

Demandware, Inc.

NYSE: DWRE

Analyst: Joseph Gonyeau

Sector: Technology

Sell

Price Target: \$37.92

Key Statistics as of 5/6/2016

Market Price:	\$46.75
Industry:	Software & Services
Market Cap:	\$1,581.2M
52-Week Range:	\$26.47 – 79.50
Beta:	0.155

Thesis Points:

- Demandware's stock price has risen 140% since its 2012 IPO, despite declining net income, ROE, and EPS
- Revenue has been bolstered through inorganic growth, leading to an underperforming stock price
- Demandware's ROIC to WACC ratio is significantly below their competitors, a troublesome sign in the highly competitive market for cloud technology

Company Description:

Headquartered in Burlington, MA, Demandware, Inc. (DWRE) provides cloud-based e-commerce technology to brand manufacturers and retailers in the United States, Germany, the United Kingdom and elsewhere abroad. It offers software as a service (SaaS) through Demandware Commerce Cloud, a digital commerce platform that helps customers create and carry out digital commerce strategies, as well as assist customers in global expansion, predictive merchandising and in-store operations. Demandware sells its cloud based products to retailers, massive corporations as well as branded manufacturers in apparel and footwear, home and garden, health and beauty, and sporting goods. Sales are done through their direct sales force and indirect channels. Demandware has seen its stock price rise an impressive amount since its 2012 IPO, and has paired this with tremendous revenue growth. Despite this, Demandware's fundamentals have been weak, especially compared to its competitors, thus I am very bearish on the stock.



Thesis

Since its 2012 IPO, Demandware's (DWRE) stock price has risen 140% with revenues growing even faster. Although these appear to be good signs, in fact, they are simply a result of Demandware's inorganic growth through the acquisition of a number of smaller companies. These acquisitions have led to a declining net income, return on equity, and earnings per share, ultimately signaling an overvalued stock price. This is further evidenced by their bottom of the market ROIC, which is much lower than their main competitors. Although the number of retailers they are serving is growing extremely fast, their strategy is not working, leading to a bolstered top line and weakened bottom line. This makes now the perfect time to engage in a short position on a very bearish stock.

Industry Outlook

Demandware's total addressable market is in the middle of three large sectors: retail, digital commerce and cloud computing. It is estimated that the size of the global retail market is approximately \$22 billion, the global commerce software market is approximately \$10 billion and the global cloud market is approximately \$50 billion. The e-commerce market is growing most quickly, with this growth driven by widespread broadband internet connectivity, proliferation of mobile devices such as smart phones, growing consumer preference for online shopping, and messaging platforms and mobile applications and the convergence of the digital and brick and mortar retail channels. Digital and physical channels are converging, with customers demanding a more relevant, personalized shopping experience while retailers seek to meet these needs. Retailers are also looking to improve efficiency, reduce complexity, replace outdated hardware and software, and lower costs by automating processes, optimizing inventory, and centralizing all key product and consumer information to provide flexible, personalized experiences. As the digital commerce market expands, it is equally becoming more complex. Some of the trends that are driving this complexity are the rapid pace of innovation, the need to maintain scale and global presence, increasing consumer demand for personalization, and the proliferation of retail channels.

As Demandware currently sits, their declining ROIC to WACC is leading to value destruction, while their competitors are creating value, and are poised to capitalize on this \$50 billion market.

Business Model

Demandware offers a comprehensive cloud commerce platform. Specifically, they offer the Demandware Commerce Cloud, consisting of related services and participation in a community that extends the value of the platform. They also offer a business model that is designed for sustained customer revenue growth, evident through their large number of recent acquisitions. They deliver solutions on-demand to customers who are able to access and manage their commerce business over the internet using a standard web browser and through mobile applications. Their customers utilize the Demandware Commerce Cloud to create compelling ecommerce and in-store consumer interactions, as well as to deliver omni-channel experiences. They sell subscriptions to their cloud software and related services through both a direct sales force and indirect channels. Most of their revenues are derived from subscriptions to the Demandware Commerce Cloud and services related to the offering. Subscription fees for e-commerce customers are based on a revenue share pricing model, where customers pay a percentage of their total gross revenue that is processed on the Demandware platform.

Financials

As of 2014, Demandware had well over 200 active clients, including Columbia Sportswear, L'Oreal, Brooks Brothers, Vineyard Vines, Motorola, and Callaway Golf. Demandware was even ranked among the top 10 companies in the e-commerce platform category in the 2014 Top Tech Guide. Since its IPO, its stock price has risen by over 140% with impressive revenue growth to match. From its 2012 IPO to 2015, revenue grew an impressive 320%, including 50% growth from 2014 to 2015. Ironically, despite such a profound revenue growth and rise in stock price, Demandware has consistently underperformed the S&P 500, especially over the last year and a half. Demandware's lack of success in relation to the S&P 500 may be attributed to their diminishing net income. Despite such wide acclaim, Demandware's net income

has been consistently deteriorating since their 2012 IPO. Since 2012, Demandware's net income has plummeted by 751%, from -\$4.3 million to -\$36.6 million in 2015. Furthermore, net income declined 35% in 2014 and an additional 18% in 2015. ROE also has been on a steady decline since their IPO, plummeting from -8.8% to -13% in 2015. To compound this, EPS also has been on a downward trend, while revenue and stock price have ironically increased. EPS declined by \$0.31 from 2014 to 2015, keeping in line with their 341% EPS decline since their 2012 IPO. Demandware's EPS is especially weak compared to their competitors. The market for cloud technology is very competitive, and two companies that have proven to be major competitors for Demandware are HP (HPE) and Oracle (ORCL). Both have seen major success in their unique approaches to cloud technology. Demandware's EPS has been negative for the last four years, seeing a consistent decline over the same period. Oracle and HP have EPS of \$.51 and \$.33, respectively, staying in the positive over the last four years.

Acquisitions

Decline in net income, ROE and EPS are likely attributable to Demandware's focus on expanding up market, targeting larger customers to drive a growth in their customer base. Much of their revenue growth is derived through major acquisitions. In early 2014, Demandware acquired Mainstreet Commerce, a cloud-based order management provider for an undisclosed amount. By October of 2014, Demandware also acquired CQuotient, Inc., a cloud personalization provider for an undisclosed amount. Finally, in January of 2015, they acquired Tomax Corporation for \$75 million. \$60 million of which was in cash, with the other \$15 million in contingent retention-based payments. This acquisition gave Demandware access to companies such as Hallmark and LL Bean. As shown by the graph below, these acquisitions have been focused on bolstering sales and online market value, not the bottom line.

Acquisitions Accelerate our Journey

		Sell More on Commerce Platform	Online GMV Growth	Share of Wallet	TAM Expansion
Order Management		✓✓✓	✓✓✓	✓	✓
Predictive Intelligence		✓✓	✓✓✓	✓	✓
Point Of Sale		✓✓	✓✓	✓✓✓	✓✓✓

© 2015 Demandware. All product and company names and logos are trademarks™ or registered™ trademarks of their respective holders.

demandware

Value Destruction

Demandware also is destroying value, with an underperforming ROIC to WACC ratio of -1.0404, compared to HP's impressive value creating 16.15 and Oracle's 1.34. Fundamentally, Demandware is substantially behind two of its largest competitors, as can be seen in the graph below.



Considering Demandware's substantial acquisitions, it is important to examine ROIC without goodwill. ROIC without goodwill is a better measure of the company's performance related to its peers as it does not reflect the large premiums paid for acquisitions. Without goodwill, Demandware's ROIC is -19.8%, compared to -14.1% with goodwill. This signals that though their large acquisitions have led to massive revenues, they are actually destroying value relative to their competition.

Conclusion

Demandware's recent earnings call showed slight promise for the stock as it beat EPS by \$.05 and also beat revenue by \$2.48 million. Regardless, their strategy of growth through acquisition has not been successful. This is evidenced by Demandware's alarming trend between revenue and NOPAT as well as their ROIC without goodwill of -19.8%. Furthermore, declining net income, EPS and ROE indicate that Demandware may be

overvalued. Add these reasons to their short interest of 16.24% and 9.15 days to cover, and I'm very bearish on the stock. Based on my proforma valuation, I have Demandware at an intrinsic value of \$30.47, and a 1-year target price of \$37.92 for a target return of around 10.78%. This makes now the perfect time to engage in a short position on an overvalued stock.

Demandware, Inc. (DWRE)		CENTER FOR GLOBAL FINANCIAL STUDIES		BEARISH																																																																															
Analysis by Joseph Gougeau 5/6/2016		Current Price: \$42.50 Dividend Yield: 0.0%		Intrinsic Value \$30.47 Target Price \$37.92																																																																															
Target 1 year Return: -10.78% Probability of Price Increase:		Description Demandware, Inc. provider enterprise-class cloud commerce solutions in the United States, Germany, the United Kingdom, and internationally.		Market Data Market Capitalization \$1,581.20 Daily volume (mil) 0.13 Shares outstanding (mil) 36.57 Diluted shares outstanding (mil) 36.03 % shares held by institutions 78% % shares held by investment Managers 11% % shares held by hedge funds 5% % shares held by insiders 9.92% Short interest 16.24% Days to cover short interest 9.45 52-week high \$75.90 52-week low \$26.47 Levered Beta 2.18 Volatility 0.00%																																																																															
		General Information Sector Information Technology Industry Internet Software and Services Last Guidance November 3, 2015 Next earnings date August 4, 2016 Estimated Country Risk Premium 6.90% Effective Tax rate 34% Effective Operating Tax rate 34%		Part Earning Surprise <table border="1"> <thead> <tr> <th>Quarter ending</th> <th>Revenue</th> <th>EBITDA</th> </tr> </thead> <tbody> <tr> <td>3/31/2015</td> <td>0.96%</td> <td>-758.72%</td> </tr> <tr> <td>6/30/2015</td> <td>0.61%</td> <td>-3553.58%</td> </tr> <tr> <td>9/30/2015</td> <td>1.56%</td> <td>-1191.12%</td> </tr> <tr> <td>12/31/2015</td> <td>2.67%</td> <td>-115.53%</td> </tr> <tr> <td>3/31/2016</td> <td>2.41%</td> <td>-274.50%</td> </tr> <tr> <td>Mean</td> <td>1.64%</td> <td>-1178.69%</td> </tr> <tr> <td>Standard error</td> <td>0.4%</td> <td>623.1%</td> </tr> </tbody> </table>		Quarter ending	Revenue	EBITDA	3/31/2015	0.96%	-758.72%	6/30/2015	0.61%	-3553.58%	9/30/2015	1.56%	-1191.12%	12/31/2015	2.67%	-115.53%	3/31/2016	2.41%	-274.50%	Mean	1.64%	-1178.69%	Standard error	0.4%	623.1%																																																						
Quarter ending	Revenue	EBITDA																																																																																	
3/31/2015	0.96%	-758.72%																																																																																	
6/30/2015	0.61%	-3553.58%																																																																																	
9/30/2015	1.56%	-1191.12%																																																																																	
12/31/2015	2.67%	-115.53%																																																																																	
3/31/2016	2.41%	-274.50%																																																																																	
Mean	1.64%	-1178.69%																																																																																	
Standard error	0.4%	623.1%																																																																																	
Management Ebling, Thamar Adams, Timothy Barnett, Jeffrey Whitcomb, Wayne Gayal, Rabit Smith, Erica		Partitions Chairman of the Board, Chief Chief Financial Officer, Exec Chief Operating Officer, Exec Chief Technology Officer Senior Vice President of Eng Vice President of Investor R		Peer Markets, Inc. Carozziano OnDemand, Inc. LivePerson Inc. Benefitfocus, Inc. ChannelAdvisor Corporation Shopify Inc. LogMeIn, Inc. IntraLink Holding, Inc.																																																																															
Profitability ROIC 6.9% NOPAT Margin 9% Revenue/Invested Capital 0.75 ROE 4.9% Adjusted net margin 9% Revenue/Adjusted Book Value 0.55		Total compensation per share 10.19% per annum over 5y -73.33% per annum over 1y 46.73% per annum over 5y 46.06% per annum over 5y N/A N/A		Total return to shareholders N/A -6.2% per annum over 1y N/A N/A 0% per annum over 0y N/A																																																																															
Invested Funds Total Cash/Total Capital 34.9% Estimated Operating Cash/Total Capital 10.2% Non-cash working Capital/Total Capital -0.6% Invested Capital/Total Capital 75.5%		DWRE (5 year historical - Industry (LTM)) 24.19% 11.05% 2.19 -4.58% 10.72% -0.43		DWRE (5 year historical - Industry (LTM)) 14.03% 18.9% 0.74 15.01% 17.4% 0.86																																																																															
Capital Structure Total Debt/Common Equity (LTM) 0.03 Curt of Existing Debt 3.76% Estimated Curt of new Borrowing 4.17% CGFS Risk Rating B Unlevered Beta (LTM) 2.17 WACC 19.00%		DWRE (LTM) 52.9% 9.3% -0.6% 57.1%		DWRE (5 year historical - Industry (LTM)) 68% N/A -13% 46%																																																																															
Porter's 5 forces (score are out of 100) 		Revenue growth <table border="1"> <thead> <tr> <th>Period</th> <th>Revenue growth</th> </tr> </thead> <tbody> <tr> <td>Base Year</td> <td>42.5%</td> </tr> <tr> <td>3/31/2017</td> <td>32.0%</td> </tr> <tr> <td>3/31/2018</td> <td>26.0%</td> </tr> <tr> <td>3/31/2019</td> <td>22.0%</td> </tr> <tr> <td>3/31/2020</td> <td>16.0%</td> </tr> <tr> <td>3/31/2021</td> <td>14.0%</td> </tr> <tr> <td>3/31/2022</td> <td>14.0%</td> </tr> <tr> <td>3/31/2023</td> <td>13.0%</td> </tr> <tr> <td>3/31/2024</td> <td>13.0%</td> </tr> <tr> <td>3/31/2025</td> <td>12.0%</td> </tr> <tr> <td>3/31/2026</td> <td>5.0%</td> </tr> <tr> <td>Continuing Period</td> <td>2.1%</td> </tr> </tbody> </table>		Period	Revenue growth	Base Year	42.5%	3/31/2017	32.0%	3/31/2018	26.0%	3/31/2019	22.0%	3/31/2020	16.0%	3/31/2021	14.0%	3/31/2022	14.0%	3/31/2023	13.0%	3/31/2024	13.0%	3/31/2025	12.0%	3/31/2026	5.0%	Continuing Period	2.1%	Valuation <table border="1"> <thead> <tr> <th>Period</th> <th>Invested Capital</th> <th>Net Claims</th> <th>Price per share</th> </tr> </thead> <tbody> <tr> <td>Base Year</td> <td>\$29.55</td> <td>-\$33.59</td> <td>\$29.76</td> </tr> <tr> <td>3/31/2017</td> <td>\$54.26</td> <td>-\$47.85</td> <td>\$37.03</td> </tr> <tr> <td>3/31/2018</td> <td>\$94.09</td> <td>-\$80.49</td> <td>\$46.16</td> </tr> <tr> <td>3/31/2019</td> <td>\$191.48</td> <td>-\$137.87</td> <td>\$56.73</td> </tr> <tr> <td>3/31/2020</td> <td>\$339.31</td> <td>-\$270.49</td> <td>\$69.89</td> </tr> <tr> <td>3/31/2021</td> <td>\$423.61</td> <td>-\$374.06</td> <td>\$82.85</td> </tr> <tr> <td>3/31/2022</td> <td>\$551.73</td> <td>-\$506.20</td> <td>\$96.99</td> </tr> <tr> <td>3/31/2023</td> <td>\$712.76</td> <td>-\$675.48</td> <td>\$112.23</td> </tr> <tr> <td>3/31/2024</td> <td>\$888.48</td> <td>-\$883.78</td> <td>\$128.53</td> </tr> <tr> <td>3/31/2025</td> <td>\$1,065.37</td> <td>-\$1,150.54</td> <td>\$145.72</td> </tr> <tr> <td>3/31/2026</td> <td>\$1,250.04</td> <td>-\$1,488.85</td> <td>\$162.96</td> </tr> <tr> <td>Continuing Period</td> <td></td> <td></td> <td></td> </tr> </tbody> </table>		Period	Invested Capital	Net Claims	Price per share	Base Year	\$29.55	-\$33.59	\$29.76	3/31/2017	\$54.26	-\$47.85	\$37.03	3/31/2018	\$94.09	-\$80.49	\$46.16	3/31/2019	\$191.48	-\$137.87	\$56.73	3/31/2020	\$339.31	-\$270.49	\$69.89	3/31/2021	\$423.61	-\$374.06	\$82.85	3/31/2022	\$551.73	-\$506.20	\$96.99	3/31/2023	\$712.76	-\$675.48	\$112.23	3/31/2024	\$888.48	-\$883.78	\$128.53	3/31/2025	\$1,065.37	-\$1,150.54	\$145.72	3/31/2026	\$1,250.04	-\$1,488.85	\$162.96	Continuing Period			
Period	Revenue growth																																																																																		
Base Year	42.5%																																																																																		
3/31/2017	32.0%																																																																																		
3/31/2018	26.0%																																																																																		
3/31/2019	22.0%																																																																																		
3/31/2020	16.0%																																																																																		
3/31/2021	14.0%																																																																																		
3/31/2022	14.0%																																																																																		
3/31/2023	13.0%																																																																																		
3/31/2024	13.0%																																																																																		
3/31/2025	12.0%																																																																																		
3/31/2026	5.0%																																																																																		
Continuing Period	2.1%																																																																																		
Period	Invested Capital	Net Claims	Price per share																																																																																
Base Year	\$29.55	-\$33.59	\$29.76																																																																																
3/31/2017	\$54.26	-\$47.85	\$37.03																																																																																
3/31/2018	\$94.09	-\$80.49	\$46.16																																																																																
3/31/2019	\$191.48	-\$137.87	\$56.73																																																																																
3/31/2020	\$339.31	-\$270.49	\$69.89																																																																																
3/31/2021	\$423.61	-\$374.06	\$82.85																																																																																
3/31/2022	\$551.73	-\$506.20	\$96.99																																																																																
3/31/2023	\$712.76	-\$675.48	\$112.23																																																																																
3/31/2024	\$888.48	-\$883.78	\$128.53																																																																																
3/31/2025	\$1,065.37	-\$1,150.54	\$145.72																																																																																
3/31/2026	\$1,250.04	-\$1,488.85	\$162.96																																																																																
Continuing Period																																																																																			
Sensitivity Attribution Analysis 		ROIC/WACC <table border="1"> <thead> <tr> <th>Period</th> <th>ROIC/WACC</th> </tr> </thead> <tbody> <tr> <td>Base Year</td> <td>9.2%</td> </tr> <tr> <td>3/31/2017</td> <td>20.5%</td> </tr> <tr> <td>3/31/2018</td> <td>20.9%</td> </tr> <tr> <td>3/31/2019</td> <td>22.4%</td> </tr> <tr> <td>3/31/2020</td> <td>23.1%</td> </tr> <tr> <td>3/31/2021</td> <td>23.6%</td> </tr> <tr> <td>3/31/2022</td> <td>25.6%</td> </tr> <tr> <td>3/31/2023</td> <td>27.7%</td> </tr> <tr> <td>3/31/2024</td> <td>30.0%</td> </tr> <tr> <td>3/31/2025</td> <td>32.4%</td> </tr> <tr> <td>3/31/2026</td> <td>33.8%</td> </tr> <tr> <td>Continuing Period</td> <td>35.0%</td> </tr> </tbody> </table>		Period	ROIC/WACC	Base Year	9.2%	3/31/2017	20.5%	3/31/2018	20.9%	3/31/2019	22.4%	3/31/2020	23.1%	3/31/2021	23.6%	3/31/2022	25.6%	3/31/2023	27.7%	3/31/2024	30.0%	3/31/2025	32.4%	3/31/2026	33.8%	Continuing Period	35.0%	Target Price Distribution - P(price ↑) = 0% 																																																					
Period	ROIC/WACC																																																																																		
Base Year	9.2%																																																																																		
3/31/2017	20.5%																																																																																		
3/31/2018	20.9%																																																																																		
3/31/2019	22.4%																																																																																		
3/31/2020	23.1%																																																																																		
3/31/2021	23.6%																																																																																		
3/31/2022	25.6%																																																																																		
3/31/2023	27.7%																																																																																		
3/31/2024	30.0%																																																																																		
3/31/2025	32.4%																																																																																		
3/31/2026	33.8%																																																																																		
Continuing Period	35.0%																																																																																		