BLUEGRASS CAPITAL RESEARCH

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Technology | *Software Application*
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ServiceNow

Buy $NOW: ServiceNow Positioned for Growth

ServiceNow remains a global leader in cloud-based software, supported by a strong competitive moat and its effective land, expand, and retain strategy for growth. The accelerating adoption of artificial intelligence across businesses represents a tailwind, with ServiceNow's generative AI offerings providing a significant growth opportunity. **We initiate $NOW with a BUY rating and a price target of $1,169.**

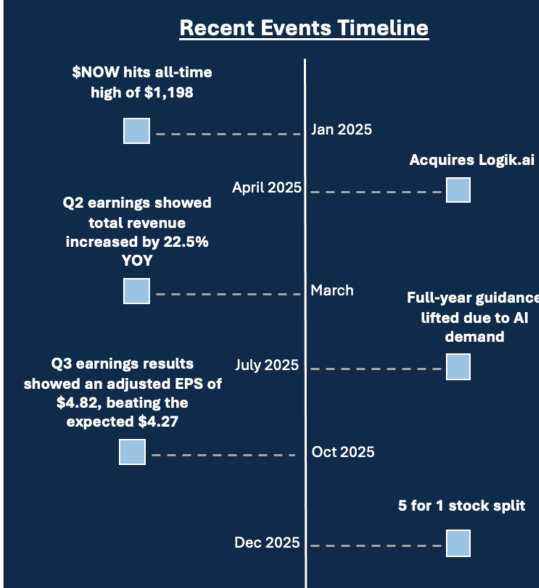
Thesis Point 1 ServiceNow benefits from a strong competitive moat driven by high switching costs. While the platform initially focused on IT service management, it has since expanded into HR, customer service, finance, and operations. ServiceNow employs a land, expand, and retain growth strategy, typically onboarding customers with a single product. That initial offering features an easy-to-use, highly customizable user interface that integrates into existing workflows. Once customers realize value from the core product, they can expand the services they receive from the platform, across multiple functions. This approach embeds the platform deeply within customer organizations, creating operational dependence as multiple departments collaborate and share data on the same system. As a result, switching away from ServiceNow becomes increasingly costly and disruptive. This strategy has driven high customer retention, with rates around 98%. Additionally, approximately 75% of customers use multiple products, highlighting both the effectiveness of the land and expand model and that there is still plenty of room for additional expansion, driving growth.

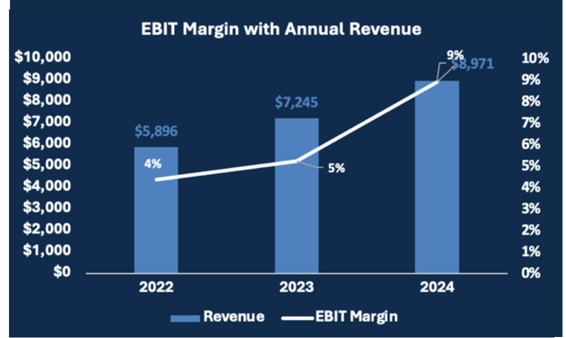
Thesis Point 2 ServiceNow is well positioned to benefit from the accelerating adoption of artificial intelligence. In September 2023, the company launched Now Assist, integrating generative AI capabilities across its platform. Now Assist is embedded throughout ServiceNow's applications, enabling customers to enhance productivity, automate decision-making, and improve workflow efficiency. Consistent with ServiceNow's land, expand, and retain strategy, Now Assist is offered as an add-on, deepening customer engagement and increasing average client value. The company expects Now Assist deals to exceed $500 million in average client value by 2025. Reflecting strong early traction and confidence in long-term demand, ServiceNow has raised its AI revenue contribution target from $250 million in FY2026 to $1 billion. More broadly, business adoption of AI continues to accelerate, with a growing number recognizing the productivity benefits generative AI can bring. With more businesses seeking to utilize AI, demand will grow for ServiceNow's AI add-on products.

Company Overview Founded in 2004 and headquartered in California, ServiceNow is a global leader in cloud-based software that enables organizations to digitize and automate workflows. The platform operates across four core solution areas: Technology, Customer and Industry, Employee, and Creator workflows. ServiceNow serves approximately 8,400 customers worldwide, including 85% of the Fortune 500. Despite operating in a highly competitive industry, ServiceNow differentiates itself through its tightly integrated platform of applications, high switching costs, and easy-to-use, user-friendly interface.

servicenow

TICKER:	$NOW
RATING:	BUY
PRICE:	$865.06
PRICE TARGET:	$1,169.30
MARKET CAP:	$164.693bn
52-W RANGE.	$678.66 - $1,198.09
P/E:	95.33x
IMPLIED UPSIDE:	35.17%





Risk 1

While ServiceNow's high switching costs create a strong competitive moat, the company faces risk from competitors adopting a similar land, expand, and retain strategy. Competitors such as Salesforce currently concentrate on specific functional areas, like customer service, however, if these platforms successfully expand into adjacent workflows, they could erode ServiceNow's differentiation as a single, integrated platform for use across multiple departments. ServiceNow could lose existing customers who previously chose the platform due to its unique platform if better offers arise, losing subscriptions and creating a decline in revenue growth.

Risk 2

Although ServiceNow has seen early success with AI-enabled products such as Now Assist, the competitive landscape remains intense. Alternative AI solutions, including offerings such as IBM's Watsonx.ai, present possible substitutes. While existing customers may prefer ServiceNow's AI tools due to their platform integration, competitors offering comparable functionality at lower price points could limit adoption and constrain the revenue ServiceNow expects from its AI initiatives.

Catalysts

The primary catalyst for ServiceNow's stock is increasing demand for its AI-enabled features. The land and expand approach is ServiceNow's business strategy for growth. Therefore, if businesses continue to adopt AI, this should drive sales of ServiceNow's generative AI products, such as Now Assist.

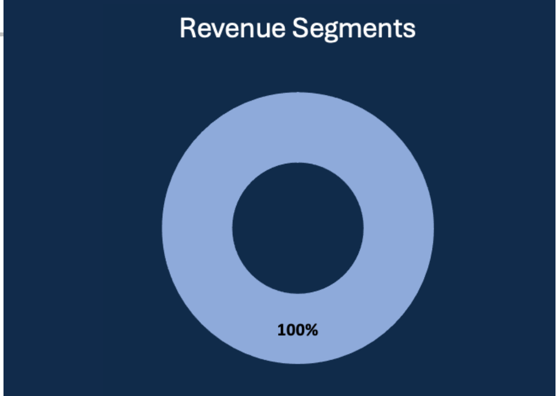
Valuation

DCF Analysis ($mm)	FY2024 31/12/2024	FY2025 12/31/2025	FY2026 12/31/2026	FY2027 12/31/2027	FY2028 12/31/2028	FY2029 12/31/2029	FY2030 12/31/2030
Revenue	10,984	13,181	15,553	18,236	21,245	24,591	28,280
Revenue Growth	*22%*	*20%*	*18%*	*17%*	*17%*	*16%*	*15%*
Internet Software & Sei	10,984	13,181	15,553	18,236	21,245	24,591	28,280
EBIT	1,397	2,109	2,566	3,032	3,559	4,150	4,808
EBIT Margin	*13%*	*16%*	*17%*	*17%*	*17%*	*17%*	*17%*
Tax Expense	313	1	616	728	854	996	1,154
Effective Tax Rate	*22%*	*0%*	*24%*	*24%*	*24%*	*24%*	*24%*
NOPAT	1,084.00	2,107.93	1,950.39	2,304.16	2,704.52	3,153.85	3,653.79
D&A	470	727	858	1,006	1,172	1,357	1,560
Capex	852	1,028	1,213	1,423	1,657	1,918	2,206
Changes in NWC	(455)	(1,273)	(1,502)	(1,761)	(2,051)	(2,374)	(2,730)
UFCF	1,157	3,080	3,097	3,648	4,271	4,967	5,738
PV of FCF		3,074	2,966	3,227	3,488	3,746	3,997

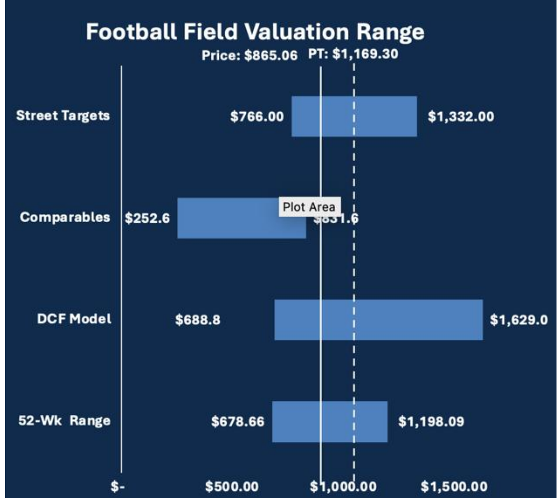
Our 5yr DCF model assumes a 50.0x EV/EBITDA mutliple. Revenue growth remains strong, assuming ServiceNow's land, expand, and retain approach continues in effectiveness. Accelerating adoption of AI by businesses leads to a rise in existing customers purchasing add-on products, driving revenuem, widening margins, and creating an increase in average customer value. The resulting CAGR over the 5 year period is 17.9%.

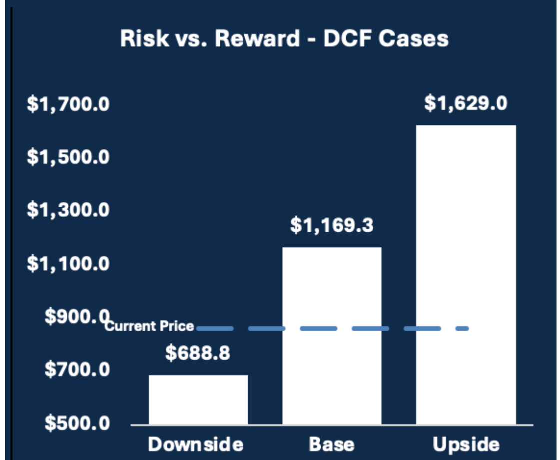
Conclusion

We see strong long-term growth potential for ServiceNow, underpinned by its strong competitive moat and effective land, expand, and retain strategy. This model enables the company to drive revenue growth from its existing customer base even as the pace of new customer additions moderates. In addition, ServiceNow's investments in AI-driven add-on products, such as Now Assist, position the company to benefit from the accelerating adoption of artificial intelligence across business operations. The integration of these AI capabilities into ServiceNow's existing workflow platform lowers adoption friction and enhances customer value, reinforcing the expand component of its growth strategy. Taking this tailwind into account along with ServiceNow's singificant competitive moat, **we initiate coverage with a BUY rating and a $1,169 PT with a 35.17% upside.**



Terminal Value	
EV/EBITDA Exit Multiple	50.0x
Terminal Value	$318,401
PV of Terminal Value	$221,785
Implied TEV	$242,285
(-) Debt	$2,402
(+) Cash	$2,725
Implied Equity Value	$242,608
Diluted Shares Outstanding	207
Implied Share Price	$1,169.30
Upside/Downside	35.2%





Income Statement ($mm)	2024A	2025E	2026E	2027E	2028E	CAGR%
Revenue	10,984	13,181	15,553	18,236	21,245	17.9%
EBITDA	1,867	2,836	3,424	4,038	4,731	26.2%
EBIT	1,397	2,109	2,566	3,032	3,559	26.3%
NOPAT	1,084	2,108	1,950	2,304	2,705	25.7%

Margin & Growth Data	2024A	2025E	2026E	2027E	2028E	AVG%
EBITDA Margin	17.0%	21.5%	22.0%	22.1%	22.3%	21.0%
EBIT Margin	12.7%	16.0%	16.5%	16.6%	16.8%	15.7%
Revenue Growth	22.4%	20.0%	18.0%	17.3%	16.5%	18.8%
EBIT Growth	74.6%	51.0%	21.7%	18.1%	17.4%	36.6%

Valuation Metrics	2024A	2025E	2026E	2027E	2028E	AVG%
P/FCF	137.2x	51.6x	51.3x	43.5x	37.2x	64.1x
EV/Sales	#VALUE!	12.0x	10.2x	8.7x	7.5x	9.6x
EV/EBITDA	84.9x	55.9x	46.3x	39.2x	33.5x	51.9x
FCF Yield	0.7%	1.9%	2.0%	2.3%	2.7%	1.9%

Comparable Companies

$mm

Ticker	Mkt Cap	EV	P/E LTM	Revenue LTM	EBITDA LTM
Palo Alto Networks, Inc. (NasdaqGS:PANW	$133,608	$129,827	120.1x	$9,557	$1,383
Salesforce, Inc. (NYSE:CRM)	$245,710	$246,022	34.2x	$40,317	$11,801
Workday, Inc. (NasdaqGS:WDAY)	$59,041	$55,991	92.8x	$9,231	$1,210
Adobe Inc. (NasdaqGS:ADBE)	$149,202	$149,255	21.0x	$23,769	$9,551
ServiceNow	$179,484	$172,209	94.1x	$12,667	$2,498

Ticker	LTM EV/EBITDA	Gross Margin	EBITDA Margin	EBIT Margin	Yr Rev Growth Rate LF
Palo Alto Networks, Inc. (NasdaqGS:PANW	93.9x	73.5%	14.5%	11.7%	15.3%
Salesforce, Inc. (NYSE:CRM)	20.8x	77.7%	29.3%	22.0%	8.4%
Workday, Inc. (NasdaqGS:WDAY)	46.3x	75.6%	13.1%	9.4%	13.2%
Adobe Inc. (NasdaqGS:ADBE)	15.6x	89.3%	40.2%	36.6%	10.5%
ServiceNow	68.9x	78.1%	19.7%	14.4%	21.1%

High	93.91x	89.3%	40.2%	36.6%	21.1%
75th Percentile	68.94x	78.1%	29.3%	22.0%	15.3%
Average	49.12x	78.8%	23.4%	18.8%	13.7%
Median	46.27x	77.7%	0.0%	14.4%	13.2%
25th Percentile	20.85x	75.6%	14.5%	11.7%	10.5%
Low	15.63x	73.5%	13.1%	9.4%	8.4%

Insert Company Name		
Implied Enterprise Value (25th Percentile)	$	52,077
Implied Enterprise Value (Median)	**$**	**115,591**
Implied Enterprise Value (75th Percentile)	$	172,209
Implied Share Price (25th Percentile)	$	252.55
Implied Share Price (Median)	**$**	**558.67**
Implied Share Price (75th Percentile)	$	831.55

Weighted Average Cost of Capital ($mm)	
Market Risk Premium	4.33%
Beta	0.96
Risk Free Rate	4.19%
Cost of Equity	8.25%
Weighted Average Cost of Debt	4.80%
Tax Rate	24.00%
Cost of Debt	0.05%
Total Equity	$158,709
Total Debt	$2,402
Equity/Total Capitalization	98.51%
Debt/Total Capitalization	1.49%
WACC	8.30%

Downside Case: Our $688.83 downside case PT is based on a 45.0x EV/EBITDA multiple, assuming demand for additional product add-ons, including those that use generative AI, falls among existing customers. Revenue growth falls to 14% in 2026 and then continues to decline, with margins narrowing after 2025.

Upside Case: Our $1629.00 upside PT case is based on a 60.0x EV/EBITDA multiple, assuming the demand for additional add-ons is higher than expected, with an increase in sales beating expected revenue growth. Margins continue to expand, reaching 19% in 2030.