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WHAT IS NETAPP GOING TO DO WITH ANOTHER $1.1 BILLION?

NetApp (NTAP : NASDAQ : $24.32 | Not rated) announced this morning that it has priced $1.1 billion of convertible notes. This brings the company's total cash on hand to approximately $2.2 billion. It is our opinion that NetApp is bulking up its balance sheet in preparation for an acquisition. Our list of targets that we feel would add technological diversity, enterprise exposure, and accelerating top line growth to NetApp includes: 3PAR (PAR : NYSE : $10.95 | BUY), Data Domain (DDUP : NASDAQ : $24.48 | BUY), Compellent (CML : NYSE : $13.23 | Not rated), Netezza (NZ : NYSE : $12.87 | BUY), GlassHouse (private) and DataDirect (private).

Rationale for acquisitions

NetApp's revenue growth has slowed significantly over the past year, from the high 20s to the high teens, as aggressive start-ups have encroached on the low end of the company's storage business. SATA-based and ISCSI-connected systems from EqualLogic (purchased by Dell), Lefthand Networks, and Compellent have pushed NetApp to move up-stream in the enterprise to find additional market share. NetApp has a highly sophisticated file system architecture, but the value of that architecture is somewhat lost when deployed in small and medium-sized enterprises (SMEs). At the higher end of the storage market, enterprises have been reluctant to deploy NAS-based solutions to I/O-intensive, mission-critical applications. Historically, it has been difficult to manage the many NAS devices required to provide vast amounts of storage, although recently NetApp has addressed this issue with its integration of its Spinnaker acquisition. In our opinion NetApp needs to acquire growth and has ample financial resources to do so.

Some of the attributes we believe NetApp will look for in a target company include: appliance based, enterprise focused, storage centric, with a service element. We would peg the purchase price range as $700 million to $1.4 billion.

Action

Of our list of acquisition candidates, we would focus on Data Domain, which offers NetApp considerable advantages and is still significantly under-priced relative to our price target. **We would continue to recommend purchase of DDUP shares on fundamentals, with an outside possibility of attracting acquisition interest as an upside valuation bonus.**

ADDITIONAL DETAILS

Our list of buy-out possibilities (in order of strategic fit)

- DataDomain. DDUP offers a replication and deduplication appliance for mid-tier enterprises. DDUP's appliance architecture would fit well with that of NTAP, and NTAP's channel partnerships could be leveraged. DDUP has a market capitalization of $1.4 billion and therefore is at the high end of our purchase range assumption. However, the company is currently experiencing hyper-growth of revenues, up 166% for 2007, and projected to grow another 86% in 2008. Although both companies sell competing de-duplication products, we believe NTAP could successfully transition to DataDomain's solutions.

- 3Par. 3Par is not an appliance-based solution – it's more of a refrigerator than a toaster. However, 3Par has a clustered storage architecture that is particularly well suited for enterprise applications. With NTAP competing against EMC's mid-range Clariion products, PAR would position NTAP to target EMC's high-end Symmetrix products. An obstacle to such a merger is the "one-architecture" NTAP has always highlighted when competing with EMC. EMC has multiple architectures for its systems, as those products have been acquired through acquisitions (most notably the Clariion products purchased with the Data General purchase). Multiple architectures make tight integration between various products difficult. 3Par would also allow NTAP to enter into the managed hosting market, which we believe will show significant growth over the next several years. PAR's ability to share storage among multiple users is a key enabler of storage hosting services. PAR is growing revenue approximately 40% per year, with a market cap of $650M.

- Netezza. Netezza, growing revenue about twice the rate of NTAP, sells a storage appliance, with the "secret sauce" its software operating system. NZ targets its systems to the database sector, but the business model is very similar to Network Appliance. NZ recently announced that it would incorporate EMC storage within its systems. A purchase by NTAP would disrupt that relationship, while at the same time move NTAP into the high-end enterprise customer base. With a $750 million market cap, Netezza would be a very manageable acquisition for NTAP.

- Compellent. An alternative to moving up into the high-end enterprise would be to counter-attack in the mid-range market and purchase Compellent. Compellent delivered 119% top-line growth in 2007, over 50% growth projected for 2008. Compellent has an extensive array of distributor partners that could benefit NTAP, but as with PAR, the purchase would add a second architecture to NTAP. At $400 million of market cap and $80 million of revenue, this would almost classify as a "tuck-in" purchase.

- Glasshouse. Instead of moving up the technology curve into the high-end enterprise, NTAP could chose to add more services to its product offerings. Glasshouse, a private company that filed to go public in December 2007, is a leading provider of "IT consulting, technology integration and managed services that address inefficiencies and risks inherent in storage and data infrastructure" (from the prospectus). Recently EMC and Hewlett-Packard have moved more aggressively into services offerings, following IBM's strategy, and such a move might be contemplated by NTAP.

Glasshouse generated $72 million in sales in 2007 and would also fall into the "tuck-in" acquisition category.

- **DataDirect Networks**. If NTAP really wanted to stretch its technological capabilities, it could acquire DataDirect Networks, another private company. DataDirect has historically offered extremely fast and scalable storage capabilities to the high-performance storage market. The company is now applying its expertise to other sectors that have very large storage requirements, such as Internet media, life sciences, and government, and stressing performance, density, power efficiency, scalability and throughput. This would be a stretch for NTAP, and certainly move the company away from its "appliance" roots. But to position itself on the cutting edge of storage technology, DataDirect could be an interesting match.

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Company	Disclosure
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Data Domain	1A, 2, 3, 5, 7
Netezza Corporation	7

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