

F5/Acopia Opportunities Trump Wall Street Worries

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Abstract: The worry warrants on Wall Street are at it again. F5 Networks shares have been on a downward run since the company announced its acquisition of file virtualization specialist, Acopia Networks. ESG believes that these reactive objections disregard market realities. According to ESG Research data, the F5/Acopia combination fits well with ongoing enterprise data center consolidation, WAN optimization, Wide Area File System (WAFS) and IT virtualization trends. Given F5's installed base and market leadership, this deal could provide F5 with plenty of "green field" and up-selling opportunities in the not-too-distant future.

Overview

When it comes to the investment business, there are a few absolute certainties to live by. On Wall Street, change is bad, future uncertainty is worse and market volatility is downright awful. When the market gets bogged down in a period of profound doubt, all news is treated as bad news.

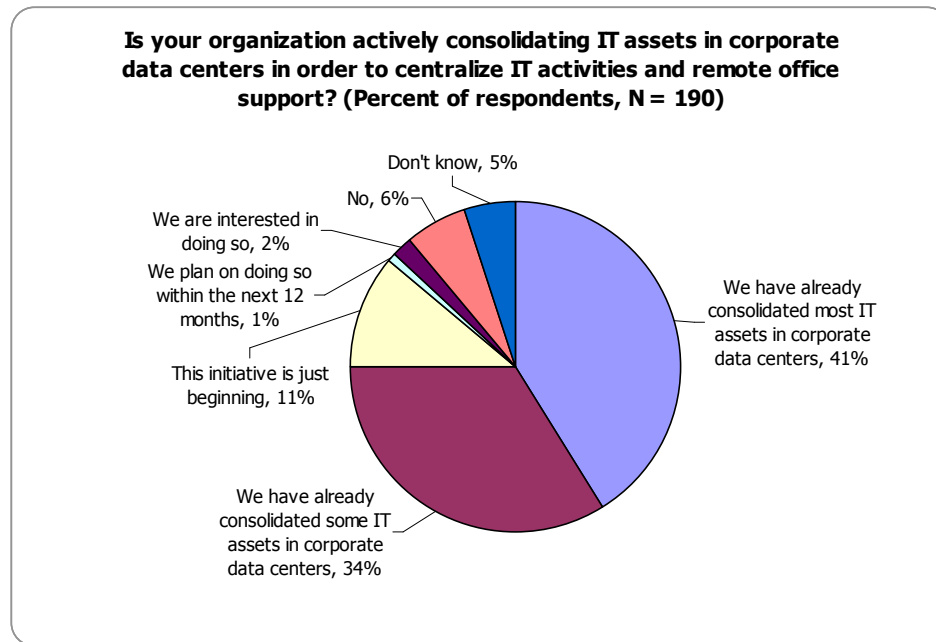
In the wake of the July stock market correction and overall gloominess, F5 Networks recently announced its intention to acquire Acopia Networks. The deal is intended to marry F5's abilities in virtualizing web and application servers with Acopia's similar skills in file virtualization. While the F5/Acopia merger made sense to ESG, Wall Street hasn't been as certain. In a few short days, F5 shares were down more than 25% as investors headed for the exits.

Why is Wall Street so bearish on this deal? Analysts are worried that the Acopia acquisition moves F5 into the storage market and pits it against a new crop of skilled established competitors like EMC, HP and NetApp. Investors are also skeptical about any near-term revenue benefits and remain focused on the "integration risks" associated with any merger. This negativity kicked off an inevitable spiral: Analyst "downgrades" led to a sell-off, triggering institutional investor programs to sell shares which then unloaded large blocks of stock—a classic example of herd mentality in action.

ESG Research Paints a Different Picture

When Symantec merged with Veritas in late 2004, investors couldn't get their arms around the convergence of security and storage and the share price plunged. It took a few years, but Wall Street now recognizes that a combination of regulatory compliance, corporate governance, IT risk management and data privacy make storage and security natural bedfellows. ESG sees a similar pattern of market synergy between application and file virtualization for several reasons:

- **IT consolidation continues unabated.** According to ESG Research, enterprises continue to consolidate IT resources in large corporate data centers in order to provide centralized control of application and file services for remote and branch offices (see Figure One). Why? Users point to numerous gains including improved data protection, reduced operational expenditures and enhanced security. In summary, IT consolidation drives a rare combination—business and IT benefits.
- **Consolidation can—and usually does—impact service delivery.** Many well-intended CIOs run into the same IT consolidation brick wall. Delivering applications and services over a WAN infrastructure can create inevitable performance problems. Since the objective is providing excellent service to any user/device in any location, simply throwing more WAN bandwidth is no more than a band-aid solution in the face of an avalanche of growing WAN utilization, dynamic traffic loads, new types of file-based documents and chatty application/file protocols.

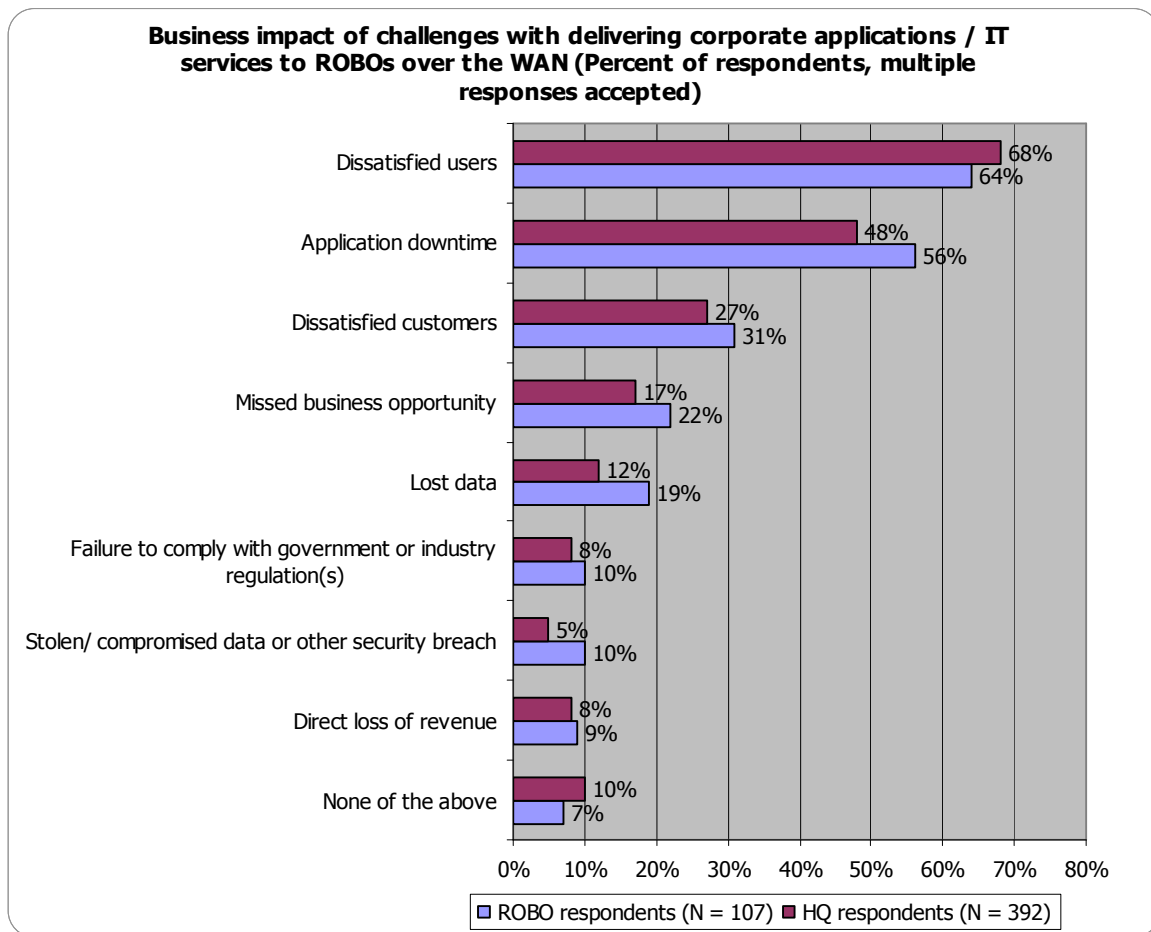
Figure One: Enterprise IT Consolidation

- **Poor WAN service delivery impacts the business.** CEOs expecting capital and operating costs from IT consolidation may be in for a rude awakening when WAN service delivery challenges impact employee morale, business applications, and customer satisfaction (See Figure 2).

WAN and application optimization issues will likely escalate as enterprises IP traffic explodes with the implementation of dynamic distributed technologies such as SOA, data center virtualization and web 2.0 collaboration tools. File access will suffer a similar fate as corporations add multi-gigabyte multimedia and 3-D files to the mix.

Ultimately, there is a logical performance/technology gap between distributed users and centralized services. F5 has focused on bridging this gap for years by providing networking technologies that virtualize web and application servers. Acopia simply extends this virtual functionality to the file domain.

Figure Two: Business Impact Related to WAN Service Issues



Optimization, Acceleration, and File Virtualization to the Rescue

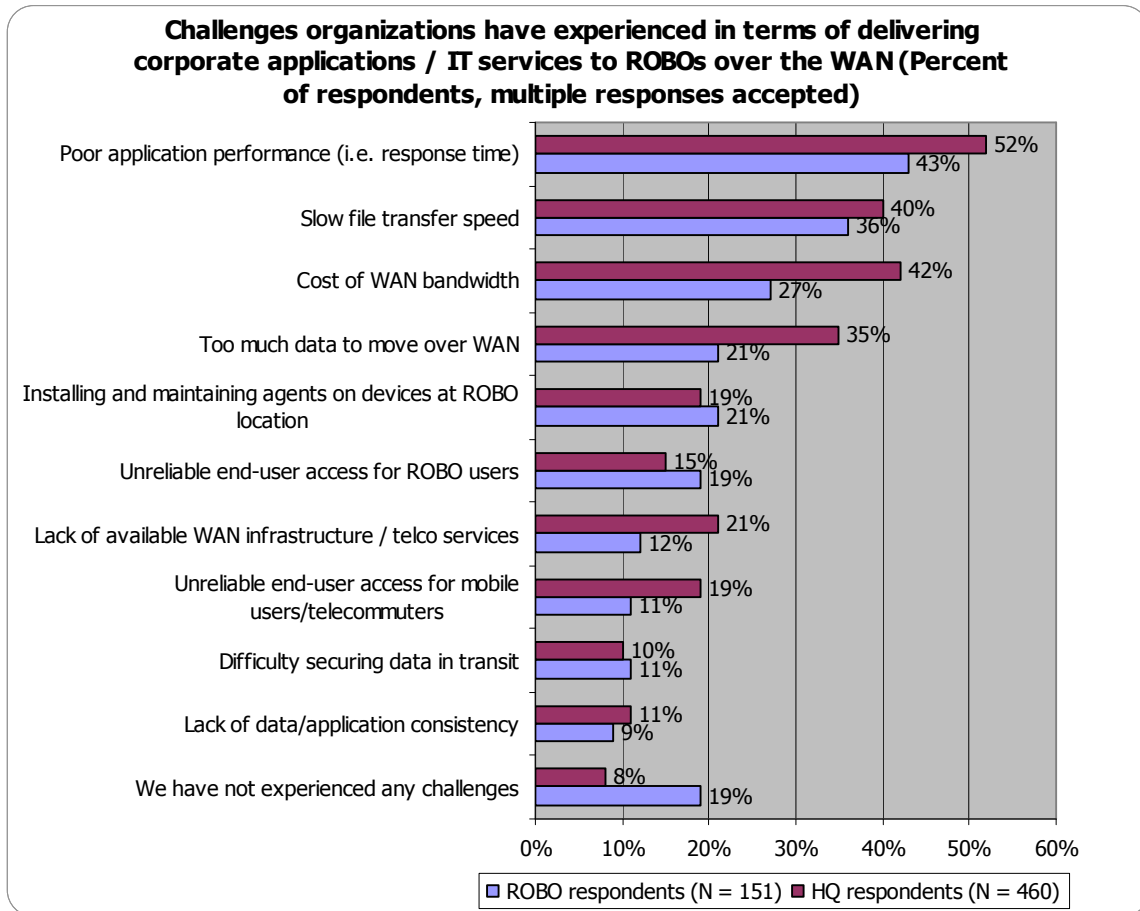
The problems described above are no secret to the technology industry. ESG estimates that the application acceleration and WAN optimization markets will soon top \$1 billion in combined revenue and continue to enjoy double-digit growth into the future. Unlike other segments, WAN optimization, application acceleration and WAFS markets aren't dominated by a few pioneering companies. Many market leaders gained entrance to this lucrative and booming market through an M&A door. Examples of this pattern include:

1. **April 2005:** Juniper Networks purchases Peribit Networks (\$337 million) and Redline Networks (\$132 million).
2. **June 2005:** Citrix acquires NetScaler for \$300 million.
3. **September 2006:** Blue Coat Networks purchases the NetCache business from Network Appliance.

Wall Street could legitimately argue that these deals don't really compare to F5/Acopia. Juniper and Citrix purchased companies to get them into the optimization/acceleration business while Blue Coat simply gobbled up a competitor in order to extend its market leadership. On a comparative basis, investors contend that F5/Acopia is an apples and oranges combination of networking and storage lacking similar synergistic benefits. ESG disagrees. There is actually plenty of evidence to suggest that WAN optimization, application acceleration and IT/file virtualization are extremely complementary. ESG maintains this theory because:

- **Users need help in all of these areas.** When ESG asked enterprise organizations to define problems associated with delivering centralized services for Remote Offices/Branch Offices, poor application performance (i.e. response time) and slow file transfer speeds topped the list (see Figure Three).

Figure Three: Enterprise Faces WAN Optimization and WAFS Challenges



Enterprises want to address these issues with integrated technology solutions that virtualize applications and IT services and come from leading technology vendors—not fly-by-night startups or multiple independent boxes.

- **Existing market success.** Riverbed, one of the leading WAN optimization vendors, has enjoyed wild customer and stock market success by preaching the marriage of WAN optimization and Wide Area File System integration. This story isn't exactly unique. Cisco's 2004 acquisition of Actona and Packeteer's 2006 purchase of Tacit followed a similar rationale.

In aggregate, these proof points demonstrate that the consolidation between WAN optimization, IT virtualization and WAFS is well underway. F5 is following a similar visionary strategy and making the bet that it can out-execute these others.

The F5 To-Do List

ESG's optimism may not convince Wall Street investors on the merits of this deal, but F5/Acopia's execution will. To ring out the value of this deal, F5/Acopia must:

- **Take the message to the streets.** To compete with Riverbed and others, F5 must become an evangelist for integrated WAN optimization, IT virtualization and now WAFS services. F5 should embrace a strong thought leadership program, cross-train direct sales reps and channel partners and schedule visits with all of its top customers. The goal? Make sure that F5 is included in all RFPs and

product evaluation.

- **Include file virtualization in its application architectures.** F5 has done a great job in designing prescriptive “application-ready” virtual architectures for applications like Exchange and Outlook Web Access (OWA). To add to its sales pipeline, the company should build similar file virtualization architectures for basic file serving, content distribution and collaboration applications like SharePoint.
- **Present an integration roadmap.** In the best of circumstances, Acopia functionality will be available in staple F5 products such as Big IP and WANJet. F5 needs to take a plan to customers that articulates the short-term value of its application/web virtualization and WAFS services and its longer term product integration schedule.

The Bottom Line

Wall Street cynicism aside, ESG Research indicates a number of areas demonstrating numerous complementary market and product opportunities. There is execution risk, but this is no different than any other merger in any other market. Yes, this is the biggest acquisition by F5 thus far, but the company has done okay with its previous purchases like URoam and Swan Labs. Obviously, someone in F5’s Seattle headquarters knows what he or she is doing.

ESG believes that large organizations are moving forward with a new generation of distributed applications and a virtual IT infrastructure. In spite of the fact that Wall Street remains dubious about this deal, enterprise CIOs will welcome all the WAN optimization, IT virtualization and WAFS help that they can get!