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Sector: Software

August 26, 2019

Workday, Inc.

F2Q20 Preview and Assuming Coverage

Our view: We assume coverage of Workday and preview the company's F2Q20 earnings report. We maintain an Outperform rating and $225 price target (10.0x EV/CY21E revenue) While checks come back mixed, long-term we view WDAY as a leader in two of the largest markets in Enterprise Software and consider the durable growth story to be one of the best in our sector.

Key points:

Durable Growth Story with a Financials Call Option. We believe WDAY's penetration globally is <10%. And, with significant leadership position in the Cloud HCM market, a $20B opportunity, we believe there is line of sight to 25% market share and a $5B business. With 80%+ of the company's revenues today coming from HCM, yet only 25% of the company's addressable market attributable to this segment, we believe there is a large, untapped opportunity supportive of sustained 25%+ subscription revenue growth rates over a multi-year period with Cloud Financials the biggest call option today. We believe this $50B+ opportunity is ripe for disruption, with 50% of the market today owned by ORCL and SAP and the remaining 50% owned by a large number of sub-scale vendors. Additionally, with net new ACV growth in excess of +50% Y/Y in the most recent quarter, and customer count rapidly scaling (from ~200 in mid CY 2016 to 530 in mid CY 2018), we believe Cloud Financials is reaching an inflection point and quickly becoming a meaningful line of business.

Summary Checks. Channel commentary comes back mixed heading into the WDAY's F2Q20 earnings period though we believe that guidance on key metrics such as subscription backlog growth has been set conservatively. On the positive side, partners note that Adaptive Insights is performing well above expectations and that the volume of mid-market Financials deals is indicative that there is potential for the large enterprise Financials market to thaw. Providing caution into the print, however, are indications that a senior Europe-based executive has departed the company and sales turnover in some regions is elevated.

Valuation. Workday has underperformed our High Efficiency peer group average over the last year, trading up +31.5% vs. the group average of +45.9% (equal-weighted). Over the time period, WDAY has gone from trading at a 16% to a 26% discount to the High Efficiency comp group average. With leadership positions in two of software's largest end markets, and modest penetration rates globally, we see WDAY sustaining strong (mid-20%) growth rates over a multi-year period. With shares attractively priced today at 8.6x EV/CY21E revenue vs. High Efficiency peers at 11.6x EV/CY21E revenue, we reiterate our Outperform rating and $225 price target (10.0x EV/CY21E revenue, modestly below the group average).

Outperform

NASDAQ: WDAY; USD 192.13

Price Target USD 225.00

WHAT'S INSIDE	
☐ Rating/Risk Change	☐ Price Target Change
☐ In-Depth Report	☑ Est. Change
☑ Preview	☑ News Analysis

Scenario Analysis*

Downside Scenario	Current Price	Price Target	Upside Scenario
150.00	192.13	225.00	260.00
↓ 22%		↑ 17%	↑ 35%

*Implied Total Returns

Key Statistics

Shares O/S (MM):	184.3	Market Cap (MM):	35,410
Dividend:	0.00	Yield:	0.0%
		Avg. Daily Volume:	1,451,409

RBC Estimates

FY Jan	2019A	2020E	2021E	2022E
Revenue	2,822.2	3,558.6	4,397.2	5,382.6
Prev.		3,557.6	4,390.0	5,445.2
EPS, Ops Diluted	1.36	1.52	1.99	2.52
Prev.		1.70	2.74	3.83
P/E	NM	NM	NM	76.2x

Revenue	Q1	Q2	Q3	Q4
2019	618.6A	671.7A	743.2A	788.6A
2020	825.1A	871.3E	911.4E	950.8E
Prev.			908.9E	952.3E
2021	1,007.3E	1,076.7E	1,131.9E	1,181.3E
Prev.	994.9E	1,061.4E	1,133.0E	1,200.8E
EPS, Ops Diluted				
2019	0.33A	0.31A	0.31A	0.41A
2020	0.43A	0.30E	0.32E	0.47E
Prev.		0.35E	0.44E	0.48E
2021	0.45E	0.45E	0.52E	0.56E
Prev.	0.58E	0.62E	0.71E	0.83E

All values in USD unless otherwise noted.

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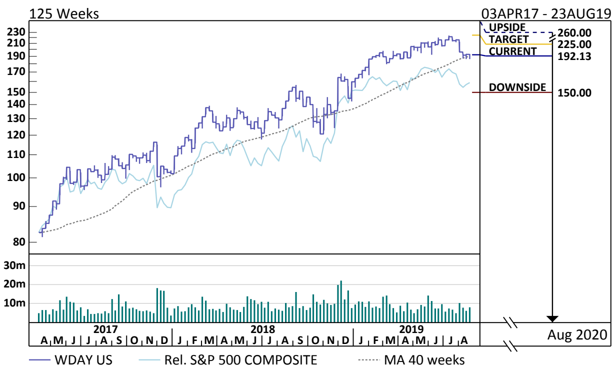
For Required Conflicts Disclosures, see Page 13.

Target/Upside/Downside Scenarios

Exhibit 1: Workday, Inc.



Source: Bloomberg and RBC Capital Markets estimates for Upside/Downside/Target

Price target/base case

Our price target of $225 is 10.0x EV/Rev on our CY21 estimates. This target multiple is slightly behind our High Efficiency comp group, as WDAY's efficiency score is lower than the average. Our price target supports our Outperform rating.

Upside scenario

Our upside scenario of $260 assumes 11.6x EV/Rev on our CY21 estimates. This multiple is in line with our High Efficiency comp group average. We see shares achieving this valuation in the event that Adaptive Insights and Cloud Financials support durable 30%+ subscription revenue growth.

Downside scenario

Our downside scenario of $150 assumes 6.7x EV/Rev on our CY21 estimates. This multiple is in line with our medium growth comp group and indicative of a scenario where WDAY's subscription revenue growth rate slows materially, likely due to a change in competitive win/loss ratios.

Investment summary

Potential catalysts

Large addressable market: We estimate that the broader ERP market, which we believe Workday could address over time, has a TAM of more than $50B in 10 years.

Cloud ERP penetration remains relatively low: The more broadly defined ERP market (including financial management, enterprise asset management, manufacturing and operations, and supply chain) is around 10% penetrated today (vs. 45% for CRM and 35% for HCM).

Competition has become stronger, but Workday's win rates remain strong: We believe that Workday's win rate remains strong and the biggest impediment to growth remains customers making no decision to move off their existing platform and to extend the life of their on-premises system with an upgrade.

Core financials trends positive: Workday has more than 500 financials customers and the scalability of the product continues to improve.

Valuation can be justified: We think Workday can become a bigger company than its predecessor PeopleSoft, just as Salesforce.com is about 7x the size of Siebel, the client-server leader in CRM, when it was acquired.

Risks

Competitors continue to invest: SAP and Oracle have invested aggressively in their respective cloud HCM solutions (Oracle with Fusion HCM and Taleo and SAP with SuccessFactors). SAP and Oracle also continue to use price as a tactic to dissuade customers from moving to Workday. It is possible that over time both tactics will affect Workday's ability to win customers.

Key person risk: We think senior management brings strong understanding of customer needs and a clear view on the infrastructure and functional direction of modern enterprise applications. A change in senior management could potentially affect our thesis on the stock.

Valuation: We believe the company has to deliver sufficient growth to justify its valuation and any execution errors or external events could lead to multiple compression.

Financials needs to become a larger contributor to growth: We still think there is significant growth opportunity in HCM; however, we think financials needs to become a bigger contributor to growth over the next two to three years.

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F2Q20 Preview and Assuming Coverage

We assume coverage of WDAY while maintaining an Outperform rating and $225 price target (10.0x EV/CY21E revenue). Our investment thesis is as follows:

- **Growth Story Far from Over.** We believe that WDAY's penetration globally is less than 10% in HCM (~10% in North America and closer to 5% internationally). The company had previously identified roughly 33,000 potential customers and believes it can achieve 25% penetration within the ~$20B HCM TAM or roughly ~$5B. In addition, the company has previously stated that roughly 80% of ACV is coming from net new customers and existing revenues can easily be doubled by selling all SKUs to existing customer base. We believe that the combination of core financials, planning, analytics, a nascent PaaS offering, and forthcoming portal functionality (a $100B+ TAM by 2022 according to the company) can drive a 25% CAGR over the next five years with FCF margins ramping into the mid-20% range.
- **Call Option in Cloud Financials.** With 80%+ of the company's revenues concentrated in HCM, yet only 25% of the company's addressable market attributable to the segment, we believe there is ample room and opportunity to support a sustained high rate of growth over a multi-year period. As a reminder, the ERP market today represents ~$50B of annual spend, with two vendors (ORCL and SAP) owning approximately half of the market and a slew of legacy vendors owning the remaining 50%. We believe the most important of these near-term is the company's internally developed Cloud Financials product. With net new ACV growth in excess of +50% Y/Y, and customer count rapidly scaling (from ~200 in mid CY 2016 to 530 in mid CY 2018), we believe Cloud Financials is reaching an inflection point, particularly in the mid-market. In the large enterprise space, we believe Financials will see a more gradual adoption pace, with large deployments (SYSCO, Quicken Loans, J.B. Hunt, etc.) providing case studies that lower adoption barriers. Our quarterly checks did indicate another marquee financials win with a global advertising company and we continue to hear about anecdotal positives around 2H large deal activity.
- **Adaptive Insights, a Trojan Horse.** With the acquisition of Adaptive Insights completed exactly one year ago, our checks suggest that momentum is accelerating under the Workday umbrella, with bookings performing well ahead of expectations. Benefiting results are, we believe, a broader sales organization, a successful pivot up market, and Adaptive's hidden gem: a best-in-class front end that has financial professionals excited to adopt the product. With the Financial Planning software market estimated to grow from $1B today to ~$2.4B by CY25, and with Adaptive Insights at a ~$115M subscription revenue run rate as of F4Q19, we believe Adaptive represents a continued high-growth opportunity with significant synergies for follow-on Cloud Financials sales.
- **Valuation.** Workday has underperformed our High Efficiency peer group average over the last year, trading up +31.5% vs. the group average of +45.9% (equal-weighted). Over the time period, WDAY has gone from trading at a 16% to a 26% discount to the High Efficiency comp group average. With leadership positions in two of software's largest end markets, and modest penetration rates globally, we see WDAY sustaining strong (mid-20%) growth rates over a multi-year period. With shares attractively priced today at 8.6x EV/CY21E revenue vs. High Efficiency peers at 11.6x EV/CY21E revenue, we reiterate our Outperform rating and $225 price target (10.0x EV/CY21E revenue, modestly below the group average). If we assume the company grows revenues at a 25% CAGR after the current guided year (FY20) and expands FCF margins from ~12% today to 25% in FY24E, which we see as achievable with the company targeting 25% OMs longer-term, we believe shares could be valued at $273 in approximately two years assuming a 35x FY+2 P/FCF multiple (a slight discount to the current FY+2 High Efficiency peer multiple) and dilution of 4%

annually. In this scenario, shares could increase ~42% from current levels and provide investors with an annualized ~19% return over the next two years.

What We're Hearing (Recent Channel Commentary)

Channel commentary comes back mixed heading into the WDAY's F2Q20 earnings period though we believe that guidance on key metrics such as subscription backlog growth has been set conservatively. On the positive side, partners note that Adaptive Insights is performing well above expectations and that the volume of mid-market Financials deals is indicative that there is potential for LE Financials market to thaw. Providing caution into the print, however, are indications that a senior Europe-based executive has departed the company and sales turnover in some regions is elevated.

- Starting with Adaptive Insights, partners are overwhelmingly positive on the recent pace of business. We believe that Adaptive is playing a leading role in garnering interest in core Financials replacements with its strong planning and analysis capabilities that excite financial professionals. More interestingly, partners also suggest that Adaptive's reporting and front-end dashboards may be the crown jewels of the acquisition, with customers excited about the look and feel of the product.
- With regard to mid-market Financials, partners suggest this is also an area of strength. Specifically, we believe business here has been robust at sub 3,500 employee organizations. Partners suggest that a large enterprise pipeline also exists, with deals targeted in the 4Q period that could prove to be key logos that thaw this market.
- Less encouragingly, partners suggest that the pace of business in Europe has been less than planned, with the U.K. (driven by Brexit issues) being a particularly difficult region for both financials and HCM. We stress, however, that these issues appear to be temporary, with deals not being lost but rather decision cycles being elongated due to macro uncertainty.
- Similarly, we believe that business in the eastern region has been a bit below expectations, resulting in some internal sales reorganization.
    - With regard to other regions, our anecdotal conversations suggest that the West is outperforming with some notable deals, with the South being in-line while Central may be slightly below.
- Looking ahead to Rising (WDAY's annual user conference), we believe incremental focus areas will include "portal" technology in the HCM space.

Financial Preview

- Looking to the quarter, Workday guided to subscription revenue of $746–748M (+32% Y/Y) with PS&O revenue of ~$124M (+17% Y/Y), implying Total Revenues of $870–872M (+30% Y/Y).
- Through FY19, WDAY delivered a consistent amount of upside relative to subscription revenue guidance – approximately 1.4% quarterly – which translated into upside of $7–10M on a dollar basis.
  - WDAY has cautioned against beats in FY20 being as significant on a percentage basis as the company continues to scale and visibility continues to increase. However, in F1Q20, WDAY delivered upside of 1.2% ($8M) relative to guidance.
  - If we assume that WDAY outperforms its subscription revenue guidance by 1.0% in F2Q20, the company would deliver upside of ~$7.5M in the period and subscription revenue growth would be +33% Y/Y.
- Following the F2Q19 report, WDAY increased its expectation for full-year subscription revenues by ~88bps, adjusting for the inclusion of Adaptive Insights. This raise was double the ~44bps raise following F1Q. Looking to FY20, we note that WDAY increased its full-year guidance expectation by 49bps following the F1Q report. We caution against expecting a large raise following the F2Q report given a questionable macro environment and FX rates (which admittedly impact WDAY less than most).
- While WDAY no longer provides guidance to deferred revenue or billings growth, consensus estimates call for total deferred revenue of $1.87B (+26% Y/Y) and calculated billings of $921M (+24% Y/Y).
  - Consensus deferred implies sequential growth of +1.0% and a dollar increase of $40M. This compares to the year-ago period, which showed sequential growth of 4.8% and a sequential increase of $68M. As a result, we view consensus expectations as achievable, particularly in light of the inclusion of Adaptive Insights whose financials did not impact the year-ago period.
- Workday gave guidance for 27–29% subscription backlog growth for 2Q and we model Subscription Revenue Backlog of $7.018B (+28% Y/Y; +3.8% Q/Q).
  - This 3.8% sequential growth and $300m sequential dollar add compare to 5.8% growth and the same sequential dollar add in the year-ago quarter. This appears to be highly achievable given the similarity to the year-ago period, which did not include any additions from Adaptive.
  - Management also mentioned that subscription revenue backlog growth in 2H20 should be in the low-20% range due to more difficult Y/Y compares amidst an expectation for a greater percentage of net new ACV to land in 4Q.
  - We note that investors are increasingly looking at “subscription revenue bookings,” calculated as the quarterly change in subscription revenue backlog plus subscription revenue in the period. While no consensus estimate is available, we model subscription revenue bookings of $1.006B (+16% Y/Y). We note that this metric can be volatile, having grown +46% in F1Q20 and only +3.7% in the year-ago (F2Q19) period.
- As a final point, we note that while FX is anticipated to be a headwind in the quarter, Workday is more insulated from its impact than most companies. As a reminder, the U.S. dollar is the functional currency for the entities out of which Workday sells. This means that after Workday enters a contract, the FX rate is locked in once it’s billed. Additionally, Workday hedges its exposure going forward. Thus, the true FX impact to which Workday is exposed is on new deals signed in the quarter and the year, where Workday may have gone into a period assuming a certain spot rate on a deal but exchange rates on signing result in a different, potentially worse, rate.

Exhibit 2: Things to Remember from Prior Quarters

Things to Remember – One Year Ago (F2Q19)	Things to Remember – One Quarter Ago (F1Q20)

• Milestone: >35% of Fortune 500 and ~50% of Fortune 50 have selected Workday for HCM.
  ○ Notes that penetration rates for Cloud HCM remain low globally and that HCM is only 25% of its TAM
• 60% new customer growth for Financials, and a Fortune 500 win.
  ○ 530 Financials customers, and 8 in the Fortune 500
• Record high renewals, calculated as a percentage of original contract value.
• GM's declined normally due to cost of customer conference.
• Cash flows stronger than expected in weakest seasonal quarter, driven by collections.
• Billings accelerated. Backlog faced tough comps, FX headwinds, and duration headwinds.
• Noted that HCM is 90% of its business
	• Financials net new ACV growth >50%
	• 150 standalone Adaptive deals. 50 platform and planning add-on deals.
	• Net retention >100%
	• Reminded investors to keep in mind that the company faces "very difficult" second-half comps this year.
	• Aneel Bhusri (CEO) noted, "If there's one thing I would call out about this quarter, it's that all of the product lines are beginning to kick in and take presure off HCM."
	• Chano Fernando (Co-President) noted that large deals are increasingly moving into the fourth quarter but the pipeline is healty and the quality of global opportunities is strong.
	• Cash flows were a little light, driven by stronger than expected Q4 collections. Given strength of 4Q periods, can sometimes be hard for the company to predict the split between 4Q and 1Q.
	• Prism grew +70% in the quarter

Source: RBC Capital Markets, Company reports

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Long-Term Valuation Scenarios

If we assume the company grows revenues at a 25% CAGR after the current guided year (FY20) and expands FCF margins from ~12% today to 25% in FY24E, which we see as achievable with the company targeting 25% OMs longer-term, we believe the shares could be valued at $273 in approximately two years assuming a 35x FY+2 P/FCF multiple (a slight discount to the current FY+2 High Efficiency peer multiple) and dilution of 4% annually. In this scenario, shares could increase ~41% from current levels and provide investors with an annualized ~19% return over the next two years.

Exhibit 3: Five-Year Forecast (High Level) ($MM except per share)

Long-Term Scenario			
	FY20	FY21	FY24
Total Revs	$ 3,558.6	$ 4,397.2	$ 8,688.06
CAGR:	---	---	25.0%
Years:	---	---	4.00
Free Cash Flow	$ 404.2	$ 516.5	$ 2,172.0
FCF Margin:	11%	12%	25%
CAGR:	---	---	52.3%
Shares Outstanding	238.3	249.0	278.8
Annual Dilution	---	---	4%
FCF Per Share	$ 1.70	$ 2.07	$ 7.79
Current Price	$ 192.13	$ 192.13	$ 192.13
P/FCF	113.3x	92.6x	24.7x
Long-Term Price	---	---	$ 272.68
Target Multiple (FY+2)	---	---	35.0x
Years Away	---	---	2.00
Total Return	---	---	41.9%
Annualized Return	---	---	19.1%

Source: RBC Capital Markets estimates, Company reports

Valuation and Price Target

Our $225 price target is based on 10.0x EV/CY21E revenue, slightly behind our High Efficiency comp group, as WDAY's efficiency score is lower than the average.

Exhibit 4: WDAY vs. High Efficiency Comp Group

	Price	EV	EV/Revenue			Rev. Growth			Free Cash Flow			EV/FCF			FCF Margin			Growth + Margin		
Ticker	8/23/19	($mm)	CY19E	CY20E	CY21E	CY19E	CY20E	CY21E	CY19E	CY20E	CY21E	CY19E	CY20E	CY21E	CY19E	CY20E	CY21E	CY19E	CY20E	CY21E
ADBE	$282.44	$143,133	12.6x	10.7x	9.4x	23.2%	17.6%	13.9%	$ 4,482.0	$ 5,383.0	$ 6,248.4	31.9x	26.6x	22.9x	39.5%	40.3%	41.1%	62.7%	57.9%	55.0%
CRM	$151.57	$131,922	7.8x	6.3x	5.4x	26.8%	25.3%	16.0%	$ 2,940.8	$ 3,941.4	$ 4,916.0	44.9x	33.5x	26.8x	17.5%	18.7%	20.1%	44.3%	43.9%	36.1%
DBX	$ 17.76	$ 7,803	4.7x	4.1x	3.7x	18.7%	14.5%	11.1%	$ 396.9	$ 511.5	$ 533.4	19.7x	15.3x	14.6x	24.0%	27.0%	25.4%	42.7%	41.5%	36.5%
NOW	$263.07	$ 53,698	15.5x	12.1x	9.6x	32.6%	28.5%	26.1%	$ 972.2	$ 1,277.5	$ 1,670.2	55.2x	42.0x	32.2x	28.1%	28.7%	29.8%	60.7%	57.3%	55.9%
SPLK	$118.56	$ 18,384	8.1x	6.6x	5.5x	29.1%	22.0%	19.9%	$ (236.3)	$ 51.0	$ 245.0	NM	NM	75.0x	(10.4%)	1.8%	7.4%	18.7%	23.8%	27.3%
TWLO	$127.96	$ 18,393	16.5x	12.4x	9.8x	71.9%	33.0%	26.3%	$ (34.2)	$ 33.7	$ 77.1	NM	NM	NM	(3.1%)	2.3%	4.1%	68.8%	35.3%	30.4%
ZEN	$ 80.39	$ 9,980	12.3x	9.4x	7.4x	35.3%	30.6%	27.7%	$ 44.5	$ 101.0	$ 178.2	NM	98.8x	56.0x	5.5%	9.6%	13.2%	40.8%	40.1%	40.9%
ZM	$ 91.63	$ 26,908	51.0x	36.5x	28.1x	59.5%	39.6%	30.0%	$ 29.5	$ 49.1	$ 88.4	NM	NM	NM	5.6%	6.7%	9.2%	65.1%	46.3%	39.3%
ADSK	$143.99	$ 33,674	10.5x	8.5x	7.2x	27.3%	23.0%	19.0%	$ 1,250.2	$ 1,630.9	$ 2,024.3	26.9x	20.6x	16.6x	38.9%	41.2%	43.0%	66.2%	64.2%	62.0%
ANSS	$210.71	$ 17,410	11.7x	10.7x	9.8x	14.2%	9.8%	8.5%	$ 467.6	$ 559.5	$ 671.5	37.2x	31.1x	25.9x	31.4%	34.3%	37.9%	45.6%	44.0%	46.4%
AYX	$139.03	$ 8,585	22.9x	17.2x	12.9x	47.7%	33.6%	33.1%	$ 24.2	$ 47.7	$ 106.5	NM	NM	80.6x	6.5%	9.5%	16.0%	54.2%	43.1%	49.1%
AZPN	$133.45	$ 9,770	16.3x	15.5x	14.5x	8.9%	5.1%	7.5%	$ 250.1	$ 279.6	$ 303.5	39.1x	34.9x	32.2x	41.8%	44.5%	44.9%	50.7%	49.6%	52.4%
COUP	$140.18	$ 10,390	30.7x	24.0x	17.8x	33.4%	27.7%	34.6%	$ 39.9	$ 62.0	$ 79.4	NM	NM	NM	11.8%	14.3%	13.6%	45.1%	42.0%	48.2%
NEWR	$ 58.50	$ 3,150	5.5x	4.4x	3.6x	27.3%	24.0%	22.4%	$ 50.2	$ 72.1	$ 103.2	62.8x	43.7x	30.5x	8.8%	10.2%	11.9%	36.1%	34.2%	34.4%
OKTA	$132.46	$ 15,154	28.3x	21.5x	16.4x	38.4%	31.5%	30.9%	$ 8.8	$ 41.3	$ 87.7	NM	NM	NM	1.6%	5.9%	9.5%	40.1%	37.4%	40.4%
PAYC	$248.91	$ 14,665	20.1x	16.3x	13.2x	28.8%	23.3%	23.1%	$ 159.6	$ 194.8	$ 234.2	91.9x	75.3x	62.6x	21.9%	21.7%	21.1%	50.7%	45.0%	44.3%
PFPT	$114.91	$ 6,672	7.6x	6.3x	5.3x	22.7%	20.9%	18.4%	$ 197.4	$ 261.8	$ 322.2	33.8x	25.5x	20.7x	22.4%	24.6%	25.6%	45.2%	45.5%	43.9%
SHOP	$382.75	$ 44,092	28.7x	21.4x	16.0x	43.4%	34.0%	33.4%	$ 16.0	$ 69.6	$ 189.0	NM	NM	NM	1.0%	3.4%	6.9%	44.4%	37.4%	40.3%
TEAM	$141.05	$ 35,414	25.6x	20.1x	15.5x	32.4%	27.4%	29.8%	$ 451.1	$ 567.5	$ 781.5	78.5x	62.4x	45.3x	32.7%	32.3%	34.2%	65.0%	59.6%	64.0%
VEEV	$158.13	$ 24,270	23.5x	19.8x	16.8x	22.0%	18.8%	17.6%	$ 361.2	$ 444.6	$ 565.1	67.2x	54.6x	42.9x	34.9%	36.2%	39.1%	57.0%	55.0%	56.7%
ZS	$ 71.28	$ 9,717	28.5x	21.6x	16.6x	44.3%	32.1%	30.0%	$ 42.1	$ 66.4	$ 103.6	NM	NM	93.8x	12.4%	14.8%	17.7%	56.7%	46.8%	47.7%
Mean:			**18.5x**	**14.5x**	**11.6x**	**32.8%**	**24.9%**	**22.8%**				**49.1x**	**43.4x**	**42.4x**	**17.8%**	**20.4%**	**22.5%**	**50.5%**	**45.2%**	**45.3%**
Median			**16.3x**	**12.4x**	**9.8x**	**29.1%**	**25.3%**	**23.1%**				**42.0x**	**34.9x**	**32.2x**	**17.5%**	**18.7%**	**20.1%**	**50.7%**	**44.0%**	**44.3%**
WDAY	**$192.13**	**$ 49,033**	**14.0x**	**11.3x**	**9.4x**	**26.7%**	**23.5%**	**21.0%**	**$ 441.7**	**$ 654.8**	**$ 645.2**	**NM**	**74.9x**	**76.0x**	**12.6%**	**15.1%**	**12.3%**	**39.3%**	**38.6%**	**33.4%**

Source: Company reports, FactSet consensus estimates

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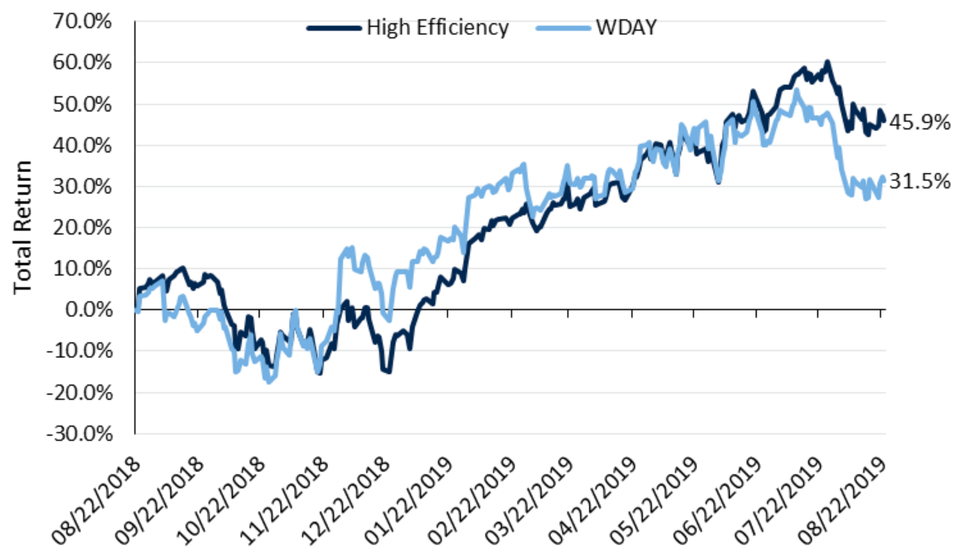
Appendix

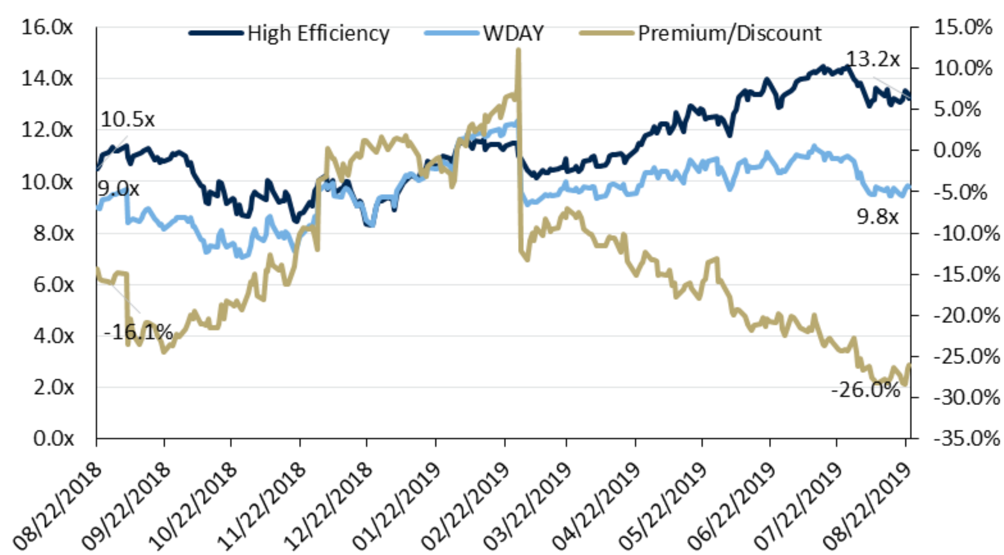
Trading History

Exhibit 5: One-Year Return History



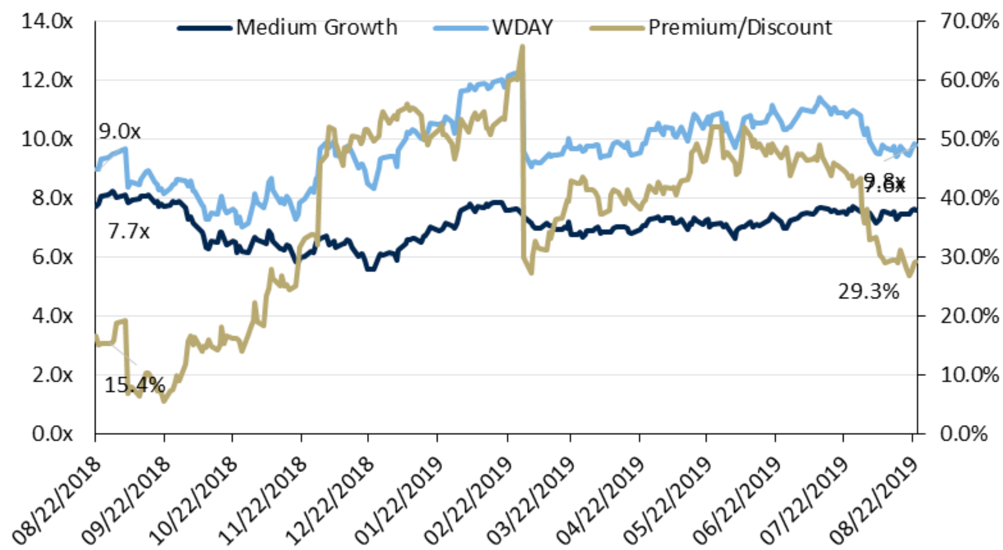
Source: FactSet Research Systems

Exhibit 6: Valuation vs. High Efficiency Comp Group



Source: Company reports, RBC Capital Markets

Exhibit 7: Valuation vs. Medium Growth Comp Group



Source: Company reports, RBC Capital Markets

Valuation

Our price target of $225 is 10.0x EV/Rev on our CY21 estimates. This target multiple is slightly behind our High Efficiency comp group, as WDAY's efficiency score is lower than the average. Our price target supports our Outperform rating.

Risks to rating and price target

Valuation leaves no room for error: We believe the company has to deliver sufficient growth to justify its valuation and any execution errors or external events could lead to multiple compression.

Competitors continue to invest and use other tactics to avoid customer erosion: Competitors are investing in their cloud HCM solutions and are also continuing to use price as a tactic. It is possible that over time both tactics will affect Workday's ability to win customers.

Key person risk: We think senior management brings strong understanding of customer needs and a clear view on the infrastructure and functional direction of modern enterprise applications. A change in senior management could potentially change our thesis on the stock.

Financials needs to become a larger contributor to growth: We still think there is significant growth opportunity in HCM; however, we think financials needs to become a bigger contributor to growth over the next two to three years.

Progress on FCF and earnings: We believe the company needs to manage its business model such that a path to improving profitability can be seen. In addition, we expect to see progress on FCF generation and model significant FCF generation over the next three years.

Company description

Workday, Inc. provides enterprise cloud-based applications to large enterprises for human capital management (HCM), payroll, financial management, time tracking, procurement, and employee expense management. The company was founded in 2005 and is headquartered in Pleasanton, California.

Workday (WDAY) Non-GAAP Income Statement	FY 2018	Quarter Ended Apr-18	Jul-18	Oct-18	Jan-19	FY 2019	Quarter Ended Apr-19	Jul-19	Oct-19	Jan-20	FY 2020E	Quarter Ended Apr-20	Jul-20	Oct-20	Jan-21	FY 2021E	FY 2022E
Subscription services	$ 1,787.8	$ 522.1	$ 565.7	$ 624.4	$ 673.5	$ 2,385.8	$ 701.0	$ 747.3	$ 782.4	$ 827.0	$ 3,057.7	$ 876.6	$ 933.6	$ 980.3	$ 1,034.2	$ 3,824.8	$ 4,713.2
Professional services	355.2	96.5	106.1	118.8	115.1	436.4	124.0	124.0	129.0	123.8	500.9	130.6	143.1	151.6	147.1	572.4	669.4
Total Revenues	**2,143.1**	**618.6**	**671.7**	**743.2**	**788.6**	**2,822.2**	**825.1**	**871.3**	**911.4**	**950.8**	**3,558.6**	**1,007.3**	**1,076.7**	**1,131.9**	**1,181.3**	**4,397.2**	**5,382.6**
Cost of Subscription Services	240.1	67.9	75.2	81.7	86.9	311.7	89.4	97.1	101.7	107.5	395.8	114.0	121.4	127.4	134.4	497.2	612.7
Cost of Professional Services	316.3	85.2	99.7	103.5	107.5	395.9	111.1	112.9	117.4	112.7	454.1	116.3	130.2	138.0	133.9	518.3	610.2
Total Cost of Revenues	556.5	153.1	174.9	185.2	194.4	707.6	200.5	210.0	219.1	220.2	849.8	230.2	251.5	265.4	268.3	1,015.5	1,222.9
Gross profit	**1,586.6**	**465.5**	**496.8**	**558.0**	**594.2**	**2,114.6**	**624.5**	**661.3**	**692.3**	**730.6**	**2,708.8**	**777.0**	**825.1**	**866.5**	**913.0**	**3,381.7**	**4,159.7**
Research and development	657.6	186.3	213.5	228.6	241.3	869.7	243.0	270.1	278.0	275.7	1,066.8	312.3	333.8	339.6	354.4	1,340.0	1,614.8
Sales and marketing	578.0	164.6	172.1	199.7	202.5	738.8	221.2	230.9	246.1	237.7	935.9	256.9	274.6	288.6	301.2	1,121.3	1,345.7
General and administrative	135.3	33.8	43.1	80.0	57.8	214.8	52.6	69.7	72.9	71.3	266.5	70.5	75.4	73.6	76.8	296.2	376.8
Total Operating Expenses	1,371.0	384.7	428.7	508.4	501.5	1,823.3	516.8	570.7	597.0	584.8	2,269.2	639.6	683.7	701.8	732.4	2,757.5	3,337.2
Operating income	**215.6**	**80.8**	**68.1**	**49.7**	**92.7**	**291.3**	**107.7**	**90.6**	**95.3**	**145.9**	**439.5**	**137.4**	**141.4**	**164.7**	**180.6**	**624.2**	**822.5**
Other income (expense), net	32.4	14.3	19.1	39.0	27.2	99.5	18.7	(1.6)	-	(1.6)	15.5	-	(1.6)	-	(1.6)	(3.2)	(3.2)
Pre-Tax Income	**248.0**	**95.1**	**87.2**	**88.6**	**119.8**	**390.8**	**126.5**	**89.0**	**95.3**	**144.3**	**455.1**	**137.4**	**139.8**	**164.7**	**179.0**	**621.0**	**819.3**
Provision for Income Taxes	6.4	16.2	14.8	15.1	20.4	66.4	21.5	15.1	16.2	24.5	77.4	23.4	23.8	28.0	30.4	105.6	139.3
Effective tax rate (%)	2.6%	17.0%	17.0%	17.0%	17.0%	17.0%	17.0%	17.0%	17.0%	17.0%	17.0%	17.0%	17.0%	17.0%	17.0%	17.0%	17.0%
Net Income	**$ 241.5**	**$ 78.9**	**$ 72.4**	**$ 73.5**	**$ 99.5**	**$ 324.4**	**$ 105.0**	**$ 73.9**	**$ 79.1**	**$ 119.7**	**$ 377.7**	**$ 114.1**	**$ 116.1**	**$ 136.7**	**$ 148.6**	**$ 515.4**	**$ 680.0**
Pro Forma EPS	$ 1.05	$ 0.33	$ 0.31	$ 0.31	$ 0.41	$ 1.36	$ 0.43	$ 0.30	$ 0.32	$ 0.47	$ 1.52	$ 0.45	$ 0.45	$ 0.52	$ 0.56	$ 1.99	$ 2.52
Diluted Shares	230.0	236.0	237.4	238.6	241.2	238.3	245.3	247.8	250.3	252.8	249.0	255.3	257.8	260.4	263.0	259.1	269.7
Q/Q Share Dilution	---	-0.5%	0.6%	0.5%	1.1%	---	1.7%	1.0%	1.0%	1.0%	---	1.0%	1.0%	1.0%	1.0%	---	---
Y/Y	10.4%	6.3%	5.2%	1.4%	1.7%	3.6%	3.9%	4.4%	4.9%	4.8%	4.5%	4.1%	4.1%	4.1%	4.1%	4.1%	4.1%
Q/Q Change																	
Subscription Services	---	6.6%	8.3%	10.4%	7.9%	---	4.1%	6.6%	4.7%	5.7%	---	6.0%	6.5%	5.0%	5.5%	---	---
Professional Services	---	4.3%	9.9%	12.0%	(3.1%)	---	7.8%	0.0%	4.0%	(4.0%)	---	5.5%	9.5%	6.0%	(3.0%)	---	---
Total Revenue	---	6.2%	8.6%	37.0%	6.1%	---	4.6%	5.6%	4.6%	4.3%	---	5.9%	6.9%	5.1%	4.4%	---	---
Y/Y Change																	
Subscription Services	38.5%	30.6%	30.2%	34.7%	37.5%	33.4%	34.3%	32.1%	25.3%	22.8%	28.2%	25.1%	24.9%	25.3%	25.1%	25.1%	23.2%
Professional Services	25.2%	20.4%	16.8%	29.4%	24.4%	22.9%	28.5%	16.9%	8.6%	7.6%	14.8%	5.3%	15.3%	17.6%	18.8%	14.3%	16.9%
Total Revenue	36.1%	28.9%	27.9%	33.8%	35.4%	31.7%	33.4%	29.7%	22.6%	20.6%	26.1%	22.1%	23.6%	24.2%	24.2%	23.6%	22.4%
Margin & Expense Analysis																	
Subscription Services Gross Margin	86.6%	87.0%	86.7%	86.9%	87.1%	86.9%	87.2%	87.0%	87.0%	87.0%	87.1%	87.0%	87.0%	87.0%	87.0%	87.0%	87.0%
Professional Services Gross Margin	11.0%	11.7%	6.0%	12.9%	6.6%	9.3%	10.4%	9.0%	9.0%	9.0%	9.3%	11.0%	9.0%	9.0%	9.0%	9.5%	8.8%
Total Gross Margin	**74.0%**	**75.2%**	**74.0%**	**75.1%**	**75.3%**	**74.9%**	**75.7%**	**75.9%**	**76.0%**	**76.8%**	**76.1%**	**77.1%**	**76.6%**	**76.6%**	**77.3%**	**76.9%**	**77.3%**
Subscription Services, % of Total Revenue	83.4%	84.4%	84.2%	84.0%	85.4%	84.5%	85.0%	85.8%	85.8%	87.0%	85.9%	87.0%	86.7%	86.6%	87.5%	87.0%	87.6%
Professional Services, % of Total Revenue	16.6%	15.6%	15.8%	16.0%	14.6%	15.5%	15.0%	14.2%	14.2%	13.0%	14.1%	13.0%	13.3%	13.4%	12.5%	13.0%	12.4%
Research & Development, % of Total Revenue	30.7%	30.1%	31.8%	30.8%	30.6%	30.8%	29.4%	31.0%	30.5%	29.0%	30.0%	31.0%	31.0%	30.0%	30.0%	30.5%	30.0%
Sales & Marketing, % of Total Revenue	27.0%	26.6%	25.6%	26.9%	25.7%	26.2%	26.8%	26.5%	27.0%	25.0%	26.3%	25.5%	25.5%	25.5%	25.5%	25.5%	25.0%
General & Administrative, % of Total Revenue	6.3%	5.5%	6.4%	10.8%	7.3%	7.6%	6.4%	8.0%	8.0%	7.5%	7.5%	7.0%	7.0%	6.5%	6.5%	6.7%	7.0%
Operating Expenses, % of Total Revenue	64.0%	62.2%	63.8%	68.4%	63.6%	64.6%	62.6%	65.5%	65.5%	61.5%	63.8%	63.5%	63.5%	62.0%	62.0%	62.7%	62.0%
Operating Margin	**10.1%**	**13.1%**	**10.1%**	**6.7%**	**11.8%**	**10.3%**	**13.1%**	**10.4%**	**10.5%**	**15.3%**	**12.4%**	**13.6%**	**13.1%**	**14.6%**	**15.3%**	**14.2%**	**15.3%**
Key Metrics																	
Subscription Revenue Backlog	**5,200**	**5,200**	**5,500**	**5,900**	**6,740**	**6,740**	**6,800**	**7,058**	**7,140**	**8,152**	**8,152**	**8,055**	**8,361**	**8,691**	**9,807**	**9,807**	**11,798**
Q/Q	---	0.0%	5.8%	7.3%	14.2%	---	0.9%	3.8%	5.0%	15.5%	---	(1.2%)	3.8%	7.9%	17.3%	---	---
Y/Y	33.3%	30.0%	25.0%	31.1%	29.6%	29.6%	30.8%	28.3%	21.0%	21.0%	21.0%	18.5%	18.5%	21.7%	20.3%	20.3%	20.3%
Subscription Revenue Bookings	**3,087.8**	**522.1**	**865.7**	**1,024.4**	**1,513.5**	**3,925.8**	**761.0**	**1,005.7**	**864.0**	**1,839.5**	**4,470.2**	**778.8**	**1,239.7**	**1,310.5**	**2,150.4**	**5,479.4**	**6,703.7**
Q/Q	---	(56.1%)	65.8%	18.3%	47.7%	---	(49.7%)	32.1%	(14.1%)	112.9%	---	(57.7%)	59.2%	5.7%	64.1%	---	---
Y/Y	46.3%	4.5%	3.7%	81.8%	27.2%	27.1%	45.7%	16.2%	(15.7%)	21.5%	13.9%	2.3%	23.3%	51.7%	16.9%	22.6%	22.3%
Deferred Revenue	**1,537.1**	**1,415.1**	**1,483.2**	**1,570.3**	**1,949.3**	**1,949.3**	**1,830.2**	**1,864.8**	**1,847.1**	**2,293.8**	**2,293.8**	**2,183.9**	**2,236.9**	**2,235.2**	**2,822.7**	**2,822.7**	**3,481.3**
Q/Q	---	(7.9%)	4.8%	5.9%	24.1%	---	(6.1%)	1.9%	(0.9%)	24.2%	---	(4.8%)	2.4%	(0.1%)	26.3%	---	---
Y/Y	25.8%	17.9%	21.3%	27.8%	26.8%	26.8%	29.3%	25.7%	17.6%	17.7%	17.7%	19.3%	20.0%	21.0%	23.1%	23.1%	23.3%
Billings	**2,458.7**	**496.6**	**739.9**	**830.3**	**1,167.6**	**3,234.3**	**705.9**	**906.0**	**893.7**	**1,397.5**	**3,903.1**	**897.4**	**1,129.7**	**1,130.2**	**1,768.8**	**4,926.1**	**6,041.2**
% of Total	100.0%	15.4%	22.9%	25.7%	36.1%	100.0%	18.1%	23.2%	22.9%	35.8%	100.0%	18.2%	22.9%	22.9%	35.9%	100.0%	100.0%
Q/Q	---	(44.2%)	49.0%	12.2%	40.6%	---	(39.5%)	28.3%	(1.4%)	56.4%	---	(35.8%)	25.9%	0.0%	56.5%	---	---
Y/Y	29.1%	8.3%	35.1%	47.8%	31.1%	31.5%	42.2%	22.5%	7.6%	19.7%	20.7%	27.1%	24.7%	26.5%	26.6%	26.2%	22.6%

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Required disclosures

Conflicts disclosures

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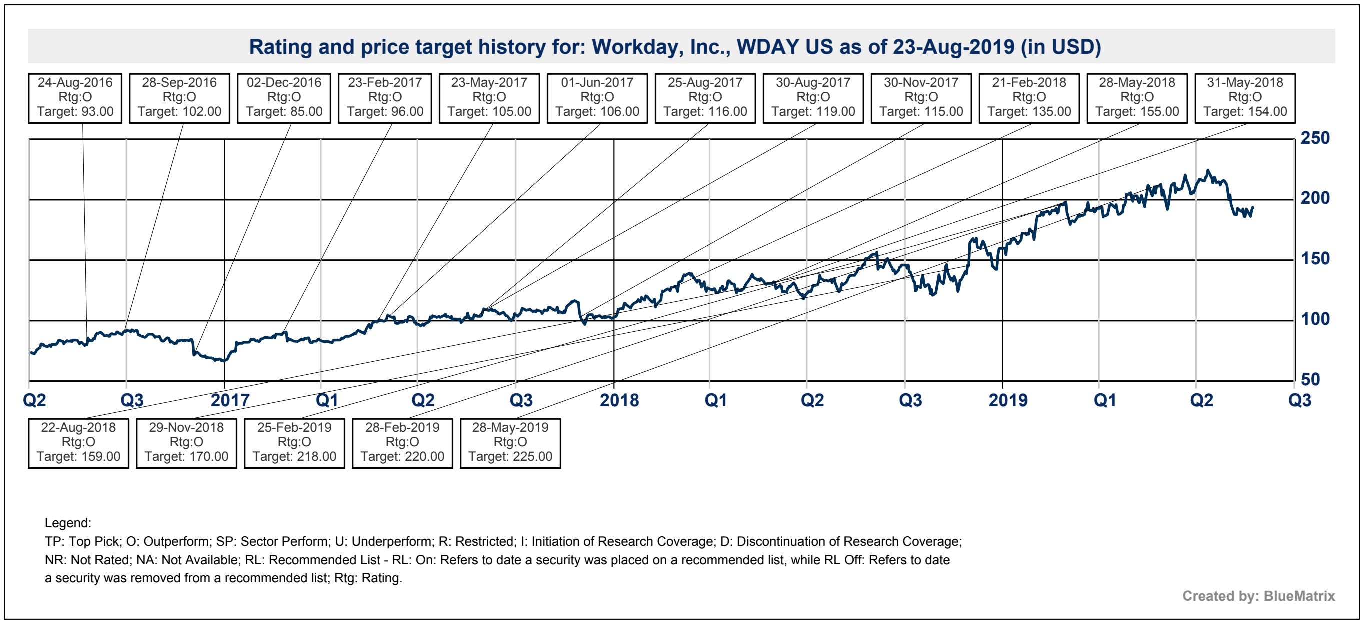

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Workday, Inc.

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