HP's Autonomy deal highlights pattern of bad ideas

MICHAEL LIEDTKE - AP Technology Writer - Associated Press

Hewlett-Packard's $9.7 billion acquisition of Autonomy seemed like a bad idea long before Tuesday's allegations of an accounting scandal made clear it was a deal that should never have happened.

It's the latest in a cavalcade of costly blunders at HP. The Silicon Valley pioneer has squandered billions of dollars on ill-advised acquisitions, compounding the challenges it already faces as it scrambles to adjust to a world that is shifting away from PCs to smartphones and tablets.

On Tuesday, HP took an $8.8 billion write-down for the Autonomy acquisition. Hewlett-Packard Co. CEO Meg Whitman alleged that executives at Autonomy used various accounting tricks to make the British software company appear more profitable.

The Autonomy deal may amplify the pressure on HP to reshuffle its board of directors, which already had been overhauled after a series of previous embarrassments. The debacles, dating back to 2006, include prying into the personal phone records of reporters covering the company to its widely criticized hiring of Leo Apotheker as CEO after the company's previous leader, Mark Hurd, resigned amid questions about his relationship with a female contractor.

Although HP says it was duped into paying too much for Autonomy under the since-fired Apotheker, the deal ultimately was approved by 10 of its current 11 directors, including Whitman, who served on the board for nine months before being appointed as CEO in September 2011

Only shareholder activist Ralph Whitworth wasn't on the board when HP authorized Apotheker to buy Autonomy in August 2011. Just five weeks after the deal was announced, HP's directors fired Apotheker, a move some analysts trace to the company's almost immediate remorse over the Autonomy acquisition.

But Apotheker's ouster may not be enough to placate shareholders who are seething with renewed anger over the deal. The allegation that Autonomy had been "willfully" deceptive leading up to HP's purchase raises the specter of a criminal investigation. It also opens a torrent of potentially distracting class-action lawsuits on behalf of shareholders alleging HP's board was negligent.

"When I talk to investors, that is what they are concerned about: the credibility of the board," said Sterne Agee analyst Shaw Wu. "There already has been a lot of turmoil at this company, but maybe they still need more change." Wu said he isn't even sure Whitman's job as CEO is safe because of her presence on the board when

the Autonomy deal was approved.

In a research note, Topeka Capital Markets analyst Brian White called for a new purge of HP's board.

Whitman said she regrets voting in favor of the Autonomy acquisition while insisting HP did its due diligence. That was an assertion echoed by Apotheker in a prepared statement.

HP Chairman Ray Lane, who joined the board when Apotheker was hired in 2010, didn't respond to an interview request Tuesday.

Mark Williams, a finance professor at Boston University and a former bank examiner for the Federal Reserve, called HP's accusations against Autonomy "due diligence deflection".

"Just to say 'we paid too much because of fraud' doesn't negate the fact of inadequate due diligence," said Williams. "Some responsibility needs to come back to HP."

At least one of HP's board members, McKesson Corp. CEO John Hammergren, has experience the aftermath of an accounting scandal. McKesson named Hammergren as its CEO after revealing it had been conned into buying software maker HBO & Co. for $12 billion in 1999. The accounting fraud wiped out half of McKesson's market value. The San Francisco company has since bounced back under Hammergren, but the comeback took years to pull off.

Investors are losing hope that HP will rebound because the company has made so many questionable decisions in the five years since Apple Inc.'s release of the first iPhone changed the way people use technology. The upheaval has reduced demand for HP's PCs and printers.

"I don't see how anyone could invest in this company any longer," said ISI Group analyst Brian Marshall, who described HP as "an unmitigated train wreck."

HP's stock plunged $1.59, or nearly 12 percent, to finish Tuesday at $11.71. The shares haven't closed this low since October 2002 when HP was still facing a shareholder backlash over its acquisition of rival Compaq Computer.

That deal has turned out better than the acquisitions HP has made during the past five years under three different CEOs. In that time, HP has spent more than $40 billion to buy dozens of companies. In a reflection of how poorly the biggest of those deals have performed, HP's market value has fallen to just $23 billion. That's about 70 percent less than what HP was worth in June 2007 when the first iPhone went on sale.

In the last three months, HP has absorbed nearly $17 billion in non-cash charges to account for the diminished value of its 2008 acquisition of technology consulting service Electronic Data Systems and its 2011 purchase Autonomy. Last year, HP

took a nearly $900 million hit for its purchase of device maker Palm Inc.

Other deals for computer networking gear maker 3Com ($2.7 billion deal), data storage service 3Par $2.4 billion) and software maker ArcSight ($1.5 billion) are working out better, so far.

But the Autonomy deal never seemed to make sense to anyone outside HP.

"Something smelled bad about it from the beginning," said 451 Research analyst Alan Pelz-Sharpe, who has been following Autonomy since the company went public in 1998.

Autonomy, which was based in Cambridge, England, had been known for a "dog-eat-dog" sales culture that drove employees to do whatever it took to hit their quarterly targets or risk incurring the wrath of CEO Mike Lynch, Pelz-Sharpe said. "It was never a happy company," the analyst said. "It was always a place where people were frightened to speak out."

Whitman fired Lynch in May because she was frustrated with Autonomy's poor results since the acquisition, which closed less than two weeks into her tenure as HP's CEO. She said she had no idea that she would uncover conduct that led her to allege Autonomy had been fabricating sales before she ousted Lynch. In a statement to the Financial Times, Lynch denied any wrongdoing at Autonomy.

By the spring of 2011, Autonomy was desperately seeking a buyer, according to Oracle Corp. CEO Larry Ellison, whose company has become a bitter HP rival. In a series of statements last year, Ellison said Lynch and investment banker Frank Quattrone tried to persuade Oracle to buy Autonomy. The most serious pitch came in an April 1, 2011 meeting, according to Ellison, who described Autonomy's asking price as "absurdly high."

Quattrone, who faced charges of misconduct for his handling of IPOs during the Internet boom in the late 1990s, and Lynch have acknowledged meeting with Oracle executives. But they have denied offering to sell Autonomy.

HP wound up buying Autonomy at a price that was 64 percent above the company's market value. On the same day the Autonomy deal was announced, Apotheker also revealed he was scrapping HP's attempt to sell mobile devices running on Palm's software. He also said he was mulling a possible sale of the PC division. All those developments stunned investors, leading to a one-day drop of 20 percent in HP's stock price.

Even if HP's board had doubts about the Autonomy deal after Apotheker's exit, the company probably had little choice but to consummate it because the laws of England make it difficult to renege once an offer is made, Pelz-Sharpe said. "About the only way you can do it is if you can prove fraud has been committed."

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AP Technology Writer Barbara Ortutay in New York contributed to this story.

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