



ASSET MANAGEMENT

FLASH NEWS



12-12-2011

SuccessFactors acquisition by SAP : what it really means

On December 3rd, SAP has announced plans to [acquire software-as-a-service \(SaaS\) business software provider SuccessFactors](#) for \$40 per share, a 52% premium over the company's closing price of \$26.25 on December 2. The deal is worth \$3.4 billion. Valuation is anything but cheap: SAP pays 10 times SuccessFactors' 2011 estimated revenues and 322 times its estimated adjusted net income (consensus estimate Bloomberg). SuccessFactors is a 3% position in the IT_{Funds} Info Tech we initiated in the second half of September. Beyond the good news for the Fund, we think the deal has a lot of ramifications we would like to share.

From 2008 to 2011, SuccessFactors revenue (\$334 million in 2011) have increased by a factor of three. The peer group (SuccessFactors, Taleo, Workday, Salesforce.com, Right-Now Technologies, Ariba...) is growing at a 20%-30% annual rate. We hear daily of Oracle and SAP customers ripping off their traditional on-premise software infrastructure to go instead on demand. We think this is due to a combination of powerful factors.

Technically, Software-as-a-Service (SaaS) is a business software application that can be accessed from a PC through any browser, from a tablet or a smartphone. No installation is required: deployment is done with a few mouse clicks. The same application is used by everyone (this is called multi-tenant) though each business customer runs its own instance and can customize the application according to its needs. Because the same software is used by all customers, updates (typically 2 to 4 times a year) are available instantly. As Salesforce.com pitches its customers: no software, no upgrade.

Enterprise business line divisions (HR, Sales&Marketing, Procurement...) can **for the first time ever select the application that best suits its needs without having to go through the IT department**. A welcome move as a lot of managers feel that IT corporate department does just not get it. That in itself is already a tectonic shift. IT loses the power of being in charge of running the IT infrastructure (servers, databases, network, storage...): with SaaS, the infrastructure is run (and shared) by the vendor.

SaaS customers are always up-to-date thanks to regular software updates, at no cost. This is critical from a business perspective because upgrades are costly, commit corporate resources and take time with little perceived value. The consequence is that on premise customers usually wait for the last moment to upgrade, hence do not benefit from the improvements brought up by their vendors. The constant evolution also means that **the gap between SaaS and on-premise software increases over time, a typical feature of disruptive technologies.**

SaaS means no capex, something of paramount value when cash preservation is the norm. A key argument for sure to get the CFO's approval.

SaaS software has been written from ground up a few years ago to suit 21st century needs, not to meet requirements that occurred in the eighties or nineties. It is very interesting to see to what extent **SaaS applications are Internet-centric, social-enabled, run on every mobile device, smartphone or tablet and reflect front-office needs rather than back-office process automation focus of on premise application.** There is no way to run CRM (Customer Relationship Management) without being immersed in Facebook, Twitter or influential blogs because this is where customers are engaging with each other. E-procurement needs to connect buyers and suppliers through market places. Travel and expense management is all about building a seamless bridge between the enterprise, airlines, train companies, hotels. HR (Human Resource) needs to be natively interfaced with LinkedIn and Monster.com. This is a true paradigm shift in the way software is designed.

Facebook-like user interface. Facebook, Amazon.com, eBay are the benchmarks of SaaS vendors. Has anybody ever asked for a Facebook manual ? Yet what the average user can do with Facebook is amazing. Salesforce.com takes Facebook as its reference design, Ariba (e-procurement) aims at making business exchanges as easy as trading on eBay... Easy to user Internet-like interfaces means that enterprise users are more productive. It also is the way to attract digital natives who look at Windows-based client/serveur applications as they look at silent movies.

Variable costs. SaaS is a service, paid for through a subscription model, basically per user per month. There is no upfront cost, everything is variable. If an enterprise needs to downsize, the cost will decrease with the decreasing number of employees. Another key business value in tough times. Some sell-side analysts still think this is the main differentiation of SaaS versus on premise. Not really: nothing prevents a traditional software vendor to set up a subscription payment for its customer.



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Flexibility. A lot of enterprises are eager to seize business opportunities in emerging markets. With SaaS, expanding to a new country or new location is much faster. A fast and reliable Internet connection is the only requirement to start operations. An application can be made accessible instantaneously to thousands of users in just a few clicks if needed. As Cognizant's CEO coined: "In fact, it is because of this persistent uncertainty and volatility that our clients are working hard to protect investments that are directed towards building agility into their businesses". (..) And, they're looking to, in many way, take advantage of that volatility". We believe that **SaaS may increasingly become a strategic enterprise choice going forward for this reason.**

No longer a novelty. In the 2008-2009 time frame, SaaS was still a novelty. Corporations were not sure how the model worked, what the pros and cons were, references in their vertical were lacking, vendors were still small and some unprofitable. Not anymore. Chief Information Officers, instead of fighting head-on SaaS have learned they had better go with it if they want to keep their job. They still can add value by taking care of data synchronization, security and helping get better terms. And there are much more trained people to help implement SaaS in the enterprise.

Do more with less. Operating efficiency is a key corporate concern right now. SaaS helps rip off old costly on premise legacy software (suppliers tend to overcharge perceived captive customers) and replace it by SaaS solutions which bring innovative new features for a fraction of the maintenance cost. SuccessFactors estimates that the annual maintenance revenue for traditional HR software (dominated by PeopleSoft/Oracle and SAP) amounts to \$2bn per year. Adding on top of that the cost of running a database, middleware, hardware maintenance and related headcount, we easily quadruple this saving to \$8bn.

As we can see, SaaS brings a lot of arguments, **with real proven business value. Moreover, SaaS fits exceptionally well with the current uncertain economic environment.** No wonder that SAP acquires SuccessFactors, as its SaaS footprint remains tiny. **Clock is ticking for traditional software vendors.**

About IT Asset Management

For nearly 20 years, IT Asset Management is an independent asset management company which differentiates with its ability to anticipate and capitalize on underlying trends in the global technology industry. Leader in France, IT Asset Management manages and markets three specialized funds:

- *IT Technologies Investissement, French fund, invested in information technology,*
- *IT Funds Info Tech, Luxembourg sicav, invested in information technology,*
- *IT Funds Clean World, Luxembourg Sicav, invested in environmental technologies.*

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