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BUSINESS

IBM's Rometty Bets Her Legacy on Red Hat Deal

\$33 billion purchase is unprecedented move by the computing giant; experts see risk



Chief Executive Ginni Rometty has sought to shrink IBM's older, slower-growth lines of business while focusing on artificial intelligence, the blockchain and the cloud. PHOTO: FOCKE STRANGMANN/EPA-EFE/REX/SHUTTERSTOCK

By Jay Greene

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With her \$33 billion deal for Red Hat Inc., [RHT 45.38% ▲](#) Chief Executive Ginni Rometty is placing the biggest bet of her career on something International Business Machines Corp. has never done: a massive acquisition.

IBM [IBM -4.13% ▼](#) is paying an amount for Red Hat that roughly equals the combined value of all the deals it has done in the past 15 years, as tracked by Dealogic. IBM said unreported deals push the tally of previous acquisitions higher. The deal's value represents about 30% of IBM's current stock-market capitalization. IBM's next biggest deal was a \$5 billion purchase of Cognos Inc. in 2007.

For most of her nearly seven-year tenure as CEO, Ms. Rometty has tried to shake the rust off the aging tech giant with bets on emerging opportunities such as artificial intelligence and the blockchain, some of which have yet to pay out. With the Red Hat deal, IBM is making a significant gamble on a longtime pillar of its turnaround plans, the business of renting out computing power and software in the cloud.

Stoxx 600 **355.51** 0.90% ▲U.S. 10 Yr **-6/32 Yield** 3.112% ▼Euro **1.1368** -0.04% ▼

“This is a bet-the-company move by IBM,” said Matt McIlwain, managing director of Madrona Venture Group LLC, a venture firm that focuses on cloud computing. The firm isn’t an investor in either IBM or Red Hat.

On Monday, the companies said in a securities filing that Red Hat would pay IBM a \$975 million termination fee if the deal doesn’t close in a year.

Big acquisitions have a long history of not working out. And there are reasons to be skeptical of IBM’s track record, said Craig Lowery, an analyst at Gartner Inc.

IBM paid roughly \$2 billion to buy SoftLayer Technologies Inc. in 2013, hoping to make a dent in Amazon.com Inc.’s leadership in the market for renting computing power and software, called infrastructure as a service.

But SoftLayer never became a service that threatened Amazon or others, or served as a platform from which IBM could significantly boost its other applications, Mr. Lowery said.

“They’ve made a lot of deals,” he said. “None of them have been particularly successful.”

An IBM spokesman disputed that sentiment, noting the company has done well integrating services businesses, such as with its \$3.5 billion acquisition of the consulting arm of PricewaterhouseCoopers LLP in 2002.

One thing the Red Hat deal seems likely to ensure: Ms. Rometty’s continued leadership at IBM, said Toni Sacconaghi, an analyst at Sanford C. Bernstein. At 61 years old, Ms. Rometty is past the age when the previous two IBM chiefs retired.

IBM and Red Hat expect the deal to close in the second half of next year, at which point it will take time to integrate. “When you make your bed, you usually have to lay in it,” Mr. Sacconaghi said.

Whether or not successful, the deal likely will provide a bookend to Ms. Rometty’s continuing struggle to breathe new life into the 107-year-old company. Her efforts to shrink IBM’s older, slower-growth lines of business while focusing on what she refers to as high-value businesses remain a work in progress.

The Red Hat deal is aimed at boosting IBM in the cloud, a key piece of those fast-growing businesses. Amazon dominates the market of providing computing power and software for rent with 51.8% of world-wide revenue last year, according to Gartner.

But Microsoft Corp. , Alibaba Group Holding Ltd. and Alphabet Inc.’s Google have built bigger businesses there, and IBM garnered just 1.9% of last year’s world-wide revenue in the market, according to Gartner. The IBM spokesman described Gartner’s definition of the market as “thin,” saying that customers see the business more broadly.

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collection of faster-growing businesses—led to nearly six years of falling revenue. IBM initially reversed that streak in January and added two more quarters of growth. But it slipped again, posting a 2.1% slide in its latest quarter. IBM's shares are off 22% since the beginning of the year and fell another 4.1% to \$119.64 in Monday trading.

Ms. Rometty and IBM's board “had to do something that was reasonably dramatic,” a former IBM executive said of the deal.

The building of IBM's strategic-imperatives business, which totaled nearly 50% of the company's revenue last quarter, set the company up well to acquire Red Hat, the IBM spokesman said. “It's not a desperate move,” he said.

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