

NetApp Should Consider Another Acquisition, Experts Advise

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2009-07-09

Several storage industry analysts tell eWEEK they believe NetApp should take a breather and then pursue an acquisition that makes sense—one that it can afford yet one that will help the data storage company broaden its market opportunities and keep growing.

In the wake of what certainly had to be a crushing blow to NetApp's strategic plans—not to mention its corporate ego—when EMC outbid it for Data Domain, the question remaining is this: What happens next for NetApp, the network-attached-storage pioneer that used to be known as simply a "good little file server maker"?

"Regroup, don't rush into [the] next acquisition too quickly so that it looks reactionary, take a bit of time—however, not too long—[then] get back up and try riding (or castrating) that bull again," Greg Schulz, founder and senior analyst at StorageIO, suggested to eWEEK.

That sentence summed up the perspectives of a number of other storage experts contacted by eWEEK. (By the way, Schulz was referring to NetApp co-founder Dave Hitz' recently published book, "How to Castrate a Bull: Unexpected Lessons on Risk, Growth and Success in Business.")

In this decade, NetApp has become successful in providing storage for large IT-based corporations, such as Oracle and Yahoo, and for a wide range of enterprises of different sizes in a number of vertical markets. It has climbed up to become the world's second-largest independent storage company, at about \$3 billion yearly in revenue—second only to EMC itself.

Over time, NetApp has continued to improve its position in the world storage software market to rank behind only EMC, Symantec and IBM. Top external disk storage supplier EMC and fifth-place NetApp have been posting double-digit revenue growth for the last few years, up until 2009 and the world recession. Even with that huge challenge, their single-digit profit numbers still are excellent.

EMC went to extra trouble to establish its own separate subsidiary, Envoy Merger, for the specific purpose of landing the acquisition of relatively small (\$300 million yearly sales) Data Domain: It obviously wanted the midmarket sales potential that Data Domain represents—at all costs.

Why? Two key reasons: One, Data Domain has excellent software and loyal clients in the midmarket, which is precisely where EMC wants to keep expanding; and, two, a combined NetApp/Data Domain would have had the potential to dominate the small and midsize business markets in a few years.

Along with consumers, SMBs will be creating the lion's share of the world's data over the next 10 years. Someone's got to store all that content somewhere. EMC, with Data Domain, is now much better prepared to sell into those sectors. The company is expected to maintain Data Domain as an independent, recognizable brand, and to retain as many current field staff people as it can employ.

The picture for EMC appears clearly defined. But what happens now with NetApp?

There are other companies out there, such as ExaGrid, Quantum, Xiotech, 3PAR, Copan Systems, Compellent, CommVault, and Sepaton, which would also make good midmarket acquisitions for a company like NetApp or a major data systems maker. Most analysts contacted by eWEEK said they believe this market consolidation isn't over, not by a long shot.

Robin Harris, principal analyst at StorageMojo, wrote in his blog that NetApp should now turn its attention to acquiring Quantum, which ironically is closely aligned with EMC and Data Domain through deduplication-licensing deals.

"Should NetApp buy Quantum? With EMC officially overpaying for DD [\$2.1 billion in cash, triple the value of the company four months ago], this could be very smart for NetApp," Harris wrote July 6. "With a current market cap of [about] \$200 million—and a 52-week high market cap of [about] \$400 million, they would be an excellent consolation prize should EMC win Data Domain."

Harris listed the advantages to NetApp of acquiring Quantum:

—**Dedup appliance product line**—ripe for the cost improvement that NetApp's buying power would give them.

—**Dedup patent portfolio**—to help keep EMC honest.

—**Good market positioning**: "Buy the technology that EMC has licensed from us!"

—**Way lower cost**. Anti-trust concerns would keep EMC from bidding on Quantum, so unless another spoiler comes along—IBM, HP [Hewlett-Packard], Dell, HDS [Hitachi Data Systems]—a deal could be much closer to QTM's 52 week high.

—**A happy Silicon Valley home for ex-Data Domain staffers**. No non-competes in California and most of the technology is already cross-licensed, which is about as clean as these things get.

Quantum also has good arrays designed for high-end, high-capacity storage requirements, the kind that most of the Fortune 100 companies use every day. With all that Quantum firepower in its arsenal, NetApp would be much better fortified to approach larger-enterprise IT managers and CTOs—the exact market direction Chairman and CEO Dan Warmenhoven and NetApp need to go.

Could NetApp itself become a takeover target? It's possible, but not likely any time soon, analysts said. The consensus seemed to be that NetApp would be expensive and can probably only be acquired by a major systems maker. It might fit in well with Cisco Systems or HP—two companies that want to "own" the data center someday and that might be looking to fill out their storage product lines.

"It would have to be a major strategic move for somebody, and the product line would have to fit very tightly with a company's existing catalog," one analyst said.

Unni Narayanan, CEO of Primary Global Research, told eWEEK he believes NetApp needs to upgrade its product line in a few areas if it wants to better penetrate the Fortune 100 market.

"Although they have fantastic, easy-to-use product families, they lack three things. No. 1 is high-availability attributes," Narayanan said. "What the user trades off in ease of use, they lose in terms of availability. When a NetApp filer crashes, for example, it can take a day to rebuild it and bring it back up. A big major carrier is not going to risk the downtime."

Narayanan also said NetApp needs "more feet on the ground [in sales, marketing and channels]. The emerging markets are outside of the U.S., particularly in Europe and Asia. Even though NetApp's products would be perfect in those markets, NetApp doesn't have the resources to compete effectively."

Finally, Narayanan said, in view of the "huge consolidation wave now going on in the IT storage sector, NetApp runs the risk of missing the boat on those opportunities. There are a lot of companies with point solutions that could benefit NetApp."

Brian Babineau of Enterprise Strategy Group agreed that Quantum would be a good pickup for NetApp.

"Quantum has a few assets that can get NetApp going again—a huge tape installed base that could be migrated to disk, their own data deduplication software and system, and a very robust file system that could be used in some parts of the market where NetApp does not play today," Babineau said. "The tape business is definitely not growing, but migration is a good opportunity. If data grows, people need more disk (or tape) to back it up."

Babineau said, however, he doesn't think NetApp will make a move just for the sake of making a response to EMC's snagging of Data Domain.

"They will figure out areas in the market where they can attack—data protection is the most obvious—and see what companies can accelerate that attack," Babineau said. "NetApp still has a fairly healthy business, but it doesn't have the growth rates it once had. So I believe the company will look at businesses—not technologies—which can jump-start the growth."

Charles King, principal analyst with Pund-IT, had an interesting take on the EMC-Data Domain deal and what it revealed about NetApp.

"Coming from a psychological perspective, what was interesting about this deal was that we basically saw in the bidding process what it took to make NetApp blink," King told eWEEK. "I wasn't surprised that EMC won this [bidding contest]; they have better cash resources. But if NetApp moves ahead to do other acquisitions and other investments, we have a sense now—unless things change very radically—of what they can afford. That automatically puts a company at a disadvantage in a competitive bidding situation."

"It's an interesting strategic point, but that's not the type of information that you want out there in the market."

NetApp Chief Marketing Officer Jay Kidd was cool in his assessment of the loss of the Data Domain acquisition in a conversation with eWEEK.

"Of course, we're flattered that EMC would spend \$2.2 billion or \$2.3 billion to keep Data Domain's technology out of the hands of NetApp," Kidd said. "However, Data Domain was strictly additional and incremental to our product line. We have plenty of growth opportunities within our own markets, and we'll continue to pursue them."

"Data Domain was definitely a 'want,' not a 'need.'"