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IS IT 1999 AGAIN?

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Is It 1999 Again?

Buckley Capital Partners

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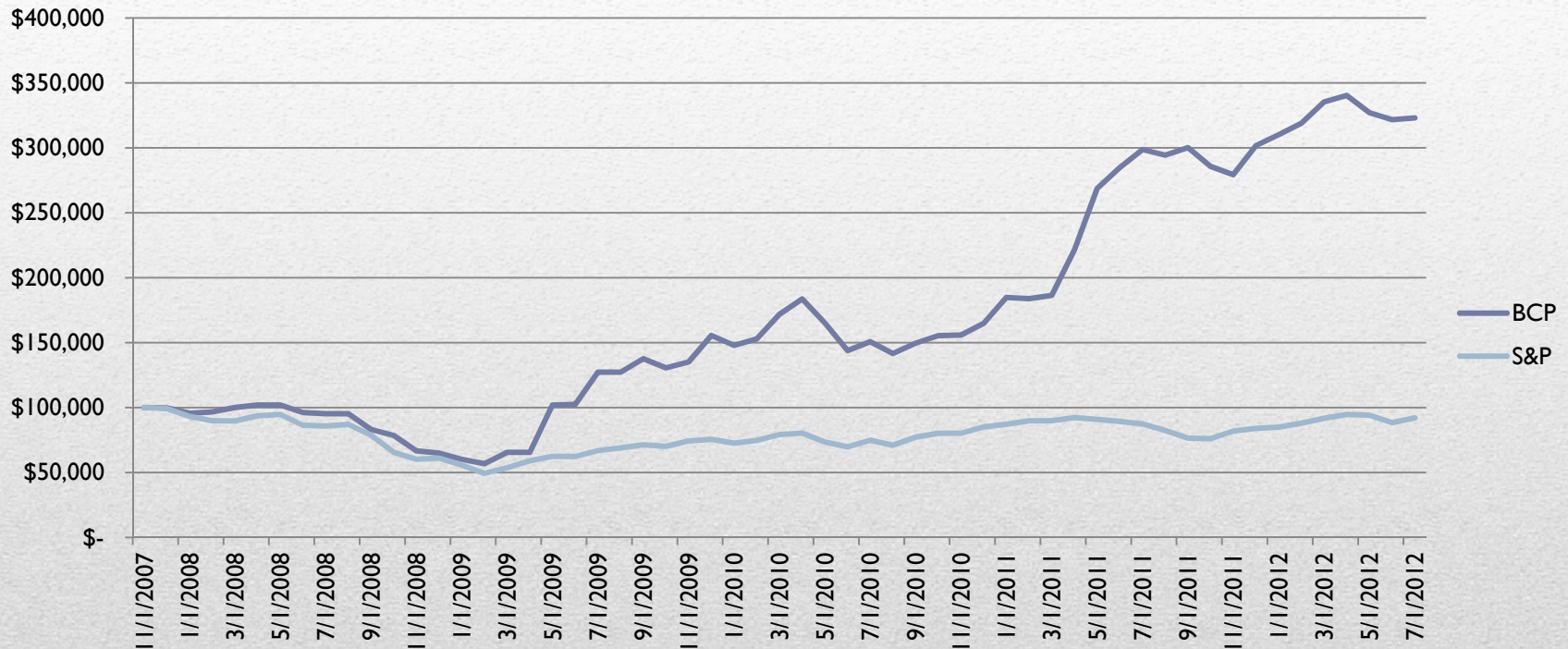
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Buckley Capital Background



*Returns are gross of fees, and reflect \$100,000 invested in separately managed accounts (unaudited) in Nov 2007, which were transitioned into the fund in Jan 2011.

The graph above shows the performance of separately managed accounts managed by the General Partner from Nov 1, 2007 until Jan 1, 2011. All performance after Jan 1, 2011 refers to Buckley Capital Partners performance including the reinvestment of dividends. The gross return does not include a management fee or incentive-based fees. Monthly and year to date figures are estimates and un-audited. All investment returns prior to 2011 are unaudited. Inception to date figures for Buckley Capital Partners incorporate audited results from prior years and un-audited results from the current year.

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References to the S&P 500 are for informational and general comparative purposes only. There are significant differences between such indices and the investment program of BCP.

Background as a Short Seller

- I became a short seller in an embarrassing way, being long China frauds
- Visited 50 Chinese companies
- When I went to china I was long, when I came back, I was short
- Here's why:

Here's What I Thought



Here's What I Bought



Here's What I Thought



Here's What I Bought



China Trade Is Over

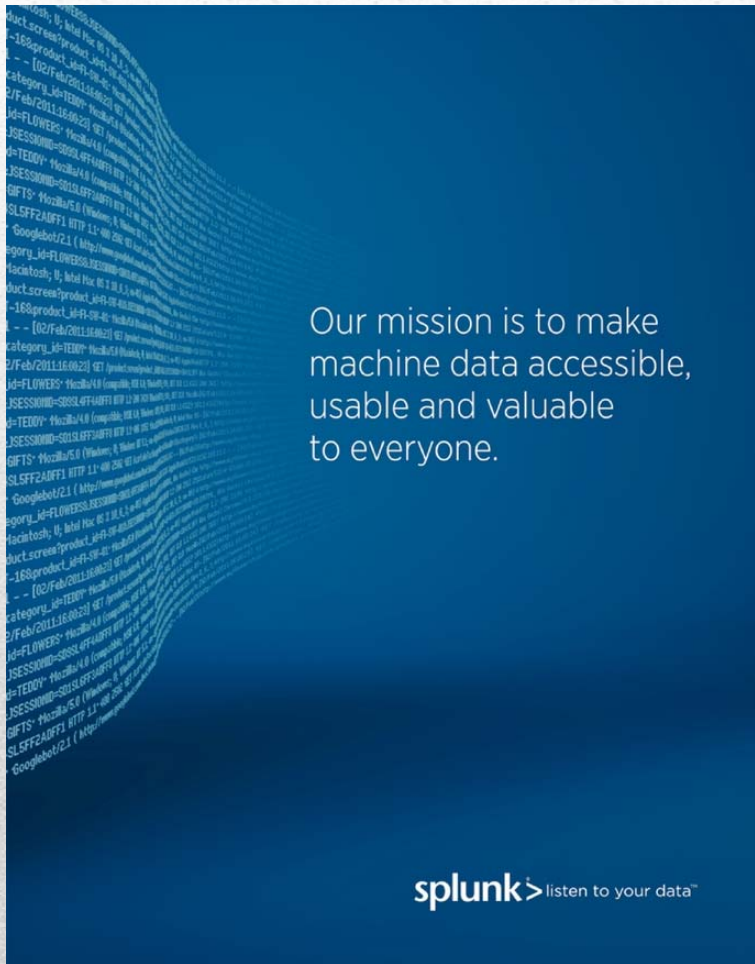
- Shorting China frauds has generally played out
- Started looking for short opportunities elsewhere
- Found 1999-like valuations among tech companies with bad business models

Characteristics of a Good Company


- Strong business model
- Strong moat
- Little to no competition
- No obsolescence risk
- High operating margins
 - Now let's invert this

Characteristics of a Bad Company

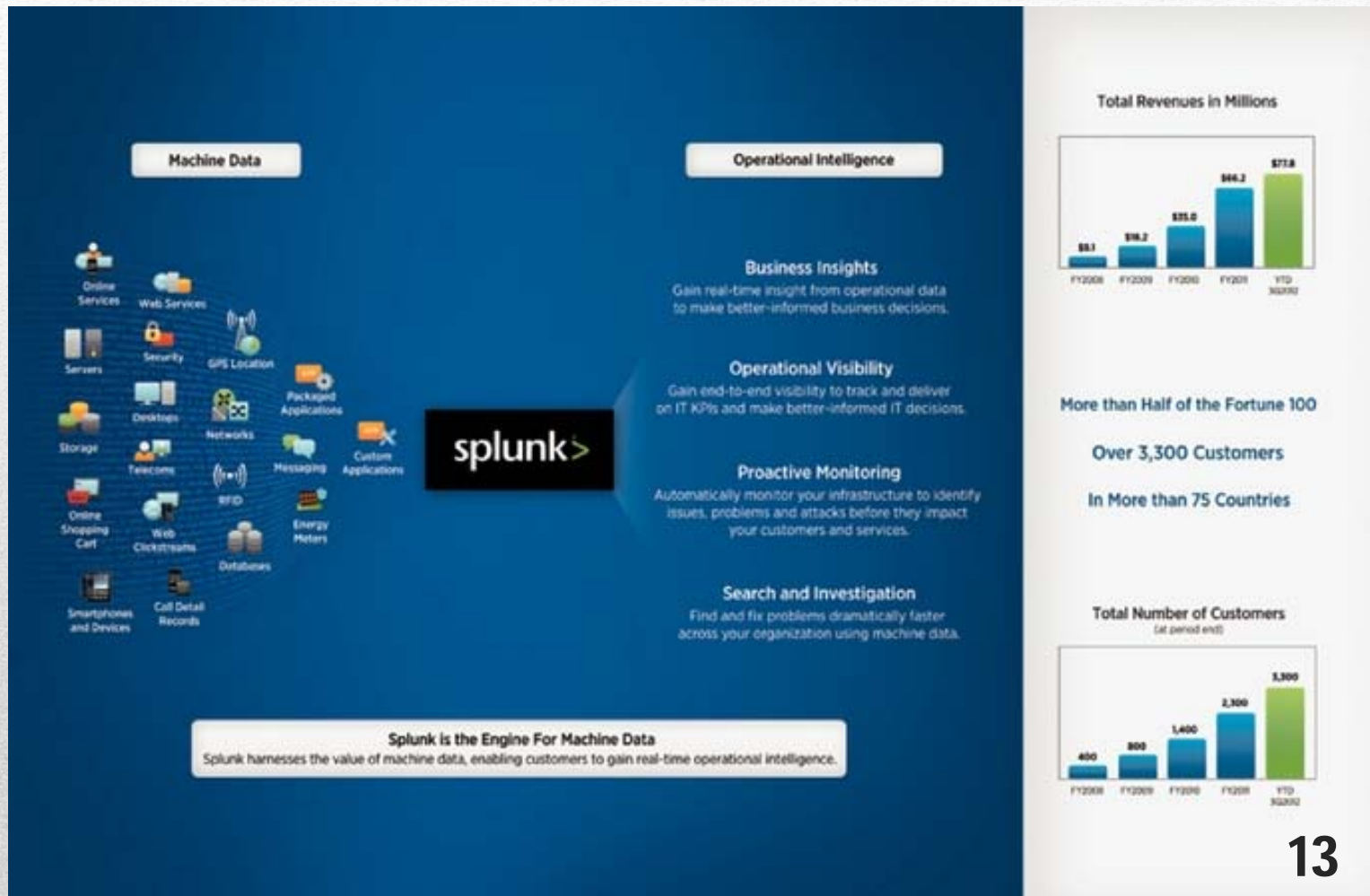
- Questionable business model
- Little moat
- Fierce competition
- Technology risk
- One-product company
- Low operating margins
- High valuation
 - I think Splunk (SPLK) meets these criteria



Our mission is to make machine data accessible, usable and valuable to everyone.

splunk  listen to your data™

Business Overview

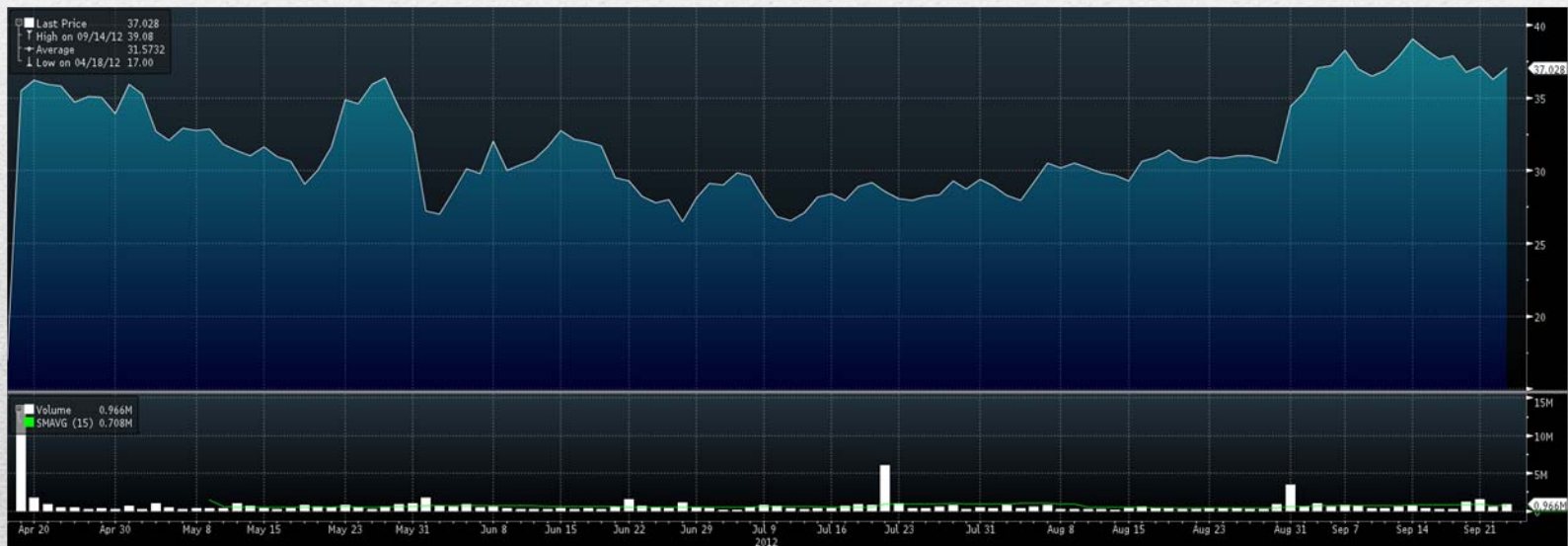


Splunk's Revenue Model

- One-time fee for perpetual use of the software with a maintenance contract
- Annual term fee to license the software
- Pricing based on indexed capacity

Splunk Chart

- IPO'd April 19th at \$17 and was up over 90% in first day
- Has doubled since the IPO price



Overview

- Share Price: \$36.72
- Fully diluted Market cap: \$4.23 Billion
- 9.2% of the float is short (available, low-cost borrow)
- P/TTM sales: 27.1x
- FY 2013 growth rate: 54% (71% YOY growth in Q2)
- 271x consensus 2015 EBITDA
- But this is not a valuation short, rather a business model short with a rich valuation as an added kicker
- A commoditized product competing against well capitalized and fierce competitors

Questionable Moat

- Switching costs are very low for customers
- Splunk boasts that customers can have their software up and running within a few hours - but this means that competitors can do the same
- Very little patent protection



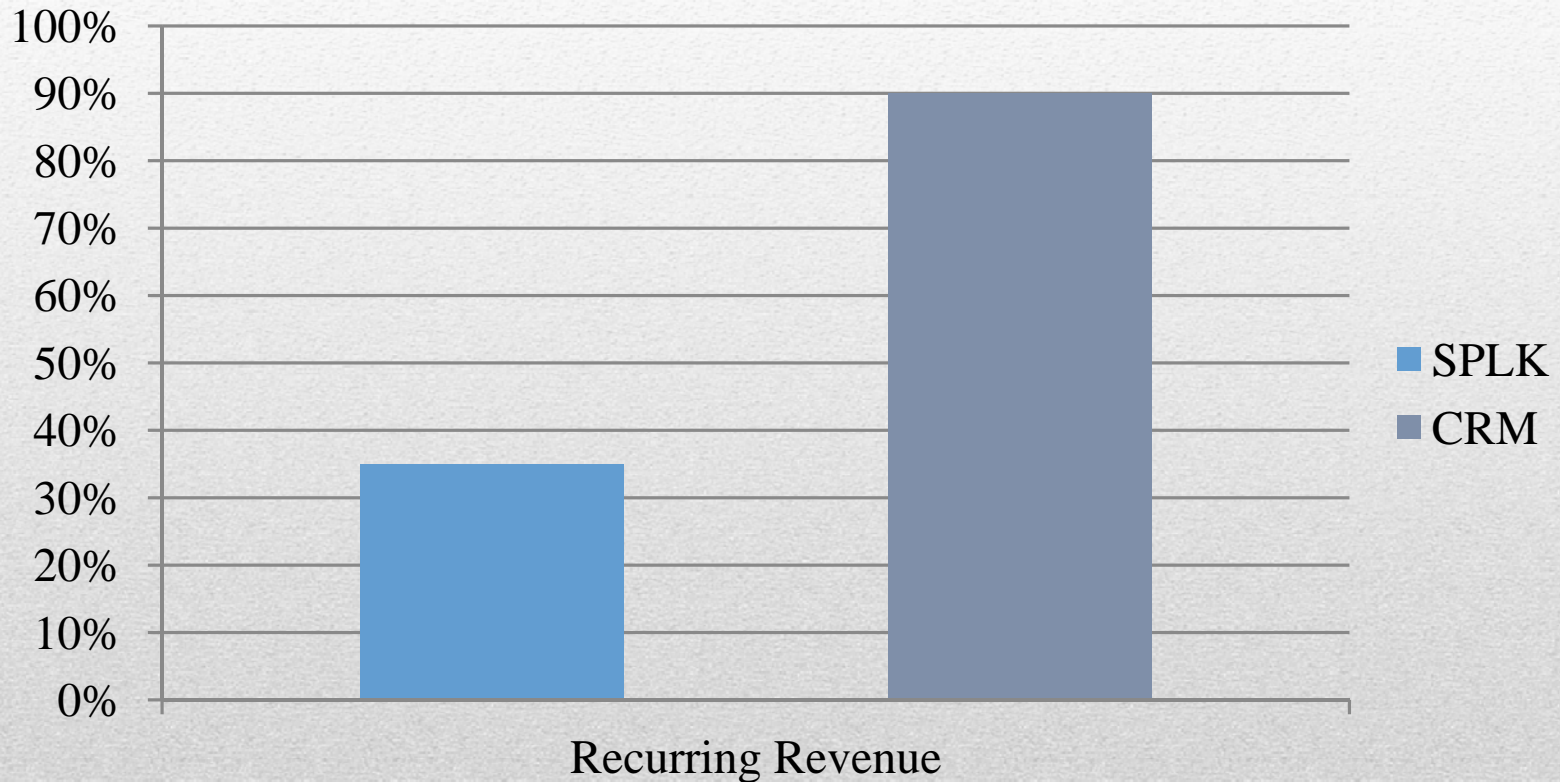
Splunk Is Not a Typical Software-As-A-Service (SaaS) Business

- Typical SaaS businesses have annuity-like recurring revenue
- From Splunk's 10-Q:
 - “A substantial majority of our license revenue consists of revenues from perpetual licenses, under which we generally recognize the license fee portion of the arrangement upfront”

SaaS Issues

- Risk section of 10-Q:
 - “If customers were to require that we provide our product via a SaaS deployment, we would need to direct a significant portion of our capital investments to implement this alternative business model, which would negatively affect our gross margins. Even if we make these investments, we may be unsuccessful in implementing a SaaS business model. Moreover, sales of a potential future SaaS offering could cannibalize sales of our Splunk Enterprise software licenses. In addition, the change to a SaaS model would result in changes in the manner in which we recognize revenues.”

Splunk Doesn't Have Salesforce.com's Recurring Revenue Model...



...and Trades at a Much Higher Valuation



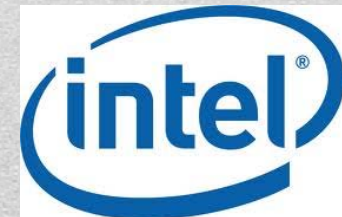
Competition

- Tough competitive position
- Squeezed into a niche between quality and price



Top-End Competition

- Splunk is competing with some of the most efficient and well-run tech companies in the world
- From Q2 2013 Splunk earnings call the CEO mentions:
 - “There’s plenty of competitors. Every time we go into a customer, especially when it’s a point solution conversation, if it’s a security use case, they’re comparing us against all the normal security suspects. And when we go into some operational use case, it’s the same.”



Numerous Competitors at the Low End

FLUENTD

XPLG



elasticsearch.

logstash

 cloudera

loglogic.

splunk™

 sumologic



KIBANA

GREYLOG₂

FLUME

EventTracker
Logging In Depth

Where's Splunk?

FLUENTD

XPLG



EventTracker
Logging In Depth



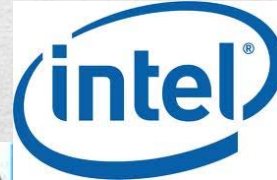
elasticsearch.

logstash

cloudera



loglogic



splunk>

sumologic



KIBANA



GREYLOG2



QUEST
SOFTWARE

FLUME

bmcsoftware

ORACLE

Splunk's Niche is Being Squeezed

- Splunk is losing on the point solutions side, because they are going head to head with IBM, BMC, MSFT
- Splunk's CEO on the most recent conference call:
 - “If we just get dragged into a very narrow point solutions conversation, the other guys know how to sell, too.”
- Integrated solutions is left, where they will have difficulty competing on price
- So if you combine a commoditized product, with heavy competition both on quality from one side and price on another, you have a very tough sale
- Why Use Splunk?

Potential Price War

- Integrated solutions – competition based on price
- From field calls, determined customers feel the pricing is very high
- Splunk's CEO on Q2 2013 call:
 - “We get some pressure around data volumes and all that because it's a unique pricing model”
- Spoke with EventTracker employee who said Splunk and EventTracker businesses are 80-90% the same

	EventTracker (Competitor)	Splunk
Cost for 100 servers	200MB log data/day - \$34,000	200MB log data/day - \$120,000 (list)

Price Drop From EventTracker Prices

- 71% price drop

Customers Leaving Splunk

- Direct quotes from Splunk customers:
 - “We are currently using Splunk but given the amount of data that we want to aggregate, we won't be able to afford Splunk or any other similarly priced solution sustainably.”
 - “I used both Splunk and Scribe for years in the past, and with satisfaction, but recently I switched to **Fluentd**: <http://fluentd.org>. It's more efficient than Splunk / Scribe, less invasive, with less software dependencies”
- More competition than 12-24 months ago

Technology Risk – One-Product Company

- Technology risk is especially big because Splunk is a **one-product company**
- Highly competitive industry that is very difficult to model given the level of competition
- Analysts are giving Splunk the benefit of the doubt that it will be able to compete technologically with all the bigger software players

Smaller Target Market

- Splunk's target market is much smaller than they admit
- In their main segment, IT operations, their top 5 competitors hold 53.5% of the market
- Less than 10% in “business intelligence”

Market	Size (\$billions)
IT Operations	\$18.6
Business Intelligence	\$12.5
Security	\$1.3
Total	\$32.5 \$19.9

IT	Market Share
IBM	17.8%
CA	12.3%
BMC Software	10.0%
Microsoft	6.9%
HP	6.5%
Total	53.5%

Smaller Target Market (2)

- Estimated number is 80% in point solutions - we know the market is much heavier on the point solutions side
- They really focus on integrated solutions, so target market is down to ~\$5 billion
- Splunk bull case assumes massive growth with a huge target market, which is highly unlikely

	Target Market (\$Billions)	
Point Solutions IT	\$14.8	
Integrated Solutions IT	\$3.8	
Security	\$1.3	
Total	\$19.9	\$5.1

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Tough Path to Profitability

- A high-growth company can rationally spend money to purchase growth if sales are annuity-like
- But Splunk mostly has one-time sales
- Questionable operating leverage in this business
- Sell side agrees with me: consensus 2015 estimates for EBIT margins are only 4.8%, implying little operating leverage

Management Incentives

- Management is heavily incentivized by the bonus structure to maximize revenue and bookings (GAAP revenue plus change in deferred revenue).
- Management bonuses are primarily based on sales growth, not earnings

Recap

- Questionable business model
- Small moat
- Strong competition
- One-product company
- Smaller target market
 - So how would you act if you were an insider?

Insiders Are Selling Aggressively

- Insiders have sold just over 10% of the company.
- Stock sales by insiders exceed TTM revenues!

Seller	Position	# Shares
Sevin Rosen	VC Fund	1,945,363
August Capital	VC Fund	1,953,508
JK&B Capital	VC Fund	1,679,960
Godfrey Sullivan	CEO	500,000
David Conte	CFO	110,000
Eric Swan	Co-Founder, CTO	700,000
John G. Connors	VC Fund	1,158,727
Nicholas Sturiale	Director	1,945,363
Crossover Ventures	VC Fund	2,210,000

- In total, approximately 65 employees, executives, and directors sold stock in an offering at an average price of 27.26.

Lock Up Ends Soon

- 31 million shares can be sold beginning on October 15th
- A total of 57 million shares will be unlocked in next 12 months, more than doubling the float
- Given their history, it seems likely that insiders will continue to sell in size, which could pressure the stock
- Look at Groupon and Zynga after their lock ups expired

Catalyst



Valuation

- So what would you pay for this business?
- Would you pay 20x? 40x? 60x? 80x?
- Splunk currently trades at 27x TTM sales

A Strategic Acquisition at Anywhere Close to Today's Price is Unlikely

- Comparables indicate that a strategic acquiror might pay 6-8x TTM sales for Splunk's current business
- This would value the company at \$8.06-\$10.75/share

Acquirer	Target	Price (billions)	P/S Multiple	Recurring Revenue
HP	Arcsight	\$1.5	7.8	41%
Oracle	Taleo	\$1.9	6.1	83%
Oracle	Rightnow	\$1.5	7.5	79%
	Splunk	\$4.2	27.1	35%

Splunk vs. Industry Winners

Case	5 Year Growth	FCF Margins	FCF Multiple
Average	23%	19%	22x

- An analysis of the growth rate, margins, and EV/FCF multiples of leading successful software companies shows that Splunk is *far* more expensive than average
- Applying the average FCF multiple to Splunk results in a stock price of \$11.71, down 68%

Splunk Bull Case

Case	5 Year Growth	FCF Margins	Multiple	Target
Bull	40%	29%	45x	\$75

- For Splunk to double in the next five years, it will have to grow revenues at 40% annually, increase its FCF margins six-fold, and trade at a very rich 45x FCF

No Growth Valuation

- If Splunk slowed sales and marketing spending to maintenance levels, its FCF margins would increase to 19% (from today's less than 5%)
- Splunk would still be trading at ~140x FCF
- Does this sound like a good bet???

	Market cap (billion)	Share price	EV/FCF Multiple
Splunk	4.23	36.72	~140x

Conclusion

- Weak business model with low recurring revenue
- Undifferentiated product in rapidly changing, fiercely competitive industry
- Potential price war
- Heavy insider selling
- Trading at 27x trailing sales and 271x consensus 2015 EBITDA
- Ipo lock up expires in two weeks
- In various valuation scenarios, worth between ~\$6-\$12/share or ~65%-85% downside from today's levels