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Taleo Shows Some Talent

Taleo (Nasdaq: TLEO) is one of a new breed of enterprise software providers. That is to say, it delivers its solutions on-demand. In other words, Taleo hosts software on its own servers and customers log in via the Internet. It relieves customers of time-consuming and expensive administrative details. Furthermore, they only pay for what they use.

Customers log into the system through an Internet connection. Taleo hosts the complex software so customers don't have to deal with the administrative headaches. What's more, Taleo can easily update the software from its central servers. And by charging a subscription fee (per user), it's more affordable for customers.

Looking at the nuts and bolts, the software employs an ASP approach. This approach entails a fixed investment up front on behalf of Taleo or any other provider to build the necessary infrastructure to host the software, but it requires relatively low marginal investment per additional customer. Basically, by spreading the fees out by using subscriptions, it does hurt cash flows in the short run. However, it does help for the long term as the company builds predictable recurring cash flows. As the revenue stream reaches critical mass, I expect margins to reach the point of scalability.

It's a method that's getting a lot of traction in the marketplace. For instance, **Salesforce.com (NYSE: CRM)** and even Bill Gates of **Microsoft (Nasdaq: MSFT)** fame are pushing on-demand solutions.

In the third quarter, Taleo posted a 30% increase in revenues to \$19.9 million, but the company is still losing money. In the third quarter, it posted a loss of \$1.6 million, which was down from a net income of \$260,000 in the same period last year. Looking a bit more deeply, it seems the loss was the result of amortization of acquired intangibles and costs on early retirement of debt. Net income for the spoken of periods would have come in at \$170 million and \$474 million without the aforementioned charges.

It's also worth noting that the company encountered significantly higher translation losses (due to currency exchanges) as compared to last year, adversely impacting profits.

While the company is not profitable, this is not necessarily a red flag. The company is in the growth phase and, in fact, only recently had its IPO so as to invest more in

its growth. To the extent that it's able to continue to make revenues grow, there might well be a go.

Basically, Taleo helps companies of all sizes with talent management, such as with recruiting, assessing new hires, and managing workforces. The software helps on a variety of fronts: cost reduction, quality and productivity improvement, and so on.

So far, Taleo is building a strong customer base. Examples include **Aramark**, **Motley Fool Stock Advisor pick Dell (Nasdaq: DELL)**, **Hewlett-Packard (NYSE: HPO)**, and **Starbucks (Nasdaq: SBUX)**. The Taleo system has roughly 500,000 registered users in about 100 countries.

As we have seen with stand-out companies like **Google (Nasdaq: GOOG)**, it's critical to have a talented workforce. And the case itself seems compelling enough. Taleo customers posted a 49% better performance than the S&P 500 in 2004. Whether this is related to critical differences in organizational philosophy, structural factors, the actual impact of Taleo, or any other red herring makes for interesting debate. But the mandate is nonetheless clear -- smart investment in human capital is critical to out performance in today's increasingly service-oriented economy.

In other words, the growth potential for Taleo is significant, which makes the company an interesting play. According to the CEO: "The impending baby boomer labor shortage, the challenge of managing a global workforce, and the increasing reliance on contract labor has made it more complex and expensive to find, keep, and effectively utilize talent."