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## Software AG Acquires IDS Scheer To Finalize Its Five-Year Restructuring Plan

Software AG Will Pass The €1 Billion Revenue Mark Once It Closes The Deal

by **Stefan Ried, Ph.D.**

with Thomas Mendel, Ph.D., Bradford J. Holmes, and Miroslaw Lisserman

### EXECUTIVE SUMMARY

Software AG continues to stay the course on its five-year turnaround plan. After stabilizing its legacy application business — mostly by replacing its former integration offering with the webMethods technology stack it acquired in 2007 and successfully establishing a new Software AG brand — its acquisition of IDS Scheer will fix the one remaining pressing issue: Software AG's professional and consulting services. While IDS Scheer strongly positions itself around the ARIS product line, which is a leading business process analysis and enterprise architecture tool, its main contribution to Software AG will be its consulting practice. Taken together, the webMethods business line, the IDS Scheer ARIS product family, and the consulting practice will not only turn Software AG into a leading BPM vendor with vertical industry understanding, but it will also change the scene for every vendor that currently partners with IDS Scheer or Software AG. To really leapfrog the competition, Software AG should now think about its next strategic move: buying into the IT management software or business intelligence market.

### SOFTWARE AG'S FIVE-YEAR TURNAROUND

When Karl-Heinz Streibich took over as CEO at Software AG in October 2003, the company was in a dismal state; revenues were in freefall, and customer trust was disappearing. Its amazing turnaround into a stable, profitable, and respected software vendor in only five years came from following two basic principles:

- **Continuously improve operational excellence with existing staff.** Increasing margins, controlling costs, and harvesting maintenance revenues have been major ingredients of the stabilization effort.
- **Disruptively acquire technology and market access.** Its first major acquisition in 2007 of webMethods not only replaced large parts of Software AG's own integration technology, but it also established access to the North American market.

In this respect, Software AG's announced acquisition of IDS Scheer is a continuation of the second part of Streibich's strategy.<sup>1</sup> Here are some insights into the deal itself:

- **Software AG has already *de facto* acquired 47.68% of IDS Scheer's total shares.** Dr. August-Wilhelm Scheer, founder and chairman of IDS Scheer AG's supervisory board, and Dr. Alexander Pocsay, co-founder and co-chairman of that board, have committed to accepting the takeover offer for all the shares that they personally hold.

- **Software AG will buy the rest of the IDS Scheer shares for cash.** The total value of the takeover offer amounts to approximately €482 million.<sup>2</sup> The offer period is expected to start during Q3 2009, and Software AG expects to close the transaction in Q4 2009.

Although IDS Scheer is a publicly traded company, the two founders personally hold an enormous 47.68% of all its shares. This has streamlined the deal significantly and avoided an escalating auction with SAP, the only other company that might have made a bid.

The deal indicates that the charismatic, 67-year-old Professor Scheer will not be joining Software AG. Although he is one of the most outstanding IT entrepreneurs in Germany and he invented the whole idea of business process discovery and analysis, his presence in a post-merger process would slow down the integration into a merged company.

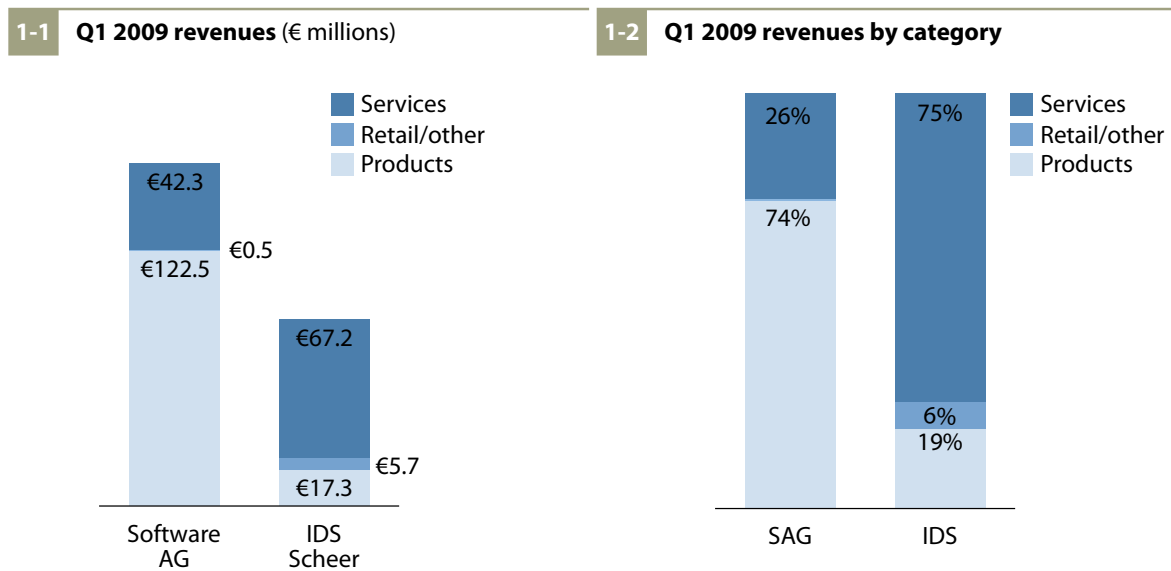
### IDS Scheer's Major Contribution Is Not Its ARIS Product Family But Its Services Expertise

The ARIS product family dominates the public perception of IDS Scheer. However, the deal size of €482 million and IDS Scheer's total 2008 revenues of €399 million mean an evaluation of only 1.2 times revenue. Such a low number would usually bring into question the quality and viability of the software products. But this is not the case with IDS Scheer: The ARIS products are mature but still provide innovation around business process discovery and enterprise architecture management. The background to this evaluation is IDS Scheer's revenue structure: It is mainly a services and consulting company; only 19% of its license and maintenance revenues are based on its own products (see Figure 1). While Software AG has reached the ideal 75:25 ratio for global software vendors — with 74% of its revenues coming from products versus 26% from consulting services — IDS Scheer is at the opposite end of the scale; it is a services-focused company with an enabling product. This not only justifies the relatively low price for IDS Scheer's products and intellectual property, but it also reveals Software AG's real intention behind the deal. Its professional services division was the only area that it had not restructured successfully. Once it closes the deal, Forrester expects that, at least in Germany, Software AG will integrate its current professional services division into the successfully run and bigger IDS Scheer consulting organization — not the other way around.

IDS Scheer's consulting services are already structured well, with extensive experience in 20 different industry verticals.<sup>3</sup> They will finally provide a vertical approach for Software AG's business process management (BPM) and integration-centric go-to-market offering. Software AG has been struggling to find the right approach to verticalization over the past four years and has even developed some industry-specific business application frameworks for the insurance business. Forrester believes that business process platform vendors shouldn't verticalize their platforms or add industry-specific applications.<sup>4</sup> They are able to compete more effectively with the tier one middleware vendors if they use a consulting partner to contribute this vertical domain expertise. Unfortunately, Software AG has failed to build enough strong partnerships for this in Germany over

the past three years, but it has now closed the gap with this acquisition. The result is a horizontally oriented, industry-independent product portfolio that it has extended with the ARIS tools and combined with its own vertical consulting arm, albeit mainly in Germany. This approach will focus R&D efforts on a competitive platform, sold internationally via implementation partners, and will hopefully result in solid consulting and product revenues from Germany.

**Figure 1** The Revenue Streams For Software AG And IDS Scheer



Source: Software AG 2008 Annual Report, IDS Scheer 2008 Annual Report

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Source: Forrester Research, Inc.

### The Acquisition Means A Merged, BPM-Centric Portfolio

IDS Scheer’s products originally focused on business process discovery and documentation. A continuous stream of innovation has extended its capabilities in recent years to various modeling use cases, and it has managed to address the demands of nontechnical business analysts. At the same time, the ARIS product family has tried to bridge the gap between high-level process design and executable BPM runtime environments. IDS Scheer has had many successful partnerships with vendors that provide these environments, such as Microsoft, Oracle, and SAP, because it didn’t have a competing BPM runtime environment in its own portfolio. However, this initial benefit turned out to limit its growth, positioning IDS Scheer in a niche position around the larger vendors. To get further shares of the BPM initiatives at large customers, IDS Scheer developed a second product branch focused on process performance management, which monitors the performance of BPM runtime platforms with a full understanding of the process landscape.<sup>5</sup>

While the ARIS design capabilities complement Software AG's current BPM offering, the process performance management tool — ARIS Business Performance Edition — overlaps with the functionality of the webMethods business activity monitoring (BAM) product. Software AG has to figure out how to successfully merge the intellectual property it has just acquired.

### How Software AG Can Capitalize On The Acquisition Internationally

The ARIS product family provides analysis and life-cycle management for business processes across all kinds of runtime implementations. This sophisticated approach mainly resonates in Europe. Many customers separate business process analysis and planning from implementation in a BPM system or other traditional IT system. For example, the ARIS tools provide a holistic view of a business process across various users as well as an ERP system and a mainframe environment.

While US customers tend to use the modeling tools that a BPM runtime engine, for example, provides inside the ERP system, many European customers gain a sophisticated understanding of a process from a separate design tool like ARIS outside the runtime modeling tools. Also, human process steps outside any IT system could easily be included in the process documentation.

This different approach in Europe, which contrasts with the North American preference for packaged applications and standard processes, is one of the main reasons why IDS Scheer gains a much greater share of its revenues from its home region than Software AG does (see Figure 2).<sup>6</sup> The bottom line is that Software AG can't expect its international sales force to be able to sell the ARIS product family in all regions. This requires a cultural fit in addition to local consulting expertise.

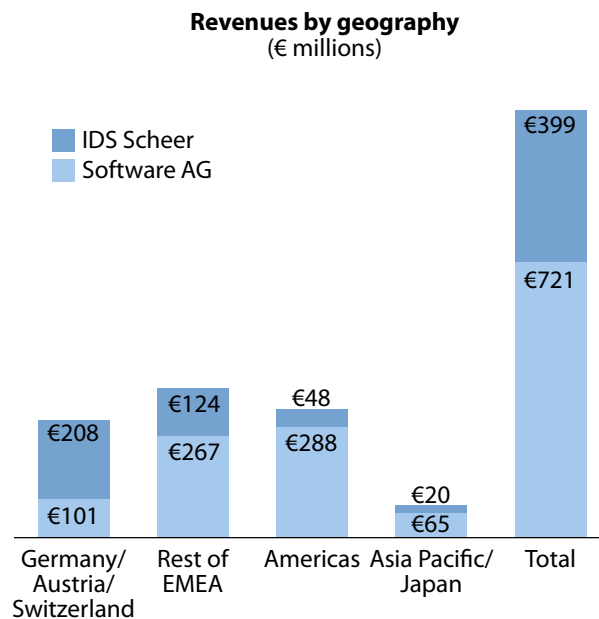
### What's Next, Herr Streibich?

Based on the two vendors' global Q1 2009 numbers, the merged revenues will result in a product-related revenue contribution of just 55%. This is not enough to drive product innovation that will satisfy its implementation partners globally. Although hitting €1 billion in revenues is a huge milestone in its history, Software AG is not big enough to run a product business and consulting business under two different sub-brands and avoid frequent channel conflicts; in other words, it can't replicate IBM's go-to-market approach. Software AG's future strategy and massive investment must have a renewed product focus. It could extend its platform footprint in many different directions:

- **The current economic situation requires greater IT management efficiency.** BMC-like functionality is still missing from Software AG's portfolio. The acquisition of a tier two player, such as REALTECH, would be a natural extension of Software AG's portfolio.<sup>7</sup>
- **Software AG's customers are cost-sensitive.** Software AG should therefore help them manage their IT costs more efficiently and embrace the emerging product category of IT financial management software.<sup>8</sup> It could establish itself in this area with another acquisition or by basing an offering on IDS Scheer's enterprise architecture capabilities.

- **A comprehensive business process platform requires business intelligence.** Extending its product portfolio in the direction of business intelligence (BI) is another potential option for Software AG; it would need to acquire a company like arcplan or QlikTech or commit to developing a BI product based on its existing technology stack.<sup>9</sup>

**Figure 2** The Combined Revenues Of Software AG And IDS Scheer By Geography



Source: Software AG 2008 Annual Report, IDS Scheer 2008 Annual Report, Analyst Presentation: Software AG announces offer for IDS Scheer

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Source: Forrester Research, Inc.

## RECOMMENDATIONS

### THE ACQUISITION AFFECTS EVERYBODY AROUND THE TWO VENDORS

The projected accumulated annual revenues of IDS Scheer and Software AG would be around €1.1 billion. With this, Software AG's CEO Karl-Heinz Streibich delivers on his promise to grow the company's revenues to the magic €1 billion mark by 2010. However, this acquisition will alter most of the relationships in the ecosystem around Software AG and IDS Scheer — and possibly add to their competitive pressures.

- **Customers should not be concerned.** The only area of change would involve the merger of the ARIS process performance management products with webMethods' BAM product. The majority of the ARIS product family will be unaffected.

- **German system integrators implementing webMethods face new competition.** A merger with the IDS Scheer consulting force will give Software AG a stronger market presence in Germany for general integration and BPM implementation projects. International and North American system integrators in particular won't see any changes.
- **BPM runtime vendors currently partnering with IDS face complex partnerships.** IDS Scheer currently has partnerships with Microsoft, Oracle, and SAP around their business process runtime environments. Although Software AG is committed to continuing these partnerships, a merged sales force will sell, for example, webMethods middleware in competition with SAP NetWeaver, once it has access to the large number of SAP customers using ARIS.
- **SAP could evaluate a closer partnership with Software AG.** The valuable customer relationships that IDS Scheer has established with many European SAP customers should not be underestimated. If SAP wants to avoid confusing competitive situations with Software AG in front of customers, it should consider evaluating more Software AG technology components as part of a balanced partnership. Software AG has a much bigger and more predictable product engineering organization than the relatively small IDS Scheer product development group.
- **Software AG should retain its product focus.** The only way that Software AG can keep both its high revenues and high margins is to focus on its product business. A skilled consulting team can enable and support this, but the company shouldn't mutate into a consulting firm.

## SUPPLEMENTAL MATERIAL

### Companies Interviewed For This Document

Software AG

## ENDNOTES

<sup>1</sup> Source: "Ad Hoc Disclosure According To § 15 WPHG; Software AG announces tender offer for IDS Scheer," Software AG press release, July 13, 2009 ([http://www.softwareag.com/corporate/inv\\_rel/news/adhoc-releases/20090713\\_AdHoc\\_tender.asp](http://www.softwareag.com/corporate/inv_rel/news/adhoc-releases/20090713_AdHoc_tender.asp)).

<sup>2</sup> Software AG will pay a consideration — via its subsidiary SAG Beteiligungs GmbH — of €15 per IDS Scheer share in cash.

<sup>3</sup> Visit <http://www.ids-scheer.com/en/Consulting/Industries/3760.html> for a list of these industries.

<sup>4</sup> As Cordys has not yet reached the €1 billion revenue mark, Forrester recommended that it keep all products horizontal and look for industry-specific consulting partners and system integrators. See the January 30, 2009, "[The Strategic Turnaround: Cordys Repositions To Verticals With An Indirect Sales Model](#)" report.

<sup>5</sup> The business process performance management is partly built on an OEM agreement with Systar. Forrester expects that these parts could be replaced by the webMethods BAM infrastructure.

- <sup>6</sup> We calculated the regional revenues from the revenue percentages that Software AG provided as well as the total revenues provided in the Software AG and IDS Scheer annual reports for 2008. Due to rounding, the figures might vary slightly from the official 2008 total revenue numbers stated in the annual reports.
- <sup>7</sup> Forrester has written a market overview of the major IT management software players. It sets the benchmark for the evaluation of a second-tier acquisition target. See the June 11, 2009, "[Market Overview: Business Service Management](#)" report.
- <sup>8</sup> Forrester has written an overview of the new software category and its basic capabilities. See the May 7, 2009, "[Market Overview: IT Financial Management Software](#)" report.
- <sup>9</sup> For an overview of the business intelligence market, see the May 29, 2009, "[Market Momentum: Business Intelligence, Q1 To Q3 2008](#)" report. A Forrester blog discussion of the BI opportunity for Software AG is available at [http://blogs.forrester.com/business\\_process/2009/07/bi-analytics-and-cep-some-fruitful-potential-followons-from-software-ags-acquisition-of-ids-scheer.html](http://blogs.forrester.com/business_process/2009/07/bi-analytics-and-cep-some-fruitful-potential-followons-from-software-ags-acquisition-of-ids-scheer.html).