total revenue growth + free cash flow margin > 50%), outperforming its cloud software peers at their different development stages. ServiceNow continues to unleash its operating leverage, supported by its land-and-expand strategy. Total sales representative productivity increased by 43% from 2017 to 2021. We forecast S&M expense ratio to decline from 36.8% in 2023 to 35.9/34.8/33.8% in 2024/2025/2026E, while the R&D and G&A expense ratios should remain relatively steady over 2024-2026E. Driven by the operating leverage, we forecast non-GAAP net margin to improve from 24.7% in 2023 to 26.4/27.1/28.2% in 2024/2025/2026E.

Earnings Summary

(YE 31 Dec)	FY22A	FY23A	FY24E	FY25E	FY26E
Revenue (US\$ mn)	7,245	8,971	10,857	13,081	15,580
YoY growth (%)	22.9	23.8	21.0	20.5	19.1
Adjusted EBITDA (US\$ mn)	2,189	2,928	3,618	4,498	5,552
EPS (Adjusted) (US\$)	7.66	10.86	14.07	17.37	21.56
Consensus EPS (US\$)	7.66	10.86	12.70	15.45	19.07
P/S (x)	21.4	17.3	14.3	11.8	9.9
P/E (x)	290.7	63.0	126.4	95.3	70.8

Source: Company data, Bloomberg, CMBIGM estimates

BUY

Target Price US\$897.80
Up/Downside 16.7%
Current Price US\$769.44

US Software Sector

Saiyi HE, CFA
 (852) 3916 1739
 hesaiyi@cmbi.com.hk

Wentao LU, CFA
 luwentao@cmbi.com.hk

Ye TAO
 franktao@cmbi.com.hk

Stock Data

Mkt Cap (US\$ mn)	154,988.3
Avg 3 mths t/o (US\$ mn)	830.6
52w High/Low (US\$)	769.44/414.93
Total Issued Shares (mn)	201.4
Source: FactSet	

Shareholding Structure

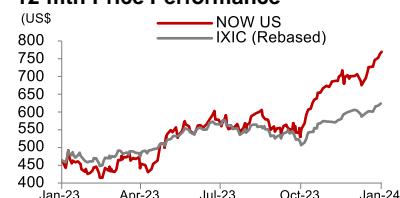
The Vanguard Group	8.4%
BlackRock	8.0%
Source: Company data	

Share Performance

	Absolute	Relative
1-mth	9.7%	7.0%
3-mth	39.7%	13.8%
6-mth	33.3%	21.8%

Source: FactSet

12-month Price Performance



Source: FactSet

ServiceNow: investment thesis

Riding on the secular trend of digitalisation

ServiceNow is a one-stop platform that offers a comprehensive set of SaaS solutions to facilitate the digitalisation of all enterprise workflows, including IT, customer, employee and creator workflows. We believe ServiceNow is well-positioned to benefit from the secular tailwind of digital transformation, given its unparalleled leadership in the global ITSM market and expanding digital solutions that could meet various digitalisation demands. Global enterprises' investment in digital transformation is expected to grow at a CAGR of 16% over 2024-2026E and reach US\$3.4tn in 2026E, according to IDC. IT services spending will be a key part of the investment. According to Gartner, worldwide IT spending is estimated to grow by 4.2/7.9% YoY to US\$1.3/1.4tn in 2022/2023E.

ServiceNow has established strong leadership in the ITSM market (its ITSM revenue in 2021 was over 3 times that of its closest competitor, per Gartner), the TAM of which is expected to grow at a CAGR of 15% over 2021-2025E and reach US\$81bn in 2025E, per Gartner. In addition, ServiceNow has been expanding its workflows to other areas that are essential to enterprise digital transformation, such as customer workflows, employee workflows and creator workflows. For these non-tech workflows, the TAM is expected to reach US\$139bn in 2025E, representing a CAGR of 13% over 2021-2025E, based on Gartner and ServiceNow estimate.

Strong growth engine built on the land-and-expand strategy

ServiceNow has developed a strong growth engine based on its land-and-expand strategy. The company had accumulated 1,897 customers with over US\$1mn annual contract value (ACV) by 4Q23, covering over 80% of the Fortune 500 companies. ServiceNow's customers exhibit strong loyalty, with an over 95% renewal rate since 2020 and over 2/3 of the existing customer spending incremental dollars with ServiceNow. This provides ServiceNow with opportunities to up-sell and cross-sell its products. For the upselling opportunity, ServiceNow targets the penetration rate of premium SKUs to reach 55% in the long term, versus 40% in 2022; for the cross-selling opportunity, the company expects the percentage of net new ACV contributed by the non-technology workflows to rise from 41% in 2022 to 55% in 2024E. Overall, the company targets its subscription revenue to deliver a CAGR of 23% over 2022-2024E and reach US\$10.4bn in 2024E, driven by workflows/market/client base expansion.

Robust business model to deliver strong ROE

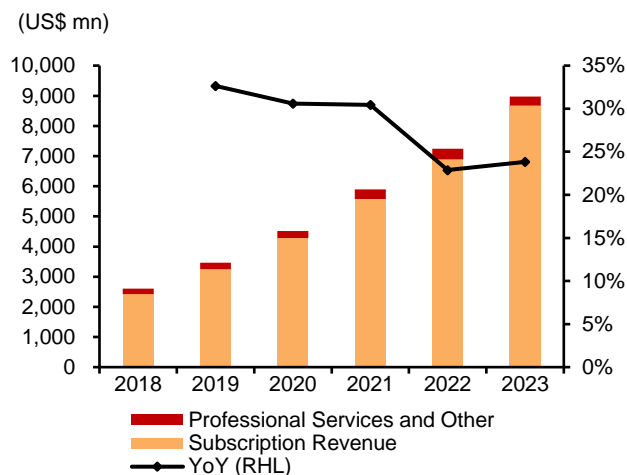
ServiceNow has a solid financial profile through adhering to its Rule of 50 (i.e. total revenue growth + free cash flow margin > 50%). ServiceNow's total revenue growth + free cash flow margin was 53% in 2022, leading several other SaaS peers such as Twilio, Salesforce and Ring Central. The company's total revenue growth rate plus free cash flow margin outperformed the average of its cloud software peers at different development stages.

ServiceNow continues to unleash its operating leverage, supported by its land-and-expand strategy. Total sales representative productivity (commissionable net new annual contract value, or NNACV, divided by total sales representatives) increased by 43% from 2017 to 2021. With over 125% net expansion rate and over 85% of NNACV contributed by existing customers, we expect further operating leverage on S&M front. We forecast S&M expense ratio to decline from 36.8% in 2023 to 35.9/34.8/33.8% in 2024/2025/2026E, while the R&D and G&A expense ratios should remain relatively steady over 2024-2026E. Driven by the operating leverage, we forecast non-GAAP net margin to improve from 24.7% in 2023 to 26.4/27.1/28.2% in 2024/2025/2026E.

Given the company's strong top-line growth and operating leverage, we forecast non-GAAP net income to grow 30/23/24% YoY to US\$2.9/3.5/4.4bn in 2024/2025/2026E. We value ServiceNow at US\$185bn (US\$897.8 per share) based on 50x 2024E EV/EBITDA. Our target EV/EBITDA is at a premium to the sector average (34x), which is justified by ServiceNow's strong revenue growth outlook and margin profile.

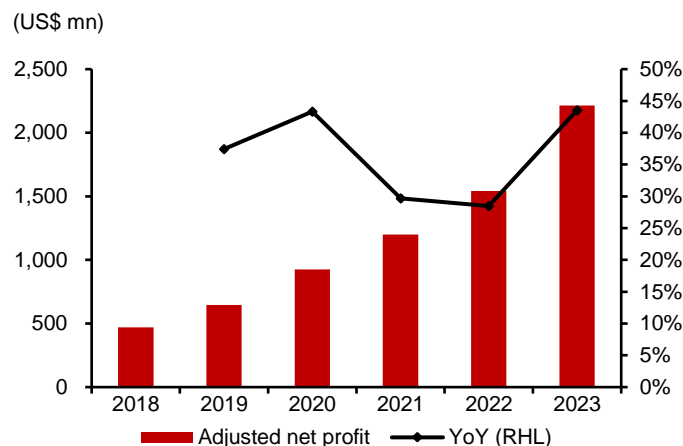
ServiceNow: focus charts

Figure 52: ServiceNow: total revenue trend



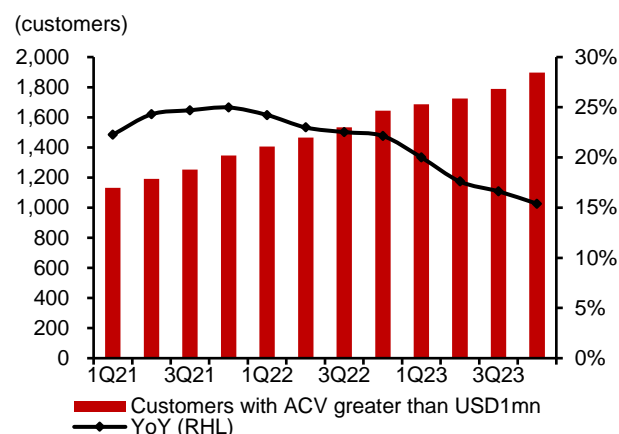
Source: Company data, CMBIGM

Figure 53: ServiceNow: adjusted net income



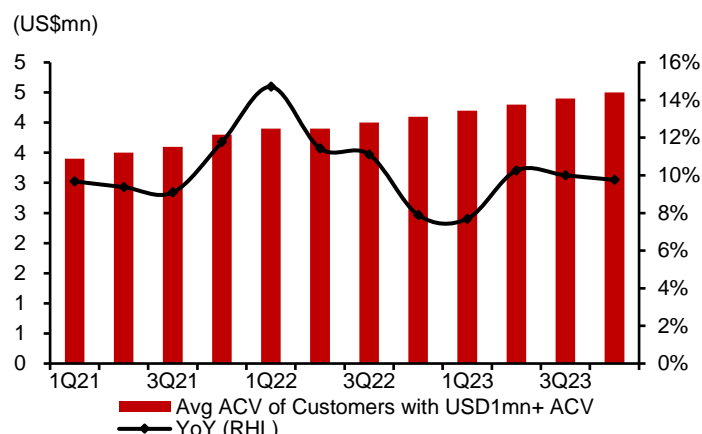
Source: Company data, CMBIGM

Figure 54: ServiceNow: no. of customers with >US\$1mn ACV



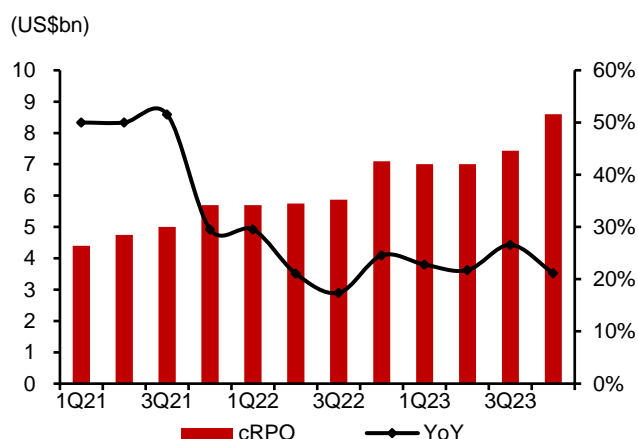
Source: Company data, CMBIGM

Figure 55: ServiceNow: avg. ACV of customers with >US\$1mn ACV



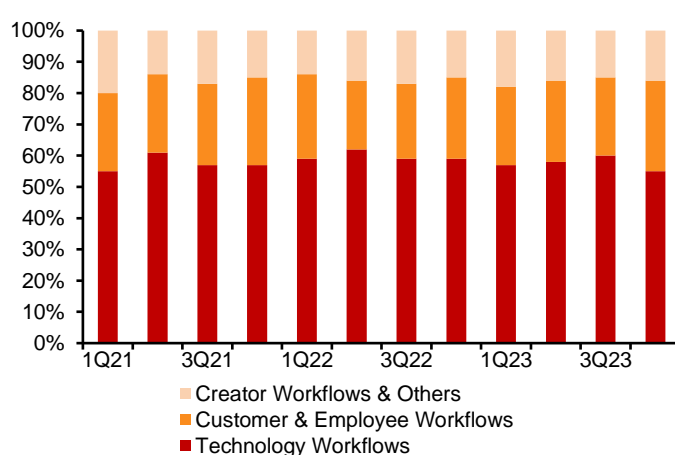
Source: Company data, CMBIGM

Figure 56: ServiceNow: cRPO trend



Source: Company data, CMBIGM

Figure 57: ServiceNow: NNACV mix by workflows



Source: Company data, CMBIGM

ServiceNow: company overview

ServiceNow has developed a one-stop SaaS platform that facilitates the digital transformation of both front-office and back-office workflows in the enterprises. Starting from its core technology workflows, it has now expanded to four workflows with c.20 different products: 1) technology/IT workflows that unite IT, risk management and security operations on a single platform; 2) employee workflows that enhance efficiency and experience of HR and workplace service through digital processes; 3) customer workflows that improve customer experience and go beyond CRM and field services; and 4) creator workflows that build workflow apps with a low-code platform.

Figure 58: ServiceNow: one-stop platform for digital transformation



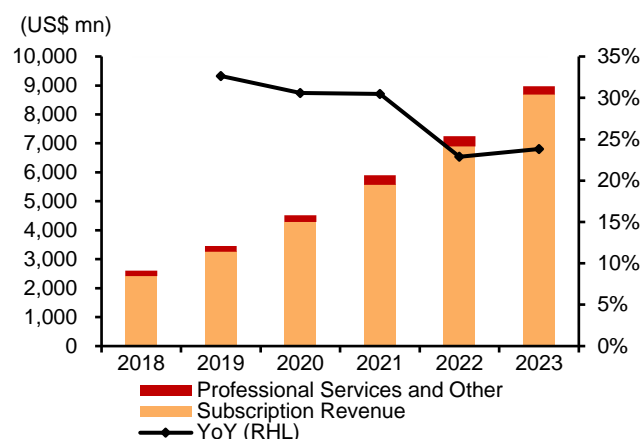
Source: Company data, CMBIGM

Figure 59: ServiceNow: major solutions

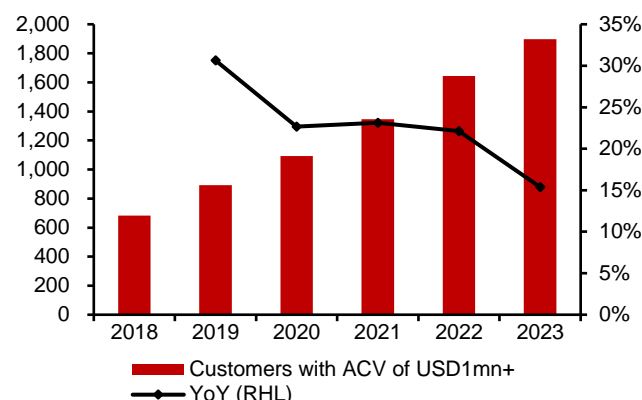
Workflow	Solutions	Targeted users
Technology workflow	<ul style="list-style-type: none"> IT Service Management IT Operation Management Strategic Portfolio Management 	<ul style="list-style-type: none"> Information Technology Developers & Site Reliability Engineers Security & Risk Practitioners
Customer workflow	<ul style="list-style-type: none"> Customer Service Management Field Service Management Financial Service Operations 	<ul style="list-style-type: none"> Customer Service Customer Operations Lines of Business by Industry
Employee workflow	<ul style="list-style-type: none"> HR Service Delivery Workplace Service Delivery Safe Workplace Suite Legal Service Delivery 	<ul style="list-style-type: none"> Human Resources Workplace / Facilities Legal Teams
Creator workflow	<ul style="list-style-type: none"> App Engine IntegrationHub Manufacturing Connected Workforce 	<ul style="list-style-type: none"> IT Developers Citizen Developers Process Owners

Source: Company data, CMBIGM

ServiceNow total revenue grew at a CAGR of 26% over 2021-2023 and reached US\$9.0bn in 2023, mainly driven by steady expansion of its customer base and the incremental budget spent by existing customers. The number of customers with ACV of over US\$1mn grew by 15% YoY to 1,897 in 2023.

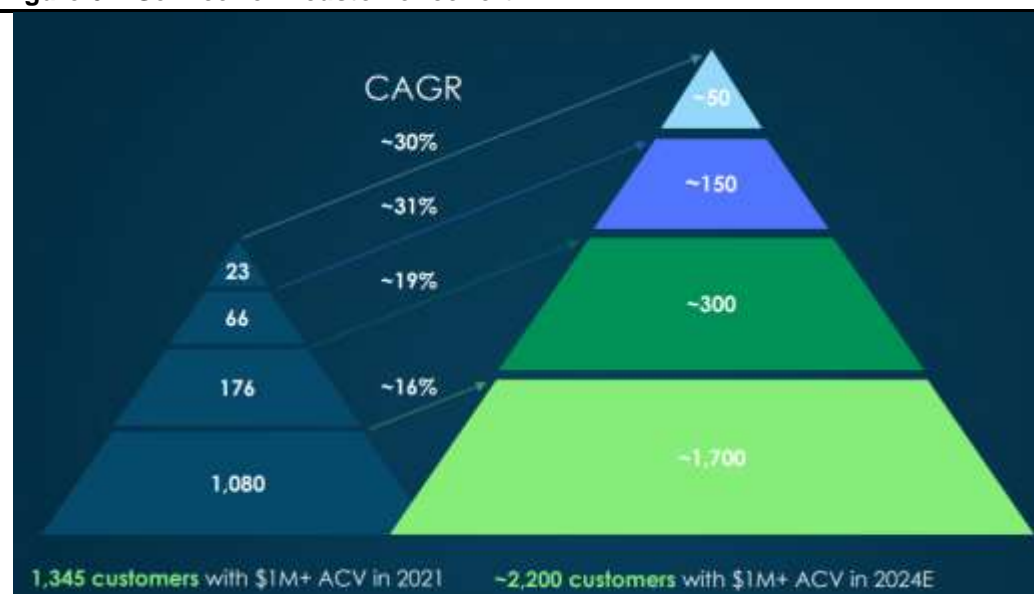
Figure 60: ServiceNow: revenue trend

Source: Company data, CMBIGM

Figure 61: No. of customers with ACV of US\$1mn+

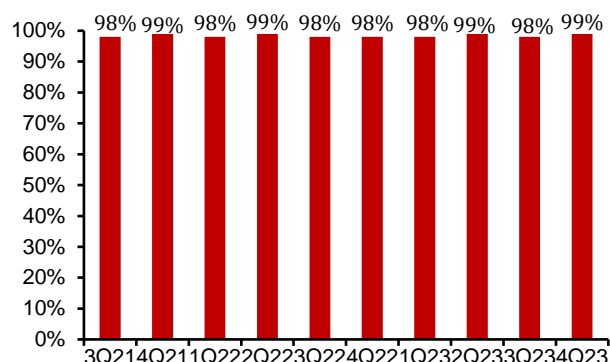
Source: Company data, CMBIGM

ServiceNow's largest customers delivered the fastest customer count growth among its customer cohort, as large enterprises' demand for digital transformation continue to rise. The US\$10mn+ ACV customer count achieved a CAGR of 95% over 2017-2021 and is expected to grow at a CAGR of 31% over 2021-2024E, reaching c.200 in 2024E, per the company's estimate.

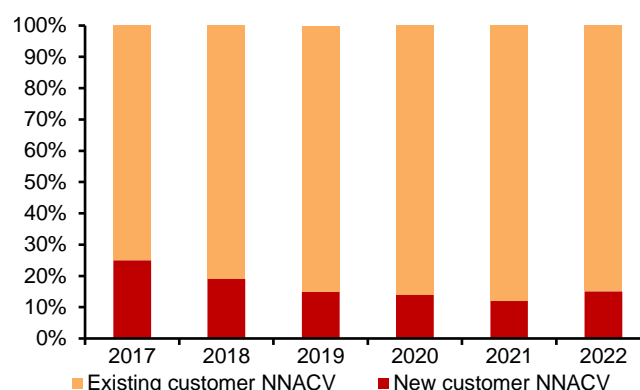
Figure 62: ServiceNow: customer cohort

Source: Company data, CMBIGM

ServiceNow has developed a strong growth engine based on its land-and-expand strategy. With strong product and customer loyalty, ServiceNow maintained an over 95% renewal rate since 2020. Once products are landed, customers continually expand their IT budget with ServiceNow. In 2022, the existing customers contributed over 85% of the Net New ACV (NNACV), and 2/3 of the existing customers spent incremental dollars with ServiceNow. The overall net expansion rate in 2022 was above 125%.

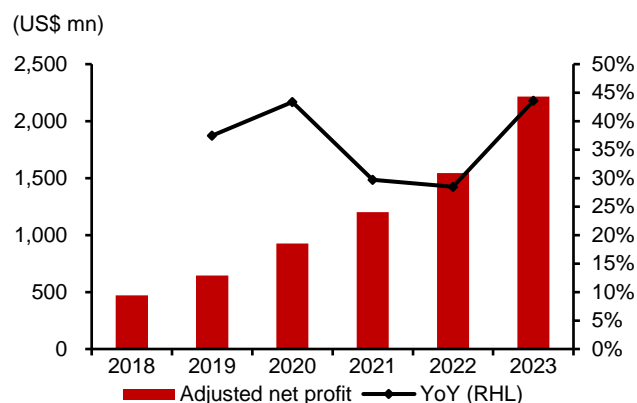
Figure 63: ServiceNow: renewal rate

Source: Company data, CMBIGM

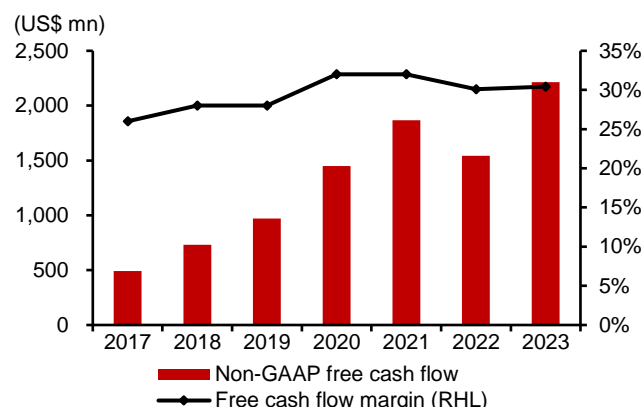
Figure 64: ServiceNow: NNACV breakdown

Source: Company data, CMBIGM

ServiceNow's non-GAAP net income reached US\$2.2bn in 2023, representing a CAGR of 26% over 2021-2023. The company also saw an improving cash flow profile, with its free cash flow margin rising from 26% in 2017 to 30% in 2023, driven by improving operation efficiency and its land-and-expand growth strategy.

Figure 65: ServiceNow: non-GAAP net income

Source: Company data, CMBIGM

Figure 66: ServiceNow: non-GAAP free cash flow

Source: Company data, CMBIGM

ServiceNow has identified four key growth areas. 1) Workflows expansion: beyond its current four workflows, the company launched industry solutions and ERP workflows in 2022, in order to better serve enterprise demand for digital transformation. 2) Market expansion: the company continues to broaden its market presence in other growth geographies such as Japan, the UK, Germany, and Canada. 3) New customer penetration: the company estimated it only penetrated 15% of its target client base and expected to further increase its penetration rate through enhanced product capability and sales effort.

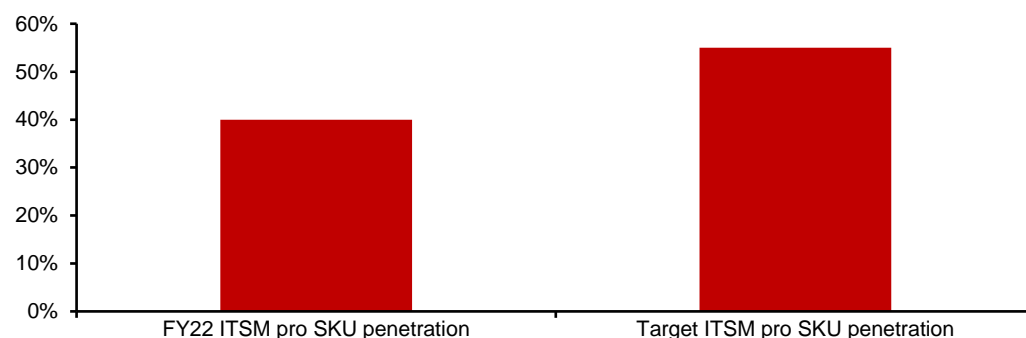
Figure 67: ServiceNow: key growth areas

Source: Company data, CMBIGM

Key opportunity 1: cross-selling and upselling workflows

With the execution of the land-and-expand strategy, the majority of ServiceNow's net new ACV came from incremental dollar spent by the installed base. Over 85% of net new ACV was from the incremental spending by existing customers in 2022.

For the upselling opportunity, ServiceNow continues to deepen its customer relationship with its premium ITSM Pro SKUs, which realized 25% price uplift versus the standard SKUs. The company targeted the penetration rate of premium SKUs to reach 55% in the long term, versus 40% in 2022, representing 3.75% potential upside to ITSM ACV.

Figure 68: ITSM Pro: upselling opportunities

Source: Company data, CMBIGM

As ServiceNow continues to step up cross-selling efforts, the company expects the percentage of net new ACV contributed by the non-technology workflows to rise from 41% in 4Q22. It sees massive opportunities to cross-sell its non-technology workflows, given the average penetration rate within existing customers for non-IT products remained low at c.20% in 2022. According to the company, once ITSM is launched in the customer's system, other non-IT products can be implemented faster within 8-16 weeks.

With the enriched solutions beyond ITSM, ServiceNow has progressed beyond CIO's tech spending and evolved to serve the entire C-suite (e.g. Chief Financial Officer, Chief Legal Officer and Chief Risk Officer).

Figure 69: ServiceNow: faster time to value for customers



Source: Company data, CMBIGM

Figure 70: ServiceNow: cross-selling opportunities beyond IT spend

Year	Products	Procurement decision made by...
2011	IT Service Management	IT managers
2015	HR, Security and Customer Service	CIO / CISO / CHRO / CCO
2023	Legal, finance, procurement and industry-specific products	Entire C-suite

Source: Company data, CMBIGM

Note: CIO – Chief Information Officer, CISO – Chief Information Security Officer, CHRO – Chief Human Resource Officer, CCO – Chief Customer Officer

Key opportunity 2: global expansion

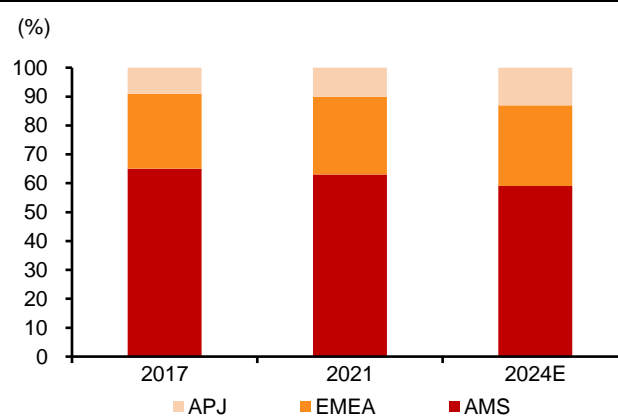
ServiceNow has broadened its market presence with enhanced service capabilities and increasing investment in infrastructure. The company has already established 34 global data centres, with 15/8/11 in America/Europe/Asia Pacific & Japan (APJ). ServiceNow expects 28/13% of NNACV to come from Europe, the Middle East and Africa (EMEA)/APJ in 2024E, versus 26/9% in 2017.

Figure 71: ServiceNow: target growth geographies



Source: Company data, CMBIGM

Figure 72: ServiceNow: NNACV contribution by region

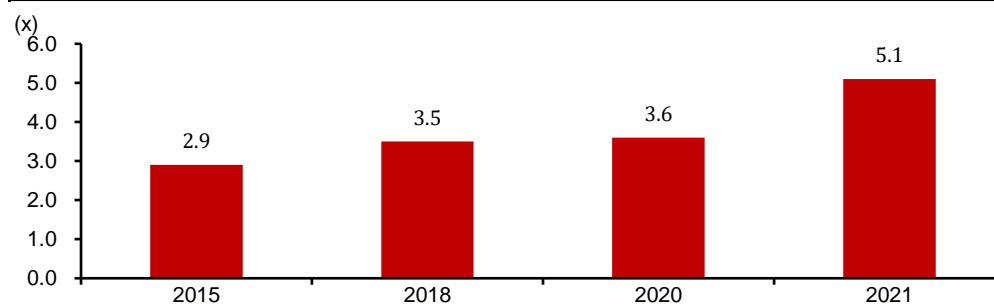


Source: Company data, CMBIGM

Key opportunity 3: enhanced sales efficiency

ServiceNow sales efficiency continues to rise, supported by its land-and-expand business model. Total sales representative productivity grew by 43% from 2017 to 2021; and the total sales efficiency increased from 2.9x in 2015 to 5.1x 2021. We expect sales efficiency to further rise in the future, as the company continues to see healthy growth of ACV across all customer cohorts once the products were launched.

Figure 73: ServiceNow: sales efficiency (change in rev./change in S&M expenses)



Source: Company data, CMBIGM

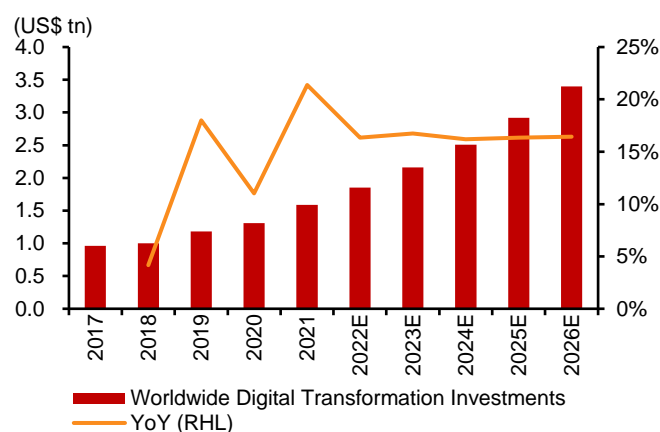
Global IT spending: riding on global digitalisation trend

Despite macro headwinds, worldwide organisations continued to step up their investment in digital transformation, which essentially helps them reduce costs and improve operating efficiency. According to a July 2022 Gartner survey of over 200 CFOs, 69% of these companies planned to increase their spend on digital technologies despite the economic downturn.

With resilient demand for digital transformation, global enterprises' investment in digital transformation is expected to grow at a CAGR of 16% over 2024-2026E and reach US\$3.4tn in 2026E, according to IDC. Traditional industries such as manufacturing, retail and utilities sectors exhibit strong demand for digital transformation. IDC data shows the top 5 industries contributed 52% of the total digital spending in 2022.

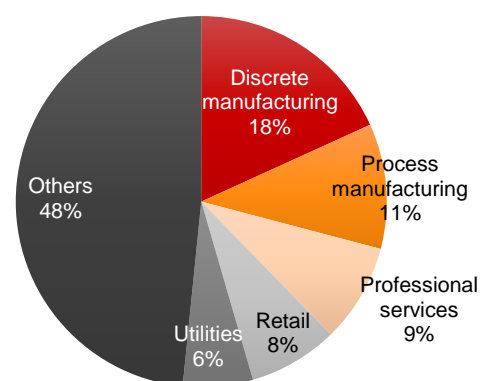
We believe ServiceNow is well-positioned to benefit from the secular tailwind of digital transformation, given its unparalleled leadership in the global ITSM market and expanding digital solutions that could meet various digital demands.

Figure 74: Global digital transformation investment



Source: IDC, CMBIGM

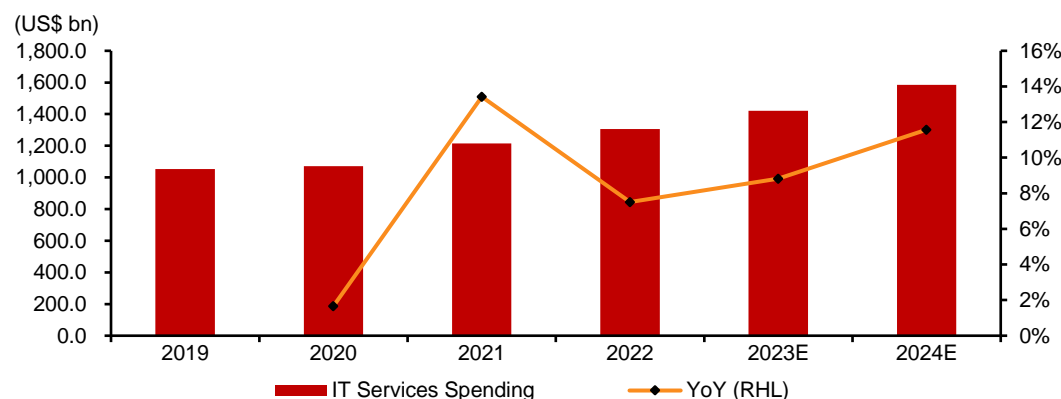
Figure 75: % of digital spending by top industries



Source: IDC, CMBIGM

Worldwide IT services spending is also growing at a steady pace, driven by the enterprise demand for digital transformation. According to Gartner, worldwide IT spending is estimated to grow by 8.8/11.6% YoY to US\$1.4/1.6tn in 2023/2024E.

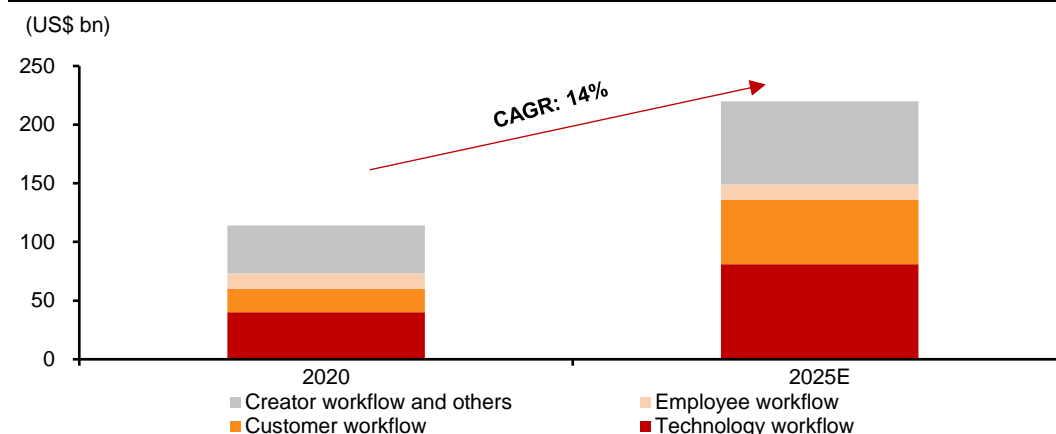
Figure 76: Worldwide IT services spending



Source: Gartner, CMBIGM

ServiceNow has already established strong leadership in the ITSM market (its ITSM revenue in 2021 was over 3 times that of its closest competitor, per Gartner), the TAM of which is expected to grow at a CAGR of 15% over 2021-2025E and reach US\$81bn in 2025E, per Gartner. In addition, ServiceNow has been expanding its workflows to other areas that are essential to enterprise digital transformation, such as customer workflows, employee workflows and creator workflows. For these non-tech workflows, the TAM is expected to reach US\$139bn in 2025E, representing a CAGR of 13% over 2021-2025E, based on Gartner and ServiceNow estimate.

Figure 77: ServiceNow: TAM



Source: Company data, IDC, Gartner, CMBIGM

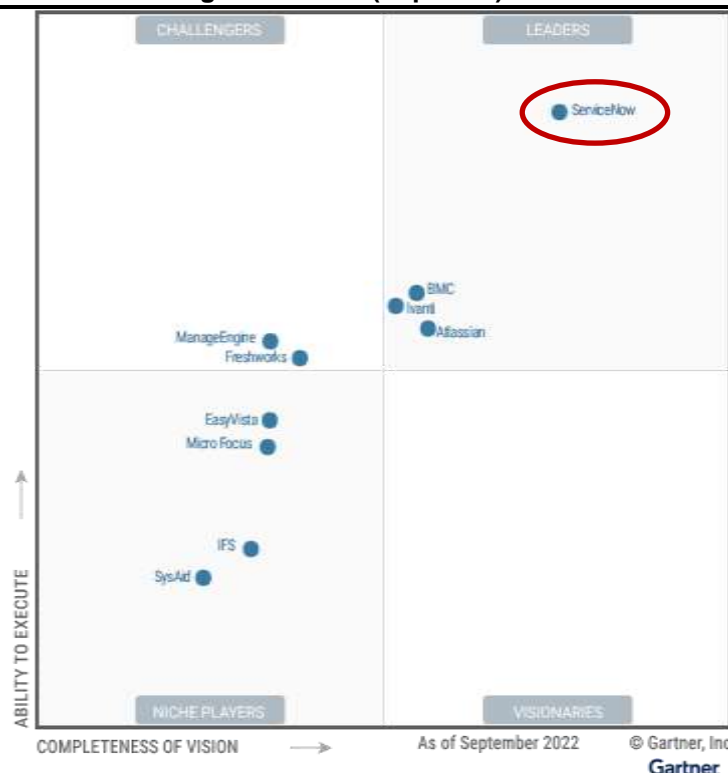
Figure 78: ServiceNow: TAM by different workflows

Workflow (US\$ bn)	ServiceNow subscription Revenue (2022)	2020	2025E	2021-2025E CAGR
Technology workflow		40	81	15%
Customer workflow		20	55	22%
Employee workflow		13	13	0%
Creator workflow and others		41	71	12%
Total	6.89 (3% of 2025E TAM)	114	220	14%

Source: Company data, IDC, Gartner, CMBIGM

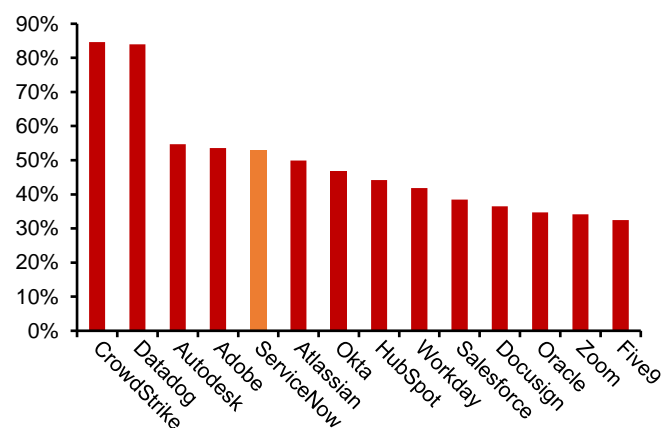
ServiceNow: leading ITSM platform with strong financial profile

ServiceNow technology workflow shows unparalleled leadership in the ITSM market. Gartner placed ServiceNow as a leader in the ITSM Magic Quadrant (Sep 2022), citing several competitive advantages of ServiceNow ITSM offerings: 1) advanced product features: ServiceNow has more native advanced features than any other vendor in Gartner evaluation, mainly attributable to its platform-focused acquisitions and native development strategy; 2) high platform adoption: customers regularly upgrade their ServiceNow products beyond ITSM to other areas such as HR and CRM system; and 3) market presence: ServiceNow has established a strong user community as well as brand awareness.

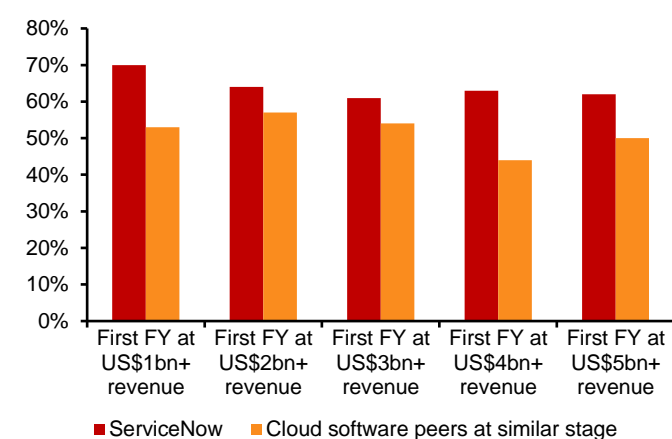
Figure 79: Gartner: ITSM Magic Quadrant (Sep 2022)

Source: Gartner, CMBIGM

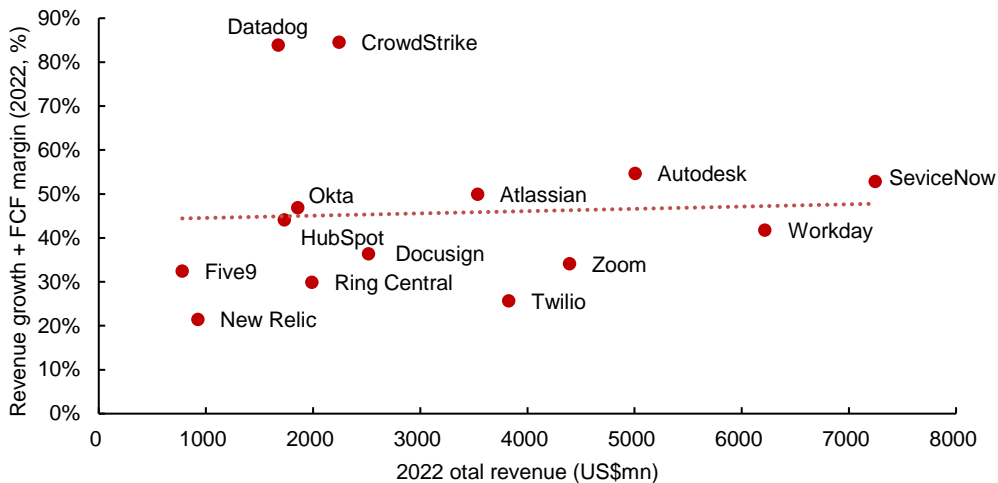
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Figure 80: Revenue growth + free cash flow margin: comparison (2022)

Source: Bloomberg, CMBIGM

Figure 81: Revenue growth + free cash flow margin: comparison at different stages

Source: Company data, CMBIGM

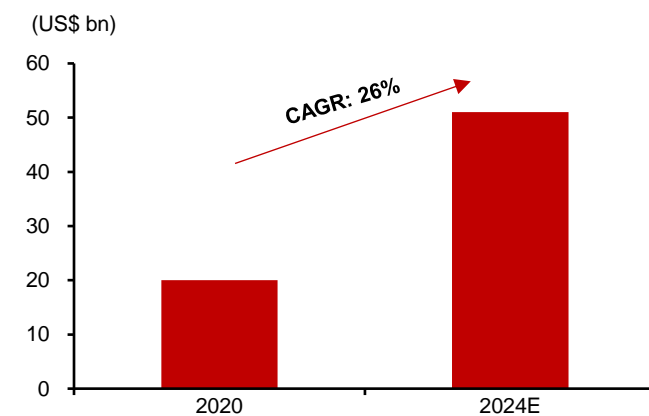
Figure 82: Revenue growth + free cash flow margin: comparison at different scales

Source: Bloomberg, CMBIGM

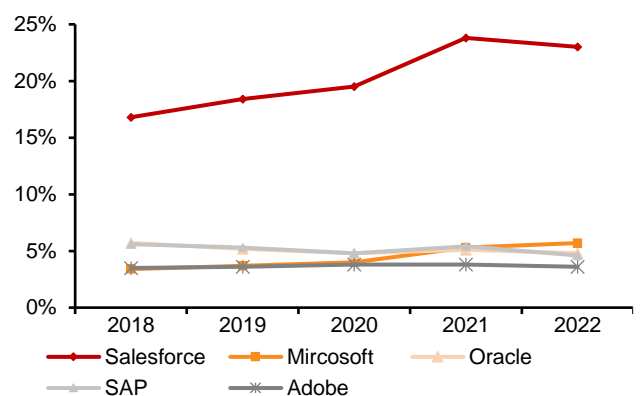
CRM & aPaaS: emerging digitalisation opportunities

Besides core IT services, ServiceNow has been actively exploring opportunities in the CRM and aPaaS (application platform as a service) area. For the CRM market, ServiceNow offers a comprehensive set of products including customer service management, field service management, and industry solutions for different sectors.

According to Gartner, the TAM of CRM is expected to grow at a CAGR of 26% over 2021-2024E and reach US\$51bn in FY24. Based on IDC data and our estimate, ServiceNow took c.2% share of the global CRM market in 2022, lagging Salesforce/Microsoft/Oracle/SAP/Adobe (23/6/5/5/4%). That said, with strong platform capabilities and extensive customer base, we expect ServiceNow to gain market share in the future.

Figure 83: Global CRM TAM

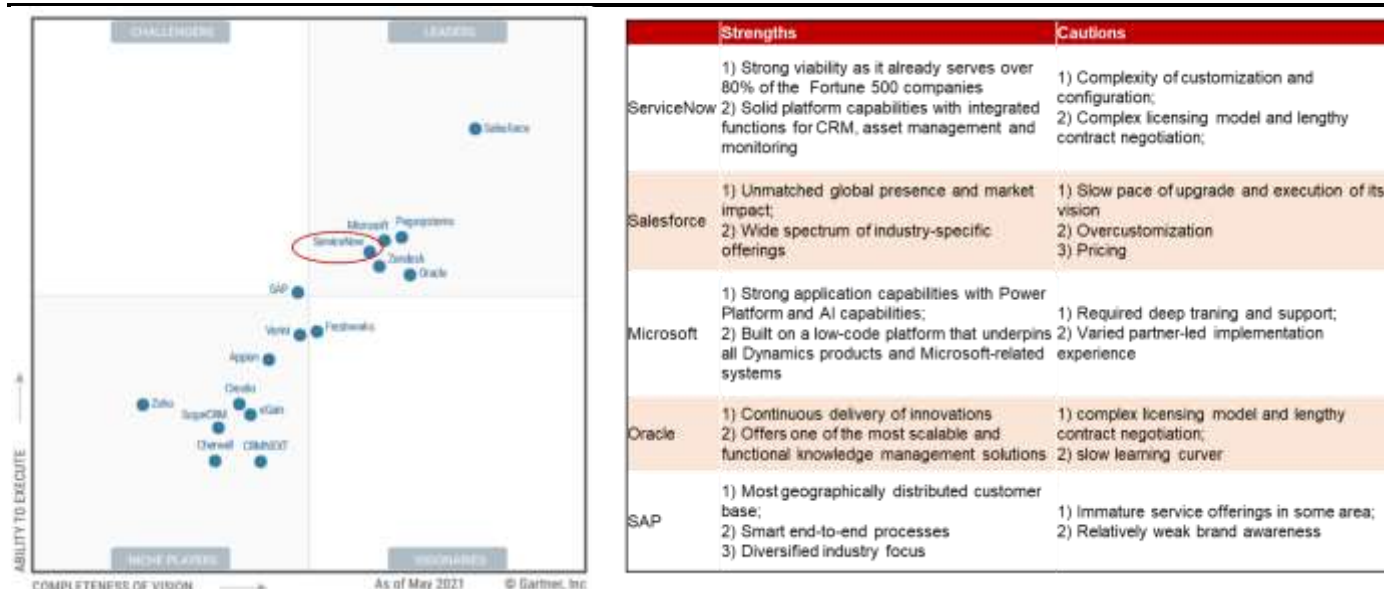
Source: Gartner, CMBIGM estimates

Figure 84: Global CRM: market share (2022)

Source: IDC, CMBIGM

According to a survey by Gartner, enterprise customers highlighted several competitive advantages of ServiceNow CRM solutions: 1) strong potential to grow its CRM customers and revenue since it has already covered a wide range of companies through its SaaS/PaaS offerings (serves over 80% of Fortune 500 companies); and 2) a comprehensive platform solution that integrates ServiceNow capabilities such as CRM, asset management and real-time monitoring. ServiceNow CRM products help enterprises connect their customer-facing team with back-end office teams, enhancing efficiency of customer relationship management.

Figure 85: Gartner: Magic Quadrant for the CRM Customer Engagement Centre



Source: Gartner, CMBIGM

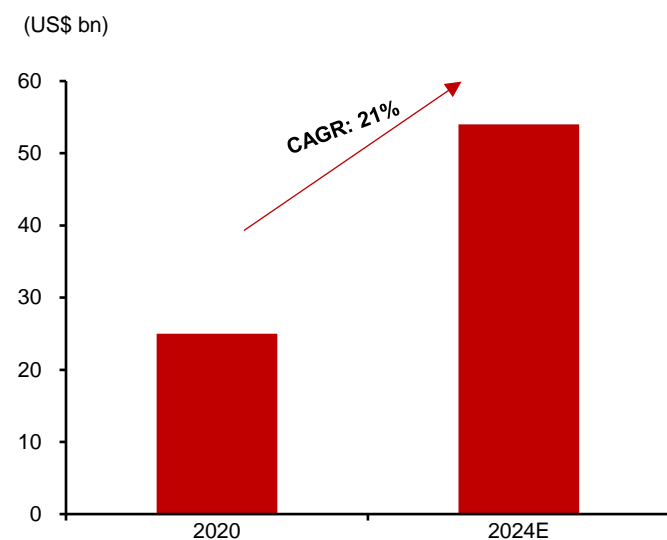
ServiceNow continued to expand its CRM client base, especially in the tech sectors where ServiceNow has strong expertise. ServiceNow CRM solutions covers over 1/2 of Fortune 500 companies in the tech sector, and 1/3 of Fortune 500 companies in the telecom & media, financial services, and healthcare sectors. We think ServiceNow can further penetrate the CRM market, as it continues to improve its product capabilities and enhance cross-selling capabilities.

Figure 86: ServiceNow CRM: wide coverage of enterprise customers



Source: Company data, CMBIGM

The aPaaS market also represents substantial opportunities for ServiceNow. According to Gartner, the TAM for ServiceNow creator workflow (mainly including High Control aPaaS and High Productivity aPaaS) could reach US\$54bn in 2024E, representing a CAGR of 21% over 2021-2024E. ServiceNow's low-code application platform App Engine was ranked as a Leader in Gartner Magic Quadrant in 2021, with strong innovation, viability and market responsiveness.

Figure 87: Global aPaaS TAM


Source: Gartner, CMBIGM

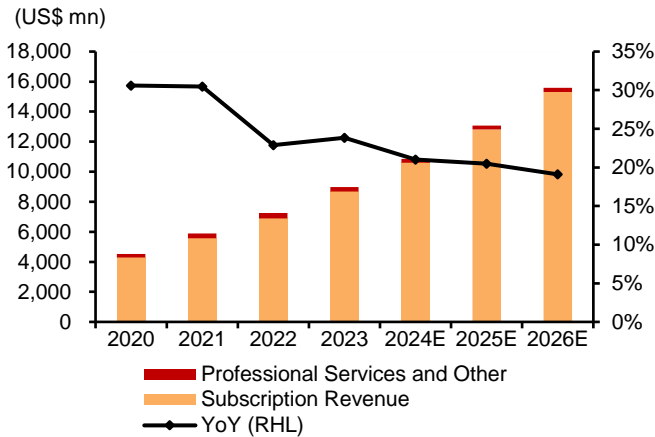
Figure 88: Gartner: Magic Quadrant for aPaaS


Source: Gartner, CMBIGM

ServiceNow: financial forecast and valuation

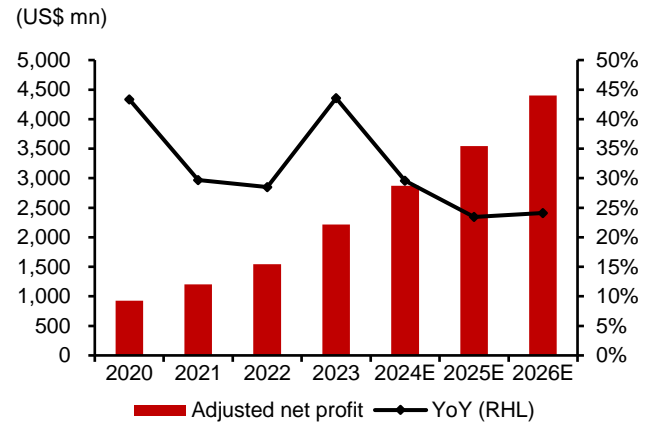
We forecast total revenue to grow at a CAGR of 20% over 2024-2026E and reach US\$15.6bn in 2026E, mainly driven by upselling of ITSM pro, cross-selling of non-tech workflows, and international expansion. Supported by strong top-line growth and operating leverage, we estimate non-GAAP net income to grow 30/23/24% YoY to US\$2.9/3.5/4.4bn in 2024/2025/2026E.

Figure 89: ServiceNow: revenue trend



Source: Company data, CMBIGM estimates

Figure 90: ServiceNow: non-GAAP net income



Source: Company data, CMBIGM estimates

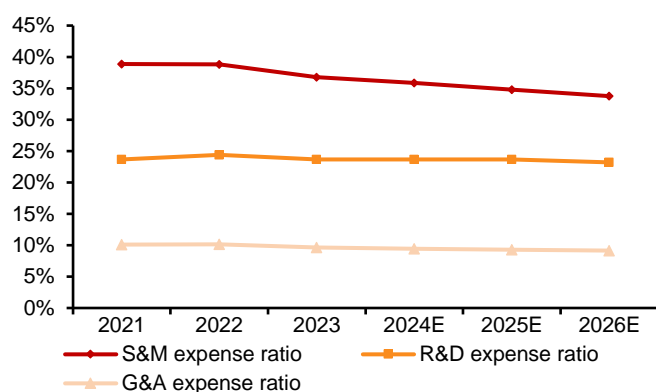
Figure 91: ServiceNow: key financial forecast

(US\$ mn)	2022	2023	2024E	2025E	2026E
Total revenue	7,245	8,971	10,857	13,081	15,580
YoY	22.9%	23.8%	21.0%	20.5%	19.1%
Subscription Revenue	6,891	8,680	10,590	12,813	15,312
YoY	23.6%	26.0%	22.0%	21.0%	19.5%
Professional Services & Other	354	291	268	268	268
YoY	9.6%	-17.8%	-8.0%	0.0%	0.0%
Gross profit margin	78.3%	78.6%	79.4%	80.0%	80.4%
S&M expense ratio	38.8%	36.8%	35.9%	34.8%	33.8%
R&D expense ratio	24.4%	23.7%	23.7%	23.7%	23.2%
G&A expense ratio	10.1%	9.6%	9.4%	9.3%	9.1%
Non-GAAP net income margin	21.3%	24.7%	26.4%	27.1%	28.2%
Non-GAAP net income	1,543	2,215	2,871	3,544	4,398

Source: Company data, CMBIGM estimates

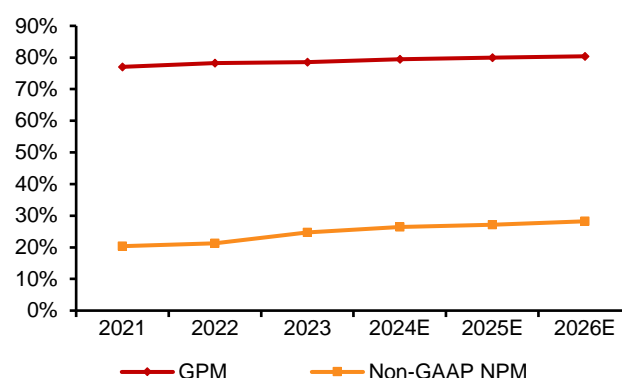
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Figure 92: ServiceNow: opex ratios



Source: Company data, CMBIGM estimates

Figure 93: ServiceNow: margin trend



Source: Company data, CMBIGM estimates

Valuation and risks

We value ServiceNow at US\$185bn (US\$897.8 per share) based on 50x 2024E EV/EBITDA. Our target EV/EBITDA is at a premium to the sector average (34x), which is justified by ServiceNow's strong EBITDA CAGR of 24% over 2024-2026E.

Figure 94: ServiceNow: target valuation

EV/EBITDA Valuation (US\$mn)		2024E
Adjusted EBITDA		3,618
Target 2024E EV/EBITDA		50.0
Target EV		180,920
Net cash		4,033
Target equity valuation		184,953
Valuation per share (USD)		897.8

Source: Company data, CMBIGM estimates

Figure 95: SaaS: valuation comparison

Companies	Ticker	Price (Local)	2023E	EV/Sales (x) 2024E	2025E	2023E	EV/EBITDA (x) 2024E	2025E	Rev CAGR 22-25E
ITSM									
ServiceNow	NOW US	769.4	17.3	14.2	11.8	54.7	41.2	32.6	22%
Atlassian	TEAM US	247.8	15.2	12.6	10.1	70.9	58.4	49.8	21%
CRM									
Salesforce	CRM US	279.9	NA	7.9	7.1	NA	19.8	18.0	11%
HubSpot	HUBS US	588.7	13.5	11.5	9.6	75.1	61.7	47.8	21%
Five9	FIVN US	77.2	6.4	5.5	4.6	36.1	31.1	23.9	17%
Security									
CrowdStrike	CRWD US	290.3	22.2	17.2	13.8	90.0	66.5	48.5	30%
Okta	OKTA US	84.8	6.2	5.6	4.9	na	na	24.4	15%
Datadog	DDOG US	124.0	18.8	15.3	12.2	79.3	66.2	48.8	25%
ERP									
SAP	SAP US	173.7	6.8	6.3	5.6	25.4	23.4	17.7	8%
Oracle	ORCL US	114.6	7.5	6.9	6.3	15.3	13.7	12.4	8%
Collaboration									
Twilio	TWLO US	71.9	2.5	2.3	2.0	15.8	15.4	13.4	9%
Ring Central	RNG US	34.9	2.1	1.9	1.8	9.4	7.7	7.6	10%
Zoom	ZM US	67.7	3.4	3.3	3.1	8.3	8.2	8.0	3%
Average			10.2	8.5	7.1	43.7	34.5	27.2	

Source: Bloomberg, CMBIGM

Note: data are as of 26 Jan 2024

Risks: loss of momentum causes a decline in valuation multiple, slower-than-expected non-tech workflow adoption impacts long-term revenue growth prospects, and intensified competition leads to revenue growth deceleration and margin erosion.

Appendix

Figure 96: Management profile

Name	Position	Prior experience
Bill McDermott	Chairman and CEO	Has served as chief executive officer since 2019. He has also served as a director of Zoom since 2020 and as a director of Fisker Inc. since 2019. He previously served as CEO at SAP from 2010 to 2019.
Chris Bedi	Chief Digital Information Officer	Has served as Chief Digital Information Officer since 2022. He has been the CIO of ServiceNow since 2015. Before joining Chris Bedi, he was CIO of JDSU from 2011 to 2015.
Chirantan Desai	Chief Operating Officer	Has served as Chief Operating Officer since 2022. He has been the Chief Product Officer of ServiceNow since 2016. Previously, he served as President at Emerging Technologies Division of EMC from 2014 to 2016.
Paul Smith	Chief Commercial Officer	Has served as Chief Commercial Officer since 2022. Paul joined ServiceNow in July 2020 as SVP & General Manager of EMEA and was promoted to President, EMEA in January 2021. Prior to ServiceNow, Paul held senior positions at Salesforce, Microsoft, and Proctor and Gamble.

Source: Company data, CMBIGM

Financial Summary

INCOME STATEMENT	2021A	2022A	2023A	2024E	2025E	2026E
YE 31 Dec (US\$ mn)						
Revenue	5,896	7,245	8,971	10,857	13,081	15,580
Cost of goods sold	(1,353)	(1,573)	(1,921)	(2,235)	(2,616)	(3,055)
Gross profit	4,543	5,672	7,050	8,622	10,465	12,524
Operating expenses	(4,286)	(5,317)	(6,288)	(7,489)	(8,864)	(10,299)
Selling expense	(2,292)	(2,814)	(3,301)	(3,895)	(4,552)	(5,259)
Admin expense	(597)	(735)	(863)	(1,024)	(1,215)	(1,425)
R&D expense	(1,397)	(1,768)	(2,124)	(2,571)	(3,097)	(3,615)
Operating profit	257	355	762	1,133	1,601	2,225
Other income	20	71	(56)	54	65	78
Interest expense	(28)	(27)	302	366	392	467
Pre-tax profit	249	399	1,008	1,553	2,059	2,770
Income tax	19	74	(723)	311	412	554
After tax profit	230	325	1,731	1,242	1,647	2,216
Net profit	230	325	1,731	1,242	1,647	2,216
Adjusted net profit	1,201	1,543	2,215	2,871	3,544	4,398

BALANCE SHEET	2021A	2022A	2023A	2024E	2025E	2026E
YE 31 Dec (US\$ mn)						
Current assets	5,220	6,654	7,777	11,874	16,862	22,827
Cash & equivalents	1,728	1,470	1,897	5,521	9,979	15,377
Account receivables	1,390	1,725	2,036	2,366	2,736	3,128
Prepayment	223	280	403	473	553	639
Financial assets at FVTPL	1,576	2,810	2,980	2,980	2,980	2,980
Other current assets	303	369	461	535	614	702
Non-current assets	5,578	6,645	9,610	9,958	10,419	11,004
PP&E	766	1,053	1,358	1,587	1,894	2,307
Right-of-use assets	591	682	715	715	715	715
Deferred income tax	692	636	1,508	1,508	1,508	1,508
Investment in JVs & assos	1,630	2,117	3,203	3,203	3,203	3,203
Intangibles	287	232	224	224	224	224
Goodwill	777	824	1,231	1,231	1,231	1,231
Other non-current assets	835	1,101	1,371	1,491	1,643	1,815
Total assets	10,798	13,299	17,387	21,833	27,280	33,830
Current liabilities	4,949	6,005	7,365	8,644	10,199	11,937
Short-term borrowings	92	0	0	0	0	0
Account payables	89	274	126	142	161	183
Lease liabilities	82	96	89	89	89	89
Contract liabilities	3,836	4,660	5,785	6,951	8,375	9,975
Accrued expenses	850	975	1,365	1,461	1,574	1,691
Non-current liabilities	2,154	2,262	2,394	2,419	2,441	2,465
Long-term borrowings	1,484	1,486	1,488	1,488	1,488	1,488
Deferred income	63	70	81	106	128	152
Other non-current liabilities	607	706	825	825	825	825
Total liabilities	7,103	8,267	9,759	11,063	12,640	14,402
Share capital	0	0	0	0	0	0
Capital surplus	3,665	4,796	5,661	7,561	9,785	12,355
Retained earnings	30	236	1,967	3,209	4,856	7,072
Total shareholders equity	3,695	5,032	7,628	10,770	14,641	19,428
Total equity and liabilities	10,798	13,299	17,387	21,833	27,280	33,830

CASH FLOW	2021A	2022A	2023A	2024E	2025E	2026E
YE 31 Dec (US\$ mn)						
Operating						
Profit before taxation	249	399	1,008	1,553	2,059	2,770
Depreciation & amortization	472	433	562	586	674	756
Tax paid	19	74	(723)	311	412	554
Change in working capital	58	174	(101)	710	895	1,024
Others	1,393	1,643	2,652	1,279	1,400	1,462
Net cash from operations	2,191	2,723	3,398	4,438	5,439	6,566
Investing						
Capital expenditure	(401)	(340)	(300)	(330)	(371)	(392)
Acquisition of subsidiaries/ investments	(565)	(566)	(717)	(194)	(232)	(261)
Net proceeds from disposal of short-term investments	(437)	(1,960)	(1,112)	0	0	0
Others	(204)	283	(38)	(291)	(379)	(515)
Net cash from investing	(1,607)	(2,583)	(2,167)	(814)	(981)	(1,168)
Financing						
Net borrowings	(61)	(94)	0	0	0	0
Others	(445)	(250)	(803)	0	0	0
Net cash from financing	(506)	(344)	(803)	0	0	0
Net change in cash						
Cash at the beginning of the year	1,679	1,732	1,475	1,904	5,528	9,987
Exchange difference	(25)	(53)	1	0	0	0
Cash at the end of the year	1,732	1,475	1,904	5,528	9,987	15,385

Source: Company data, CMBIGM estimates. Note: The calculation of net cash includes financial assets.

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