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IBM'S Proposed Acquisition of CGI

In a significant announcement made last week, IBM tendered a friendly buyout offer to CGI Informatique, one of France's leading information services firms. The offer, for $466 million U.S., represents a premium of 25% of CGI's 1992 revenues. Given CGI's 1992 net profit of $33.5 million, this is a valuation of CGI at 17 times earnings.

In extending the offer, IBM continued a shift away from a long-term strategy of making minority investments in software and services firms. IBM's minority investment strategy, which it pursued vigorously, on a world-wide basis, was begun in the late 1980's, when more than 500 such partnerships were formed.

In a much less publicized step, IBM France recently purchased the interest of its partner, Sema, assuming full responsibility for their joint ownership of Axone, an outsourcing company.

In offering to buy CGI, IBM will acquire a firm with several key strengths:

- 65% of CGI clients are in France, where the firm has a strong base.
- CGI has an excellent reputation for its PACBASE and PACLAN CASE tools, which have sold well throughout Europe and the U.S.
- UNIX support is underway for key CGI software on a variety of non-IBM platforms. There is some question as to whether this activity will continue under IBM ownership.
- CGI was one of the first vendors to move its development environment from mainframes to PC LAN workstations.
- Nearly 60% of CGI revenues now come from a well-established professional services operation.

There are several reasons why a well-established independent firm, such as CGI, would welcome an IBM takeover: investment capital is limited, and a desired migration to a client/server architecture can be expensive; the company has few VAR channels in operation;

Exhibit 1

CGI Informatique

- $374 million in revenues
- IBM offer of $466 million
- Strong French market presence
- CASE tools: PACBASE, PACLAN
- Client/server UNIX ports
- 60% Professional services revenues

Source: INPUT

and the dominant founders may conclude that this is a good time to cash in on their equity.

Shift in IBM Equity Investment Strategy?

What are the possible factors leading to IBM's wanting all of CGI? First, there may have been an assessment, at Armonk, that the hundreds of minority interests and board positions secured by IBM has not provided it with the expected leverage in influencing its partners' strategic direction, especially regarding platform-oriented resource allocations. It has been widely presumed that IBM's mere presence in the boardroom of a medium-sized service/ software vendor would be sufficient to exert effective control. This has not necessarily followed, however, as the rapid swings to client/server computing and open systems have compelled IBM's partners to react quickly to such developments, or lose ground in the market.

Second, it is clear that the services sector will produce more dramatic growth in the coming few years than can be expected from the equipment market. INPUT estimates that professional services is a $67 billion market worldwide, growing at 10% per year through 1997. Systems integration is an $18 billion industry, with projected growth of 17%. (The French market alone for these services, is in excess of $8 billion.) Equipment sales cannot approach these growth rates, and hardware margins continue to diminish.

Given these considerations, IBM evidently decided to increase its presence and market share in France—by buying it, with expectations of full control of its new subsidiary's strategies and directions.

Can Synergy be Realized?

Nearly all acquisitions, including this one, look good on paper when they are announced. But will the expected synergy really develop in the field, or will it be just a boardroom illusion? This may well depend on how much freedom IBM will allow CGI for independent operation, rather than subjecting it to the full weight of the IBM culture. It is quite possible for IBM, with the best of intentions, to suffocate a smaller company, thereby stifling innovation.

There *are* examples within the European Community of acquisitions that apparently have worked to the benefit of both parties. These include EDS and SCI/Scicon, and a number of acquisitions made by CGI itself. In these cases, the entrepreneurial spirit was able to flourish, as a delicate balance between parental control and unit independence was achieved. This will be an important factor in measuring long-term success for CGI under the IBM umbrella.

Shift in IBM Strategy?

If in fact this purchase represents a fundamental shift in IBM strategy, not an aberration, it should generate close scrutiny from IBM's major competitors, and perhaps even start bidding wars in IBM's future acquisition attempts. This would be of considerable interest to the hundreds of smaller, niche-oriented vendors who might eagerly await such a call from IBM. After all, the IBM balance sheet still contains nearly six billion dollars in cash or cash equivalents, a certain lure for many hard-pressed vendors in the intensely competitive information services world. Whether IBM will choose to spend its assets on increasing its direct ownership of key software or services players will be a subject of intense interest in the months to come.

This Research Bulletin is issued as part of INPUT's Information Services Market Analysis Program. If you have questions or comments on this bulletin, please call your local INPUT organization or Bob Goodwin at INPUT, 1280 Villa Street, Mountain View, CA 94041-1194 (415) 961-3300