

Research Note: M&A, Industry Consolidation, Competitive Analysis

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M&A Heats up in IT Equipment Recycling: Ingram Micro Acquires CloudBlue

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The News and the Issues:

Technology distributor Ingram Micro announced its acquisition of CloudBlue, a Norcross, Georgia-based IT Asset Disposition (ITAD) company. The announcement made on September 30, 2013 did not come as a surprise given the broad M&A trends affecting the sector over the past three years, trends that are likely to continue in the foreseeable future.

Such moves however, mark the debut of another leading player active in the component/IT equipment distribution sector, joining the likes of Arrow Electronics and Avnet in the ITAD industry. Meanwhile, the core pure-play space previously dominated by the likes of Intechra, TechTurn, CloudBlue and others is shrinking rapidly.

As M&A activity evolves, the ITAD industry will have to deal with the potential painful restructuring related to integration strategies that are not only specific to Ingram Micro, but other companies that underwent a similar process. More importantly, confusion is likely to affect decision makers within enterprises as well as end-user customers that use ITAD services, in particular procurement officers and IT manager. As such, we anticipate at least three key events as we look at the medium term:

1. M&A activity will continue with a handful of core assets still candidates for acquisition.
2. The integration of acquired assets within their new parent companies will be challenging.
3. With the end-user communities, procurement officers and IT managers will face uncertain choices and difficult questions, in particular when selecting an ITAD provider.

Analysis:

This week's acquisition marks an important moment in the necessary consolidation phase of the ITAD sector. It is important because it is about a sector that is rarely covered, but one that deals with critical functions of recycling. In the US alone, we estimate the IT hardware recycling sector to be valued at about \$5 billion annually, and is bigger when including premium services such as on-site data security.

In this case, it is about Ingram Micro, a Fortune 100 company that acquired the 5-year old ITAD firm CloudBlue, potentially enabling greater synergies between the two companies. The idea and value propositions of this deal seemingly make sense. Ingram Micro core focus has always been on wholesale distribution of IT equipment and components, and by acquiring CloudBlue, it signals its interest in controlling the end-of-life of IT equipment, enabling fresh opportunities with not only selling into the secondary market but also up-selling CloudBlue services to help enterprises remain compliant and efficient. It is also about establishing a 'closed-loop lifecycle' so that existing customers remain within the Ingram Micro domain. CloudBlue's services are complementary to those services provided by Ingram Micro. This is because CloudBlue focuses on eWaste recycling, remarketing retired assets into the secondary market and data security, areas that Ingram Micro is not known for.

In this acquisition, the integration may take a different form than what we saw in previous similar deals. Instead of a pure integration into the acquiring entity, CloudBlue will remain somewhat a separate unit, as a wholly owned subsidiary of Ingram Micro, and its now-ex CEO, Ken Beyer will remain the top Manager of the company, reporting to an Ingram Micro executive vice president, in charge of global logistics. This structural formulation makes sense but it may be just transitional since changes are expected in the short to medium terms.

As with some of the most recent acquisitions, Ingram Micro spoke of its global footprint as a value proposition to enable CloudBlue to expand its international reach. This vision is sound as many end-user companies are looking for an ITAD partner with international scope.

Ingram Micro joins competitors and companies that have been active acquiring ITAD business assets for some time. For instance, Avnet, a distributor of electronic

components and technology acquired a pure play firm, Round2, to expand its reach into a more closed-loop lifecycle business model.

Arrow Electronics, another leading distributor, has been perhaps the most aggressive entity, which has been very active in the M&A field acquiring such big names as Intechra, Redemtech, TechTurn, and Converge.

While other distributors are most likely watching these events and making their own assessments as how to play in the future, other key industry players are fueling the M&A sector in electronics recycling. Including Waste Management, with its acquisitions of Mordell, Affordable, and Access, as well as recycler SIMS with its acquisitions of Device, Genesis Recycling and other entities.

So what are we left with?

With CloudBlue under the Ingram Micro umbrella, the core pure-play sector is indeed shrinking, before rebounding as investor interest resumes. While there are still a few more attractive companies operating as independent entities, the marketplace is facing interesting dichotomies, starting with balancing the needs for a much more organized and consolidated services sector, while responding to the needs of end-user enterprises in terms of diversification and competition on the supply side. In this context, we are anticipating the following:

1. As the core pure-play space shrinks, new players and new names are likely to organize themselves to build new competitive capabilities when approaching potential large end-user customers. These companies have lesser “pure-play” competition to contend with, and may be much more agile in negotiating flexible terms with customers. Some of the names we are watching include but are not limited to US Micro, Belmont, GEEP, etc. While many of these companies are financially sound, the ongoing M&A movement provides them with the ability to raise financial resources and new sources of funding, if required. One area we should be watching and where fresh investments may be pouring in is around the concept of mobile device ‘recycling’ and ‘data center decommissioning’, two hot areas of interest to investors and end-user companies around the world.
2. End-user customers that have a multi-vendor policy when selecting an ITAD service supplier, including banks, healthcare institutions, insurance

companies, government entities, etc, will be forced to consider talking to ITAD firms that were not on their radar screen in the past. This not only broadens the supply ecosystem, but it brings to the forefront ITAD companies that have been reluctant to get their names front and center.

3. Also for end-users, it is back to square one when it comes to due diligence. The now-acquired ex pure play firms have adopted some of the same core functions and offerings that became standard, including data security practices, remarketing, and recycling, with auditing and reporting as central tasks. Now that these firms are out of the market, getting to know new players will require added costs in terms of due diligence.

Post-Acquisition Key Questions:

While this M&A movement bodes well for emerging ITAD companies, there are still critical questions that remain to be answered on the long-run as we move into the integration phase.

Question 1: One of the main questions is how to define the role of the ITAD business unit within the large acquiring parent companies, regardless of who they are. The success of such acquisitions specific to ITAD hinge on two basic assumptions:

- a. The acquired company must have sufficient autonomy to function properly. In all the cases we studied we concluded that the success factors of companies that were acquired was the drive and dedication of their management team and owners, sales organization, and operational structures. By attempting to re-create new structures and reporting mechanisms, these companies risk facing a major backlash from existing customers. As such, we recommend Ingram Micro to undergo a very careful risk/opportunity evaluation before making any substantial structural changes.
- b. The acquired company must take advantage of the parent company's scale and global footprint and not just become a source of revenue per se. Finding new customers will be important and the help of the parent company must be instrumental in getting into new accounts. This means

that educating and incentivizing Ingram Micro's sales force to sell ITAD services will be critical in the success of CloudBlue going forward.

Although seemingly simple, these two basic assumptions are often very difficult to implement. Often parent companies push for integration policies that make sense to those driving them at that time, but they miss the mark. Strategic errors and tactical missteps push customers to shift to new suppliers and key executives leaving the company. Because these acquired companies represent a tiny fraction of the parent company's global revenue, resources are not always available for the newly acquired company to grow, and sales organizations accustomed to selling into the components market may resist and could stick to old practices.

Question 2: One of the key questions that parent companies and the entire industry must deal with is their readiness to face the new IT platforms that are emerging as a result of reduced use of PCs and increase use of mobile devices and datacenters. Most of the valuable ITAD companies are ill prepared to deal with the displacement of classic IT assets like desktops and laptops by such products and services as tablets, smartphones, and the cloud. These acquisitions are important in that they deal with the "recycling" of classic IT assets, but they are not sufficiently focused on the fast growing device and datacenter ecosystems. Given this, we see the emergence of new players in the ITAD space that could become formidable competitors. Watch for companies like Gazelle, NextWorth, eRecyclingCorps, among others.

Conclusion:

All in all, the acquisition of CloudBlue by Ingram Micro is good news for many, starting with the ITAD industry itself. Standards will likely take shape as the acquiring company, and its competitors, will be seeking to impose best practices that are so important in the area of compliance and data security, environmental stewardship and cost control. But it also raises important questions about the integration of acquired entities into their parent company's structures, the readiness of these companies to embrace new ITAD practices for mobile devices and datacenters, and finally dealing with nervous end-user companies that utilize these services.