

REPORT REPRINT

Hewlett Packard Enterprise looks to boost hyperconverged story with reach for SimpliVity

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The company will continue to use StoreVirtual for entry-level storage offerings, but over time, the much richer SimpliVity software stack will be used as a common data fabric across its hyperconverged, 3PAR storage, composable and multi-cloud offerings.

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Hewlett Packard Enterprise, which was looking somewhat under-invested in storage, has reached for SimpliVity, widely considered the number two player in hyperconverged systems after Nutanix. HPE already has its own hyperconverged offerings based around the StoreVirtual software stack it originally derived from LeftHand Networks, a storage company it acquired in October 2008. It will continue to use StoreVirtual for entry-level storage offerings, but over time, the much richer SimpliVity stack will be used as a common data fabric across its hyperconverged, 3PAR storage, composable and multi-cloud offerings. Becoming part of HPE is probably not the exit originally envisioned for heavily funded SimpliVity, which, at one point, had looked set to follow its rival Nutanix onto Wall Street.

THE 451 TAKE

According to 451 Research's Market Monitor service, the hyperconverged infrastructure (HCI) market closed out 2016 with \$1.8bn in revenue and a CAGR of 41% that will grow to a little under \$6bn in 2020. As the market opportunity expands and HCI products become more popular in the market in enterprise datacenters, service provider environments and remote offices, HCI will divert revenue away from the established infrastructure space. For this reason, in the last few years, all the major storage and systems players such as Dell-EMC, HPE, Lenovo and Cisco have shored up their HCI offerings to hedge against the potential market disruption that HCI's growth will create. HPE's acquisition of SimpliVity and its plans to implement OmniStack as a common data fabric across multiple product offerings is its way of benefiting from the high interest and growth rates of HCI while continuing to push the benefits of hybrid models that incorporate existing and more traditional systems, as well as public and private cloud-based deployments. More specifically, HPE needed a response to Nutanix in particular, but Dell-EMC with VMware VSAN as well, and SimpliVity was the obvious choice.

DEAL DETAILS

HPE will pay \$650m for hyperconverged systems startup SimpliVity, the largest transaction announced by the company since it emerged from a historic split of the Silicon Valley pioneer. HP had largely been out of the M&A market as it worked on the corporate divorce, but both legacy HP businesses have picked up the pace since the November 2015 separation. SimpliVity is HPE's fourth acquisition in that 14-month span. Morgan Stanley advised SimpliVity on the sale after serving as the placement agent in the startup's previous funding round, a whopping \$175m series D in March 2015.

According to our understanding, HPE is paying 6.5 times trailing sales for SimpliVity, which increased revenue roughly 35% to about \$100m in 2016. SimpliVity's multiple is a discount compared to the current trading valuation, which doesn't reflect any acquisition premium, of HCI standout Nutanix. At a current market capitalization of \$4.3bn, Nutanix is valued at 8.2 times sales over the past four quarters of \$524m. The main reason for the valuation discrepancy is that Nutanix is growing nearly three times faster than SimpliVity, off a significantly larger revenue base.

SimpliVity's exit also represents a fairly sharp discount to its last private-market funding less than two year ago. At the time, SimpliVity noted the round valued the company at more than \$1bn. The deal is expected to be completed during HPE's fiscal second quarter, which ends in April 2017. SimpliVity will be integrated within HPE's Software-Defined and Cloud Group.

TARGET PROFILE

Westborough, Massachusetts-based SimpliVity was founded late in 2009 by CEO Doron Kempel, previously the founder and CEO of backup deduplication specialist Diligent Technologies, which was sold to IBM in 2008 for an estimated \$168m. Although it was founded only a few months after its chief rival Nutanix, SimpliVity spent much longer in its development phase, releasing its first products in April 2013, almost two years after Nutanix. It justified this delay by claiming to have built its own software stack entirely from scratch rather than repurposing some existing open source components as Nutanix has.

The flagship OmniCube product is a 2U-high hyperconverged system offering integrated storage, processing and networking for virtualized environments with data management functionality, performance, protection and capacity services layered on top. SimpliVity raised a total of \$276m in funding. The most recent round – a massive \$175m series D – was led by Waypoint, which is also a SimpliVity customer. SimpliVity put in place a 100% channel model but did require qualification of its servers. It started out with Dell servers, later adding the option to use Cisco, Lenovo and, most recently, Huawei.

Against its core competitors, SimpliVity has a couple of differentiators. It included dedupe in the design from the start, not as an add-on (as with Nutanix and VMware). SimpliVity argues that this makes it significantly more cost-effective at scale. The other differentiator is integrated backup and recovery, perhaps a more powerful differentiator for SimpliVity (because backup is a very sticky app), but one that's been hard to articulate, potentially lengthening the sales process. The company has shipped 6,000 systems and has 1,300 customers.

ACQUIRER PROFILE

Refocusing was last year's theme for HPE following the separation from the printer and PC business (HP Inc) in late 2015. Last year, HPE offloaded much of its software division to Micro Focus and its professional services business to CSC. Flush with cash from these divestitures, HPE began looking round for properties to boost and revitalize its core systems, storage and networking businesses. In August, it picked up SGI (Silicon Graphics), one of the few remaining independent hardware vendors (and one of the pioneers) for just \$275m, or 0.5x trailing revenue. SGI operates mostly in the high-performance computing and hyperscale segments, where innovation is still in high demand but market conditions are tough. HPE has also been deepening its networking partnership with Arista.

DEAL RATIONALE

HPE arguably invented hyperconvergence – or at least, its forerunner of 'virtual SAN' – nine years ago when it began selling a software-only VM version of its LeftHand-originated scale-out storage. Now called HP StoreVirtual, that software has more than 10,000 production deployments, according to HPE. However, the vast majority of those do not run applications on the same servers as StoreVirtual. They are stand-alone rather than hyperconverged storage systems.

Recently, HPE has been building out its converged infrastructure software stack, focusing on the OneView management control plane and unified APIs for compute, storage and networking that provide the intelligence for HPE's composable infrastructure, consisting of disaggregated pools of compute, storage and networking that can be dynamically assigned to support any workload (physical, virtual or containerized), and span traditional and cloud-native applications. This requires a composable data fabric, which HPE has said it is continuing to develop, enabling data to be shared across storage systems, hyperconverged appliances, composable infrastructure and hybrid clouds. The SimpliVity stack is now expected to be utilized as the basis for this common data fabric.

Partly because it came to market later than Nutanix, SimpliVity chose to implement a channel distribution model without any direct OEM relationships. Its original Dell relationship came under threat from both Dell's OEM deal with Nutanix and from the Dell-EMC merger that made VMware's hyperconverged stack the most likely long-term direction of travel. Late in 2014, SimpliVity released a reference architecture for OmniStack software running on Cisco UCS servers, and the following year went a step further by integrating OmniStack with Cisco's UCS Director management appliance. But Cisco undermined that relationship somewhat in 2016 by unveiling its own HyperFlex HCI products using the software stack from its own tightly coupled partner Springpath.

In November 2015, SimpliVity added the option to use OmniStack software preinstalled on Lenovo servers as a lower-cost alternative. But once again, Lenovo offered alternative choices and continued to promote Nutanix as its primary HCI partner. The option of running the SimpliVity software stack on HPE ProLiant servers remained the most obvious gap in its portfolio. HPE's ownership should also solve the complex 'meet in the channel' model that SimpliVity had to work with for its multi-vendor options.

HPE has a huge installed base in the SME/SMB space, which is where HCI is initially gaining the most momentum – customers here want to radically simplify their IT infrastructure to make it more cost-effective to manage with a smaller staff. Over the past year, SimpliVity has been targeting HPE EVA customers and having some level of success. However, many larger enterprises are also looking at HCI, both for the remote office/branch office and for the core datacenter, and SimpliVity's customer mix was half enterprise, half SMB, compared to 40% enterprise, 60% SMB for the market as a whole. One thing HPE will need to get right is how it positions SimpliVity relative to 3PAR. Before the acquisition, SimpliVity would have argued that it could easily function as an alternative to 3PAR.

HPE will continue with its existing hyperconverged offerings – the enterprise and vSphere-only HC 380 and the remote office/branch office VMware or Hyper-V HC 250 – with no immediate changes to the product roadmap. It will also continue to support existing SimpliVity customers, all using non-HPE hardware platforms, but ongoing sales on non-ProLiant platforms will likely cease as soon as the OmniStack software is qualified to run on HPE's flagship DL380 ProLiant servers, promised within 60 days of the deal closing. In the second half of 2017, a range of integrated HPE SimpliVity HCI systems based on ProLiant hardware will be introduced. The roadmap includes broader hypervisor support (Hyper-V, containers and OpenStack). HPE will continue to support SimpliVity's use of hardware accelerators in platforms where they can be easily accommodated (such as the DL380), but the overall direction is toward a pure software-defined model.

COMPETITIVE LANDSCAPE

The HCI market continues to grow at a rapid pace, although it remains relatively small compared with the rest of the IT infrastructure landscape. Nutanix's successful public IPO increased general awareness of this still relatively new market segment. While the initial HCI charge was led by well-funded startups – most notably Nutanix, SimpliVity, Scale Computing and Pivot3 – nearly all of the infrastructure behemoths – including Cisco, Dell-EMC, Hitachi Data Systems and Hewlett Packard Enterprise – soon launched competitive HCI products to keep pace. VMware entered the space in March 2014 with Virtual SAN and EVO:RAIL, and while initial sales were disappointing, VMware's revised offerings in 2016 were more positively received. Another potential major competitor is Microsoft. Its recently released Windows Server 2016 includes an HCI feature called Storage Spaces Direct. Surviving smaller vendors include HyperGrid (GridStore), Maxta and StorMagic.

The obvious destination for HCI beyond the datacenters of enterprises and midsize vendors is the hybrid cloud market, where HCI vendors must learn to play nice with the hyperscale cloud providers while embracing needed innovations such as containers. But the journey will not be an easy one because there are still lingering questions related to the scalability of HCI platforms and the potential vendor lock-in that they may be creating. As clusters grow in size, the networking infrastructure that connects nodes and the network monitoring tools needed to manage traffic and locate problems will require tighter integration to keep up with rapidly evolving workloads and customer requirements. To support hybrid cloud, further development of cloud-orchestration and workload-migration tools for both enterprises and service providers is becoming increasingly urgent. And startups that began as appliance vendors face the awkward transition to a software-defined business model.

ACQUIRER

Hewlett Packard Enterprise

TARGET

SimpliVity

SUBSECTOR

Hyperconverged infrastructure

DEAL VALUE

\$650m

DATE ANNOUNCED

January 17, 2017

CLOSING DATE, EXPECTED

HPE's fiscal Q2, ending April 2017

ADVISERS

Morgan Stanley (SimpliVity)