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BMC Software’s $6.9 Billion Buyout Reflects Cloud Shift

By Aaron Ricadela and Sarah Frier - May 6, 2013

BMC Software Inc. (BMC) agreed to be taken private in a $6.9 billion deal by Bain Capital LLC and Golden Gate Capital after struggling to compete with newcomers better equipped to handle the shift toward cloud computing.

The buyout group, which includes Singapore’s GIC Special Investments Pte Ltd. and Insight Venture Partners, is taking control of BMC in the third-largest private-equity deal of 2013. The investors agreed to pay $46.25 a share in cash, a 13 percent premium to the closing price on March 4, before Bloomberg reported that BMC had drawn renewed takeover interest.

BMC, a Houston-based provider of software that keeps corporate computer networks running smoothly, gets about 40 percent of its sales from the lucrative business of managing powerful mainframe computers from International Business Machines Corp. Yet it has had a harder time keeping up with rivals in the market for server software, which has been moving to companies’ data centers as customers rely more on programs delivered over the Web.

“They’ve been outpositioned by some of the growth companies out there,” said Joel Fishbein, an analyst at Lazard Capital Markets. “The world’s changed from a technology perspective very dramatically, and they haven’t been able to keep up.”

The emergence of software delivered as a service via the so-called cloud has helped newer competitors such as ServiceNow Inc. and Splunk Inc. to grab market share. BMC is also contending with traditional rivals CA, Hewlett-Packard Co. and IBM. About a quarter of new ServiceNow customers are replacing BMC products, ServiceNow Chief Executive Officer Frank Slootman said in a recent interview.

Investor Pressure

BMC held talks last year with buyout firms amid pressure from activist investor Elliott Associates LP, its second-largest shareholder, which said the company would be worth more in a sale than as a public entity. It decided to do a $1 billion stock repurchase instead. BMC attracted renewed interest in March ahead of the expiration of Elliott’s standstill agreement, a person familiar with the situation said at the time. In April, the company said it planned to cut jobs after a review of its operations, without specifying the number of positions to be eliminated.

BMC is facing "intense competition" from smaller suppliers and customers have been reluctant to sign contracts, given the uncertainty about its future, Abhey Lamba, an analyst at Mizuho Securities USA, wrote in a research note today. He has a neutral rating on the shares.

Cloud Computing

As a private company, BMC plans to become more aggressive in managing cloud-computing applications and mobile devices, BMC CEO Bob Beauchamp said in an interview.

"There's no guarantee a go-private transaction can make a company more competitive, but in this case I feel good about it," he said. "We have an incredibly strong, profitable, growing mainframe business."

While Elliott was pushing for a higher price, BMC's struggle to expand in software and services delivered over the Internet made a richer offer unlikely, according to Fishbein.

"We thought the price at most was going to be $48," Fishbein said. "They got the lower end because buyers saw the deterioration of the company."

Shares of BMC were unchanged at $45.42 at the close in New York. The software maker had a market value of about $6.5 billion as of May 3.

BMC sells software that manages fleets of computer servers and mainframes, configuring new machines and applying updates to older ones. One of BMC's business units makes software for managing server networks and the other is focused on mainframe products.

Cash Flow

"The deal makes sense given how much cash flow the company can manage from its mainframe operations," said Kirk Materne, an analyst at Evercore Partners Inc. (EVR) in New York. Bain is paying about nine times BMC's projected 2014 cash flow, which Materne estimates will be $774 million.

Over the past year, there have been about 190 pending or completed acquisitions announced for U.S. providers of enterprise software, with an average deal value of $157 million and a typical premium of 29 percent, according to data compiled by Bloomberg.

Beauchamp said operating privately would reduce the quarter-to-quarter "volatility" in BMC's results.

Private-Equity Deals

The transaction is another indicator of the private-equity industry’s renewed interest in technology deals, an area that’s yielded uneven results.

Only two private-equity deals announced so far this year are bigger than the proposed BMC transaction -- the sale of H.J. Heinz Co. to Warren Buffett’s Berkshire Hathaway Inc. and 3G Capital Inc. for about $23 billion, and the buyout of Dell Inc. (DELL) by co-founder Michael Dell and Silver Lake Management LLC for $24.4 billion. BMC’s agreement with Bain includes a 30-day period to solicit alternative proposals, according to the statement.

From 2005 to 2007, the peak of the buyout boom, private- equity firms completed four technology deals of comparable scale to Dell, according to data compiled by Bloomberg. Two of the LBOs are mired in losses, while the others, including the Silver Lake-led acquisition of SunGard Data Systems Inc., have produced minimal gains for the buyers and their investors.

Buyout Firms

The BMC acquisition would be Bain’s biggest since 2007, when it teamed up with firms including Carlyle Group LP to buy construction-supply business HD Supply Holdings Inc. from Home Depot Inc. for $8.5 billion.

Created almost three decades ago by Mitt Romney, the losing candidate in the 2012 U.S. presidential race, Boston-based Bain oversees about $70 billion in managed assets, according to its website. The private-equity firm struck its largest deal in 2006 with the $33 billion takeover of hospital operator HCA Inc. Romney retired from Bain in 1999.

Golden Gate, a San Francisco buyout firm with more than $12 billion under management, is led by David Dominik, a former Bain Capital managing director.

Morgan Stanley (MS) and Bank of America Corp. are serving as financial advisers to BMC, while Wachtell, Lipton, Rosen & Katz is providing legal counsel.

Credit Suisse Group AG (CS), RBC Capital Markets and Barclays Plc are serving as financial advisers to the buyout group and have agreed to provide debt financing in connection with the transaction. Qatalyst Partners LLC is also advising the buyers. Kirkland & Ellis LLP is serving as legal counsel.

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