

ServiceNow Inc. (NOW)

\$312.85 (As of 01/22/20)

Price Target (6-12 Months): **\$332.00**

Long Term: 6-12 Months

Zacks Recommendation:

Neutral

(Since: 01/21/20)

Prior Recommendation: Outperform

Short Term: 1-3 Months

Zacks Rank: (1-5)

2-Buy

Zacks Style Scores:

VGM:C

Value: F

Growth: A

Momentum: D

Summary

ServiceNow is benefiting from growing adoption of wide range of application-based products by public and big private companies. Robust pipeline and improvement in bookings hold promise. As businesses, government agencies, among others, "cloudify" their infrastructure, ServiceNow platform is well poised to gain adoption. Additionally, the company continues to witness traction from Fortune 500 companies. Further, the company's expanding global presence, strong partnerships and strategic buyouts are expected to aid financial performance. Notably, shares of the company have outperformed the industry in the past year. However, increasing expenses on product development and expanding international presence is likely to limit margin expansion in the near term.

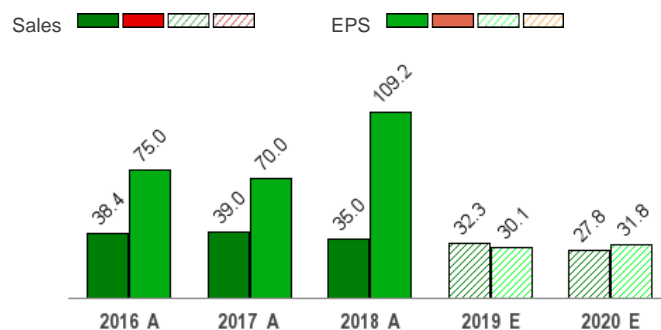
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$317.27 - \$182.46
20 Day Average Volume (sh)	1,394,305
Market Cap	\$58.7 B
YTD Price Change	10.8%
Beta	1.33
Dividend / Div Yld	\$0.00 / 0.0%
Industry	Computers - IT Services
Zacks Industry Rank	Top 44% (112 out of 255)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	11.2%
Last Sales Surprise	0.0%
EPS F1 Est- 4 week change	0.0%
Expected Report Date	01/29/2020
Earnings ESP	0.6%
P/E TTM	99.6
P/E F1	73.3
PEG F1	2.6
P/S TTM	18.2

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2020	1,010 E	1,067 E	1,133 E	1,209 E	4,411 E
2019	789 A	834 A	886 A	942 E	3,451 E
2018	589 A	631 A	673 A	715 A	2,609 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2020	\$0.90 E	\$0.93 E	\$1.20 E	\$1.19 E	\$4.27 E
2019	\$0.67 A	\$0.71 A	\$0.99 A	\$0.88 E	\$3.24 E
2018	\$0.56 A	\$0.49 A	\$0.68 A	\$0.77 A	\$2.49 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 01/22/2020. The reports text is as of 01/23/2020.

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 2018, total revenue surged almost 36% over 2017 to \$2.609 billion.

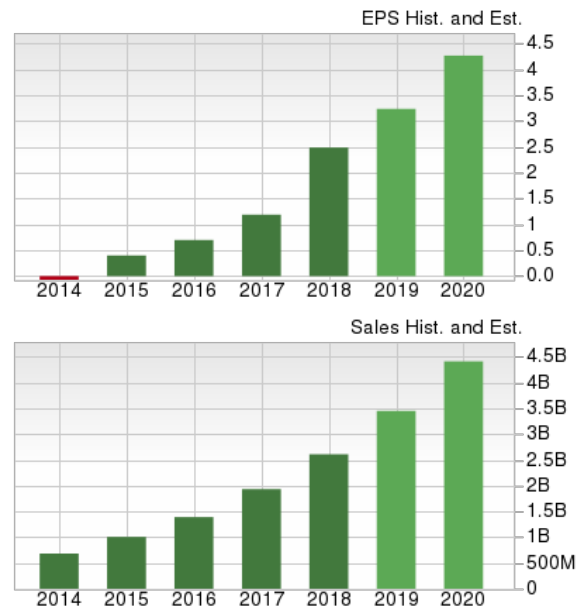
ServiceNow derives revenues from two sources – subscriptions (92.8% of revenues) and professional services and other (7.2%).

North America, Europe, the Middle East and Africa (EMEA), and Asia Pacific & Other contributed approximately 66.3%, 25% and 8.7% of revenues, respectively.

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

As of Dec 31, 2018, ServiceNow had approximately 5,400 enterprise customers, including more than 44% of the world's 2,000 largest companies, as defined by an annual ranking by the Forbes magazine. The figure also represents more than 75% of the Fortune 500 companies, as defined by an annual ranking by the Fortune magazine.

ServiceNow derived 66% of its revenues from North America, while the remaining 34% came from its foreign operations in 2018.



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 Global 2000 or G2K customer base (44%) and Fortune 500 clientele (75%) has been driving ServiceNow's top-line growth. The strong backlog of approximately \$5.1 billion at the end of 2018 (up 35% over 2017) is a key catalyst in this regard. Further, it is penetrating the non-G2K customer base, 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. The company's customer base has increased steadily during the period, with Global 2000 (as defined by Forbes) customers increasing from 533 at the end of 2014 to 883 at the end of 2018. Number of customers with annualized contract value (ACV) greater than \$1 million has also increased from 157 at the end of 2014 to 678 at the end of 2018. Given the company's expanding product portfolio (including emerging products), increasing multi-product customer base and strong renewal rate (almost 98%), 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 easily achieve the top-line target of \$4 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) and Appsee (2019) are expected to boost its predictive modelling capabilities, consequently expanding ServiceNow's intelligent automation product portfolio going ahead.

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.

Reasons To Sell:

- ▼ 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 \$950.97 million as of Sep 30, 2019. 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 (34% in 2018) 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.
- ▼ Moreover, the company is trading at premium in terms of Price/Book (P/B). ServiceNow currently has a trailing 12 month P/B ratio of 41.04, which compares unfavorably to some extent with what the industry saw in the last year. Hence, valuation looks slightly stretched from P/B perspective.

Stiff competition in non-ITSM product segments, modest growth in professional business, continuing losses, muted free cash flow growth and stretched valuation are key negatives.

Last Earnings Report

ServiceNow Beats on Earnings Estimates in Q3, Ups '19 View

ServiceNow reported third-quarter 2019 non-GAAP earnings of 99 cents per share, surpassing the Zacks Consensus Estimate of 89 cents. Further, the figure improved 44.9% on a year-over-year basis.

Revenues of \$885.8 million were almost in line with the Zacks Consensus Estimate of \$886 million and surged 32% from the year-ago quarter. Geographically, North America, Europe, Middle East and Africa (EMEA), and APAC & Other contributed 67%, 24%, and 9%, respectively to revenues.

Meanwhile, non-GAAP revenues (excluding impact of foreign exchange) of \$899.2 million surged 34% from the year-ago quarter.

Quarter Details

Non-GAAP Subscription revenues (adjusted for constant currency) advanced 35% from the year-ago quarter to \$847.6 million.

Non-GAAP Professional services and other revenues improved 11% adjusted for cc from the year-ago quarter to \$51.7 million.

Total billings improved 28% on a year-over-year basis (adjusted for constant currency and constant billings duration) to \$921 million.

Non-GAAP adjusted subscription billings of \$869.1 million surged 29% year over year. Professional services and other billings increased 12% to \$51.9 million.

ServiceNow maintained consistent renewal rate of 99% during the reported quarter. Fortune 500 companies' clientele expansion continues to grow and came in at 75% at the end of the third quarter.

Additionally, the company completed 46 transactions that generated net new annualized contract value (ACV) exceeding \$1 million. Further, the company's total number of customers contributing more than \$1 million to business reached 809 in the third quarter. The figure surged 32% on a year-over-year basis.

The ongoing digital transformation of organizations, including big private and public companies, and different levels of government agencies, have been acting as tailwinds. ServiceNow's strength in ACV performance also remains a positive.

Product-Wise Break-Up of Top 20 New Wins

Out of top 20 new customer additions to the company's customer base in the third quarter, 18 included adoption of three or more products.

Considering the IT domain, IT Service Management (ITSM), IT Operations Management (ITOM), IT Asset Management (ITAM) and IT Business Management (ITBM) product lines witnessed adoption by 17, 16, 10 and seven customers out of these 20 wins, respectively.

Further, the emerging products (EP) segment is comprised of Customer Service Management (CSM), HR Service Delivery (HR), Security Operations and Intelligent Apps (IA) product lines. In the reported quarter, out of the top 20 new deals, CSM, HR, Security and IA were part of seven, 10, seven and six deals, respectively.

Meanwhile, Platform Add-ons and other services, comprising Performance Analytics, Cloud Options, among others, were leveraged by all the 20 wins.

Notably, IT, EP and Platform Add-ons contributed 55%, 30% and 15%, respectively to net new ACV.

Operating Details

During the third quarter, non-GAAP gross margin came in at 81%, expanding 100 bps on a year-over-year basis.

The company's non-GAAP operating margin was 26%, expanding 200 bps on a year-over-year basis.

Further, free cash flow margin was reported at 14%, compared with the year-ago figure of 17%.

Balance Sheet & Cash Flow

As on Sep 30, 2019, ServiceNow had cash and cash equivalents and short term investments of \$1.471 billion compared with \$1.653 billion in the previous quarter.

During the reported quarter, cash from operations came in at \$210 million compared with the prior-quarter figure of \$243.7 million.

The company also generated free cash flow of \$121 million compared with \$193.8 million reported in the prior quarter.

Guidance for Q4

For fourth-quarter 2019, non-GAAP adjusted subscription revenues are anticipated between \$897 million and \$902 million, indicating growth of 35% from the year-ago quarter.

Non-GAAP adjusted subscription billings are projected within the range of \$1.270-\$1.275 billion, suggesting an improvement of 33-34% from

Quarter Ending 09/2019

Report Date	Oct 23, 2019
Sales Surprise	0.01%
EPS Surprise	11.24%
Quarterly EPS	0.99
Annual EPS (TTM)	3.14

the year-ago reported figure.

Further, non-GAAP operating margin is anticipated to be 21%.

Raises View for 2019

ServiceNow revised subscription revenues and billings outlook for fiscal 2019, backed by an impressive pipeline. For full-year 2019, non-GAAP adjusted subscription revenues are now anticipated in the range of \$3.302-\$3.307 billion from the previous band of \$3.289-\$3.299 billion, suggesting growth of 36-37%.

Non-GAAP subscription billings are now anticipated to improve in the range of 32-33% year over year to \$3.817-\$3.822 billion, indicating an improvement over the previous band of \$3.804-\$3.814 billion.

However, the company reiterated the margin outlook, thanks to increasing investments. Non-GAAP subscription gross margin is expected to be 86%, while operating margin and free cash flow margin are projected to be 21% and 28%, respectively.

Growth in each of the segments has been adjusted for constant currency and constant billings duration.

Recent News

On Jan 22, 2020, ServiceNow inked a deal to acquire Loom Systems, with an aim to improve its AIOps capabilities.

On Nov 19, 2019, it was reported that ServiceNow will replace Celgene to join S&P 500 on Nov 21.

On Nov 18, 2019, ServiceNow announced appointment of Gina Mastantuono as Chief Financial Officer, effective Jan 13, 2020.

On Oct 22, 2019, ServiceNow declared that Bill McDermott is set to join ServiceNow as CEO, president and a member of the board of directors, by end of 2019.

On Sep 24, 2019, ServiceNow introduced two latest certified ServiceNow applications, namely BitSight for Security Incident Response and BitSight for Vendor Risk Management. The latest applications offer robust automation of digital workflows, enabling customers to identify cyber risks and assess security performance.

On Sep 18, 2019, ServiceNow's GovCommunityCloud achieved FedRAMP High Impact Provisional Authority to Operate (P-ATO). The certification will aid federal agencies in adopting cloud-based solutions in a secure manner.

On Jul 18, 2019, ServiceNow announced that Gartner recognized the company as a Leader's in the "2019 Gartner Magic Quadrant for Integrated Risk Management."

On Jul 9, 2019, ServiceNow and Microsoft expanded partnership with an aim to accelerate digital transformation. With the partnership, Microsoft and ServiceNow are focusing on enhancing their portfolio with more intelligence and cognitive capabilities.

Valuation

ServiceNow shares are up 5.2% in the past six-month period and 68.5% over the trailing 12-month period. Stocks in the Zacks sub-industry are down 1.1% while the stocks in the Zacks Computer & Technology sector are up 14.8% in the past six-month period. Over the past year, the Zacks sub-industry and sector are up 25% and 33.5%, respectively.

The S&P 500 index is up 10.7% in the past six-month period and 24.9% in the past year.

The stock is currently trading at 13.08X forward 12-month sales, which compares to 5.19X for the Zacks sub-industry, 3.74X for the Zacks sector and 3.56X for the S&P 500 index

Over the past five years, the stock has traded as high as 15.81X and as low as 5.38X, with a 5-year median of 9.84X. Our Neutral recommendation indicates that the stock will perform in line with the market. Our \$332 price target reflects 13.88X 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 F 12M	Current	13.08	5.19	3.74	3.56
	5-Year High	15.81	10.29	3.74	3.56
	5-Year Low	5.38	4.34	2.30	2.54
	5-Year Median	9.84	7.46	3.01	3.00
P/B TTM	Current	41.04	16.35	5.61	4.54
	5-Year High	44.95	31.78	5.61	4.55
	5-Year Low	13.22	7.05	3.13	2.85
	5-Year Median	36.21	9.81	4.22	3.61
EV/Sales TTM	Current	17.86	5.23	4.40	3.33
	5-Year High	18.62	8.12	4.40	3.33
	5-Year Low	6.66	4.16	2.56	2.16
	5-Year Median	12.61	5.93	3.46	2.80

As of 01/22/2020

Industry Analysis Zacks Industry Rank: Top 44% (112 out of 255)



Top Peers

Fair Isaac Corporation (FICO)	Outperform
Inovalon Holdings, Inc. (INOV)	Outperform
ASGN Incorporated (ASGN)	Neutral
CDW Corporation (CDW)	Neutral
Amdocs Limited (DOX)	Neutral
DXC Technology Company. (DXC)	Neutral
EPAM Systems, Inc. (EPAM)	Neutral
Infosys Limited (INFY)	Neutral

Industry Comparison Industry: Computers - It Services				Industry Peers		
	NOW Neutral	X Industry	S&P 500	CDW Neutral	DOX Neutral	EPAM Neutral
VGM Score	C	-	-	A	B	B
Market Cap	58.66 B	3.44 B	24.65 B	19.62 B	10.02 B	12.78 B
# of Analysts	14	5	13	7	5	9
Dividend Yield	0.00%	0.00%	1.77%	1.11%	1.53%	0.00%
Value Score	F	-	-	B	C	D
Cash/Price	0.03	0.06	0.04	0.01	0.05	0.07
EV/EBITDA	162.11	12.32	13.98	18.17	12.32	42.28
PEG Ratio	2.62	1.99	2.05	1.59	1.94	1.79
Price/Book (P/B)	41.04	5.46	3.38	20.99	2.83	8.55
Price/Cash Flow (P/CF)	145.77	14.90	13.60	19.54	13.06	48.67
P/E (F1)	73.27	21.15	19.07	20.86	16.46	35.86
Price/Sales (P/S)	18.19	1.68	2.69	1.12	2.45	5.90
Earnings Yield	1.36%	2.80%	5.24%	4.80%	6.08%	2.79%
Debt/Equity	0.75	0.23	0.72	3.57	0.00	0.12
Cash Flow (\$/share)	2.15	1.39	6.94	6.99	5.70	4.78
Growth Score	A	-	-	A	B	B
Hist. EPS Growth (3-5 yrs)	NA%	16.94%	10.60%	21.73%	6.12%	26.81%
Proj. EPS Growth (F1/F0)	31.85%	9.62%	7.53%	9.01%	4.83%	20.91%
Curr. Cash Flow Growth	342.44%	14.90%	13.90%	19.83%	2.45%	38.99%
Hist. Cash Flow Growth (3-5 yrs)	114.97%	18.94%	9.00%	14.79%	3.85%	26.61%
Current Ratio	1.05	1.32	1.22	1.33	1.39	4.38
Debt/Capital	42.92%	37.45%	42.99%	78.13%	0.00%	10.71%
Net Margin	1.09%	1.78%	11.21%	4.04%	11.73%	11.38%
Return on Equity	6.62%	8.86%	17.16%	91.07%	15.98%	18.44%
Sales/Assets	0.73	0.81	0.55	2.31	0.78	1.17
Proj. Sales Growth (F1/F0)	27.80%	8.61%	4.08%	5.65%	3.15%	23.04%
Momentum Score	D	-	-	A	B	B
Daily Price Chg	-0.04%	0.00%	-0.04%	0.37%	-0.17%	0.30%
1 Week Price Chg	4.56%	1.01%	2.29%	-3.87%	2.78%	4.19%
4 Week Price Chg	10.08%	3.85%	2.05%	-4.47%	2.41%	9.85%
12 Week Price Chg	25.17%	11.15%	6.92%	7.22%	13.06%	31.18%
52 Week Price Chg	70.06%	12.73%	21.50%	67.81%	35.09%	71.78%
20 Day Average Volume	1,394,305	215,893	1,518,423	876,892	677,901	215,893
(F1) EPS Est 1 week change	0.00%	0.00%	0.00%	0.36%	0.00%	0.00%
(F1) EPS Est 4 week change	0.00%	0.00%	0.00%	0.36%	0.00%	0.37%
(F1) EPS Est 12 week change	0.00%	-0.59%	-0.23%	3.51%	-0.70%	2.30%
(Q1) EPS Est Mthly Chg	0.00%	0.00%	0.00%	0.19%	0.00%	0.00%

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	D
VGM Score	C

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.

Disclosures

This report contains independent commentary to be used for informational purposes only. The analysts contributing to this report do not hold any shares of this stock. The analysts contributing to this report do not serve on the board of the company that issued this stock. The EPS and revenue forecasts are the Zacks Consensus estimates, unless indicated otherwise on the reports first page. Additionally, the analysts contributing to this report certify that the views expressed herein accurately reflect the analysts personal views as to the subject securities and issuers. ZIR certifies that no part of the analysts compensation was, is, or will be, directly or indirectly, related to the specific recommendation or views expressed by the analyst in the report.

Additional information on the securities mentioned in this report is available upon request. This report is based on data obtained from sources we believe to be reliable, but is not guaranteed as to accuracy and does not purport to be complete. Any opinions expressed herein are subject to change.

ZIR is not an investment advisor and the report should not be construed as advice designed to meet the particular investment needs of any investor. Prior to making any investment decision, you are advised to consult with your broker, investment advisor, or other appropriate tax or financial professional to determine the suitability of any investment. This report and others like it are published regularly and not in response to episodic market activity or events affecting the securities industry.

This report is not to be construed as an offer or the solicitation of an offer to buy or sell the securities herein mentioned. ZIR or its officers, employees or customers may have a position long or short in the securities mentioned and buy or sell the securities from time to time. ZIR is not a broker-dealer. ZIR may enter into arms-length agreements with broker-dealers to provide this research to their clients. Zacks and its staff are not involved in investment banking activities for the stock issuer covered in this report.

ZIR uses the following rating system for the securities it covers. **Outperform-** ZIR expects that the subject company will outperform the broader U.S. equities markets over the next six to twelve months. **Neutral-** ZIR expects that the company will perform in line with the broader U.S. equities markets over the next six to twelve months. **Underperform-** ZIR expects the company will underperform the broader U.S. equities markets over the next six to twelve months.

No part of this report can be reprinted, republished or transmitted electronically without the prior written authorization of ZIR.