

ServiceNow Inc. (NOW)

\$405.06 (As of 06/30/20)

Price Target (6-12 Months): **\$465.00**

Long Term: 6-12 Months

Zacks Recommendation: **Outperform**

(Since: 06/29/20)

Prior Recommendation: Neutral

Short Term: 1-3 Months

Zacks Rank: (1-5)

3-Hold

Zacks Style Scores:

VGM:B

Value: F

Growth: A

Momentum: C

Summary

ServiceNow is riding on robust adoption of its workflows by companies undergoing digital transformation. Further, strategic alliances with the likes of Microsoft remain tailwinds. The company is well poised to benefit from growing adoption of its wide range of application-based products across industries. Robust pipeline and improvement in bookings also hold promise. As businesses, government agencies and others continue to 'cloudify' their infrastructure, the company is well poised to gain adoption. Moreover, it continues to witness traction from Fortune 500 companies. The company's expanding global presence and strategic buyouts are expected to drive growth. Shares have outperformed the industry on a year-to-date basis. However, increasing expenses on product development are likely to limit margin expansion in the near term.

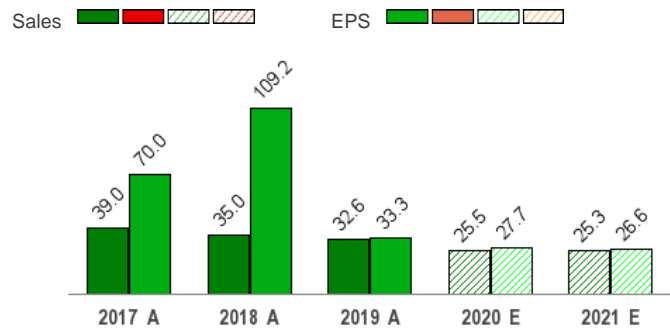
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$411.58 - \$213.99
20 Day Average Volume (sh)	1,757,582
Market Cap	\$77.2 B
YTD Price Change	43.5%
Beta	1.34
Dividend / Div Yld	\$0.00 / 0.0%
Industry	Computers - IT Services
Zacks Industry Rank	Bottom 43% (145 out of 253)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	9.4%
Last Sales Surprise	2.7%
EPS F1 Est- 4 week change	0.0%
Expected Report Date	07/22/2020
Earnings ESP	0.0%
P/E TTM	109.2
P/E F1	95.5
PEG F1	3.4
P/S TTM	20.8

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021	1,271 E	1,315 E	1,377 E	1,468 E	5,442 E
2020	1,046 A	1,047 E	1,084 E	1,165 E	4,343 E
2019	789 A	834 A	886 A	952 A	3,460 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2021	\$1.23 E	\$1.23 E	\$1.44 E	\$1.43 E	\$5.37 E
2020	\$1.05 A	\$1.02 E	\$1.05 E	\$1.10 E	\$4.24 E
2019	\$0.67 A	\$0.71 A	\$0.99 A	\$0.96 A	\$3.32 A

*Quarterly figures may not add up to annual.

The data in the charts and tables, including the Zacks Consensus EPS and Sales estimates, is as of 06/30/2020. The reports text is as of 07/01/2020.

Overview

Santa Clara, CA-based ServiceNow Inc. provides cloud computing services that automate digital workflows to accelerate enterprise IT operations. The company's Now Platform enables enterprises to enhance productivity by streamlining system processes.

By utilizing ServiceNow's product portfolio, customers can design any workflow application to reduce the manual time taken by complex processes, and consequently optimize total cost of ownership or TCO.

The company's solutions address the needs of many departments within an enterprise, including IT, human resources (HR), facilities, field service, marketing, customer service, security, legal and finance.

Now platform is the foundation of the company's cloud-based services.

The company has three product suites for IT management and operations. These are IT Service Management (ITSM), IT Operations Management (ITOM) and IT Business Management (ITBM) solutions.

Non-IT products include Customer Service, HR and Security Operations.

ServiceNow's end-markets are quite varied, which includes financial services, consumer products, IT services, health care, government, education and technology.

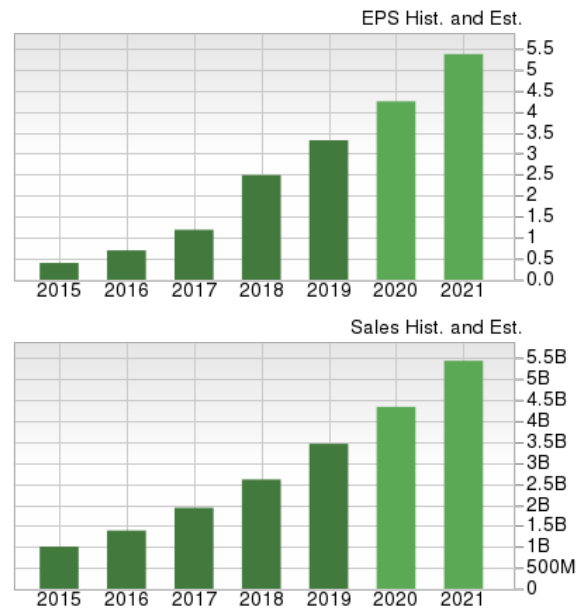
In 2019, total revenues came in at \$3.460 billion.

ServiceNow derives revenues from two sources – subscriptions (94% of 2019 revenues) and professional services and other (6% of 2019 revenues).

North America, Europe, the Middle East and Africa (EMEA), and Asia Pacific & Other contributed approximately 67%, 24% and 9% of revenues, respectively in first-quarter 2020.

The company operates data centers in Australia, Brazil, Canada, Hong Kong, Netherlands, Singapore, Switzerland, UK and the U.S.

ServiceNow has approximately 6,200 enterprise customers, including more than 44% of the world's 2,000 largest companies, as outlined by an annual ranking by the Forbes magazine. The figure also represents more than 80% of the Fortune 500 companies, as defined by an annual ranking by the Fortune magazine.



Reasons To Buy:

- ▲ ServiceNow is a dominant name in the IT service market (ITSM). The company continues to win market share by replacing legacy on-premise systems with cloud-based processes. G2K customers contribute approximately 50% of the top-line and the company expects the mix to remain steady in the long haul. The growing penetration at Fortune 500 clientele (80%) has been driving ServiceNow's top-line growth. Further, it is focusing primarily on public and big private entities, rapidly, which will further drive top-line growth in the long run.
- ▲ ServiceNow is rapidly expanding into non-ITSM markets like human resource and security solutions by launching new products and services. Shorter-sales cycle of these new products (particularly security solutions) as compared with the traditional ITSM business is driving top-line growth. The company is also focused on strengthening sales team across the different non-ITSM markets, which will expand customer base going ahead.
- ▲ ServiceNow has a diversified customer base, which is evident from the fact that none of the customers exceeded 10% of revenues in the last couple of years. Notably, the number of customers with annualized contract value (ACV) greater than \$1 million has also increased from 157 at the end of 2014 to 892 at the end of 2019. Given the company's expanding product portfolio (including emerging products), increasing multi-product customer base and strong renewal rate (almost 97%), we expect the company to achieve this target much earlier. ACV is also expected to improve from \$1 million in 2016 to \$2 million by 2020, which will help the company in achieving the top-line target of \$10 billion.
- ▲ Acquisitions have played an important part in ServiceNow's growth trajectory over the years. The acquisitions of Neebula Systems (2014), BrightPoint Security and ITapp (both in 2016) has aided the company to expand product portfolio, particularly security and ITOM solutions. Also in 2017, the company had acquired Qlue, a developer of virtual messaging agents. The buyout is expected to enhance its customer experience. The acquisitions of Telepathy and SkyGiraffe (both concluded in 2017) are expected to enhance the company's enterprise mobile experience. The acquisitions of DxContinuum (2017), Parlo (2018), FriendlyData (2018), Appsee (2019), Loom Systems (2020) and Passage AI (2020) are expected to boost its predictive modelling capabilities, consequently expanding ServiceNow's intelligent automation product portfolio going ahead.
- ▲ ServiceNow has a strong balance sheet with ample liquidity position. As of Mar 31, 2020, ServiceNow had cash and cash equivalents and short-term investments of \$1.858 billion compared with \$1.691 billion as of Dec 31, 2019. Cash flow from operations during the first quarter came in at \$491.6 million compared with the prior-quarter figure of \$421.2 million. The company also generated free cash flow of \$408.6 million compared with \$342.2 million reported in the prior quarter. The increasing liquidity and cash flow trend reflect that the company is making investments in the right direction. Moreover, the cash is available for pursuing strategic acquisitions, investment in growth initiatives and distribution to shareholders. Further, total debt to total capital of 34.7% is lower than industry's figure of 47.5%.

Dominant position in the ITSM, ITOM markets, growing fortune 500 customer base, rapid growth in non-ITSM markets like HR, Security and product enhancements via strategic acquisitions are key catalysts.

Risks

- ServiceNow faces stiff competition in the non-ITSM markets from the likes of Oracle and salesforce.com, which are well-established players. Although the company has an edge in the security response market, the customer service and HR solutions faces significant competition from these players. As non-ITSM markets become a larger contributor to the company's total revenue, increasing competition can weigh on growth. Moreover, cut-throat competition can hurt pricing power as well as lengthen the sales cycle, which will negatively impact top-line.
 - ServiceNow has been incurring losses over the last five years and has an accumulated deficit of \$304 million as of Mar 31, 2020. The company anticipates reporting loss in the near term due to increased costs such as non-cash charges associated with equity awards, business combinations and other expenses. Despite the improving top line, mounting losses doesn't bode well for investor confidence.
 - ServiceNow generates a significant portion (35% in first-quarter 2020) of revenues from the International market. Adverse foreign currency exchange rates are likely to impede revenue growth in the near term owing to the strengthening of the U.S. dollar compared with the Euro and other foreign currencies, which is a significant concern.
 - The company is trading at premium in terms of Price/Sales (P/S). ServiceNow currently has a trailing 12-month P/S ratio of 21.78X. This level compares unfavorably with what the industry witnessed in the prior year. Additionally, the ratio is higher than the average level of 17.02X and is near the high end of the valuation range in this period. Consequently, the valuation looks slightly stretched from P/S perspective.
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Last Earnings Report

ServiceNow Beats Q1 Earnings Estimates, Trims View

ServiceNow reported first-quarter 2020 adjusted earnings of \$1.05 per share, which increased 9.4% year over year.

Revenues of \$1.046 billion beat the consensus mark by 2.7% and increased 33% year over year. Geographically, North America, Europe, Middle East and Africa (EMEA), and APAC & Other contributed 67%, 24%, and 9% to revenues, respectively.

Moreover, non-GAAP revenues (excluding impact of foreign exchange) of \$1.059 million surged 34% from the year-ago quarter's figures.

Quarter Ending 03/2020

Report Date	Apr 29, 2020
Sales Surprise	2.72%
EPS Surprise	9.37%
Quarterly EPS	1.05
Annual EPS (TTM)	3.71

Quarter Details

Non-GAAP Subscription revenues (adjusted for constant currency) rallied 36% from the year-ago quarter's figure to \$1.006 billion.

Non-GAAP Professional services and other revenues increased 7% (adjusted for constant currency) from the year-ago quarter's level to \$53 million.

Total billings rose 30% on a year-over-year basis (adjusted for constant currency and constant billings duration) to \$1.114 billion.

Non-GAAP adjusted subscription billings of \$1.065 billion surged 32% year over year. Professional services and other billings increased 2% to \$49 million.

ServiceNow maintained consistent renewal rate of 97% during the reported quarter. Fortune 500 companies' clientele expansion continues to grow and came in at almost 80% at the end of the first quarter.

Operating Details

In the first quarter, non-GAAP gross margin was 83%, up 300 basis points (bps) on a year-over-year basis.

Total operating expenses came in at \$773.6 million during the quarter, up 25.1% from the year-ago quarter's reported figure.

The company's non-GAAP operating margin was 24%, up 500 bps on a year-over-year basis.

Balance Sheet & Cash Flow

As of Mar 31, 2020, ServiceNow had cash and cash equivalents and short-term investments of \$1.858 billion compared with \$1.691 billion as of Dec 31, 2019.

During the reported quarter, cash from operations came in at \$491.6 million compared with the prior-quarter figure of \$421.2 million

The company also generated free cash flow of \$408.6 million compared with \$342.2 million reported in the prior quarter. Further, non-GAAP free cash flow margin was 39%, up 100 bps on a year-over-year basis.

Guidance

For second-quarter 2020, non-GAAP adjusted subscription revenues are anticipated between \$1.008 billion and \$1.013 billion, which indicates growth of 29-30% from the year-ago quarter's figure.

Non-GAAP adjusted subscription billings are projected in the range of \$976-\$996 million, which suggests an increase of 20-22% from the year-ago reported figure.

Due to uncertainties related to the coronavirus pandemic, the company has slashed its guidance for full year 2020.

For 2020, non-GAAP adjusted subscription revenues are now anticipated between \$4.167 billion and \$4.197 billion, which indicates growth of 23%-35% from the year-ago quarter's reported figure. The prior non-GAAP adjusted subscription revenue guidance was between \$4.21 billion and \$4.23 billion.

Non-GAAP adjusted subscription billings are projected in the range of \$4.664-\$4.724 billion, which suggests a rise of 23-25% from the year-ago quarter's reported figure. The previous guidance was in the range of \$4.807-\$4.827 billion.

Recent News

On Jun 25, ServiceNow announced that it is increasing investment to boost data center capacity and unveiled two new locations across Europe — Newport, the U.K. and Dublin, Ireland. The aim is to drive digital transformation for customers amid the post-Brexit landscape.

On Jun 22, ServiceNow announced that it has inked an agreement to acquire Belgium-based configuration data management startup — Sweagle. The deal will enable ServiceNow to help customers identify and avoid application and infrastructure misconfigurations, which will prevent halts in production and accelerate digital transformation process.

On Jun 10, ServiceNow announced that it had been named as a leader in the 2020 Gartner Magic Quadrant for the CRM Customer Engagement Center.

On Jun 3, ServiceNow unveiled new industry-specific products aimed at speeding up digital transformation in the telecommunications, financial services and healthcare & life science industries.

On May 18, ServiceNow announced the launch of ServiceNow Safe Workplace suite which contains four apps designed to help companies manage the essential steps for returning employees to the workplace and ensure employee health and safety.

On May 5, ServiceNow announced its partnership with software provider Expanse to enable joint customers to automatically view, prioritize, and more quickly remediate critical Internet Asset exposures as incidents.

On May 18, ServiceNow announced the launch of a four-app suite and dashboard designed to help companies manage the essential steps for returning employees to the workplace and ensuring employee health and safety.

On May 5, ServiceNow announced that it has signed a deal to acquire the 4Facility assets of App4Mation, to strengthen its workplace services capabilities.

On the same day, the company launched the Knowledge 2020 Digital Experience, which has keynotes, breakouts, demos and live labs focused on the Now Platform and will help enterprises in speeding up their digital transformation process.

Valuation

ServiceNow shares are up 43.5% in the year-to-date period and 40.5% over the trailing 12-month period. Stocks in the Zacks sub-industry and the Zacks Computer & Technology sector are up 6.6% and 10.5% in the year-to-date period, respectively. Over the past year, the Zacks sub-industry and the sector are up 5.7% and 23%, respectively.

The S&P 500 index is down 5.2% in the year-to-date period but up 3.3% in the past year.

The stock is currently trading at 15.79X forward 12-month sales, which compares to 5.32X for the Zacks sub-industry, 3.89X for the Zacks sector and 3.48X for the S&P 500 index

Over the past five years, the stock has traded as high as 15.85X and as low as 5.38X, with a 5-year median of 9.88X. Our Outperform recommendation indicates that the stock will perform better than the market. Our \$465 price target reflects 18.13X forward 12-month sales.

The table below shows summary valuation data for NOW

Valuation Multiples - NOW					
		Stock	Sub-Industry	Sector	S&P 500
P/S F12M	Current	15.79	5.32	3.89	3.48
	5-Year High	15.85	10.11	3.89	3.48
	5-Year Low	5.38	3.86	2.32	2.53
	5-Year Median	9.88	7.1	3.13	3.02
P/B TTM	Current	34.09	16.85	5.76	4.24
	5-Year High	44.95	31.78	5.81	4.56
	5-Year Low	13.22	7.05	3.16	2.83
	5-Year Median	35.99	11.03	4.36	3.69
EV/Sales TTM	Current	19.75	4.94	4.43	3.04
	5-Year High	20.22	8.12	4.46	3.47
	5-Year Low	6.66	3.56	2.58	2.14
	5-Year Median	12.61	5.8	3.61	2.84

As of 06/30/2020

Industry Analysis Zacks Industry Rank: Bottom 43% (145 out of 253)



Top Peers

Company (Ticker)	Rec	Rank
ASGN Incorporated (ASGN)	Outperform	2
CDW Corporation (CDW)	Neutral	3
Amdocs Limited (DOX)	Neutral	3
EPAM Systems, Inc. (EPAM)	Neutral	3
Infosys Limited (INFY)	Neutral	3
Inovalon Holdings, Inc. (INOV)	Neutral	3
DXC Technology Company. (DXC)	Underperform	5
Fair Isaac Corporation (FICO)	Underperform	3

Industry Comparison Industry: Computers - It Services				Industry Peers		
	NOW	X Industry	S&P 500	CDW	DOX	EPAM
Zacks Recommendation (Long Term)	Outperform	-	-	Neutral	Neutral	Neutral
Zacks Rank (Short Term)	3	-	-	3	3	3
VGM Score	B	-	-	B	A	C
Market Cap	77.24 B	2.99 B	21.75 B	16.53 B	8.20 B	14.02 B
# of Analysts	13	5	14	6	5	11
Dividend Yield	0.00%	0.00%	1.93%	1.31%	2.15%	0.00%
Value Score	F	-	-	B	A	D
Cash/Price	0.02	0.07	0.07	0.01	0.09	0.07
EV/EBITDA	138.17	9.88	12.71	14.45	9.88	38.63
PEG Ratio	3.45	2.03	2.86	1.63	1.65	2.68
Price/Book (P/B)	34.09	4.71	2.97	18.58	2.29	8.50
Price/Cash Flow (P/CF)	131.73	11.95	11.71	14.42	10.69	42.14
P/E (F1)	96.70	33.82	21.23	21.36	14.02	45.52
Price/Sales (P/S)	20.78	2.22	2.30	0.90	1.98	5.78
Earnings Yield	1.05%	2.36%	4.48%	4.68%	7.13%	2.20%
Debt/Equity	0.50	0.25	0.76	4.01	0.06	0.13
Cash Flow (\$/share)	3.07	1.07	7.01	8.05	5.70	5.98
Growth Score	A	-	-	A	B	A
Hist. EPS Growth (3-5 yrs)	NA%	18.58%	10.93%	22.51%	6.65%	28.92%
Proj. EPS Growth (F1/F0)	27.85%	-6.29%	-9.77%	-10.82%	0.79%	2.15%
Curr. Cash Flow Growth	49.82%	15.98%	5.51%	10.39%	2.45%	27.45%
Hist. Cash Flow Growth (3-5 yrs)	106.38%	16.03%	8.62%	13.51%	3.85%	26.53%
Current Ratio	1.03	1.41	1.30	1.28	1.25	3.87
Debt/Capital	33.51%	34.09%	44.41%	80.04%	5.75%	11.51%
Net Margin	18.19%	2.66%	10.62%	4.07%	11.98%	11.79%
Return on Equity	9.47%	9.36%	15.75%	97.93%	16.03%	18.45%
Sales/Assets	0.69	0.77	0.55	2.32	0.76	1.14
Proj. Sales Growth (F1/F0)	25.49%	0.00%	-2.43%	-2.82%	0.95%	12.10%
Momentum Score	C	-	-	F	C	D
Daily Price Chg	2.66%	1.45%	1.41%	1.91%	1.13%	2.41%
1 Week Price Chg	0.03%	-2.02%	-3.90%	-7.23%	1.08%	-3.15%
4 Week Price Chg	3.09%	2.78%	-1.62%	2.57%	-4.46%	8.33%
12 Week Price Chg	54.40%	24.10%	15.67%	17.79%	6.66%	36.24%
52 Week Price Chg	40.49%	2.25%	-8.07%	3.06%	-2.09%	42.27%
20 Day Average Volume	1,757,582	594,699	2,699,706	1,157,080	957,803	426,251
(F1) EPS Est 1 week change	0.00%	0.00%	0.00%	-1.76%	0.00%	0.00%
(F1) EPS Est 4 week change	0.00%	0.00%	0.00%	-1.76%	0.00%	-0.06%
(F1) EPS Est 12 week change	10.23%	-6.90%	-10.28%	-11.80%	-2.08%	-12.89%
(Q1) EPS Est Mthly Chg	0.00%	0.00%	0.00%	0.00%	0.00%	-0.29%

Zacks Stock Rating System

We offer two rating systems that take into account investors' holding horizons: Zacks Rank and Zacks Recommendation. Each provides valuable insights into the future profitability of the stock and can be used separately or in combination with each other depending on your investment style.

Zacks Recommendation

The Zacks Recommendation aims to predict performance over the next 6 to 12 months. The foundation for the quantitatively determined Zacks Recommendation is trends in the company's estimate revisions and earnings outlook. The Zacks Recommendation is broken down into 3 Levels; Outperform, Neutral and Underperform. Unlike many Wall Street firms, we have an excellent balance between the number of Outperform and Neutral recommendations. Our team of 70 analysts are fully versed in the benefits of earnings estimate revisions and how that is harnessed through the Zacks quantitative rating system. But we have given our analysts the ability to override the Zacks Recommendation for the 1200 stocks that they follow. The reason for the analyst over-rides is that there are often factors such as valuation, industry conditions and management effectiveness that a trained investment professional can spot better than a quantitative model.

Zacks Rank

The Zacks Rank is our short-term rating system that is most effective over the one- to three-month holding horizon. The underlying driver for the quantitatively-determined Zacks Rank is the same as the Zacks Recommendation, and reflects trends in earnings estimate revisions.

Zacks Style Scores

The Zacks Style Score is as a complementary indicator to the Zacks rating system, giving investors a way to focus on the highest rated stocks that best fit their own stock picking preferences.

Academic research has proven that stocks with the best Value, Growth and Momentum characteristics outperform the market. The Zacks Style Scores rate stocks on each of these individual styles and assigns a rating of A, B, C, D and F. We also produce the VGM Score (V for Value, G for Growth and M for Momentum), which combines the weighted average of the individual Style Scores into one score. This is perfectly suited for those who want their stocks to have the best scores across the board.

Value Score	F
Growth Score	A
Momentum Score	C
VGM Score	B

As an investor, you want to buy stocks with the highest probability of success. That means buying stocks with a Zacks Recommendation of Outperform, which also has a Style Score of an A or a B.

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