Oracle's Bid for BEA: A Mexican Stand-off?

MGI Analytical Team

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MGI Research provides its clients with Actionable Intelligence™ based on our proprietary quantitative and qualitative research processes. Using MGI's data and advice, investors gain an edge in analyzing technology companies. CEO's and management teams use MGI to benchmark their performance relative to peers. MGI's proprietary technology industry benchmarks and analysis distill a complex stream of data into clear-cut recommendations.

The MGI Index ("Margin Growth Indicator" or "MGI-X") is a quantitative benchmark that identifies companies that are the most and least efficient managers of growth and profitability. Companies with bloated cost structures and inefficient business models tend to have low and declining MGI scores, while those that are constantly trimming the corporate "fat" and increasing their efficiency tend to have high and rising MGI scores.

The MGI Index answers the following key questions:

- Which management team is the most or least efficient?
- How do companies compare vs. their peers?
- How well do executives manage costs in both up and down cycles?
- How much "fat" is there in the corporate infrastructure?
- Is management taking concrete steps to improve results?

MGI Index measures management's effectiveness across key operating areas of the business. MGI uses up to eight years of publicly available financial information derived from SEC filings and management reports. MGI Index models a company's performance and synthesizes short-term, mid-term and long-term operating results into an objective, uniform measure of corporate efficiency. MGI Index takes into account changes in key budget allocation areas such as research and development, sales, marketing, capital spending, general and administrative. The result is a single number – the MGI Index, a measure of corporate operating fitness.

The events in the potential Oracle acquisition of BEA Systems seem to be following a B-movie script with tough talking characters angling to resolve their differences publicly while not losing face. It isn't a Mexican standoff just yet – the third opponent – another bidder or a white knight, is still missing and making it hard for BEA. Carl Icahn - a likely participant in this shoot-out - is sitting this one out for now.

In the course of the last week, Oracle put a Sunday, October 28th deadline on their offer to buy BEA. In response, the BEA board put a price tag on the company - $21 per share a 23.52% or almost $1.5 billion premium to Oracle's $17/share offer. Oracle promptly rejected BEA's ASK as "an impossibly high price for Oracle or any other potential acquirer" - So far, so good. Not worthy of an Oscar but it has potential to get more interesting.

Short of BEA caving in to the $17/share offer, our view is that Oracle will probably let its offer lapse on Sunday and allow BEA stock price to settle down. We do not expect BEA shares to drop like a rock – no one seriously believes Oracle will just walk away to look at other options. There are other companies in middleware (Tibco, IONA, etc.) but none are on a scale that would be meaningful to Oracle.

More likely, Oracle will initiate a tender at or about its original price some time after the $17/share offer expires at sundown on Sunday. A tender may come on Monday or even a week or two later. It would apply pressure on BEA and continue to fuel uncertainty around BEA's status - playing right into Oracle's strategy. BEA customers are not going anywhere, but new deals and contract renewals would be impacted by delays, additional terms and conditions, and that would effect BEA results on a go-forward basis. A proxy fight between Oracle and the BEA board is possible, could get nasty and may turn into a real Mexican standoff between BEA, Oracle and Carl Icahn.

There is still a possibility that Oracle and BEA may in the mid-term strike a deal somewhere in the range between $17 and $21 per share but that would require a cameo appearance from Larry Ellison.

Bottom Line: We re-iterate our view (see our note from Oct 12th, 2007) that Oracle is likely to prevail in its bid for BEA Systems..