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Slack Technologies

Is Slack Worth $17 Billion? | ***Adam Augusiak-Boro***

EXECUTIVE SUMMARY

- Slack will list on the NYSE on June 20, 2019 at a rumored valuation of nearly $17 billion
- Such a valuation implies a 37.4x Price-to-Sales (P/S) multiple, significantly above the 22.4x average P/S for Slack's SaaS peer set
- However, Slack has performed above the peer set average across a number of financial and operating metrics
- In particular, Slack's topline growth rate exceeds its peer set by 24% on average in the two years leading up to its direct listing
- Slack is also highly efficient in leveraging its sales and marketing spend, generating an LTM sales efficiency of 1.1

Slack Technologies, Inc. ("Slack"), the enterprise Software-as-a-Service ("SaaS") company that provides a cloud-based set of team collaboration tools, will become only the second large company to publicly debut through a direct listing when it begins to trade on the New York Stock Exchange ("NYSE") on Thursday, June 20, 2019. The first such company was of course Spotify, which demonstrated that a well-known, cash-rich tech company could successfully, and with relatively little price volatility, go public without the assistance of underwriters. At EquityZen, we have written extensively about direct listing mechanics and the pros and cons of bypassing a traditional initial public offering ("IPO"). If Slack is able to avoid significant volatility after its NYSE debut, we expect direct listings among tech unicorns to cautiously grow in practice, particularly among household names like Airbnb and its peers. A deep dive on direct listings is beyond the scope of the below analysis, although please refer to the EquityZen Knowledge Center for additional information on tech, venture capital and the IPO markets.

Assuming all goes well with Slack's direct listing, the questions on all our minds now are at what price will Slack

EquityZen Inc.

Adam Augusiak-Boro
Senior Associate
adam@equityzen.com

Risun Udawatta
Associate
risun@equityzen.com

Catherine Klinchuch
Director of Finance & Research
catherine@equityzen.com

Atish Davda
Founder & CEO
atish@equityzen.com

EquityZen Inc.
45 West 27th Street, Suite 200
New York, NY 10001

debut, and will it sustain its valuation. News reports leading up to Slack's direct listing have indicated that the company will initially trade at nearly a $17 billion valuation, or approximately $10 billion higher than the company's valuation in its last preferred funding round in August 2018. Such a valuation would imply a share price of over $33, or just slightly above some of Slack's secondary market trades in May at $31.50 per share. Remarkably, $33 per share would be nearly three times the price paid by Slack's Series H investors last August.

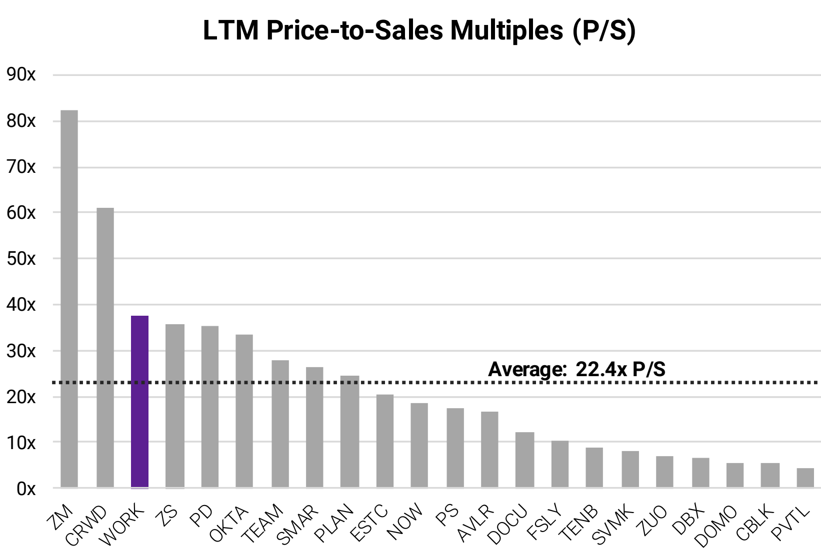
As such, in order to test this valuation's resiliency, we dug into Slack's and its SaaS peers' IPO filings to create a comprehensive comparable companies database by which to evaluate Slack's financial and operational performance leading up to its listing (for a detailed report on comparable companies analysis and other startup valuation methodologies, please see here).

Note: Market data below is as of 6/18/2019

Who Are Slack's Peers and How Does Slack Compare?

In order to assess Slack's potential $17 billion valuation, we compiled detailed financial and operational metrics on twenty-one other SaaS companies as a point of comparison to Slack. Our peer set includes companies comprising fourteen major SaaS IPOs in 2018 and three in 2019, as well as four companies that Slack considers competitors according to its filings. The full company ticker list is as follows: ZM (Zoom Video Communications), CRWD (CrowdStrike), PD (PagerDuty), ZS (Zscaler), OKTA (Okta), TEAM (Atlassian), SMAR (Smartsheet), PLAN (Anaplan), ESTC (Elastic), NOW (ServiceNow), PS (Pluralsight), AVLR (Avalara), DOCU (DocuSign), FSLY (Fastly), TENB (Tenable), SVMK (SurveyMonkey), ZUO (Zuora), DBX (Dropbox), DOMO (Domo), CBLK (Carbon Black), and PVTL (Pivotal). Slack plans to trade under the ticker "WORK."

Using our peer set, below we grade Slack along ten metrics vis-à-vis its peers, using financial and operational figures from the eight quarters prior to each peer company's respective IPO. We believe that limiting the data to performance in the years prior to each company's IPO allows us to normalize for the varying levels of company maturity among the peer set and thus provide a more meaningful comparison. Before we dive into the ten metrics, let us level set with respect to Slack's expected valuation compared to its peers as they currently trade. Below, we have compiled the Price-to-Sales (P/S) multiples (calculated as current market capitalization over last twelve months' revenue) for Slack and its peer set.



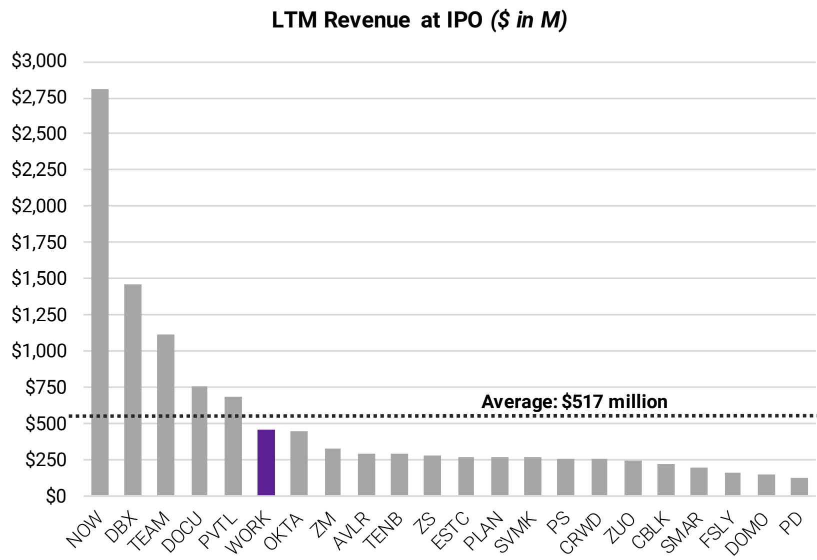
At $17 billion, Slack would have a P/S multiple of 37.4x, or approximately 15 turns of revenue higher than the peer set average of 22.4x. The P/S multiple determines how expensive (or cheap) a stock is compared to its peers. In broad strokes, the higher the multiple, the more expensive the stock is, as an investor is paying more ("P") for each dollar of sales ("S"). Slack's P/S multiple implies that the company is highly valued compared to the overall SaaS space, and will be a relatively expensive stock. This begs the question—is Slack's valuation justified?

Grading Slack's Performance—Can It Maintain a $17B Valuation?

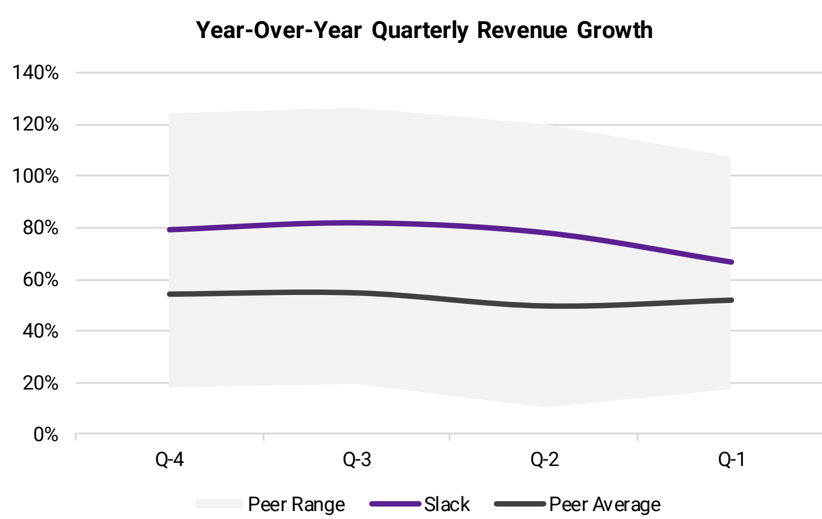
Below, we grade Slack across ten different metrics vis-à-vis its peer set, awarding the company one point for every instance in which it beats the peer average, deducting one point for every instance in which it performs below the peer average, and not adjusting Slack's grade for results that meet the peer average. When the charts below use "Q-1" through "Q-8" as units on the horizontal axis, these units denote quarters prior to each peer company's respective IPO (e.g., Q-4 would be the fourth quarter prior to IPO). Without further delay, let us dive into Slack's recent performance.

Revenue & Revenue Growth

Topline performance and growth are important numbers for investors in every tech sector. With $454 million in last twelve months' (LTM) revenue, Slack has the sixth highest sales number among its peer set.



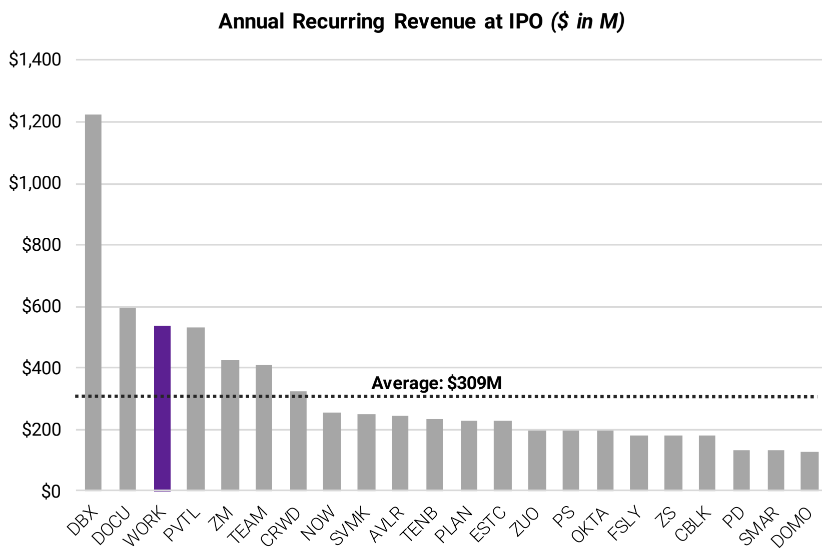
While Slack's LTM revenue is below the peer average of $517 million, companies like ServiceNow, with $2.8 billion in LTM revenue prior to its IPO, have skewed the average higher. The median LTM revenue among the peer set is only $272 million, which Slack significantly exceeds as it heads towards its direct listing.



More remarkable than its revenue in absolute terms, Slack's year-over-year quarterly revenue growth far exceeds the peer average. In the last four quarters, Slack's quarterly revenue grew 77% percent on average year-over-year, compared to only 53% average year-over-year growth for the peer set.

Grade: +1

Annual Recurring Revenue

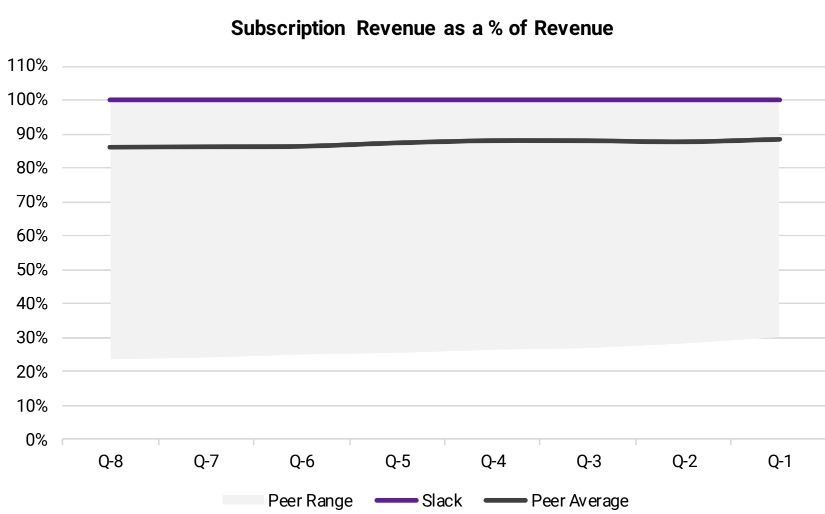


As displayed above, the average SaaS P/S multiple for our peer set is 22.4x, with companies like Zoom Video and CrowdStrike trading at over 80x and 60x, respectively. Much of the reason for this high average P/S multiple among SaaS companies has to do with their revenue sources. Generally, SaaS businesses have high levels of recurring revenue as a percentage of total revenue, which is reflective of their subscription-based business models. Consequently, SaaS companies tend to be rewarded with higher multiples for their recurring, stickier subscription revenue, as opposed to other revenue models (such as a marketplace, like Uber or Lyft, which takes a cut of each transaction). Conventional wisdom holds that software is also much easier and cheaper to scale than say a hardware company, which also partially explains why they trade at such high P/S multiples.

In Slack's case, its current annual recurring revenue (ARR) number is $539 million, which is well ahead of its LTM revenue of $454 million and the peer ARR average of $309 million. The reason Slack's ARR is higher than its LTM revenue (and also why Slack moves from sixth out of 22 in total revenue to third in ARR), is because ARR is a forward-looking metric and is calculated as four (for each quarter) times the most recent quarterly revenue number. Given Slack's above average revenue growth, it's not surprising to see it move closer towards the top in the ARR rankings.

Grade: +1

Subscription Revenue as a Percentage of Revenue



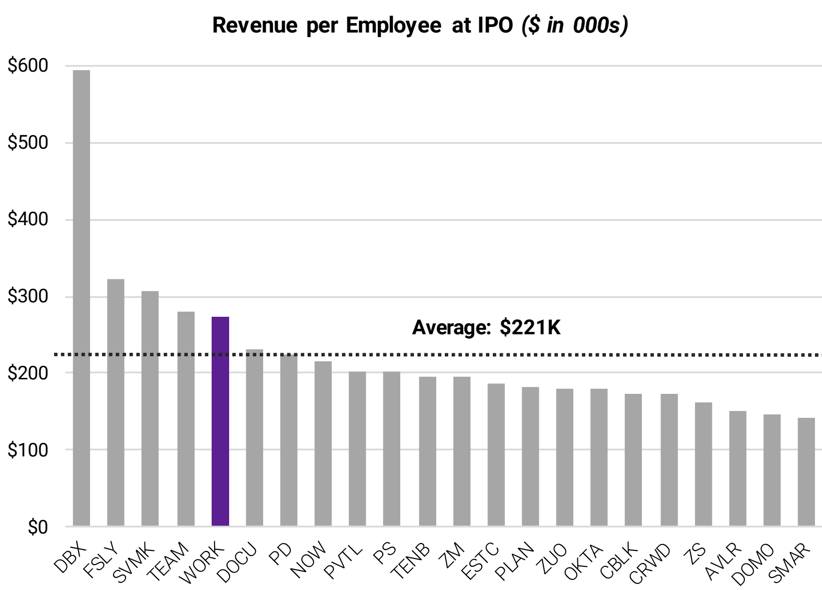
As described above, one of the key attractive features of the SaaS model is subscription-based revenue, which tends to be stickier and more predictable as SaaS company clients sign contracts for fixed periods (typically a one-year subscription).

Aside from subscription revenue, SaaS companies also often have some revenue from services they provide, such as support services for their software. Unsurprisingly, subscription revenue as a percentage of total revenue is high for our SaaS peer set, averaging 87% over the eight quarters prior to IPO. However, we have classified all of Slack's revenue as recurring, subscription revenue, as the company's filings state that substantially all of its revenue comes from monthly and annual subscription fees earned from customers accessing Slack.

Grade: +1

Revenue per Employee

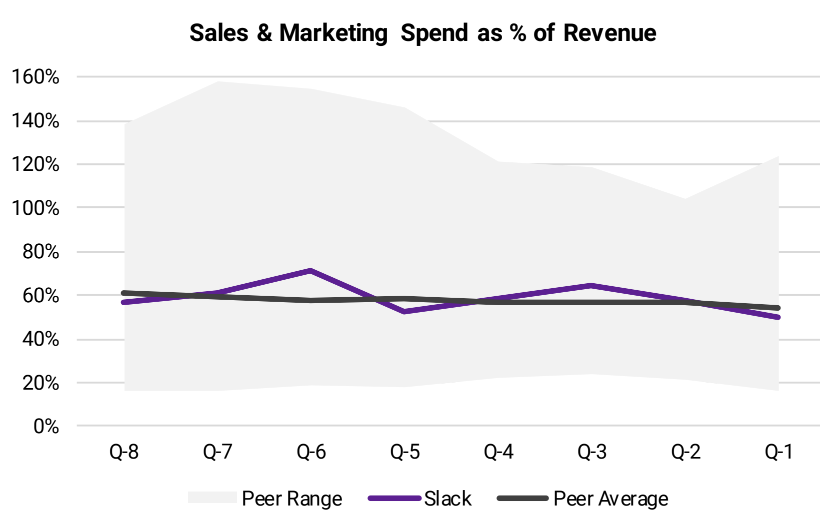
We've already established that Slack's topline growth and ARR outstrip the vast majority of its peers, but how efficient has Slack been in generating all of that revenue? One metric that is helpful in shedding light on Slack's efficiency is revenue per employee. As a company scales, increasing revenue per employee is certainly a positive sign of the health of the business. Growing revenue per employee indicates that the company is achieving economies of scale as a result of a number of potential business improvements, including strong brand awareness, improving sales efficiency, and increases in customer contract size, among other factors.



At $273 thousand in revenue per employee, Slack is significantly more efficient than over three-quarters of its peer set, which average only $221 thousand in revenue per employee.

Grade: +1

Sales & Marketing Spend as a Percentage of Revenue

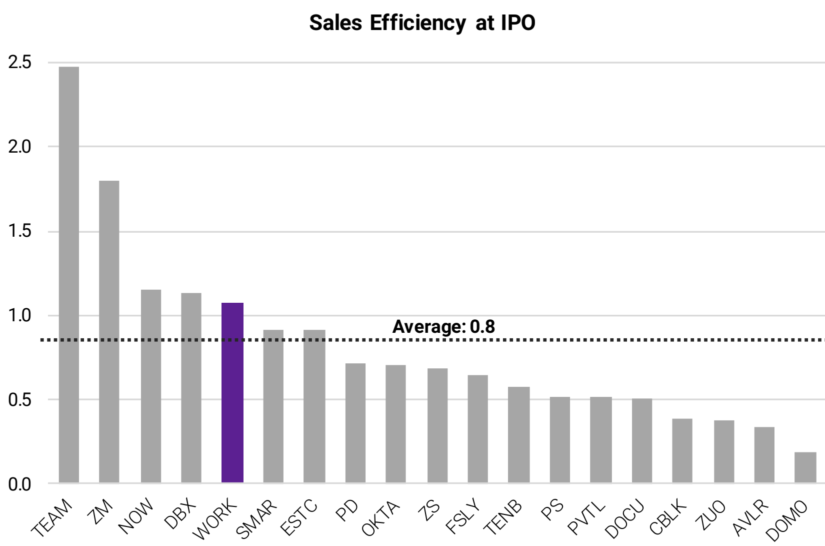


As described above, one reason for Slack's relatively high revenue number per employee may be as a result of its efficient use of its sales and marketing spend. Customer acquisition is of course critical for SaaS businesses, as once they lock in a paying customer, they can largely rely on that customer through at least the end of the subscription period. As a result, sales and marketing spend used to acquire customers tends to be quite high for SaaS companies (and for high-growth tech companies, overall).

Our data above reflects this, with Slack's peers averaging a sales and marketing spend of 58% of total revenue over the eight quarters leading up to IPO. Similarly, although Slack dipped below the average in its most recent quarter, the company has largely followed the peer mean, averaging a sales and marketing spend of 59% of total revenue over the same period. By our rules, we cannot award Slack any points for this one, although we note it's actually quite impressive that Slack's sales and marketing spend aligns with the peer average while its revenue growth is significantly higher than its peers.

Grade: 0

Sales Efficiency & Payback Period



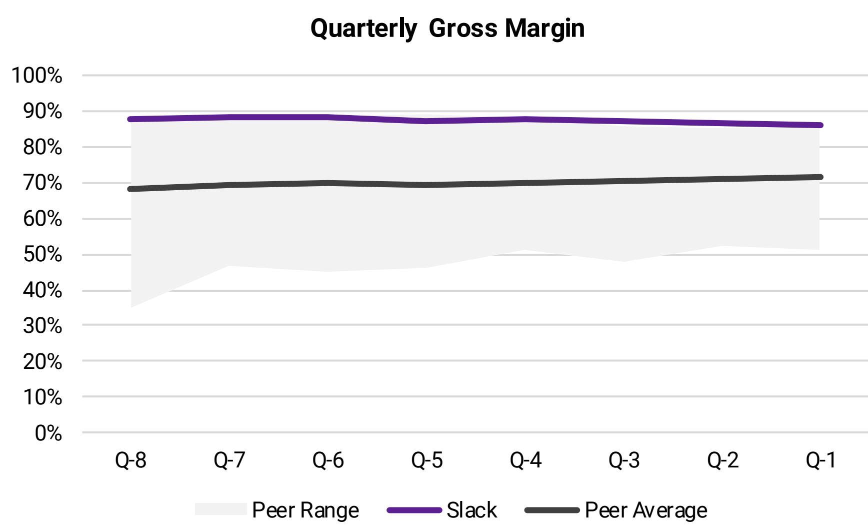
As we alluded to above, Slack has been able to do more with a similar relative amount of sales and marketing spend as its peers. In other words, Slack's sales efficiency is significantly higher than the peer set average. Sales efficiency is an insightful metric that investors often use when benchmarking SaaS businesses across various sectors. Although there is some variation in how sales efficiency is calculated, generally investors use the difference between the current period's revenue (or gross profit) and the last period's revenue (or gross profit) and divide it by the last period's sales and marketing expense. Essentially, sales efficiency will tell an investor how much new revenue or gross profit a company generates for every dollar of sales and marketing spend. Ideally, SaaS companies will have a sales efficiency of over 1.0, indicating that every dollar of sales and marketing creates more than one dollar of revenue or gross profit. The inverse of sales efficiency is payback period, or the time required for customer revenue or gross profits to "reimburse" sales and marketing costs.

At 1.1, Slack's sales efficiency is excellent, although it actually trails its competitors Atlassian (2.5), Zoom Video Communications (1.8), and ServiceNow (1.2). Regardless of some of its peers' overperformance, Slack's sales efficiency demonstrates that the company is getting serious leverage out of its sales and marketing team, generating $1.10 of gross profit for every $1.00 of sales and marketing spend. This figure also implies a payback period of under eleven months for Slack, meaning its annual gross profits essentially pay back Slack's sales and marketing expenses in less than a year. Please note that the above chart excludes Anaplan, SurveyMonkey and CrowdStrike due to lack of quarterly data for certain periods.

Grade: +1

Gross Margin

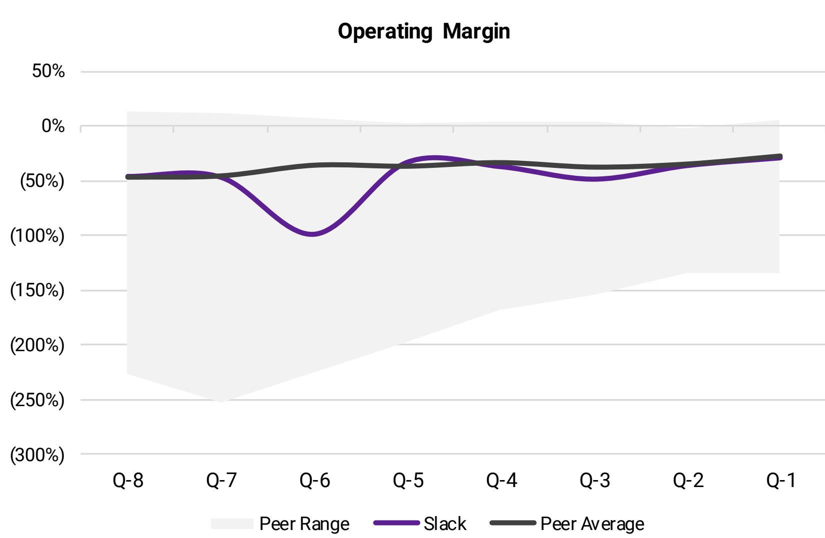
Gross margin is a widely observed metric in the SaaS world, as these types of companies typically have very high gross margins compared to other types of businesses. SaaS gross margins typically range from 60% to more than 80%, since the primary costs of goods sold ("COGS") are network and delivery costs, which tend to be much cheaper on a relative basis than say tangible materials that would go into a hardware product. Gross margin is also important because it essentially sets the ceiling for how much a company can invest in customer acquisition—the higher the gross margins, the more a company can spend on sales and marketing.



In this instance, Slack again outperforms its peers, with an average gross margin of 87% in the two years leading up to its IPO compared to a peer average of only 70%.

Grade: +1

Operating Margin

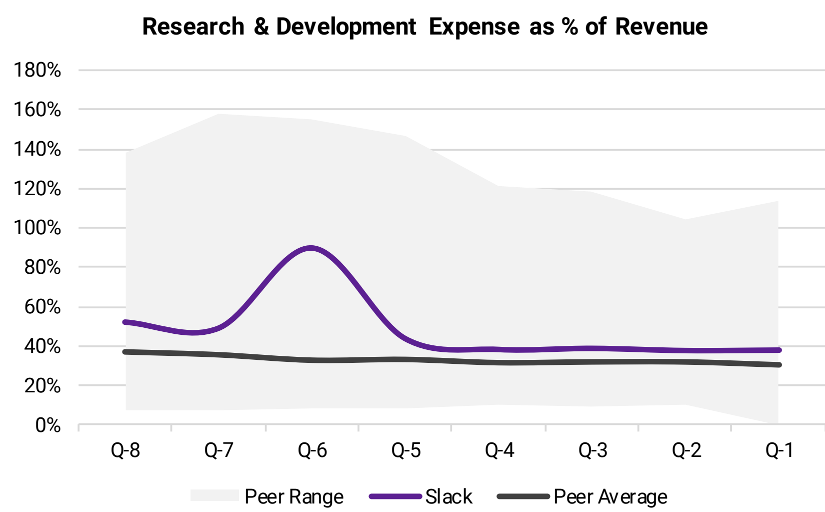


With unprofitable companies going public at a record rate, it's not surprising that operating margins are overwhelmingly negative for Slack and its peers. In fact, out of the 21 peer companies and Slack, only two companies had positive operating margins at IPO—Atlassian and Zoom Video—and both companies have been handsomely rewarded by the public markets, with their respective share prices appreciating 522% and 173%, respectively, since IPO.

For the rest of the SaaS companies in our peer set, the average operating margin in the eight quarters leading up to IPO was negative 37%, compared to negative 46% for Slack, although in recent quarters it has more or less converged on the mean. Operating losses are important to understand as they allow investors to estimate when a startup may need to raise additional capital. However, given Slack's nearly $800 million in balance sheet cash, it can continue to operate at a loss for quite some time (Slack had $166 million in LTM operating losses) as they gradually bring down their operating loss margin along with their peers.

Grade: 0

Research & Development Expense as a Percentage of Revenue

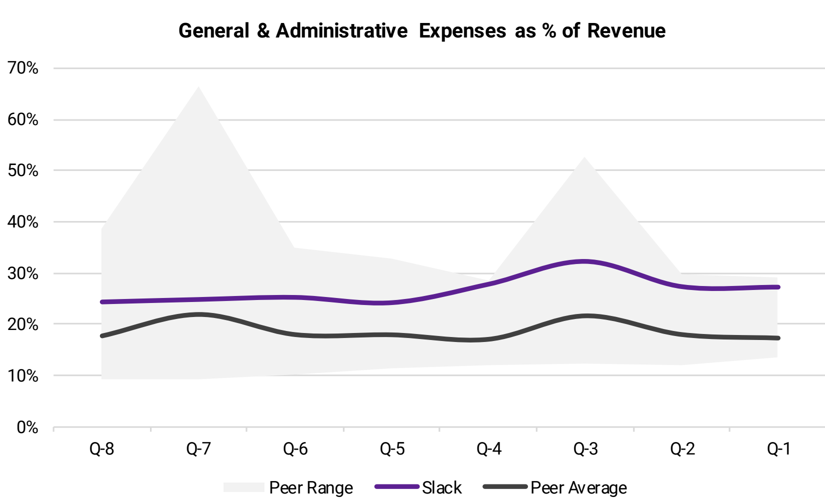


Similar to sales and marketing spend, a SaaS company's research and development expenses tend to be high relative to total revenues as these companies face continuous pressure to improve their software. Across the tech industry as a whole, research and development is one of the most significant expenses as companies race to out-innovate their competition. As we've alluded to so far, Slack has demonstrated quite impressive and efficient revenue generation, in substantial part due to its sales efficiency.

Similarly, Slack's research and development expense as a percentage of revenue has reverted to the peer average over the last five quarters. As with sales and marketing, Slack is doing more with the same average amount of research and development spend as its peers.

Grade: 0

General & Administrative Expense as a Percentage of Revenue

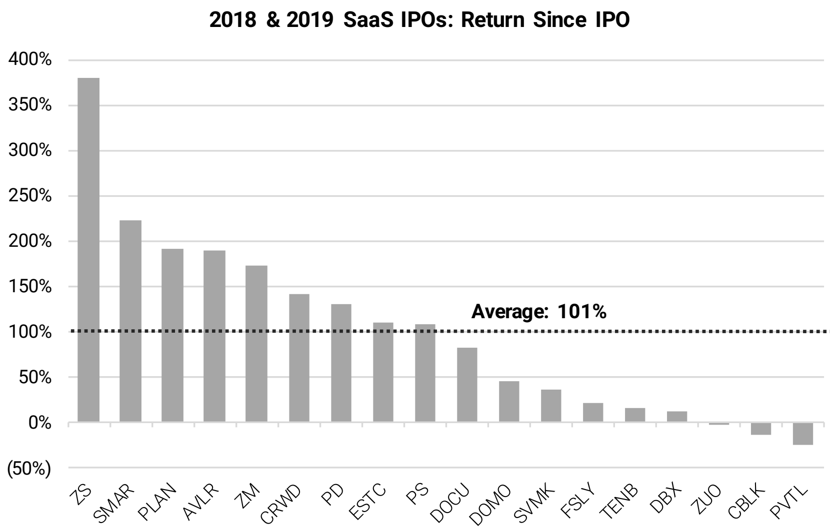


While the largest expenses for a SaaS company tend to be sales and marketing and research and development, the third typical expense bucket for SaaS businesses—general and administrative expenses—can also be quite meaningful. All businesses have these expenses, and they pertain to the day-to-day operations of a business. Typical general and administrative expenses include rent, utilities, insurance, and other expenses that relate to a company's operations and not expenses related to the production of goods or services (i.e., COGS).

In Slack's case, general and administrative expenses have remained stubbornly high compared to its peers, averaging 27% as a percentage of revenue leading up to Slack's direct listing. Unfortunately, these expenses have actually ticked upward as Slack has approached its public debut. Slack's peers averaged only a 19% general and administrative expense margin in the two years prior to IPO, significantly outperforming Slack on this cost line item. As such, we have to deduct Slack's first and only point.

Grade: -1

How Did Slack Score?



Total Points: 5

By our tally, Slack scored five points, out-performing its peers in six of ten metrics, matching peer performance in three of ten, and under-performing its peer set in only one category. While a five out of ten may not sound that impressive, Slack's score is really more like a 15 out of 20, given it could have under-performed the peer average in every category, scoring a negative ten. For comparison, Elastic (ESTC), a company that largely underperformed or equaled Slack's performance across these 10 metrics, has seen its share price appreciate by over 100% since its IPO. Consequently, we view Slack as a strong company within its peer set, given it overwhelmingly outperforms or meets the peer average. In particular, Slack's impressive revenue growth, sales efficiency and gross margins position it for success in the public markets. Regardless of how Slack's shares trade in the near-term, our long-term view is that Slack will be a strong performer.

In fact, SaaS as a business model has performed incredibly well in the last few years, as we demonstrate above. Including only the 2018 and 2019 IPOs in our peer set, the average, unweighted share price appreciation is 101% since public listing. Only three companies in our peer set have performed negatively—Zuora, Carbon Black and Pivotal. By and large, these SaaS IPOs have been extremely successful, with even Dropbox and Tenable currently trading 12% and 16%, respectively, above their IPO price. Given Slack is among the strongest of this cohort of companies, we expect it to be a solid performer after it shakes off any immediate post-IPO volatility. We're looking forward to seeing how the company trades.