



Lenovo Completes Acquisition of IBM's x86 Server Business

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On October 1, 2014, Lenovo [closed the acquisition of IBM's System x](#) server business for \$2.1 billion. The deal, which was [announced in January](#), represents an acceleration of distinct strategies for IBM and Lenovo. Not being timid about diverging from its long history in building machines, while remaining in the systems and storage businesses, IBM is focusing on future software and services — with notable investments in cloud services and data analytics. Lenovo, a strong player in the commercial and consumer hardware space, is placing a big bet to become a major player in the enterprise, hyperscale, and high-performance computing hardware markets.

Summary of the Acquisition

As previously announced, IBM is retaining System z, Power, Storage Systems, the Power-based Flex servers, and the PureApplication and the PureData integrated platforms; in addition, IBM will keep IBM Systems Director and Flex System Manager. Lenovo is acquiring the System x business — which means, on top of the technology and products, System x management and marketing and sales personnel will be going over as well, a key factor that should enable the new Lenovo x86 server unit to compete in the market.

The two companies will be partnering in licensing and OEMing each other's products. The most significant area will be on the integrated systems market, which according to IDC reached [\\$2.4 billion in 2Q14](#) and is one of the fastest-growing segments of the IT hardware industry. As part of the deal, IBM retains the "Pure" brand and continues to offer the IBM PureData and PureApplication System, which will source x86 components from Lenovo. Lenovo will offer its own integrated system where it will license IBM Storwize V7000 and Flex System Manager to deliver a unified system that integrates server, storage, and networking.

Impact to Server Market

A deal of this magnitude has some obvious market share implications, with some expected shifts in share and a shake-up in the ranking. Reviewing the past four calendar quarters in IDC's [Worldwide Quarterly Server Tracker](#), HP is the overall server market leader with 26.7% share and \$13.3 billion in revenue, IBM is second with 23.5% at \$11.7 billion, and Dell is third with 16.5% at \$8.2 billion. Lenovo accounted for only 1.0% of the server market. This is not a definitive indication of future results, but shifting IBM's last four quarters of x86 server revenue (\$4.6 billion) to Lenovo would result in IBM dropping to 14.2% share and Lenovo jumping to 10.3%. This would cause IBM and Dell to switch places in rankings (Dell taking second place and IBM in third); the new Lenovo would be in fourth place.

A sizeable chunk of the x86 server business going to Lenovo — more than half a billion worth — is in IBM standard high-performance computing accounts, and a corresponding strong contingent of the approximately 6,500 transferring IBM employees will bring needed HPC experience to Lenovo. Before the deal closed, IBM and HP were the perennial contenders for revenue leader in the HPC server market. After the sale, HP will stand as the clear leader and IBM, Dell, and Lenovo will vie for the second spot. What is less unclear is whether Lenovo will be able to retain business HPC opportunities that exist with U.S. governmental agencies and labs, with Lenovo being based in China.

SMB and Channel Perspective

IBM's sale of its x86 server business to Lenovo comes at an especially opportune time from an SMB perspective. Recent survey work by IDC shows that SMB use of server-based networks is at an all-time high in the U.S., with the majority of SMBs with as few as 20 employees using server-based networks, most often x86-based. Despite the increased use of virtualization, the average number of physical servers per company continues to grow, up to 3.4 for small businesses (firms with fewer than 100 employees) and 28.0 for midsize firms (those with 100–999 employees).

The challenge for Lenovo is that IBM's SMB brand appeal has been eclipsed by Dell and HP. Only 14.1% of SB server owners and 26.1% of MB server owners indicate that they have IBM-brand servers. And while HP is closing in on market leader Dell in terms of share of firms planning to purchase, IBM is lagging further behind. Even more potentially troubling is the relatively modest share of current SMB IBM server owners that plan to purchase IBM in the future. This is especially true for small businesses, which are much more likely to purchase HP servers in the future even though they currently own IBM servers.

In contrast, SMB owners of Dell, HP, and Cisco servers are more likely to purchase the same brand in the future. For Lenovo, this will mean that strengthening product, distribution, and SMB messaging will be especially important. IDC believes that Lenovo's plan to leverage its visibility in PCs, tablets, and smartphones is exactly what will be needed to generate SMB (and channel partner) interest in its server products.

Services Perspective

Services are still one of the most important aspects of an x86 system provider's portfolio; it separates ODM and white-box x86 server providers (Quanta, Inventec, Foxconn, etc.) from traditional x86 server vendors (IBM, HP, Dell, etc.). Most enterprises rely upon the services provided by the vendor and partners to plan, install, deploy, manage, and support their complex datacenter environments. The value proposition they set forth is greater than that of ODM/white-box providers. ODM-direct vendors have a place in IT but generally at the large cloud service provider (SP) level (Amazon, Google, etc.). SPs will carry a staff of IT professionals that can completely support a complex datacenter environment that is their mission, to deliver IT services on a massive scale — this model is generally too expensive for an enterprise; hence the use of external expertise is greatly needed.

The IBM-Lenovo agreement is a very interesting one, because between the two companies, they have the ability to possibly span the markets of service providers and traditional enterprises. Due to Lenovo's manufacturing scalability, it may be able to reach the price points that will be appealing to service providers but also, through the IBM services abilities, be able to support the enterprise.

Lenovo will now be responsible for the services portfolio management, pricing, marketing, and other administrative services for IBM's x86 systems. IDC estimates the value of IBM's support and deploy portfolio for x86 systems to be approximately \$1.5 billion of its \$8.3 billion hardware deploy and support revenue (according to IDC's Worldwide Quarterly Services Tracker). Lenovo has contracted directly (for the next five years) with IBM to provide all warranty and HW/SW maintenance service deliverables. Delivery of support and other integration, migration, and installation will fall upon IBM engineering; Lenovo will be responsible for selling and renewing support services contracts and other complementary services to the end-user community. This will be a huge boost to Lenovo's overall services portfolio, which was primarily geared toward the PC and laptop warranty services market.

To date, Lenovo's services revenue accounts for less than 2% of its overall revenue; this is much lower than the industry average. This leads to the question: Will Lenovo be able to transition and morph itself into a more services-enabled organization? This will thoroughly depend on the transition of the nearly 6,500 workers from IBM to Lenovo — if all goes smoothly, there should be little disruption in how and where the service portfolio plays with Lenovo. IDC looks forward to seeing this transition, and if all works out, Lenovo should have one of the only market strategies that could span between the SP and enterprise x86 markets.

The Geopolitical Issue

Although the worldwide server market has historically been led by U.S.-based technology brands, the global supply chain for the market has increasingly moved to Asia as more and more engineering has moved offshore to Taiwan-based ODMs while core manufacturing services largely moved to factories based in China. So, while IBM's divestiture of its x86 server business to Lenovo is expected to drive some nationalistic discussion among customers, for the most part, the global nature of the enterprise hardware supply chain makes any security concerns largely irrelevant as virtually all vendors source from the same ODM and contract manufacturing partners. That said, IDC does believe that some education and government buyers in the U.S. will be pressured to buy American. As a result, in the near term, some IBM business partners with large public sector businesses may elect to align with other vendors as some public sector buyers choose to evaluate other U.S.-based server suppliers. That said, IDC believes that the majority of IBM's customers will seamlessly move to Lenovo. Furthermore, IDC believes that, over the midterm to long term, there is much more upside potential than downside risk for Lenovo following the close of this deal.

Implications for the Server Market

With the sizeable investment in the acquisition, Lenovo will be focused on increasing the x86 server business. IDC expects Lenovo's strategy to center on capturing market share with an emphasis on segments of the market experiencing significant growth — specifically, [integrated systems](#) and [hyperscale](#) datacenters. In addition, where IBM targeted the higher end of x86 systems (blades and +4 socket systems), IDC expects Lenovo to have renewed emphasis on volume servers, which account for the bulk of the x86 market today:

- **Integrated systems:** While the overall server market is forecast to increase at a five-year CAGR of 1.3%, the integrated systems market is expected to increase at a CAGR of 32.8%. As it was within IBM, PureFlex and Flex System will be the lead products for Lenovo. The IBM staff moving to Lenovo has experience with the products, and there should be a relatively seamless continuation for the product that was launched in 2012. This segment is an open battlefield with server and storage vendors seeking to gain traction. Cisco has been the server market leader for integrated systems, and Lenovo will need to pay attention to its product road map, which is currently split across two companies.
- **Hyperscale:** IDC forecasts spending on servers into hyperscale datacenters to increase at a five-year CAGR of 94.6%. Outside of HPC, this is a segment that IBM System x has historically not had a large presence in. The few largest service providers (Google, etc.) will continue to opt for the ODM-direct model, but several of the mid-tier and managed services providers will be in-play for the traditional OEM server vendors. This is a segment that IDC expects that the System x unit will leverage Lenovo's economies of scale and experience with large datacenters in China.
- **Volume servers:** Blades and +4 socket servers present a higher margin sale, but 1 and 2 socket rack and tower servers still represent more than one-half of the total spending server market. The lower margin business meant that volume servers were a less attractive business compared with IBM's Power and Mainframe. Shifting to Lenovo, the System x unit instantly becomes one of the higher-margin businesses. To gain market share, Lenovo System x will compete in the volume server space; Lenovo's supply chain and economies of scale combined with a business no longer inhibited by meeting high margins should make Lenovo a formidable competitor in the x86 segment. HP and Dell have been the largest competitors in the segment. IDC sees Lenovo as a viable threat with each vendor's channel strategy being a factor in success.

IBM selling the x86 server business has long been the speculation of rumors. IDC views the sale to an emerging server OEM as a positive for the industry. A sale to an established OEM vendor (rumored to have been Dell and Fujitsu) would have in effect meant consolidation for the industry. The Lenovo acquisition means more choice for customers and increased competition in the industry — which historically translates into further innovation and industry progress.

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