

Skype no longer Secure

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Microsoft Agrees To Buy Skype For \$8.5B

NEW YORK (Dow Jones)--Microsoft Corp. (MSFT) agreed to acquire Skype for \$8.5 billion in cash, a move the software giant hopes will enhance the communications capabilities of its wide-ranging products and allow it to better keep pace with technology rivals such as Google Inc. (GOOG) and Apple Inc. (AAPL).



The deal lets Microsoft integrate Skype's free and low-cost Internet video and telephony services into everything from its Bing search engine to Windows smartphones and its Xbox 360 video game system. The need to add a communications component is seen as crucial with the growing popularity of Apple's Facetime video chat service and Google Voice.

"It is definitely now or never for Microsoft," Ovum analyst Richard Edwards said. "There are other products and companies out there that offer a much better fit architecturally than Skype--and they come with a much cheaper price tag, too--but Skype is undoubtedly the product Microsoft needs to stay in the game."

But Microsoft faces questions over how it can execute on its vision of enhanced communications services. The promise of adding such a service drove eBay Inc. (EBAY) to acquire Skype in 2005, but the two businesses never fit together. EBay sold a majority stake in the business to a group of investors in 2009.

"I always had a hard time seeing how eBay was going to leverage Skype," said Steve Hilton, an analyst at Analysis Mason. "At least Microsoft understands the power of communication."

Skype will become a new business division within Microsoft, and Skype CEO Tony Bates will assume the title of president of the Microsoft Skype division, reporting directly to Microsoft Chief Executive Steve Ballmer.

In addition to its voice and video capabilities, Skype brings a base of 170 million customers to which Microsoft can sell its other services. Skype also counts many small businesses as its customers, although analysts say the service isn't secure enough for Microsoft's base of enterprise customers.

Ballmer vowed to continue to support Skype on non-Microsoft platforms, which means keeping the service available to iPhone and Mac users.

"We will continue to support non-Microsoft platforms because it's fundamental to core value

proposition," Ballmer said during a conference call on Tuesday. He added Microsoft will continue to build upon Skype's customer base.

The Skype deal ranks among the biggest acquisitions in the 36-year history of Microsoft, a company that traditionally has shied away from large deals. In 2007, Microsoft paid about \$6 billion to acquire online advertising firm aQuantive Inc. Many current and former Microsoft executives believe Microsoft significantly overpaid for that deal. But they are also relieved that Microsoft gave up on an unsolicited \$48 billion offer for Yahoo Inc. (YHOO) nearly three years ago. Yahoo is valued at half that sum today.

Microsoft Chief Financial Officer Peter Klein said he expects the Skype deal to get regulatory approval this year. The company is using cash held overseas to purchase Skype, which is based in Luxembourg. Ballmer added he expects Skype to be added to earnings immediately after the deal closes.

The deal shows how far Skype has come since it was launched in 2003 by Niklas Zennstrom and Janus Friis, two men who had created a file-sharing technology called Kazaa that became widely associated with music piracy. While Skype was initially popular with techies, it increasingly worked its way into the mainstream by offering free or cheap phone calls which were especially appealing to international callers.

When eBay Inc. (EBAY) purchased the company in 2005 for \$2.6 billion in cash and stock, Skype was regarded as something of an experiment in which eBay's buyers and sellers would use the service to communicate about potential transactions.

The experiment faltered, and eBay gave up on Skype in 2009, selling a 70% stake to a group of technology investors including Silver Lake Partners, venture capital firms Index Ventures and Andreessen Horowitz, and the Canada Pension Plan Investment Board, who will make a handsome return on the Microsoft transaction.

While Microsoft has had more experience with communications services, its track record has been mixed.

"Microsoft has had plenty of voice-centric train wrecks over the years," Hilton said, the most recent being an enterprise phone system software called Response Point.

And for all its promise, Skype has had a mixed history as an operating business. It has produced little net profit in the eight years since it was founded. Profits continue to remain elusive as the company expands its business world-wide. Last year the company posted revenue of \$860 million and \$264 million in operating profits, but it still had a loss of \$7 million. The company had \$686 million in long-term debt as of Dec. 31.

Bates said his customers average 100 minutes a month each. He added the biggest revenue opportunity for the company will come from serving video ads to its customers.

Skype uses a technology called voice over Internet protocol, which treats calls as data like email messages and routes them over the Internet, rather than a traditional phone network. Skype's software, which can be downloaded free, allows users to call other Skype users on computers or certain cellphones for free. Skype users can also call land lines for a fee and conduct video calls.

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