

Slack in the Box

An analysis of Slack's competitive positioning and longer-term growth

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Note: This note was updated from its original version to reflect management's updated FY2020 guidance provided on June 10, which implied a significant slowdown in growth relative to FY2019. Our growth scenario and valuation overview has been updated to reflect this lower outlook.

Key takeaways

- Slack is an early pioneer in the evolution of enterprise chat and is likely to maintain a leadership position for several years.
- While Slack's goal to fully replace email serves as a helpful North Star for the company, we believe email's demise is unlikely given its deep enterprise entrenchment and ability to evolve.
- Private trading in the stock suggests the company could list at a price range of \$26-\$32, which would imply a market cap of \$14 billion-\$17 billion and an EV/revenue multiple in the range of 22x-27x. This compares to other recent SaaS IPOs at 38x for Zoom and 22x for PagerDuty.

Investment overview

Note: Slack is expected to list shares directly on NYSE on June 20.

We view Slack as a leader in collaboration software and an early pioneer in reinventing the enterprise communications space. The company has experienced tremendous growth in recent years with deepening penetration among existing users. Slack's self-service model and freemium offering has proven a very effective and low-cost go-to-market strategy that is helping the company trend toward profitability while also winning new business, particularly in the SMB space, where we believe it has a clear edge over incumbents. While there are many other communications and collaboration services startups in this space, we believe Microsoft is shaping up to be Slack's main competitor, as the company doubles down on investments to

Published on June 10, 2019

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improve the experience of its Teams platform. While Microsoft has a large opportunity to convert its existing customer base, we believe Slack's viral growth and wide range of integrations with other services should allow it to maintain market share and sustain its current growth trajectory.

Slack's goal to replace email and become a new communications technology layer within the enterprise strikes us as solidly ambitious. In general, we agree email has in many ways become outdated, inflexible and incapable of providing employees with adequate visibility across their organization. Yet we continue to view email as valuable, firmly entrenched and capable of evolving to meet shifting demands. While we see email's demise as unlikely in the near future, we still believe Slack management's audacious vision provides clear organizational focus.

While management's outlook for revenue growth in the range of 47%-50% in F2020 is a relatively strong slowdown from the 82% growth posted in F2019, this is still a healthy rate of expansion and the outlook could be conservative. Additionally, we believe the company's steadily narrowing operating loss will likely be viewed as a positive offset to slowing top-line growth. Longer term, we believe Slack's market opportunity as a stand-alone subscription communication app could be somewhat limited, and we expect management is likely to seek additional monetization opportunities that could expand its addressable market. These could include video or more specific team-based software.

According to the S-1, Slack's stock traded in private markets in May within a range of \$25.75-\$31.50, suggesting an EV within the \$14 billion-\$16 billion range (well above the last private market valuation of \$7.1 billion in August last year). At this price level, and assuming revenues grow by 48.5% in F2020 (in line with management's outlook), this implies a forward EV/revenue multiple of 22x-27x. This would place the company's valuation above most public competitors. Relative to recent SaaS IPOs, this range includes PagerDuty, which trades at 22x, but is below Zoom, which trades at 38x (we note Zoom is already profitable). Still, [Slack's direct listing approach](#) remains a wild card that may have unforeseen near-term impact on how the stock trades on its IPO.

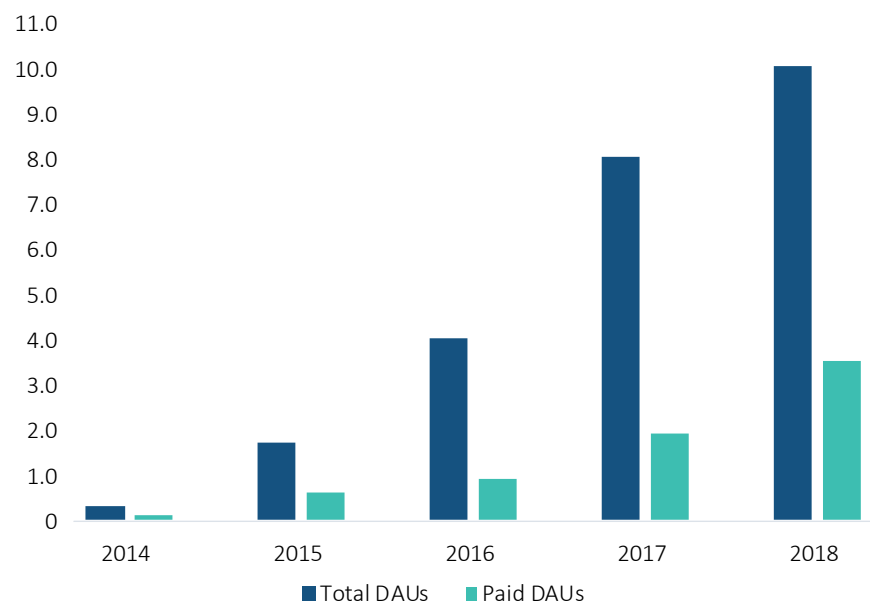
Company overview

Slack is a provider of collaboration and communication enterprise SaaS. The company was founded in 2009 and launched its first chat application services in 2014. Slack provides a range of

collaborative technologies including chat, file sharing and storage, content management, chat, blogs and social communities. It also serves as an integration layer across the many collaboration tools used throughout the enterprise, allowing various users to communicate across other software platforms.

The product has experienced tremendous growth and adoption since its launch, and the company currently has 10 million daily average users (DAU) both free and paid across 600,000 global organizations. While the company does not disclose paid users, we estimate Slack had about 3.5 million paid DAUs as of the end of its F2019 (January 2019) based on previous news reports.

Slack's daily average users (millions)



Source: Slack, TechCrunch & PitchBook Estimates

Strategic focus

Slack seeks to occupy the center of work, creating a single communications platform that allows employees to easily and seamlessly connect and share information across the entire suite of enterprise applications. Slack management views email as outdated and inflexible, providing employees with fragmented and incomplete views of enterprise activity. Management believes the use of email to communicate will eventually give way to collaboration platforms that provide better integration across workflows, allowing information to be more easily shared and providing workers with deeper context around their activities.

We believe that as organizations continue to adopt more cloud services, the ability to integrate them together is likely to grow in importance. Slack has 1,500 integrations with external software systems that span the enterprise including sales, support, IT, finance, marketing and HR. We believe these integrations are critical for Slack, as it views itself as a horizontal technology layer with the capability to connect these systems and provide employees with a better way to work and communicate across them.

Industry drivers

We see several broad fundamental themes helping drive Slack's growth:

Changing nature of workforce: We believe the gig economy is changing the nature of work and driving demand for more independent contractors, outsourced workers, freelancers and other flexible working environments. This is driving demand for better workplace collaboration tools that are easy to use, understood broadly and can integrate across the thousands of applications organizations may utilize.

Growing use of cloud applications and need to integrate work groups: The growing adoption of cloud applications is adding new complexity to the work environment as different teams use different tools to communicate. This provides an opportunity for simple collaboration platforms that can function across enterprise functions such as sales, product, HR, finance, marketing, etc.

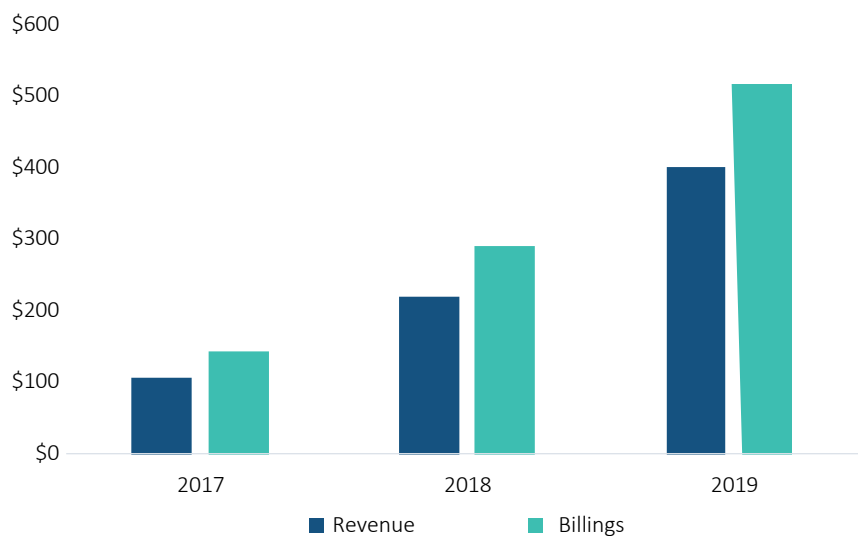
Email's inherent shortcoming for collaboration: As enterprises focus more on productivity through collaboration and employee alignment, we believe email has several inherent shortcomings. Relative to collaborative platforms, email is fragmented and specific to one individual and does not provide full historical context the way group communications can. Email is also not as cleanly integrated to other applications, preventing the ability to work across platforms.

Consumerization of IT: We believe younger workers increasingly prefer to use workplace applications that resemble the kinds of applications they use personally. These applications provide easy-to-use self-service capabilities and function seamlessly across devices. They also offer richer personalization features that make them more enjoyable to use relative to legacy workplace apps.

Financial overview

Slack has experienced very strong business growth in recent years, and trends remain very robust, although growth is slowing modestly. Revenues were up 82% in FY2019, down from 110% in FY2018. Similarly, billings growth of 179% in FY2019 was down from 202% in FY2018. We believe billings are a decent indicator of future growth trends, and a fall in billings would be worrisome. However, billings are also likely to be lumpy given timing of renewals dates and new customer closings.

Slack's revenue and billings (\$M)

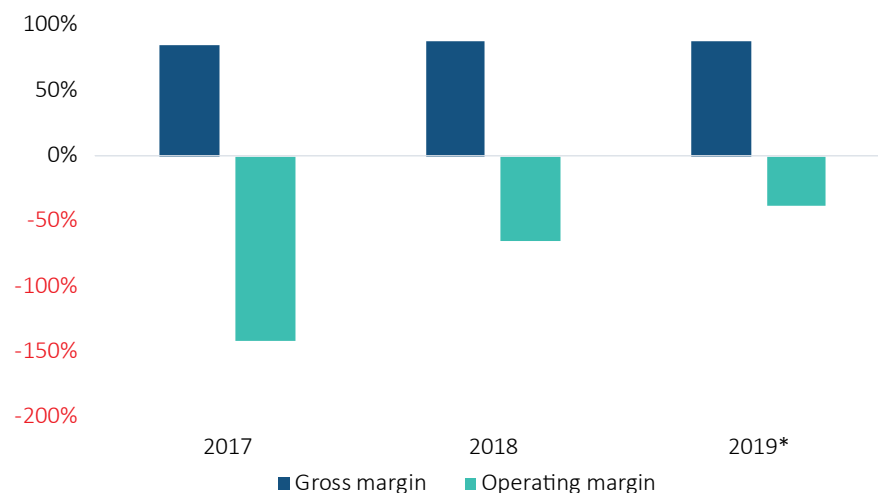


Source: Slack
*As of May 31, 2019

While Slack continues to operate at a loss, the company is on a trend toward profitability, with negative operating margin of 38% in FY2019 improving from negative 141% in FY2017. As shown, most of the leverage has been driven by scaling operating expenses.

While F1Q20 results showed a slowdown in revenue growth to 66%, management's full-year F2020 outlook for revenue growth of 47%-50% implies further slowing.

Slack's gross and operating margins



Source: Slack
*As of May 31, 2019

Valuation

According to Slack's most recent public filing, shares were trading in the private markets in a range of \$25.75-\$31.50. This range implies an enterprise value in the range of \$13 billion-\$16 billion (well above the last private market valuation of \$7.1 billion in August of 2018). We note that in some private market exchanges, Slack stock has reportedly sold in the ~\$32 range recently.

Management's F2020 (calendar year 2019) revenue growth guidance of 47%-50% implies about \$600 million in revenue at the midpoint. Using the EV range of \$13 billion-\$16 billion equates to a forward EV/revenue multiple in the range of 22x-27x. Compared to recent SaaS IPOs this year, PagerDuty trades at 22x 2019's revenue and Zoom trades at 38x. Given the rate of Slack's growth, we would expect the company may trade slightly higher than PagerDuty but is unlikely to trade in line with Zoom (which we note is profitable, whereas Slack is not).

Slack's competitor valuation comparables

Slack valuation comparables	EV/revenue (2019)*	Revenue growth (2019)*
Slack (implied)	22x-27x	49%
Zoom	38x	63%
PagerDuty	23x	38%
Okta	20x	37%
High-growth SaaS median	14x	38%

Source: PitchBook, Morningstar & Slack

*As of June 5, 2019

Note: Slack's growth estimate is based on F1Q20 results.
The high-growth SaaS median includes 23 SaaS companies.

Go-to-market and pricing

Slack's go-to-market tactics are centered primarily on a self-service approach whereby users can download the app and use it for free. Users can move up to premium paid versions of the app which are intended to be more enterprise grade and have more features and functionality (for example, unlimited message history and more third-party integrations). The company's direct sales efforts are directed at large organizations with higher revenue opportunity. As of April 2019, Slack had 645 "Paid Customers" (customers generating over \$100,000 in annual recurring revenue), representing 43% of total revenue in F1Q20.

Slack's competitor pricing chart

Company			
Slack	Free \$0	Standard \$8/month \$80/year	Plus \$15/month \$150/year
Microsoft Teams	Free \$0	Business \$150/year	E3 \$240/year
Facebook Workplace	Standard \$0	Premium \$3/month	5K+ Users Tiered
Google G Suite	Basic \$6/mnth	Business \$12/month	Enterprise \$25/month
Chanty	Free \$0	Business \$3/month	
Mattermost	EE10 \$3.25/month	EE20 \$8.50/month	

Source: PitchBook & company data

A potential risk to Slack is how well it can maintain its differentiation in the market. As competitors work to develop similar functionality at potentially lower prices this may impede Slack's ability to convert free users to paid users or increase pricing. We believe Slack's strategy to invest in its ecosystem via the Slack Fund as a potentially positive point of differentiation as it seeks to occupy a platform position within the enterprise.

Competition and market share

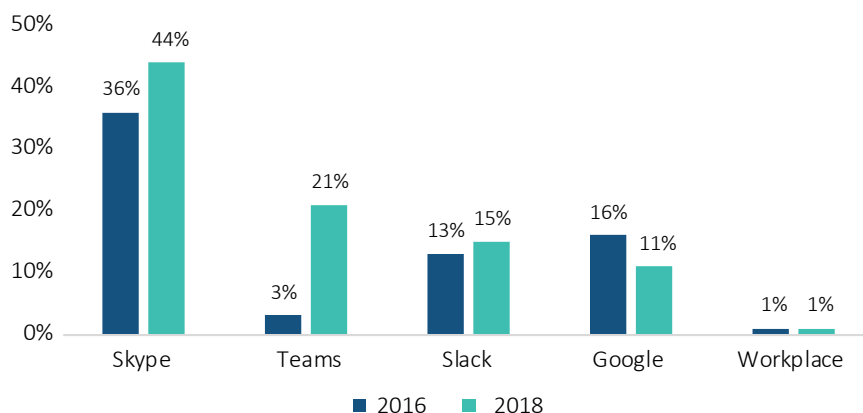
Slack lists three competitor groups in its S-1 including productivity tool and email providers (such as Google), unified communications providers (such as Cisco) and consumer application companies (such as Facebook). Given the general trend toward convergence of communication and collaboration tools at the enterprise level, we believe Slack faces a broad set of large competitors including Atlassian, Salesforce, Microsoft, Google, Facebook and Oracle.

While Slack has established partnerships with many of these organizations as part of its efforts to integrate various solutions into its platform, we believe the competitive dynamic of these relationships remains an important risk factor for the business. For example, Slack partners with Microsoft to integrate with Skype but has a very competitive relationship with Teams. However, Slack has shown an ability to win chat business against smaller competitors that have chat as an add-on to their core solutions. For example, Atlassian ceded the messaging space to Slack when it agreed to sell HipChat as part of their partnership in mid-2018. Slack has also demonstrated the potential to displace native chat functions within other platforms, as it anecdotally has become more popular than Salesforce's Chatter among sales teams.

We believe Slack's biggest competitor is Microsoft, which has made significant progress with Teams in recent years. Microsoft recently announced that 500,000 organizations are using teams with usership over 1.5 million. We believe Microsoft's key advantage is its ability to provide deep integrations across the Office 365 suite and to penetrate its existing customer base. Slack faces mounting competition from other big tech companies as well, including Facebook, which recently announced it had 2 million paid users on Workplace, and Google G-Suite and Hangouts. Private competitors in the space include Chanty, Mattermost and Samepage.

A recent survey by Spiceworks found that while Slack usage is increasing, use of Teams increased significantly in 2018 versus 2016, which we believe reflects the significant investment the company has made in the platform. While Skype dominated in this survey, we view Skype as an integration partner with Slack as opposed to a direct competitor.

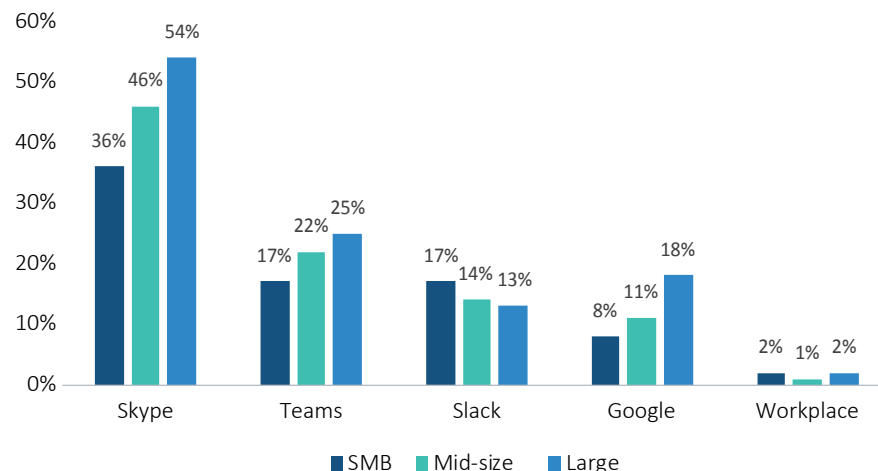
Use of chat apps at work



Source: Spiceworks

Relative to Teams, Slack has a stronger footing among smaller businesses. We believe this reflects the company's viral growth trajectory among startups and independent users, whereas the expansion of Teams has been primarily a function of Microsoft's ability to convert current large enterprise customers into users.

Use of chat apps at work by company size



Source: Spiceworks

Market opportunity

While management sizes the market for workplace communications and collaborations platforms at \$28.0 billion currently, we believe Slack's mid-term addressable market is likely much smaller than this. We believe this \$28.0 billion market size encompasses the broader "Unified Communications as a Service" (UCaaS) space identified by Gartner, which includes telephony, audio, web and video messaging services as well as email and voicemail. This is a much larger universe than Slack directly addresses today and includes companies such as Verizon, RingCentral, BT and Fuze. Ultimately, we believe that web-based chat and communications apps such as Slack remain distant threats to completely replacing the entire unified communications space.

Another way to think about the potential market opportunity is to consider Slack's penetration of the workforce. In the US, there are an estimated 81 million professional jobs, which is about 63% of the total workforce. Assuming a similar mix of professional jobs in the EU implies a total US/EU professional workforce of about 225 million people. Assuming Slack's average revenue per paid DAU is \$115, this implies a total market of \$26 billion (\$115 x 225 million). However, this assumes Slack can convert every working professional in the EU and US into a paid user, which we view as unlikely. We plot out a growth

scenario based on management's current growth outlook in which Slack expands its paid user base at a CAGR of roughly 27% for the next 10 years and arrive at a total revenue opportunity of around \$4.5 billion by 2028 (roughly 7.5x expected 2019 revenue).

Slack's daily average user growth and revenue scenario

\$M	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028	10-year CAGR
Paid DAUs	3.5	5.2	7.3	10.2	13.8	18.0	22.5	25.9	29.0	31.9	35.0	26%
<i>Annualized growth</i>	83%	48%	42%	40%	35%	30%	25%	15%	12%	10%	10%	--
Revenue (\$)	401	599	859	1,214	1,656	2,174	2,744	3,188	3,606	4,006	4,451	28%
<i>Annualized growth</i>	82%	49%	43%	41%	36%	31%	26%	16%	13%	11%	11%	--
Revenue per DAU (\$)	115	116	117	118	120	121	122	123	125	126	127	--
<i>Inflation</i>	1%	1%	1%	1%	1%	1%	1%	1%	1%	1%	1%	--
DAU growth	83%	48%	42%	40%	35%	30%	25%	15%	12%	10%	10%	--

Source: Slack & PitchBook

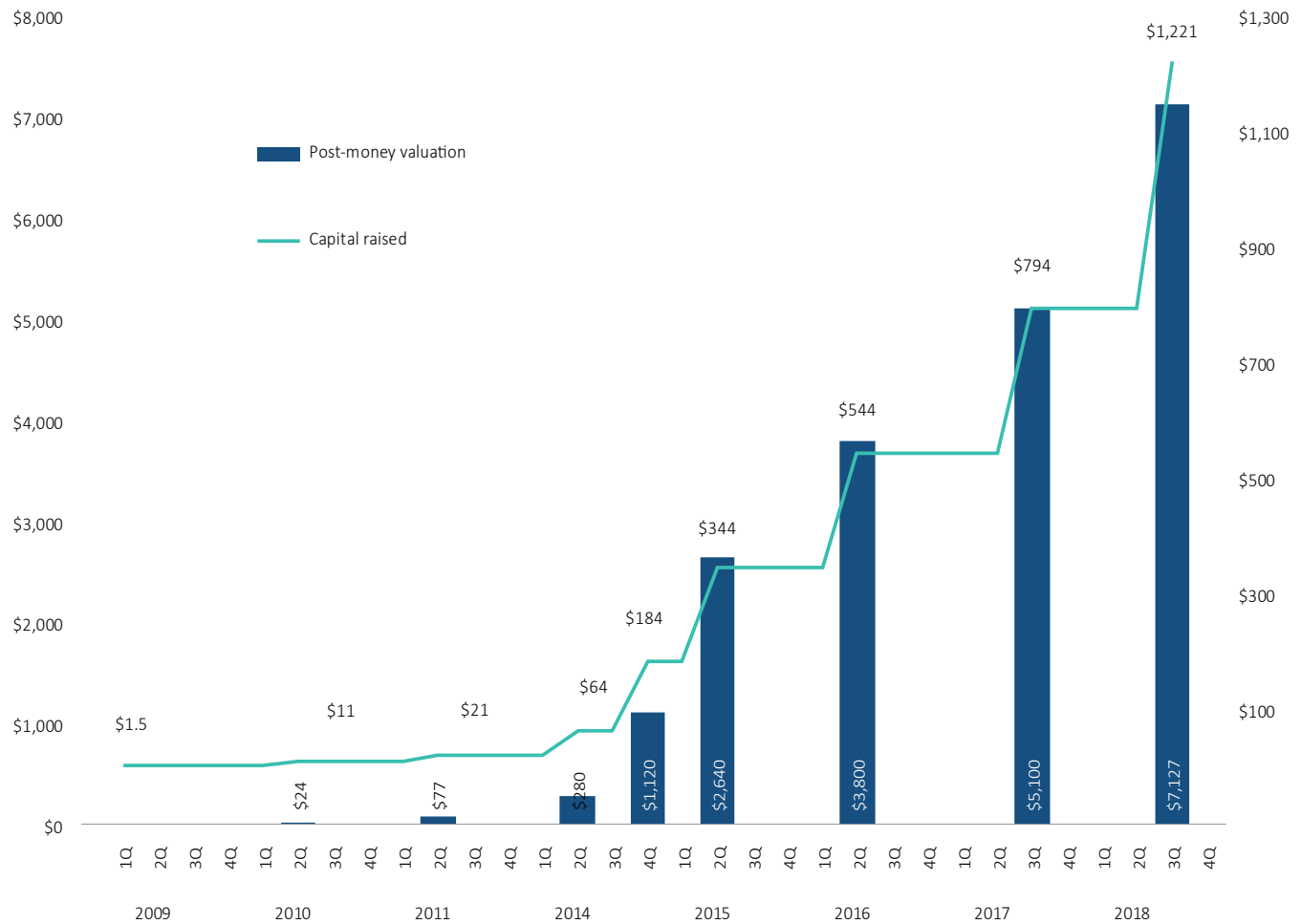
This limited long-term outlook (relative to \$25 billion) suggests Slack may seek alternative user-monetization opportunities as it expands. These strategies could include providing add-on collaboration features that may appeal to certain enterprise teams or moving into adjacent areas within the unified communications space, with video likely near the top of the list.

Slack funding history

Slack has raised \$1.2 billion from 13 deals in the private markets. The most recent deal was in August 2018, when the company raised \$427.0 million, leaving the company valued at \$7.1 billion. We note that in March of 2016, the company was reportedly in talks to be acquired by Microsoft for \$8.0 billion.

The company has had at least 53 different investors, largely consisting of VC and angel investors. This also included two large asset managers, T. Rowe Price and Wellington Management, which both participated in the most recent late-stage round in August of 2018. Top investors by deal participation included Accel and Andreessen Horowitz.

Slack's post-money valuation and capital raised (\$M)



Source: PitchBook

Top 10 investors in Slack

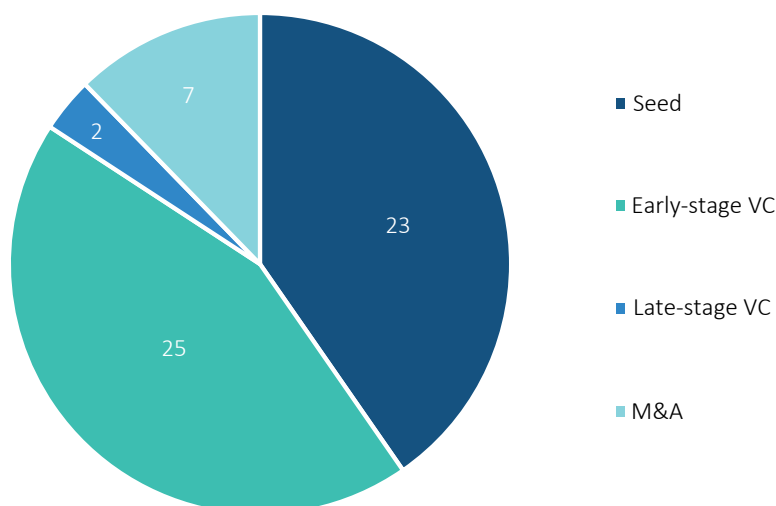
Investor	Deals
Accel	9
Andreessen Horowitz	6
Social Capital	5
Kleiner Perkins	3
IVP	3
Spark Capital	2
Index Ventures (UK)	2
SoftBank Group	2
GP Bullhound	2
GV	2

Source: PitchBook, Morningstar & Slack

Note: This includes a secondary deal in which Social Capital was involved.

Slack is also a very active investor and acquirer, having been involved in 57 deals. These primarily consist of the seed and venture-stage deals completed through the Slack Fund, established in 2015 in partnership with Accel, Index Ventures, KPCB, Social Capital, Andreessen Horowitz and Spark Capital. Management views the Slack Fund as an important component of the company's growth strategy as it primarily invests in companies building applications for the Slack platform, thereby helping support the ecosystem. As of January 2019, Slack Fund had invested \$10.1 million in 46 companies, with \$5.2 million funded by Slack and the balance funded by its partners.

Slack deals by stage*



Source: PitchBook
*As of June 5, 2019

Slack Fund investments primarily include companies developing applications that integrate with Slack, such as instant survey and polling features, recruiting applications, finance and team management functions and a multitude of AI bots. The largest deal in which Slack participated was the recent \$100.0 million financing of HashiCorp, an IT infrastructure automation software company last valued at \$1.9 billion.

Top 10 Slack investments

Top 10 deals	Round (\$M)*	Last valuation (\$M)*	Business
HashiCorp	\$100	\$1,900	IT infrastructure automation solution
Guru	\$25	\$174	AI workflow assistant
Demisto	\$20	\$560	Security software (acquired by Palo Alto Networks)
Pitch	\$19	--	Content presentation/collaboration
Nylas	\$16	\$66	Email integration platform
Astound	\$15	\$61	Customer service AI
Pinpoint	\$13	\$64	Financial performance software
Clara Labs	\$12	--	Schedule automation
Astound	\$12	\$61	Customer service AI
Loom	\$11	\$44	Video collaboration tool

Source: PitchBook
*As of June 5, 2019

Slack's seven M&A deals (no purchase price data available) are listed in the accompanying table. We note HipChat and Stride were acquired from Atlassian and intended to be shut down after their users migrated to Slack.

Slack's M&A deals

Target	Date	Business
Astro	September 2018	Email/communications software
HipChat	July 2018	Workplace chat
Missions	July 2018	Process integration/AI
Screenhero	January 2015	Collaboration software
Spaces	September 2014	Collaboration software
Stride	July 2018	Collaboration software

Source: PitchBook