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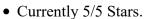- Comments (0)
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ServiceNow: Redefining Enterprise IT Service Management

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Introduction

value above $8B (Jan 2014). The firm has succeeded by modernizing the IT service management (ITSM) market through an innovative platform that is cloud-based and highly flexible. Initially conceived as an application development platform by founder Fred Luddy, the company targeted help desk and ITSM as a proving ground for its system, because as a former CTO of Peregrine Systems, he was familiar with that space.

The rest is history.

ServiceNow's annual revenue is expected to be above $400M when the firm reports its full year 2013 results at the end of January 2014, a 60% growth rate over 2012. ServiceNow burned the shorts in 2013, adding about $3B to its market value and maintaining a roughly 20X revenue multiple over its current market cap; leaving naysayers scrambling to cover their positions. ServiceNow has "poked the bear" of ITSM, specifically awakening established competitors. However, ServiceNow has the market momentum, vision, customer traction and technology architecture to maintain and even extend its lead through innovation and a maturing global ecosystem. Second half 2013 announcements address customer demands for purchasing services at a more granular level while at the same time expanding beyond core ITSM markets.

ServiceNow, however is not without challenges. A key issue facing the company is to not only growing its customer base but also embedding itself more deeply into existing accounts and extending beyond IT to validate its high valuation. A spate of announcements in 2013 was designed to accomplish this goal. Throughout last year, ServiceNow made moves to simplify its offering and deliver new services that facilitate the easier creation of applications. More recently, in the last two months of 2013, ServiceNow made several announcements that fortified its vision of "ERP for IT," further automated configuration management, improved mobile support and importantly, extended ServiceNow beyond IT into HR service automation.

With a modern platform, a focused offering and excellent sales execution, ServiceNow has injected life into the once-stagnant, slow growth ITSM market not only by bringing a SaaS business model to the table, but also re-defining how service management is done within enterprises. Wikibon has spoken to dozens of ServiceNow customers and consistently found that ServiceNow's approach of delivering one code base, one user experience (UX), one data model and a "born in the cloud" mindset has been transformational for IT organizations.

The big question is how far can ServiceNow ride this wave?

How Did ServiceNow Become So Successful?

ServiceNow's ascendency came well after it launched a SaaS-based ITSM product in 2004. At the time, ITSM products on the market were viewed as complicated, fragmented with high customer churn rates. Indeed many of the products on the market were viewed much in the same way that IT was perceived —non-responsive, stove-piped, misaligned (with business needs) and not value producing.

Two events occurred in the middle of the 2000's, which created major tailwinds for ServiceNow. At the macro level, Amazon launched AWS, which kicked off a cloud craze and heightened awareness that perhaps the Salesforce.com model was right for a new breed of apps. As well it underscored that IT services in the future would be delivered on-demand, and as part of a service-oriented catalogue approach.

The second event was more nuanced. With the introduction of ITIL 2007, the ITIL methodology (which is the gold-standard for ITSM) evolved into a more holistic, full life-cycle approach. Of particular importance

widened the scope of ITSM processes. Practitioners of ITIL were immediately challenged to evolve their internal systems, but most offerings on the market were unable to keep pace and became rapidly viewed as outdated, rigid help desk tools.

ServiceNow was the exception. The company's modern architecture, single code base and single data model, shared among all applications in the system, made it very easy for ServiceNow's customers to adapt its platform to business requirements and new ITIL processes. As with virtually all products on the market, ServiceNow started by managing incidents, problems and changes within IT as part of an overall release governance process. But in the middle of the decade, ServiceNow started to knock down blue chip customers in the Global 2000 and rapidly became the Salesforce.com of IT. Today, ServiceNow, along with Workday, are considered the next big enterprise software plays mimicking the Salesforce SaaS playbook; albeit in different markets with different architectural approaches.

Notably, unlike SaaS players such as Salesforce and Workday, which sell into the lines-of-business, ServiceNow sells almost exclusively to the IT department. Its strategy is to automate the service processes that IT touches and create an alluring platform that other business processes can easily adopt. ServiceNow's mantra is to make IT people "heroes" within their companies. Discussions with dozens of ServiceNow customers confirm that this strategy is working.

The big questions observers are asking about ServiceNow today include:

- Is the company's lofty valuation justified?
    - How large is ServiceNow's market?
    - Does ServiceNow's laser focus on Global 2000 customers limit its market size?
- Will competitive responses to ServiceNow's model limit its growth prospects?
    - Is ServiceNow's architecture truly modern and differentiable?
- Can ServiceNow compete successfully as a so-called PaaS player?

This Professional Alert will address these questions and put forth Wikibon's view of ServiceNow's prospects going forward.

Does ServiceNow's TAM Justify its Valuation?

At the end of September 2013, ServiceNow had about 1,900 customers or just under 16% of the 12,000 large enterprises that it targets. Various estimates indicate the company has between 10%-12% of the ITSM space, which is a slow growth market. ServiceNow, much like Workday, has been rapidly gobbling share to power its growth in a market once viewed as stagnant. The company's "logo slide" is impressive and growing rapidly.

Figure 1 – ServiceNow Logo Slide
Source: ServiceNow Investor Deck Q3 2013

However if ServiceNow's TAM is narrowly defined as the ITSM market, it would appear the company's valuation is far too high. The ITSM space according to research firms like Gartner is approximately $4B annually. Even at 100% share, ServiceNow's current valuation wouldn't hold water.

So why are investors so excited about ServiceNow's prospects, and why is the company's valuation escalating? We see six primary factors driving ServiceNow's valuation momentum, specifically:

1. **Growth:** Investors are starved for growth companies in enterprise tech – especially software firms -- and suppliers like Salesforce, ServiceNow, Workday, Splunk and Tableau are viewed as highly attractive because they are growing rapidly and disrupting existing markets with the marginal economics of software business models.
2. **Cloud:** Cloud computing is viewed as disruptive and transformative. Companies that have successfully drafted off the momentum of both Salesforce.com and Amazon AWS are commanding a premium from investors because their revenue streams are predictable and their business models are alluring.
3. **Platform:** ServiceNow has a platform that Wikibon has called "flat," meaning all application modules access the same data model. In our opinion, this means its architecture is highly flexible and can be easily extended beyond the ITSM space.
4. **Management:** Simply put, the market views founder Fred Luddy as a visionary and CEO Frank Slootman as an execution guru; with a proven track record of creating new markets and outselling much larger and better-funded competitors.
5. **Customer Fanaticism:** ServiceNow customers are incredibly supportive of the company. At its Knowledge conference in 2013, ServiceNow held its annual financial analysts meeting and Wall Street saw, first hand, the degree to which its customers love the company and its products.
6. **Markets Beyond ITSM:** IT now touches virtually every part of the business, and to the extent that ServiceNow's platform can extend into line-of-business domains, we believe its TAM will expand dramatically.

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