

# SPLUNK: Is It the Real Deal?

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Mention Big Data to anyone and you'll get a wide-eyed look that begs the question "What do you mean?" The fracas is that it takes on many meanings. In other words, are you talking about a company, are you talking about a product, are you talking about a capability, or are you talking about a hot sector issue, like the security market, etc?

For purposes about this discussion, I'll define Big Data as "connecting to their relevant machine data sources and to begin realizing operational intelligence."

Big Data is one of the major high technology growth trends today. With the advent of ever increasing amounts of data being generated; capturing, synthesizing, and analyzing that data for purposes of extracting useful operational intelligence to improve and enhance business and security operations is most highly desirable by many company leadership teams.

In a June 3, 2014 article by Katherine Noyes for Fortune Online "These Big Data Companies are the Ones to Watch", 10 industry experts were asked to identify "which companies are breaking new ground with big data technology?" and "which are the ones to really watch?"

That question appeared rather difficult to answer. However, amongst the 10 experts, the most shining examples polled were: [MapR](#), [MemSQL](#), [Databricks](#), [Platfora](#), [Splunk](#), [Teradata](#), [Palantir](#), [Premise](#), [Datameer](#), [Cloudera](#), [Hortonworks](#), [MongoDB](#), and [Trifacta](#).

Of that list, Splunk was identified as a company with excellent technology and it was among the first big data companies to go public on 20 April 2012. Splunk also had a strong product called Hunk—Splunk on Hadoop---directly delivering big data solutions that are more mature and easier to use than most products on the market today. Additionally, Splunk has a rather large following of satisfied Fortune 500 companies than most of the other companies.

So what about Splunk? Who are they? What are they doing? Are they a flash in the night, here one day, gone another or are they in for the long haul? Would I invest in them? If I did, how would I invest?

**Before I ever got into performing a more detailed assessment of Splunk, my first impressions were:**

1. The stock price looked like it was all over the place. Highly volatile. Unprofitable.
2. It looked like a technical analyst's dream stock allowing a day-trader to make large sums on large price swings within a day
3. A fundamental analysts' nightmare since its high sales and marketing expenses appeared to be seemingly uncontrollable in a high growth sales environment with volatile quarter-to quarter losses.

It certainly made me pause and approach this task with a more cautious demeanor. My approach to looking at a technology company as a potential investment candidate includes assessing the following things:

1. The Company Management & Leadership Team: Their industry experience and capabilities.
2. Product & Service Offerings: Are their products and services industry leading and do they have product differentiation with a solid Unique Selling Proposition (USP)
3. Technology Innovation and Investment: What is the pace and rate of research & development funds being applied. What strategies and tactics are they employing to keep products new and refreshed to maintain industry leadership in its productization?
4. Channel Reach: How extensive is their reach into the marketplace? What relationship and alliances are they using in the industry? How are they delivering their value? Do they have a solid and growing sales and marketing force?
5. Marketplace & Competition: What are their targeted markets? Are they growing and profitable markets? What is their competition? What barriers to entry have they established? How do they differentiate themselves?
6. Financial Wherewithal: What is their path to profitability? How is cash flow from operations? How do their financial ratios compare with the industry competition?

My grading criteria are based on a 5-star rating systems with 1-star being the lowest and 5-star the highest.

1. Doesn't make the cut. They are a loser in this area. Their shortcomings will have a profound negative effect for the future of the company.
2. Weak in this area. Needs vast improvements to keep pace with competition.
3. Satisfactory performance. Like everyone else in the industry. There is no clear discriminating feature – like the rest.
4. There are some clear benefits to what they are doing vis-à-vis the competition. They recognized as having great value in this area. They are continually improving.
5. Head and shoulders above the rest. Unique differentiation. Industry leading value.

### **Splunk Company Management & Leadership:** ★★☆☆

President, CEO and Chairman, Godfrey Sullivan and his leadership team have done a credible job of building Splunk to what it is today. The team appears to be replete with a host of new management blood within the last three years as one would expect in this industry since the doors swing wildly for the high technology industry.

Co-founder, Erik Swan has provided the continued stability of the company's vision from its early days of 2003 when it was started with the purpose of bringing machine data analytics to companies. There has been a rather enviable growth in revenue since Sullivan's ascension to the top spot in 2006. This team has built a enviable cadre of customers both domestically and

internationally. It has over 60% of all the Fortune 500 companies and with a list of over 7200 total customer base.

They have the full spectrum of marketing and sales functions providing an extensive array of products and services that is the industry's envy. While the team has done a very credible job of building the customer base and raising revenues admirably, they have had a very hard time controlling their sales and marketing expenses. Splunk currently spends 70% of revenues on sales and marketing, of which, a substantial amount is used to educate customers. Currently, the stock price is under pressure due to recent year-over-year profitability losses incurred due rather exorbitant sales and marketing expenses. This may be a temporary issue for the next 12 to 18 months. They are witnessing extensive demand growth from both existing and new customers. One might think that this is a good issue to have.

Look at any of the vast array of financial analysts' recommendations and you'll find a volatile array of opinions which seem to marry the volatility of its stock price. One might only begin to think that this management team is "prettifying up the pig" for a possible acquisition in the very near future to the likes of an Oracle or to an IBM who would find such an acquisition very complimentary.

### **Product & Service Offerings:** ★★☆☆

From its early days, Splunk has built product and service offerings that is the industry's envy for Big Data.

Their model is to first educate their customers to understand the importance of acquiring and analyzing the vast amounts of operational data to drive out enhanced performance in serving their customers better value and providing management with answers that increase operations efficiencies of their organizations. They do this by providing free download licensing to eventually capture the customer into repeat paying venue when they buy selected target add-on products and services to the free base enterprise engine. They also couple this with educational webinars, videos, a host of white papers demonstrating similar solutions within their own industry, and an extensive list of ROI examples where their solutions have been applied.

It hosts an array of products and services that includes solutions covering Application Management, Big Data, Business Analytics, Cloud, Digital Intelligence, Internet of Things, IT Operations Management, Microsoft Infrastructure Management, and Security & Compliance. In so far as Big Data is concerned, these products and services are a comprehensive set that few other competitors provide. This is one of the Unique Selling Propositions that Splunk has. Its content is industry leading and they do a top line job of delivering that information in a variety of ways and in a very timely manner.

Their customers are targeted with the Public Sector (including Federal Civilian Agencies, Defense & Intelligence Agencies and State and Local Governments), Online Services, Higher Education, Financial Services, Healthcare, Retail, Communications, Energy & Utilities and Non-Profits. Splunk's largest customers are CISCO, Sales Force, COMCAST, Macy's and a host of

commercial concerns. The US Government uses Splunk in every agency but not strategically like commercial concerns.

With just a slight more elaboration, you'll find is that Splunk is not an exclusively Big Data Company. It's more than that. Splunk collects and indexes all machine data for uses in:

- **IT Operations** – Error detection and identification of system errors through the layered stack of software and hardware that exists today.
- **Security:** - Splunk is ranked amongst the best Security Investigation and Enterprise Management Systems in the market today (SIEM) as ranked by Gartner. Because Splunk collects all the data that comes from anywhere, insider threat and external attacks are all captured by Splunk in near real time.
- **Web Analytics** – Splunk manages all web activities for performance and operations.
- **Application Software Development** – Splunk can detect all of the errors immediately in software development lessening the time and risk to development.
- **Internet of Things:** - Splunk can monitor all digital devices and in doing so it has some Return on Investment examples like:
  1. The “Splunked” elevator data in a Japanese Commercial Building has enabled the determination of the most popular floor of that building to charge a higher price for the lease.
  2. Eglin Air Force base through McKinney and Associates gathered all of the digital data from the buildings Air Conditioning, Card readers, and lighting systems to determine the best operational parameters and save Eglin \$3 Million dollars in costs per quarter.

### **Technology innovation and Investment:** ★★★★★

Splunk spends an industry leading 10% of revenues investing into their products and services to continually enhance and bring new product to existing markets. It has been increasing the rate of expenditure year-over-year. They have market expansion plans for a few additional markets that they leave un-named. However, their existing markets are targeted at the most profitable and extensive.

They have a large cadre of developers and technical experts available to them. They are in the San Francisco bay region where that cadre is highly available.

### **Channel Reach:** ★★★★★

Splunk has done a remarkable job of building an extensive array of business relationships with existing companies organic to and within each of their targeted markets. This model has assisted Splunk in gaining quick and early saturation into each of their markets while making it harder for the competition to unseat them. This strategy has enabled Splunk to brand their name and

services in Big Data at a much better value-added spent per marketing dollar than those companies like an HP and IBM.

Further, as I have mentioned previously, their sales and marketing expenses seem to be out-of-control. The reason for this is their ardent push for the growth and deployment of their sales and marketing team. In order to get more market penetration and growth vis-à-vis the competition, Splunk is going all out with a no holds bar approach. The only question will be: is it sustainable?

### **Marketplace & Competition:** ★★☆☆

In so far as the direct competitors previously identified in the Top 10 “Big Data” providers, Splunk is at the top of this list in their market reach, saturation and growth. While Splunk has performed an admirable job of reaching its markets ahead of the competition and laying some solid ground for the future in the Big Data realm, it has not established a barrier-to-entry that is large enough to keep the behemoths such as Oracle, HP and IBM from making large in-roads should they desire to do so.

In fact in 2013, IBM came out with the IBM SmartCloud Log Analysis which performs the basic functions of the Splunk Enterprise System. Should IBM decide to make a much larger play into machine data, Splunk could suffer market share degradation and witness increased marketing costs to increase its market differentiation. This would further stress its marketing and sales budgets.

### **Financial Wherewithal:** ★★☆☆

As I mentioned earlier, Splunk’s stock price is highly volatile. Its 52 week high stock price reached \$106.15 and witnessed a low of \$39.35. It currently stands at \$59.71. Some analysts seem to believe that its value should realistically set in the low to mid \$40s. Others advocate that a target price of \$66.00 is reasonable.

This is a company with \$7.1B market capitalization. However, it has a very low Return on Equity (-24.6%). Their operating margins are out of whack (Gross Margin = 86.1%, Operating margin = -43.6%) and with profitability that is going in the wrong direction at (-43.9%). There are more analysts who would say that this stock is a sell. At the same time, we have analysts publically advocating on Financial News shows stating this is an exciting stock to be involved with. Therein lies the true nature of technology stocks.

### **The Bottom Line Assessment:** ★★☆☆

Splunk is somewhat eclectic. It has something for anyone who might be interested in this company. Apart from its rather less than desirable financials, the company has great products and services, very good branding, a rather large and solid stable of customers, and a management team that is highly focused on providing great technologies and value to its customers.

It is currently witnessing exorbitant growth rates that are taxing it in terms of responding with an ever expanding sales and marketing work force to address that demand. Hence, it has expenses that will be expanding for the next 18 to 24 months. This will certainly affect Splunk's profitability and tax the patience of Splunk's following of financial analysts.

The bottom line is: this company is more of a risky technology investment play than it is a conservative money-making financial investment play. With risk comes reward for those who are patient or who are rather savvy and sophisticated investors particularly in the Information Technology industry.

For those investors who think in terms of holding on for an acquisition play, I think there is great opportunity in the near term for such an outcome. Some patience will be required. However, the premium may be worth the wait.

For those investors who are sophisticated technical investors who play options, this is a highly desirable candidate with great beta and volatility.

For long term conservative investors, this is no play at all.