Veeva Systems Inc. (VEEV)
F1Q Earnings Preview

**Maintain Outperform.** Veeva is the best performer in our Vertical Software coverage YTD as the company is a primary beneficiary of the shift to digital processes within commercial and clinical operations. SaaS stocks this earnings season have allowed for near-term pressure on revenue estimates provided companies can speak to long-term secular tailwinds, and so the forward-looking commentary from Veeva will likely be key. On this point, we expect CRM engagement updates to be quite good (and largely expected) but with Vault perhaps offering a source of incremental upside.

- **Maintain Outperform.**
  - Since early March, NTM revenue estimates for the SaaS universe have come down by 3-4% and the group has outperformed by 15-20%. Investors have allowed for some degree of near-term estimate pressure provided companies can speak to long-term benefits coming out of the COVID-19 environment. Veeva certainly benefits from an increase in digital solutions, and to the extent the company can speak to this, we believe the stock can continue to work.
  - Now, elevated expectations and valuation certainly makes the near-term setup a bit trickier. We will note, however, that our dialogue with new investors looking at Veeva has remained steady over recent months, and to the extent any near-term pressure does develop, there could be a captive audience looking to take advantage.
  - **Veeva reports F1Q results on May 28.**
    - F1Q guidance: revenue $327-328 million (+34% YoY), operating income $117-118 million (+26% YoY), EPS $0.59-0.60 (+19% YoY) and billings $330 million (+34% YoY). Consensus estimates are 1-2% below these figures.
    - Our estimates are above consensus during F1Q. Into F2Q, our estimates are generally in line with consensus: revenue $336 million (+26% YoY), operating income $119 million (+14% YoY), EPS $0.61 (+10% YoY) and billings $330 million (+26% YoY). Our billings estimate of $295 million (+26% YoY) is slightly above $292 million consensus. For FY21, our estimates and consensus have moved 1-2% lower since last quarterly update.
  - **A few product-related thoughts:**
    - From our checks in mid-March through last week’s WSJ report, the anecdotes on digital sales enablement suggest a positive backdrop for Veeva. We are interested in two topics: 1) what is the likelihood that recent practices have staying power beyond the COVID-19 environment (recent insights suggest HCPs are more receptive to this channel while seeing benefits from new features Veeva has introduced); 2) how does the “new reality” alter product roadmaps for CRM going forward (e.g., Engage Meeting previously had low attach rates, now that this has changed, does it broaden potential releases going forward?).
    - Last fall, Veeva announced SiteVault, products built specifically for clinical trial sites. Recently, there has been a flurry of product announcements building out additional functionality, including remote monitoring and patient portals. We are curious if the current focus on clinical trial timelines can help accelerate certain aspects of the Vault platform.

Veeva Systems Inc., headquartered in Pleasanton, California, provides industry-specific cloud solutions for the global life sciences industry.

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Investment Thesis

**Don’t underestimate life sciences!** The life sciences industry generates $2.0 trillion in revenues annually, with customers actively investing in technology solutions to improve drug development, time-to-market, and commercial success. Since Veeva completed its IPO in 2012, its addressable market opportunity from life sciences has grown from $5 billion to over $9 billion as the company has successfully launched new products which solidify Veeva as an end-to-end solutions provider for the industry.

- Even after significant growth, Veeva estimates it is only ~25% penetrated at large enterprise customers with Commercial Cloud and 10% penetrated with Vault (based on current spend versus total addressable), leaving sizeable white space remaining.
- We believe the combination of healthy industry growth, rising technology investment, and Veeva outperformance position the company to sustain a 20% CAGR during the next several years.

**Cracking open Vault opportunity.** Veeva Vault has been a gamechanger for Veeva’s financial performance since its launch in 2011. The ability to manage the digital supply chain for medical content and promotional materials, and offer a suite of applications that span the full drug development lifecycle, has made the Vault Platform an indispensable solution for life sciences companies of all sizes. This strategic positioning has been bolstered by a steady cadence of new product launches that capitalize on unmet market needs and/or replace outdated technology practices in the industry.

- With a three-year revenue CAGR of 45%+, Vault revenues surpassed that of the foundational Commercial Cloud business during Fiscal 2020. Given the opportunity moving forward to cross-sell at existing customers, leverage early momentum for new products with significantly higher deal values (particularly in the clinical suite), and further penetrate a large universe of customers (including precommercialization companies), we expect Vault to remain a key driver of performance in years ahead (we model a forward three-year CAGR of 30%+).

**Paving more runway for Commercial Cloud.** Commercial Cloud results have reaccelerated during Fiscal 2020 given large enterprise rollouts on a global basis, the increasing adoption of CRM by SMB accounts, and continued momentum in add-on features. The reacceleration in CRM seat growth during Fiscal 2020 is impressive given Veeva’s already-sizeable installed base (approximately 80%+ market share).

- Over the mid-term, we expect adoption of add-on features into this customer base to represent a greater portion of targeted 10%+ annual growth. Each add-on feature can represent 15-25% of the value of the base CRM seat, implying a total market opportunity that is more than double that of core CRM.

**Expanding frontiers outside of life sciences.** The strength of the Vault Platform in addressing content and data management, particularly for regulated industries, lends itself to applications outside of life sciences. In late 2016, Veeva launched Vault QualityOne, leveraging the QMS offering (a quality management platform for process management, complaints, auditing, and change actions) and “core” document control capability to bring cloud-based quality control to the consumer goods, chemicals, and cosmetics industries. This was followed by Veeva RegulatoryOne (regulatory content submission) and Veeva Claims (marketing claims management).

- In total, Veeva assigns a $1 billion+ market opportunity to its efforts outside of life sciences. Progress subsequent to the QualityOne release has been encouraging, with over 40 customers across the US and Europe adopting a platform solution.

**Accretive growth drives strong profitability, cash flow.** Almost the entirety of Veeva’s operating margin expansion as a public company has come from higher gross margin realization. As the company
Veeva Systems Inc. has successfully grown products on the Vault Platform and expanded adoption of add-on CRM features, subscription gross margin has moved higher due to the accretive nature of Veeva’s proprietary products.

- Going forward, we expect the track record of margin expansion to “pause” given the impacts of recent acquisitions. Management’s preliminary view on Fiscal 2021 anticipates a 250bp dilutive impact from acquisitions, resulting in operating profitability of 35-36%. This level of profitability is also consistent with Veeva’s long-range targets of “35%+” through Fiscal 2025 that were communicated at the 2019 investor day. That being said, we believe there is still an opportunity for operating profitability to climb back into the high-30% range after the next 12 months as Vault and CRM add-ons grow as a percent of revenue.

Valuation. Our $206 price target assumes a 50x FCF multiple on our NTM free cash flow estimates, one year from now. This valuation is equal to the median of the one-year trading range (high/low range is 35x to 70x). We believe this is appropriate given the company’s growth prospects.

Key risks. Risks include variability in quarterly financial results/guidance, the ability to win new customers, life sciences market fundamentals, competition, and customer concentration, the uncertain environment created by COVID-19 and impacts on quarterly financial performance.

Risks & Caveats

Quarterly results and financial guidance can be variable. Because Veeva recognizes subscription revenues ratably over the term of the subscription, a majority of quarterly revenues are derived from agreements entered during prior periods. Consequently, a decline in new subscriptions, or non-renewal of existing subscriptions, is more likely to influence financial guidance for future periods. The exception is a non-renewal that occurs early in a quarter.

- The company’s sales process with prospective customers can span 12 months of longer, with newer solutions potentially exceeding timelines typical with the company’s CRM offering. If sales cycles lengthen, this could adversely impact guidance for future periods.

- The company derives approximately 20% of sales from Professional Services, where fees can fluctuate as a result of timing of customers’ implementation projects. Additionally, the gross margin generated by Professional Services fluctuates due to average billable hours worked, hourly rates, and the margin on services that are subcontracted to third-party system integrator partners.

Ability to win new customers and increase solutions per customer. Veeva’s continued ability to sustain 20%+ revenue growth rates will require success in selling new product solutions, including Veeva Vault CDMS, add-on CRM features, Veeva Nitro, and the growing offerings for customers outside of Life Sciences. While we assume the Life Sciences industry remains the main contributor to Veeva’s financial results, the company also has ongoing efforts to grow outside Life Sciences that could positively influence growth rates going forward.

Risks associated with life sciences markets. Demand for Veeva solutions could be negatively impacted by factors that affect life sciences customers, including: 1) changing regulatory environment, including actions that impact the pricing of healthcare treatments sold by customers; 2) the consolidation of companies via merger and/or acquisition, where a decision is made to assess technology solution providers (potentially impacting an existing relationship or influencing future pricing of solutions); 3) changes in market practices, including expiration of key patents, implications of new medical treatments, changes in payer relationships, changes in regulations regarding sales and marketing practices; and 4) changes in global economic conditions that impacts demand for solutions.
**Competition.** The company competes against software vendors that have also developed cloud-based solutions for the life sciences industry. The principal competitors are IQVIA (which offers a CRM application built on Salesforce1 platform in addition to data products), Medidata (which offers Rave Clinical Cloud, competing against Veeva Vault applications), Oracle (which offers numerous applications that compete against Veeva Vault applications), and OpenText (which offers several enterprise content management applications that compete against Commercial Vault applications).

**Customer concentration.** Veeva’s Top 10 customers during Fiscal 2017/18/19 accounted for 45%, 42%, and 39% of revenues, respectively. These key reference customers are often promoted during efforts to win business with new customers. The loss of a key customer would have negative ramifications for the company.

**Risks associated with cloud hosting, including data security.** The company relies on third-party providers for computing infrastructure, network connectivity, and other technology-related services. In particular, the company utilizes computing infrastructure provided by salesforce.com (with respect to Veeva CRM and certain applications) and Amazon Web Services (with respect to Veeva Vault, Veeva Network, and certain Veeva Commercial Cloud applications).

- Veeva CRM and several applications are developed on or utilize the Salesforce1 Platform of salesforce.com. The company’s agreement with salesforce.com expires on September 1, 2025. If either party elects to not renew the agreement, terms stipulate a five-year wind-down period. This agreement also stipulates that salesforce.com will not position, develop, promote, invest in or acquire applications that are directly competitive to the Veeva CRM application for sales automation that directly target pharma/biotech customers. This does not, however, prevent customization or configuration of the Salesforce1 platform by potential customers.

- Veeva’s solutions involve the storage and transmission of customer information, including sensitive information related to proprietary data related to regulatory submissions for new medical treatments and personal health information. A security breach and unauthorized access to this information likely has negative repercussions, affecting the company’s ability to attract new customers and/or grow subscriptions with existing customers.

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**Company Description**

Veeva Systems Inc., headquartered in Pleasanton, California, provides industry-specific cloud solutions for the global life sciences industry. The company began in 2007 by offering pharmaceutical companies in the U.S. with a customer relationship management (CRM) system that could optimize interactions between sales representatives and healthcare professionals. In subsequent years, this core product expanded globally and added additional functionality to create a broad suite of applications – known as the Veeva Commercial Cloud – that today represents the industry’s dominant commercial solution. Veeva began development in 2010 on its Veeva Vault Platform, a suite of enterprise content and data management applications that targeted key R&D and commercial content functions. Today, Veeva Vault applications include products which help streamline product development and better manage commercial and medical content.
Appendix - Important Disclosures and Analyst Certification

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Rating and Price Target History for: Veeva Systems Inc. (VEEV) as of 05-21-2020

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