Dot-Com IPOs: They're Baaaaack

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Salesforce.com has a little 1999 in it. The company still carries a dot-com in its moniker even though others have dropped the suffix for fear of being typecast. It can party in a style reminiscent of 1999, throwing galas for such dignitaries as the Dalai Lama with entertainment from such stars as David Bowie. And like many companies circa 1999, Salesforce.com is pitching a revolution that will upend the establishment. A recent initial public offering with a first-day pop of 56% completes the flashback.

The big question is whether this company, which hosts customer relationship management software and delivers its services through the web, can rekindle some of the IPO heyday of five years ago. Experts at Wharton say it's unlikely that the euphoric — some would say ridiculous — days of heady valuations for the latest and greatest companies will return. Nevertheless, Salesforce.com's IPO, which basically serves as a warm-up act for Google's expected big splash, is a nice confidence builder for the stock market, technology companies and Internet players. Why? "In 2001, 2002 and 2003 the IPO market was shut down in a way it hasn't been before," says Andrew Metrick, a finance professor at Wharton. "It could be the return of a more healthy stock market as good companies raise capital."

Indeed, other Internet players such as comparison-shopping company Shopping.com and RightNow Technologies – a Salesforce.com rival – are also preparing to go public.

For the broader markets, the offering of Salesforce.com and the upcoming debut of Google inject some excitement into the stock market, which has been lackadaisical in 2004. That could give people a reason to invest and drive up stocks. Is it time to get giddy? Not quite. "It's way too early to say this is the beginning of a bubble for technology stocks, and it's too early to declare the market is healthy," says Metrick. "Salesforce.com may just be a signal that the worst is behind us."

Peter Fader, a marketing professor at Wharton, sees things differently; he says it's prudent to be on guard for a rush of enthusiasm and points to some potentially disconcerting developments in the IPO market. "The attention on the IPO market is crazy," says Fader. "In theory the stock market reflects future value of a company. IPOs reflect just the betting line."

Case in point: Salesforce.com sports a $1.6 billion market capitalization even after shares settled two days after its 56% gain. That's heady for a company that hasn't topped $100 million in annual sales and competes with giants such as Siebel Systems and SAP. "All the people lining up to buy Salesforce.com are just buying to own shares and tell their friends," says Fader. "It's bragging rights." Fader notes that Google should produce a similar effect even though he supports the company's Dutch auction strategy, which should distribute shares more evenly and curb volatility.

Metrick acknowledges that valuing new companies can be difficult, especially for high flyers like Google, but suggests that new entrants to the market have something predecessors didn't – profits. That is a crucial area where companies like Salesforce.com are different than their dot-com boom predecessors. For the fiscal year ending Jan. 31, Salesforce.com reported net income of $3.5 million on revenues of $96 million. For the quarter ending April 30, net income was $437,000 on revenues of $34.8 million.

Shopping.com is also profitable, reporting net income of $6.9 million on sales of $67 million for the year ending Dec. 31, 2003. For the quarter ending March 31, the company reported sales of $21 million and a profit of $2.25 million. "That's why the IPO market is looking healthy," says Metrick. "We're moving back to the time where companies have to be profitable to go public. You also need a story."

Better Mousetrap?

The Salesforce.com story begins with its chatty CEO Marc Benioff, a former Oracle executive, who pioneered the idea of delivering enterprise applications via the web. The idea has attracted nearly 10,000 subscribers, some of whom have been burned by pricey implementations of CRM software gone awry.

The company is known as an applications services provider, a firm that delivers services via the web. The idea was popular in the late 1990s, but never really gained much traction. Salesforce.com advanced the model by delivering enterprise applications, touting its low cost of ownership and courting small and mid-sized businesses that don't have the time or money to endure lengthy installations of packaged customer services software.

Benioff has been an evangelist for his cause for so long that he neglected to pay attention to the Securities and Exchange Commission's mandated quiet period. Salesforce.com had to delay its IPO because Benioff talked about the company's prospects in a *New York Times* article. After a cooling off period, the SEC allowed Salesforce.com to proceed.

While Salesforce.com hasn't taken over the industry, it has awakened its competitors. Last year, Siebel Systems created Siebel CRM OnDemand through its acquisition of Upshot, a hosted CRM application service provider based in Mountain View, Calif. The company has a long list of competitors in its regulatory filings, including NetSuite, RightNow Technologies, Oracle, Microsoft and IBM.

Forrester analyst Erin Kinikin says Salesforce.com has a simple subscription-based business model that attracts small- and mid-sized companies as well as large companies that have autonomous sales staffs. "Salesforce.com appeals to companies that don't want a big chest thumping negotiation over software terms and don't want to pay tons of money to implement," says Kinikin.

The company's software suite is also roughly six to nine months ahead of the competition, namely Siebel's on demand products. But even if rivals close the gap on Salesforce.com, Kinikin says the company is more entrenched with smaller customers who account for 40% of revenue. "The technological advantage may be neutralized, but Salesforce.com has figured out how to sell to small- and mid-market companies," says Kinikin. "Salesforce.com created this market and now it will see if it can keep it. For the next 12 months, it has to scoop up as many customers as possible and show it belongs."

Despite Salesforce.com's current lead, there is a good chance a competitor such as SAP, Microsoft or Siebel can close the gap. "I see no evidence that Salesforce.com necessarily has a better model," says Fader. "Everyone selling CRM and ERP (enterprise resource planning) makes outrageous claims. But I give them credit for being an ASP. It is a smart way to go. Whether it's a smart implementation is the issue that needs to be separated out."

Next Up: Google

Watching how Salesforce.com unfolds is likely to take a back seat once Google hits the market. Google, quirky in its own right by seeking to democratize its IPO, is the leading web search engine and is expected to make a closely-watched debut.

Google's IPO will be telling for many reasons. Metrick says Google isn't going to be a Netscape Communications-like IPO that triggered the dot-com boom. The biggest reason is there isn't anything necessarily new about Google. Netscape was a company focused on the Internet, which at the time was largely an unknown quantity with big potential. But coupled with Salesforce.com, Google's IPO could signal a technology renaissance. "These IPOs will provide a bigger crowbar to pry the market open for good companies," says David Menlow, president of research firm IPO Financial Network. "It is a foundation layer for more deals."

In many ways, Google stands alone. For the quarter ending March 31, Google reported a profit of $63.9 million on sales of $389.6 million. For 2003, Google's sales were nearly $1 billion. While no one begrudges Google's financials, there is some debate on how to value the company. Google's valuation could be dicey since the company is scrapping the way most IPOs are priced — investment bankers set a price and let it trade. Google is going public with an auction where individual investors can bid to buy as few as five shares of common stock. The auction will gauge demand and set a price to meet it.

Menlow isn't a big fan of the Dutch auction system largely because there's no way to value the company. Individual investors may decide they want to pay $200 a share for Google. As a result, Google shares aren't expected to have a big run-up on the first day of trading. "Who is going to make a decision on what the company is worth without any financial knowledge?" asks Menlow.

Metrick points out that Salesforce.com wasn't priced well either. The company's big first day run up means that either investment bankers were skittish and priced the IPO conservatively or just mispriced it. If it's priced right you shouldn't see a big jump from Google, says Metrick. That's Fader's wish for Google too. "Hopefully there won't be this 'got to have Google' mentality, and the auction will smooth things out," he says. "If it works, you won't see crazy action."

According to Metrick, it's hard to predict how Google will be valued or if its IPO will boost the broader market. With IPOs you never really know. "Google will get a huge valuation," says Metrick. "The big question is whether the company can sustain it."