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With \$9B in bank, Dell ready to buy

"They're going to do deals," analyst says

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It was a year ago when Dell Inc.'s CEO may have given the strongest indication about the direction the company will take beyond selling personal computers.

In January 2008, Dell made the largest acquisition in its history, buying New Hampshire-based EqualLogic Inc. for \$1.4 billion. CEO Michael Dell cited virtualization software and Internet small computer system interfaces, or iSCSI, as playing a role in the company's future.

The Round Rock-based company has already made one acquisition this year, and it is positioned to complete several more as it finds itself flush with cash while tech company valuations remain depressed during the global recession, industry observers say.

Tech hardware — Dell's core business — has been generally commoditized, shrinking profit margins and prompting vendors to expand to storage and software products designed to make it easier for customers to manage data centers.

Dell (Nasdaq: DELL) officials won't directly discuss the company's merger-and-acquisition strategy, but recent deals coupled with published comments from company executives suggest that Dell is moving toward services and management software.

"Virtualization and iSCSI are two keys to simplifying IT," Michael Dell said in a January 2008 news release. "What we did for PCs and servers we are now going to do for storage."

Dell, which is scheduled to report its full-year earnings in February, has nearly \$9 billion in cash. About 40 percent of its revenue comes from non-PC products such as software, services and storage, according to the company's most recent regulatory filing.

Dell officials have suggested that it's time for the company to do more deals to expand its revenue base to compete with rivals such as Hewlett-Packard Co. (NYSE: HPQ) and IBM Corp. (NYSE: IBM). The question is: Will it gamble on large acquisitions or continue with a track record of relatively conservative deals?

"Dell clearly has the resources and clearly has the appetite and enough willing sellers to feed their [M&A] program," The 451 Group analyst Brenon Daly said. "They're going to do deals."

Virtualization products have quickly caught on with businesses because they save money. In servers, virtualization enables one server to emulate the performance of several. With applications, it operates software on a remote server rather than the user's desktop.

But virtualization also means businesses need to buy fewer servers. To offset that lost business, Dell and other hardware vendors are shifting to products designed to manage data centers.

For example, network equipment maker Cisco Systems Inc. revealed this month plans to include virtualization software in its servers.

Also, Massachusetts-based EMC Corp., once the developer of data center products, shifted gears three years ago to data center management software. It subsequently acquired online backup company Berkeley Data Systems Inc. and spun out virtualization software maker VMware Inc. (NYSE: VMW)

This month, Dell launched an online software store for consumers and small and mid-sized businesses. It also acquired the Microsoft consulting and solutions portion of Allin Corp. in a stock deal worth \$12 million.

In another software-related deal, Dell reached an original equipment manufacturers, or OEM, agreement in December 2008 with Massachusetts-based Egenera Inc., a competitor of HP, installing Egenera's virtualization software on Dell servers.

Egenera officials declined to comment on the possibility of a Dell acquisition.

Egenera is bigger than a similar company, Opsware Inc., that HP bought for \$1.6 billion in 2007, and it sells hardware that competes with Dell, making it an unlikely acquisition target, Gartner Research analyst John Enck said.

Michael Dell favors low operating expenses over the high costs of acquiring large companies, which means it's likely that the company will seek out bargains this year.

But none would be large enough to break from Dell's conservative merger and acquisition history, Enck said.

"There are so many great bargains on the market right now, it's just a question of who will take the risk to buy them," he said. "I would be shocked to see [Dell] do a major deal."

Courtesy of JB Goodwin