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DELL + EMC: 1+1 EQUALS?

Dell recently announced a definitive agreement to acquire EMC, including its approximate 80% ownership in VMware. Shortly after, EMC and VMware announced the creation of a joint venture in Cloud computing, named Virtustream. Does this mega-merger makes sense – for the companies, the industry, customers and shareholders? This report focuses on the potential impact of this acquisition on the companies, industry including potential competitors, and customers. We need to qualify this document by saying that this merger is an evolving situation and developments after the completion of this document will probably modify many of our conclusions, but we are not able to continuously update this document.

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DELL + EMC: 1+1 EQUALS?

Dell recently announced a definitive agreement to acquire EMC, which includes EMC's approximately 80% share ownership in VMware. Subsequent to that big announcement, EMC and VMware announced the creation of a new joint venture in Cloud computing, named after a recent EMC acquisition, Virtustream. EMC and VMware each own a 50% share of Virtustream. The immediate reaction of the stock market was a 20% drop in VMware's stock price. Since then, VMware's stock has recovered some of the lost value.

Despite the recent volatility of VMware's stock, there remains the big question: Does this mega-merger makes sense – for the companies, the industry, customers and shareholders? This report focuses on the potential impact of this acquisition on the companies, industry and customers.

A Caveat: At this stage of the acquisition, many details remain unrevealed or undetermined. As expected for a deal of this magnitude, there exist pros and cons for the merger, as well as many unknown challenges and unanswered questions. These combine to inject a high degree of uncertainty and variability around projecting on its impact. However, using existing knowledge of the companies and their current products, this will deliver high level insight into potential synergies and paths that the Dell-EMC may take. The success or failure of this merger will play itself out in time. Its success will ultimately depend on both Dell's vision for the combined entity and effective execution by management of the transition and transformation.

With that said, the Dell-EMC acquisition has potential for significant positive outcomes for the combined company, along with some risks. Our analysis of the potential positive outcomes and associated risks follows. However, be forewarned, actual results may vary.

OVERVIEW

The Dell-EMC merger is yet another example of traditional technology vendors having to reset strategies and transform themselves in order to survive and compete with the new digital companies and technologies. Server commoditization, the rise of cloud computing and the narrowing of infrastructure (especially hardware) profit margins due to competition have profoundly affected the industry. It is forcing many traditional technology giants to rethink, reinvent and transform their core businesses in order to compete effectively with new digital technology competitors. For Dell and EMC the search for an answer to this dilemma is over. This merger is to be their solution.

At the merger announcement, Dell announced their intention is to move the new company into high growth areas, such as digital transformation, software-defined data center, hybrid cloud, converged infrastructure, mobile and security. We believe that the combined companies have many of the assets necessary to move into these new areas. However, these assets are currently dispersed across the individual companies. It will take insightful, rapid rationalization and consolidation to successfully integrate these once the merger closes.

POTENTIAL SYNERGIES

Customer Base:

The merger extends the customer base of both companies. Benefits are expected to accrue from leveraging of the small and mid-market strengths of Dell in combination with EMC's enterprise presence. The larger, more extensive customer base will have sales opportunities and synergies to reach customers not easily accessed by the individual vendors. For example, Dell's existing enterprise solutions may have significantly better traction when sold through EMC's existing enterprise channels. Success will require sales/support staff training and refocusing. And the expected boost to revenue from the larger business will take time to realize. Therefore, it should be viewed as a shorter-term strategy and long-term tactical move. Bringing in more revenue from an expanded base will be beneficial. But, it will not in itself transform the company's business to where it needs to be.

This raises one of the major challenges that the management team faces: Can the executives and staffs break from previous product/marketing/perception silo focuses, into a new broader, cohesive strategy mindset for the new company? Have they, or how quickly can they develop and function with an innovative vision, suitable for the long haul? The difficulty and challenges of making this strategic mindset shift should not be underestimated – many have failed to make these kinds of major shifts in the past. EMC has struggled with this by too often failing to broaden their orientation beyond storage.

Expanded Capabilities

The new company will have broader capabilities that significantly expand its reach. Strategic product rationalization and integration will play a huge role in advancing Dell-EMC to become their customers' enterprise technology partners. Dell picks up many opportunities to integrate a combined product set both horizontally and vertically to create expansive, integrated solutions to pressing customer problems.

There are major synergies to be gained by combining existing, but dispersed assets in the areas of networking, storage, servers, cloud, virtualization, IT management and security. The opportunity includes both extending existing solution options, as well as creating new offerings. Such solutions will be the basis for success in the new growth areas they've identified.

Privatization Advantages

Privatization brings distinct advantages to the combined companies. During the merger process it provides greater flexibility, more freedom in action, as well as relief from some pressures of public companies. As private companies, they are freed from the quarterly/annual scrambles and scrutiny associated with delivering and reporting performance and profits that satisfy Wall Street and shareholders. Instead, executives can focus attention and activities on the merger; giving full attention to strategic issues and operational tasks such as rationalizing products and executing on a new strategy without the distraction of satisfying stockholders. We believe that privatization has some inherent operational advantages unavailable to IBM, HP and Lenovo.
However, it is no magic key, Dell-EMC needs a solid, well thought through, correct vision of the future and execution must be done right. A lot of ifs and risks remain. On the other hand, both Compuware and BMC have benefited significantly from the increased agility and strategic decision-making made possible by privatization.

The new Dell-EMC doesn't escape fully from public company concerns. VMware remains public. EMC currently owns some 80% of VMware shares, making it a majority owner. The recent volatility of VMware's stock price reflects investor uncertainty about VMware's future as part of the acquisition. VMware has been a great investment for EMC. It can be a great asset to the new Dell-EMC.

Moving Toward Cloud Computing

There is tremendous pressure for and interest in 'software-defined infrastructure and software-defined data centers'. The merger will help Dell-EMC compete, if they get the solutions, the economics and the structure right. Dell has stated their intention to move into cloud computing.

Shortly after the merger announcement, EMC and VMware announced the creation of a new jointly-owned hybrid cloud company called Virtustream (the brand of a company EMC acquired earlier this year.) Virtustream will leverage technologies from Virtustream, EMC and VMware. Virtustream's hybrid cloud management capabilities are critical core technologies needed for a push into hybrid cloud computing.

It is conceivable that this latest announcement is driving the sustained drop in VMware's stock price. VMware stockholders are understandably skittish with all the changes on the horizon. However, for the longer term Dell-EMC company, this move enables EMC and VMware a jump start on building a hybrid cloud initiative, while waiting for the larger merger to complete.

Virtustream will likely compete with VCE, a joint venture of EMC, VMware and Cisco. Cisco has reduced its share from 1/3 to just 10%. So the future is cloudy for this company anyway, especially so as Dell-EMC looks to be real.

We believe the far bigger question is whether or not the Dell-EMC combination can catch up with competitors already providing solutions and service offerings. And, if they do catch up, it is far from certain they have the ability to break-away from the growing collection of cloud vendors battling over AWS leavings. And THAT is a very big if.

Potential Challenges

Merger Mayhem

Due to the size of the merger, it is very likely that it will be a prolonged, difficult effort for the combined companies, and especially Dell. Estimates for completion of the merger range from mid-2016 to early 2017. It is reasonable to question whether Dell and EMC executives can handle a company of the combined size. (As an aside: For the HP-COMPAQ merger, it took over three years after the close for them to get everyone on the same e-mail system.) The time that it will take to restructure, integrate and transform the combined company is time that these companies can ill afford, as they strive to catch up in a highly competitive environment full of existing integrated digital vendors not distracted with executing a large merger.

Bigger and Building

The obvious question is whether or not Michael Dell and his extended management team can effectively manage the integration to a $74Billion to $77Billion business AND accomplish the transformation necessary to topple established competitors. Dell, valued at $25 Billion to $33 Billion, is taking on formidable risk by entering into a transaction that could cost an estimated $67 Billion. While there is little product overlap (reducing, but not eliminating potential conflict and rationalization problems), neither Dell nor EMC have a track record of very large, successful mergers. EMC has never fully capitalized on previous acquisitions in adjacent markets. (Despite acquiring companies that could have extended their reach horizontally, the acquired products were subsumed into overwhelmingly storage messaging for many years. Smarts Software is an example.) Other big questions include: Can a combined Dell-EMC with core legacies in hardware, make the necessary transition to become a digital services company? Can they do so in a viable timeframe? Can they seamlessly align two different company cultures to successfully address customers across the total SMB and enterprise spectrum? Can they, at the same time, do so across new, significantly expanded technology markets?

Added to the obvious differences in size, the cultures are also radically different, as are the management styles of Dell and Tucci. The question arises of whether Dell-EMC executives and staffs can break ingrained existing siloed cultures and mindsets to create a radically new company with new and innovative digital solutions. Neither company has demonstrated any ability to do so in the past. Doing so is critical to their success. Both companies struggled as they tried to enter new market segments or attempted to expand their corporate image. Also, while they have been partners for a long time, 'dating' isn't 'marriage'. Of necessity, both expect the other to undergo radical makeovers. Any relationship built on such an expectation is pretty much guaranteed to have a rocky start. Significantly, and worrisome, both partners are coming to this merger hoping to find solutions to their individual problems – not necessarily the best way to start a new relationship.

On the other hand, both companies clearly recognize they cannot survive continuing as they are. It's been said that 'the prospect of death sharpens the mind". So, the need to change, broaden their solution sets and transform themselves to survive to compete in the rapidly emerging and growing digital enterprise market, can help overcome major obstacles. In fact, significant parts of each company complement each other. These will help to shore up some weak spots. Post-merger, the remaining holes in their solution stack will have to be filled. Indications are that Dell is well aware of the challenge they face to rationalize, integrate and build new digital capabilities to address the high growth markets that they're targeting.

More Questions

This section addresses some additional questions to provide insight into other risks and potential roadblocks to success.

This deal is meant to boost Dell's $21B enterprise business. Yet, the merger itself runs counter to moves by both HP and IBM to focus on just enterprise business by shedding the low margin, hi-volume server hardware market which has been Dell's core business. Does merging with EMC's core businesses of storage hardware and software really make sense for Dell? Or, does it add additional, unneeded infrastructure overhead that will act as a drag on the merged company?

How will this merger impact existing Dell, VMware and EMC customers?

Short term, as part of attempts to manage merger financing, it's been suggested that Dell-EMC will turn to an array of techniques to conserve cash (raise prices, cut services, reduce marketing and advertising spend, cut back on product/service R&D, cut maintenance budgets, reduce staff, curtail recruiting, delay compensation, etc. All worth considering. Each with its own risks. In a robust, growing market, the risk of implementing any or all of these is manageable. In today's market, with lots of existing alternatives, any drastic reductions which result in or are perceived as lowering the quality of services and products could seriously threaten revenues.

Think about it, a stated objective is to be able to create new products and services to penetrate highly competitive new market segments. These are aimed at mid-market to enterprise customers. Cutting back on the quality of existing product and services isn't going to endear current customers or win over new ones. Dell-EMC may decide to sacrifice the small customers. But that weakens their revenue base. It's a very short term tactic that's likely to backfire. If Dell-EMC does choose to go that route they will have to execute flawlessly.

As product rationalizations occur during mergers, some products will have to be eliminated or sidelined, affecting customers using those products. When products are rationalized, integrated and repositioned, it raises customer uncertainty and confusion. The good news is that there isn't much product overlap. If Dell-EMC handles things right, they will assure that customers will relatively quickly and smoothly gain access to additional technology in areas not previously offered by the individual companies.

How will this merger impact existing Dell, VMware and EMC partners?

Partner programs will eventually have to be rationalized and integrated. This could cause some disruption for partners. There will be changes in partner related processes, agreements, procedures, etc. How smoothly these proceed will depend on the quality of the transition staff. We do, however, expect minimal changes for technology partners, except for dealing with the broader capabilities of the new company. Reseller and SI partners may experience some disruption, as the new company pulls together their partner programs and new integrated solutions come on-line.

Although Dell may create their own integrated server stacks and horizontal product integrations, it is expected that they will continue to interoperate heterogeneously with other vendor products. And the expectation is the same for VMware and EMC.

Recommendations for existing Dell, VMware and EMC customers and prospects.

1. Make sure that they understand their own interests and needs. Do not make hasty decisions about switching vendors, canceling orders or contracts.
2. Make sure they understand how their future growth and changes will have to be met. Understand that they will be the target of a lot of FUD and pressures from competitors to jump ship. Make sure that any such move is in their own best interests. Recognize the market shift to 'software-defined infrastructure' and include that in their own planning to help them decide about any moves or changes.
3. Educate themselves on the shift taking place in the server market; new architectures provide new opportunities and it is a good time to understand and evaluate them. Understand the new company's direction and decide whether it fits with their own IT strategic direction.

4. Enterprise customers should meet regularly with their EMC/Dell/VMware sales execs to keep abreast of and understand the new company's vision, as well as changes that could affect their own IT strategies. Customers can decide if the new Dell Company remains as one of many technology providers or if they become more of an enterprise technology partner.
5. Be on the lookout for reductions in quality of products and services. Dell has already indicated they do not intend to go to the financial markets for cash. Take care that any products or services you get are not reduced or cut back without a reduction in costs to you.

Competitive Landscape – Markets and Competition

Looking at the overall market, we expect short-term impacts to be minimal. Michael Dell is moving aggressively to reassure nervous customers. However, the market is gaining a much larger technology vendor. The impact of this new very large company depends on the effectiveness of the merger and its execution. Until the merger is settled, market competitors will aggressively pursue Dell and EMC customers and partners as well as attractive employees. All the usual arguments of uncertainty, confusion, disruption, poor quality, etc. will be employed to persuade the targeted group to move to where the turmoil surrounding a merger of this scale is absent.

From an industry perspective, the potential number of layoffs can be significant as redundant functions are merged and streamlined. There aren't any existing glaring overlaps so no significant reductions are likely to occur until the actual merger has been approved and is well underway.

The impacts on foreign markets will similarly be dependent on the results of the merger. More importantly, due to the dependence on partners in many overseas regions, the changes in partner programs could affect those partners and customers.

Let's now focus on the impact on the competition. The new Dell-EMC combined company has the potential to provide a powerful competitive thrust in the industry. It could be the only company able to offer total solutions to many enterprises. Since the breakup of HP, no other company has been able to offer an equivalent range of solutions. However, we have discussed earlier our caveats about this potential. Initially, the new company is likely to be internally focused while it tries to get the new management team in place and develop its strategy and tactics. Obviously, this opens up possibilities for competitors.

One can divide the competitive situation into two aspects, an air war which consists of the cloud and the new digital businesses and a ground war which involves the traditional businesses of storage, servers, and associated software. In the air war Dell-EMC will face Amazon, Microsoft, IBM and various other players[1]. For the immediate future we do not see Dell-EMC able to challenge Amazon in the public cloud. They are likely to engage in a battle with IBM and Microsoft in the hybrid cloud area.

In the ground war, Dell-EMC faces HP and Lenovo in the PC and industry standard server businesses. Given the recent separation of HP, the new HP probably cannot quickly mount a competitive threat

[1] HPE has suffered some setbacks that will likely damage its credibility in the cloud. They will struggle to get traction in this arena.

equivalent to what Lenovo can do. Our money is on Lenovo in this battle. On the storage side, there may be opportunities for IBM, HPE, and various other companies to compete for EMC's customers.

We do not see any wholesale desertion of Dell-EMC customers. Customers will probably mostly adopt a wait-and-see strategy, as we discussed above, in many cases out of simple inertia. However, some customers will undoubtedly be reluctant to make major future commitments until they see how things shake out in the new company. Some will be able to wait to see what will happen. Others will want to hedge their bets and this provides an opening for competition. However, the competitor will have to show that his offering will not be disruptive. It must easily coexist with the Dell-EMC technology that the customer has installed. Potentially, this will provide an opening for Microsoft. All of the larger customers are very familiar with Microsoft and it has both software offerings and Cloud offerings that should appeal to these customers. Customers will also see that the new management at Microsoft is making the transition into new digital businesses with some success. Microsoft may or may not choose to go after this business. To a lesser degree the same opportunity may be available to IBM which may penetrate the customer via storage and then introduce cloud offerings.

Finally, while customers may have the option to wait out the shakedown at the new company, most partners will be more nervous. After all, the partner's revenue and existence depends on their relationship with their key supplier. If the supplier decides to drop or turn into cash cows products that are vital to the partner, the partner will need to respond quickly or face extinction. Competitors have a significant opportunity here. Savvy partners will want to insure themselves against bad news from the new company since they have to know that the welfare of partners is unlikely to be uppermost in the minds of the executives of the new company.

Conclusion

There's no doubt that the Dell-EMC merger is a major industry event. However, at this point in time there exists a lot of speculation and unanswered questions. The only legitimate answer is 'we don't know'. Even the Dell and EMC executives can't answer simply because it is too early in the process. This makes prediction of impacts and outcomes cloudy at best. However, when the answers begin to reveal themselves as the process progresses, it will be easier to assess what will be the likely impact. We'll revisit these topics as time passes with more available data and information. There should be no doubt that the new company will make a mark on the industry. The uncertainty is what those marks will be and how significant they are.

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Our analysts cover a breadth of areas that are ideal to bring you the "Big picture" on new technology trends across the industry. Whether it's Cloud computing, Mobile (BYOD), the Internet of Things, DevOps, Big Data, IT Operational Analytics, Workload Optimized systems or other new trends, Ptak Associates analysts cover these trends with a unique perspective that is both deep and broad.

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