Beyond the Deal Newsletter

Mergers and Acquisitions that Achieve Breakthrough Gains

www.beyondthedeal.net

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Dear Jay,

Quote of the Month:

"One never knows what each day is going to bring. The important thing is to be open and ready for it."

Henry Moore

There is conflicting evidence as to whether there is a marked increased interest in acquisitions or whether the lull in acquisitions will continue into 2010. One indicator on the positive side is that a growing numbers of companies are asking for proposals for project management software that supports integrations. These are significant undertakings and not taken lightly. On the other side, companies that have made acquisitions their engine for growth are not quickly moving back into an acquisition mode. The phrase "cautious optimism" seems to reflect this mixed picture. Dominant trend lines will likely emerge and become clearer over the next three to six months.

In either case enterprises need to cultivate their readiness capabilities so that they can be best equipped to deal with uncertain conditions and as yet unclear patterns of opportunity.

This month the Newsletter first looks at honing your company's overall strategy before you acquire. The slower period in acquisition activity can be used to sort out how acquisitions may be part of your overall growth strategy. We moved from the "bubble of optimism" in 2008 into a "bubble of recession" in 2009. When one is in a bubble it is usually very hard to see the changing reality outside of that bubble. Acquisitions made during the higher levels of acquisition activity of the "optimism bubble" may not always have been the best fit. This more cautious period can be a time to reevaluate what is involved in moving to the next stage of what we want our companies to be.

This Newsletter continues with the "Tool of the Month" series with an interview Paul Hartzell, Senior Vice President of Merrill DataSite, on virtual data rooms (VDR's). VDR's are less than a decade old, but as technology has made major moves forward VDR's have become a major resource for managing the vast amount of data involved in the due diligence phase of acquisitions and also for providing a core resource for post deal integrations and divestitures. Many of you may already be using VDR's in your due diligence work. The article contains highlights from a much more extensive interview, which can be found at: www.beyondthedeal.com/Newsletter. We thank Paul Hartzell for sharing his rich knowledge and experience with us.

In This Issue:

Hone your Company's Overall Strategy before You Acquire

Tool of the Month: Paul Hartzell of Merrill DataSite on Virtual Data Rooms

Upcoming for the September Issue

Hone Your Company's Strategy *Before* You Acquire

According to the Wall Street Journal (August 11, 2009), the number of acquisitions of distressed companies in 2009 is moving at double the pace of 2008. While there may be substantial appeal and merit in any of these specific transactions, there is also a question of what gains are actually made in these opportunistic acquisitions. A company that may become available because of economic distress may be caught in the downdraft of the recession or may have serious internal problems, or both. Each opportunity needs to be judged in light its own characteristics and the potential acquirer's strategic needs.

Jim Collins notes in his book, *Good to Great*, that companies that did not fare well in attempting to achieve breakthroughs via acquisitions did not address the key question of , "What can we do better than any other company in the world, that fits our economic denominator and that we have a passion for?" Collins says these companies "never learned that, while you can buy your way to growth, you absolutely cannot buy your way to greatness. Two big mediocrities joined together will never make one great company."

While acquisition pricing is certainly key, it is more important for a company to make acquisitions that move it further along the path of achieving its strategic set of aspirations, in both the short and long term.

When the leadership team has a strong sense of what the company is and can become the acquisition can be a catalyst to facilitate a quantum leap toward accomplishing those goals.

To ground your company in making the right choices you need:

- Know what is happening in the market segment you are involved in
- Identify success factors for penetrating those sectors so that you can determine what capabilities and products/services you can add by the acquisition

You can then decide what acquisitions, whether these be distressed businesses or not, add to your set of distribution capabilities, product capabilities, or customer relationship capabilities.

While emerging opportunities are the great variable in acquisitions, the constant is having leadership that is grounded in the company's strategic focus and business logic. Be sure to be grounded in your strategic perspective to clarify the kinds of acquisitions that add to the capability of the entire company.

Tool of the Month:
What are VDR's and what can they do for you?

Due diligence identifies and explores any risks or liabilities so that your company can deal with them during the negotiations process. It helps acquirers determine the price range they are willing to pay as well as providing acquirers with an information base to shape acquisition and integration business plans. With well executed due diligence acquirers will have the information they needs to determine if it is best to continue the acquisition as planned, negotiate for better pricing and other terms, or terminate the initiative.

Although the greatest emphasis in due diligence is on finances, it is also the time to examine all of a target company's relevant capabilities and key areas that impact on the success of the acquisition (i.e., issues in staff development and retention, levels of technology development, richness of the innovation pipeline, environmental considerations, etc.). Bringing all of these dimensions together provides a full picture of the target. Due diligence has developed into a much more complex and extensive exercise - one that has changed from primarily being a task of checking off of boxes.

Why VDR's

Data rooms are set up to house the documents that are reviewed during due diligence. With the advent of Virtual data rooms (VDRs) there is the option for electronic, web-based data rooms that deal with many of the issues that constrain traditional paper data rooms. With VDR's:

- Data is accessible twenty-four hours a day, seven days a week.
- Documents are available simultaneously to an unlimited number of bidders. There is 100% text-based searching.
- There is no need to return documents or replace lost or damaged documents to guarantee that other reviewers have an equal opportunity to inspect them.
- Security can be set up electronically on a permission basis, with access to documents carefully monitored and tracked to within a 1/100 of a minute.
- The cost of operating a VDR can be one half to one third the cost of a paper data room, both in terms of actual dollar costs as well as in the opportunity costs. VDR's allow completion of due diligence requirements in about one third the time of using traditional paper data rooms. With VDR's the deal cycle time can typically drop from 64 days to 15 days, taking one and a half months out of the deal cycle. Since time is the enemy of all deal transactions, this speed factor makes VDR's a compelling option.

A Conversation with Paul Hartzell, Senior VP of Merrill DataSite

Below are highlights from our conversation with Paul Hartzell, Senior VP for Merrill DataSite, a groundbreaking and major VDR provider. The full interview can be accessed at www.beyondthedeal.net/Newsletter.html:

Data rooms have been in existence since at least 1935. Until the late 1900's data rooms were always paper-based, and almost always hosted at law firms or occasionally by the selling company. They were generally relegated to very unattractive settings - often rooms with no windows, no air conditioning, and uncomfortable because their purpose was the controlled display of documentation being evaluated for the buying or selling of a particular business. VDR's came of age with the arrival of expanded Internet broadband width and the software to run a complex VDR made virtual data rooms a practical alternative less than ten years ago.

The average data room handles about 23,000 pages of documents. It demands having a powerful processing engine. Merrill's DataSite developed the ability to load any type of files on line and have those files turned into encrypted images. As we convert the files, we are also converting a 100% text, searchable data base that sits behind that image. What appears on the user's end is a perfect looking picture that has every character searchable, regardless of language. Right now that includes all of the Romance languages but later in 2009 a new search engine will run all of the Chinese, Russian and Japanese characters as well. This process does not require the company loading the information to convert to any special format before the documents are uploaded to DataSite.

What's different? The difference comes from a very fundamental platform difference. DataSite uses an encrypted Java viewer which allows the end user to look through the Java viewer at images of the pages of the documents as they reside on our server. Nothing downloads. The seller has complete file control. There is nothing to cut, copy or paste on the user end. The speed is astounding. 800 page documents load in a few seconds. You can open, theoretically, an infinite number of windows to view multiple documents simultaneously. You can put multiple documents side by side on the screen at the same time. You can do all kinds of things because you don't have to download the documents.

Speed, Service and Security

The key attributes of a virtual data room come down to two very simple words: speed and service. Speed is delivered by all of the technology that has been built. Administrators can be sitting on their end and load entire file structures, the entire data room in the format which they have already structured. A robust service capability supports making the whole process happen.

Any size of company can use a VDR. Nothing is too small, either the size of the company or the size of the data room. What matters more is how critical the documentation is and how much security you want to wraparound document display or in sharing that data with others. Security levels are determined by the administrator and backed up by an ISO 27001 certified security system that specifies that the "management system can bring information security under explicit management control." Security is at the core of due diligence in acquisitions. In keeping with that, holding that ISO certification means a great deal to companies, particularly those outside of the US.

The Changing VDR Customer Profile

The adoption curve for companies using VDR's started with a couple of hearty souls in 2001 that were willing to brave emerging technology on the Internet as well as on the interface level with our hosted software. VDR use caught fire by 2005.

DataSite has grown from a $0 start up to an $85 million a year VDR operation. There were a lot of big deals getting done in the first several years but there has also been an accelerated rate of adoption in the middle market adoption space. These are firms in the middle and sub-middle market with revenues from $50 million to less than $10 million. In this range we are dealing with companies that have never made deals before and may never make deals again. That is a market that requires more education, more hand holding and more outside expertise. These companies are probably not going to get that from a financial advisor because those deals are under the radar screen for financial advisors.

Asset Readiness

The idea of getting prepared for document review is key to successful use of a VDR, both during due diligence and afterwards. Our thrust has been asset readiness. A company may have made a $100 million acquisition and found out two years later that some parts of that acquisition no longer fit its long term strategy and should be divested. Asset readiness means that a smart way of running a business is for a company to have a data room already set up, or at least 75%-85% set up to handle those kinds of eventuality. If that readiness is not there, a deal can start prematurely, with people then realizing that they do not have quick access to the documents they need. Without the necessary groundwork the deal process will stall.

Deal Fatigue

Documents from a data room are also important after the transaction is closed. At that point the problems that were somebody else's are now yours. You did not construct that information and is often not in a common format. But you need access to that information to carry out the integration of your newly acquired assets. You also need that information for any future transactions that may involve those assets.

Although people think that their work is done when they close the deal, the reality is that the real work of the acquisition - the integration work - is just beginning. This is where the phenomena of "deal fatigue" sets in. This happens after the deal closes and an acquirer is trying to realize the synergies that either have been poorly identified, or even if they have been well identified, dealing with getting to them and capturing them.

Using VDR's to Leverage Your Acquisition Gains

How do you grow a company? You can either grow by acquisition or you can grow organically. Suppose you are a $40 million company and you are in Ohio. If you decide that the best way to grow your business is to combine your business with a $40 million company that is located in Phoenix - with the idea that between the two of you, you can cover twenty five states. That is an opportunity for DataSite. The back part of this is the integration is where what we do really provides value. When two companies come together it is more usual than not for those two companies to have different ways of keeping records. They use different file formats. They may even use file formats that are not even compatible to each other. They may use different methods of communication. All of those different things have to be ironed out. If we are hosting the documents for those two companies as they combine, we have taken a whole bunch of variables out of that part of the process by giving people instant access to critical information that in many cases, they did not create.

I describe it like it is a sandwich. The front of the sandwich is a picture of the page. The back of the sandwich is the text data base that is 100% searchable.

To tie this into integrations, one of the things that is stumbling block of many, many integration issues is the fact that the people doing it have never done it before, or at best, the do it once every two to three years. I draw many parallels to our company. Merrill has made six major acquisitions over the last nine years. In the last sixteen years we have grown Merrill Corporation from less than $100 million to almost $1 billion, 10 times what it was when I joined the company. Some of it has been sales growth, some of it has been by acquisitions. That is how a lot of companies are. Merrill has lived through the acquisition part of this process and the lessons from that experience have fed into the shaping and operations of DataSite.

We also have a capability for special media, which is audio and video. Analyst meetings have been recorded. We have provision that you can hang those files off to the side so people can listen and watch them.

You have to be prepared to get your hands on a document you need and your need it because it has some fairly esoteric content and it is not yours. You have to find it and make a business decision based on it. That is our world.

September Preview:

Conversations with:

- Buddy Blaha, VP for Corporate Development and Alan Cranston, Director of Integrations, of Newell Rubbermaid, and
- Jessica Lipnack, CEO and co-founder of NetAge, a Boston-based software company that builds collaborative work environments and a leading figure in networking and social media.

Don't miss the September edition!

In addition to having the Newsletter sent to you directly, you can now access the Newsletter and article library at: http://www.beyondthedeal.net/Newsletter.html

Please send in your comments, contributions and suggestions to jaychatzkel@progressivepractices.com. They are important to making the newsletter as relevant to you as possible.

You are welcome to forward this newsletter on to a colleague or friend.

All the best,

Jay Chatzkel

Jay L. Chatzkel is coauthor of the *Beyond the Deal* book, and editor of the Newsletter. He is Principal of Progressive Practices where he assists organizations in transforming themselves into knowledge-based, intelligent enterprises. This includes working with organizations to develop skills and practices in the areas of merger and acquisition integration, intellectual capital, knowledge management, leadership and collaboration, business process management and performance measurement.

He is also author of *Knowledge Capital: How Knowledge-Based Enterprises Really Get Built* (Oxford University Press, 2003) and *Intellectual Capital* (John Wiley & Sons, 2002).