

**Problem 1. Business Strategy Analysis**

(i) Salesforce delivers its enterprise cloud computing solutions using multi-tenant technology architecture. Briefly describe the multi-tenancy architectural approach. **[3 points]**

(ii) List one key success factor and one significant risk associated with Salesforce's use of multi-tenant technology architecture. **[4 points]**

1. Key success factor

2. Significant risk

**Problem 2. Accounting Analysis**

- (i) Summarize the accounting policy used by Salesforce for commission payments to their direct sales force. **[3 points]**
- (ii) Assume that instead of using its current accounting policies for deferring the recognition of both revenues and commissions on subscription contracts, Salesforce instead recognized all non-cancelable future billings and any associated commission costs at the inception of the associated subscription contract. Estimate the Income (loss) from operations that Salesforce would have reported for the fiscal year ended January 31, 2016. **[8 points]**

- (iii) Assume that instead of using its current accounting policy for 'marketing and sales' costs, Salesforce instead capitalized these costs in the fiscal year the costs are incurred and then amortized the costs on a straight-line basis over the subsequent two fiscal years. Estimate the Income (Loss) from operations that Salesforce would have reported for fiscal year ended January 31, 2016. **[5 points]**
- (iv) Which of the above two accounting methods for marketing and sales costs do you think better reflects the underlying economics of the expenditures? Briefly explain your answer. **[3 points]**

**Do not write below this point.**

**Problem 3. Financial Analysis**

- (i) Compute the net operating asset (NOA) turnover ratios for Salesforce and Oracle for their most recent fiscal year. **[6 points]**

NOA Turnover for Salesforce =

NOA Turnover for Oracle =

- (ii) Summarize the primary reason(s) for the difference between the NOA turnover ratios that you computed above? **[4 points]**

- (iii) Estimate the average number of days that elapsed between the receipt of cash from customers and the recognition of the associated revenue for Salesforce and Oracle during the most recent fiscal year. Be sure to specify whether cash is received before or after revenue is recognized in each case. **[6 points]**

Average number of days for Salesforce =

Average number of days for Oracle =

- (iv) Briefly identify the primary reason(s) for the difference between the average number of days for Salesforce and Oracle that you computed in the question above. **[4 points]**

**Problem 4. Forecasting**

- (i) The Wedbush research report forecasts that Salesforce's 'Adjusted operating margin' will grow from 12.4% in FY16 to 15.1% in FY18 (see Figure 9 of the report). Identify the key drivers of the improved margin. **[4 points]**
- (ii) The Wedbush research report forecasts that Salesforce's balance of 'Deferred commissions' included in current assets will grow from 259.2 at the end of FY16 to 263.6 at the end of FY18 (see Figure 11 of the report). Briefly evaluate the plausibility of this forecasting assumption. **[4 points]**
- (iii) The Wedbush research report forecasts that Salesforce's 'Cash flow from Operating Activities' will be 2,331.8 for FY18 (see Figure 12 of the report). What does the research report forecast that Salesforce will do with most of this cash? **[3 points]**

**Problem 5. Valuation Analysis**

In this problem, we will value Salesforce using the residual income valuation model and the financial forecasts in the Wedbush report. Use a discount rate (cost of equity) of 9%.

- (i) Compute Salesforce's residual income for FY17 and FY18. **[6 points]**

FY17 Residual Income:

FY18 Residual Income:

- (ii) Use the residual income valuation model to value Salesforce's common equity per share at the end of FY16 by using your answers from part (i) above and Salesforce's book value of common equity at the end of FY16. Assume that residual income is zero for all years beyond FY18. Use 671 million shares in your computation. **[6 points]**

(iii) The DCF model in the Wedbush research report generates a value of \$96/share. Identify two major differences in the forecasting assumptions underlying the above residual income valuation versus the Wedbush DCF valuation that contribute to the different values. [6 points]

1.

2.

**This is the end of the exam.**