

VIEWPOINT

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WHY THIS MATTERS:

- Technology solutions have drastically altered the due diligence process in M&A transactions. Sellers who haven't used these new tools will be surprised by how much simpler it now is to provide data to potential buyers.
- Online data rooms can be used for purposes other than due diligence, so you should be aware of the capabilities of this technology even if you're not thinking of selling your business any time soon.
- New capabilities are constantly being added to online data rooms, so even if you haven't chosen to use this technology yet, you'll want to keep an eye on its development. Your next deal may be the right time to go virtual with the due diligence.

WHAT THE EVOLUTION OF DUE DILIGENCE TECHNOLOGY MEANS FOR YOUR M&A DEAL

By Laura Kevghas

Oh, what a difference a few years and some spiffy technology can make. Over the past five years, new technology, primarily in the form of online data rooms, has dramatically changed the world of M&A due diligence. In this Viewpoint, we discuss how this evolving technology has improved the due diligence process for both sellers and buyers.

THAT WAS THEN

As recently as the start of this decade, due diligence for any M&A deal involved some version of this age-old, mind-numbing scenario: A data room was set up at the offices of the seller's law firm, and the paper chase began. This room was filled with box after box of hanging files containing all the documents the seller thought buyers would want to see.

Potential buyers were invited one-by-one to visit the data room for a specified period of time to review the thousands of documents assembled there, all under the watchful eyes of law firm personnel.

At the end of their allotted time in the data room, buyers asked for specific documents to be copied and shipped to them. Each buyer's list was likely to be different, and the law firm carefully tracked what each had received.

If this sounds like a tedious way to spend your time, you're right. "In the old-fashioned data room, you had a limited amount of time to try to figure out what was important, so you just fought your way through the material," recalled Hal Schwartz, a partner in the Corporate Department at the Boston office of McDermott Will & Emery, LLP. "You often ended up throwing more bodies at the task than necessary, in retrospect, because you needed to get through everything and get notes made during your allotted time."

DATA ROOMS FOR EVERY DEAL AND EVERY BUDGET

On the upper end are providers such as Merrill DataSite, Intralinks and Capital Data Room. These providers accept virtually any file type, allow different levels of access for each document and each buyer, provide real-time monitoring of all virtual data room activities, and enable full search capability across the data room. In exchange for the high level of service provided by these vendors, you pay a premium price.

On the low end of the price and feature scale, there are multiple FTP sites that enable you to post your due diligence information in a secure online environment. However, these sites vary widely in your ability to track activity and set different permission levels.

THIS IS NOW

Flash forward to 2007 and we find a completely different scenario in which:

- A virtual data room is established using the technology of one of a number of application service providers that have entered this market over the past five or so years. All electronic documents are uploaded as Word documents, PDFs, spreadsheets, etc. (Most vendors accept documents in any electronic format, but a few only accept TIF files.) Documents that only exist in paper form are scanned and uploaded. Documents can be protected as "read only" or prospective buyers can be allowed to print or download the files.
- Buyers receive round-the-clock password-protected access to the online data room. Different protection levels can be set so only certain buyers can have access to certain documents.
- Activities in the room are electronically tracked so the seller knows how much time each buyer spends reviewing the data and precisely which documents are viewed. When a buyer asks for additional information, it is posted to the data room and becomes available to everyone.

SIGNIFICANTLY IMPROVED LOGISTICS

The obvious logistical improvements offered by online data rooms include:

- **The data is available 24/7.** Instead of having only a day or two to do a "data dump" in a physical data room, buyers can now spend as long as they want reviewing documents. Scheduling conflicts are eliminated, and buyers can view documents outside of normal business hours if they desire. And if someone wants to look at one document multiple times, they can do so.
- **The transaction moves faster because multiple buyers can view the data simultaneously.** The online data room speeds up the pace of due diligence by enabling multiple buyers to review the data simultaneously rather than sequentially. Eliminating the need to copy documents and send them to buyers also speeds up the process and eliminates copying and shipping costs for the seller.

- **The data can be updated.** As Eric Lisman, Executive Vice President – Corporate Development at Advanstar Communications, pointed out, the information in a paper data room is fixed on the date that you set up the room. "But with an online data room, we're able to provide a lot of data regarding the pacing of the business as the sale process moves forward," said Lisman, who has used online data rooms both as a seller and a buyer. "We can easily post updated information to the site on a weekly or even daily basis."
- **Travel costs are reduced for out-of-town buyers.** By reducing these costs you make the price of considering a deal more attractive to a wider group of potential buyers.
- **Responding to questions is easier for sellers.** When one buyer asks for additional information, you post that to the data room and it goes out to everyone, so you don't end up responding to the same question again and again.
- **A well organized online data room increases the buyer's perception that the company is well run.** The result is a buyer that is more comfortable and feels that the risk in completing the transaction is lower.
- **Spreading information around on the buyer's side is infinitely easier.** "If I'm coordinating the buy side and I have anywhere from 20 to 50 different people involved, including lawyers, accountants, insurance people, IT people and so on, the ability to sign them up for the data room so that they can get the information they need is of tremendous value to me," said Lisman.
- **Post-deal integration is easier.** With the seller's documents already online and available to the new owner, moving forward with post-deal integration activities can be significantly simpler and faster.

EQUALLY VALUABLE BENEFITS

Online data rooms also offer benefits that go far beyond logistic and cost issues. These include:

- **A deal may attract more buyers.** "By using an online data room, you can attract potential buyers who might want to consider the deal if they have a cheap way to do so," said Schwartz. "Also, you may draw in more people if they can see more than just a one-page teaser without expending a lot of time and money. So if you want to put more people in the game, an online data room is one of the most efficient ways to do that."
- **Buyers can more easily analyze the data and more easily bring in more experts to help analyze the data, which can reduce the time required for due diligence.** The ability to download information, particularly financial and statistical information, in their native Excel files, enables the buyer to more quickly and easily analyze the data.

Mirus has experience with certain strategic acquirers who won't participate in an auction unless an online data room is available.

When the data is available online, more expertise can also be brought to bear, from the potential buyer's firm as well as from their legal, accounting and investment banking advisors. "From an attorney's point of view, we

can bring in someone from our firm with the appropriate level of knowledge of different subjects," said Schwartz. "Also, we can discuss things with our client in a more comfortable setting and delve deeply into the data that counsel and the client determine is most concerning."

- **The ability to track buyers' data room usage is extremely advantageous.** Knowing how much time a buyer is spending in the data room can help a seller separate serious contenders from idle on-lookers. For example, as investment bankers we might conclude that an offer from a buyer who spent relatively little time in the online data room might represent more risk than an offer from a buyer who thoroughly reviewed the data made available to them. The buyer who did less thorough due diligence prior to submitting their LOI may be more likely to want to change their initial offer later in the process.
- Also, knowing exactly what documents buyers are focusing on is extremely helpful to a seller and their advisors. "If 17 different people are looking at the employment agreements and no one is looking at the customer contracts, then you know there might be an issue with the employment agreements and you can try to resolve it," said Schwartz.

In addition, this tracking ability can be of huge value should a lawsuit arise between a seller and a buyer. Paul Hartzell, Vice President, Merrill Corporation's DataSite Services, said, "Nearly all law regarding M&A revolves around two points: Was a document made available to the other party or one party says, 'I never saw that document and you can't prove I saw it.' The ability to track buyer activity eliminates that. As one of our clients told me, 'It's the best insurance policy you can buy for your company.'"
- **Faster transactions lead to faster realization of synergies.** "The early adopters of this technology have been companies that had transactions where speed was a major

factor," said Hartzell. "McKinsey did a study that showed you could achieve something in the neighborhood of 4% to 8% in almost immediate synergies in a good transaction. So speed to close and then subsequently speed to integration has a very quantifiable number next to it."

BACK TO THE FUTURE

Thanks to these many benefits, the new due diligence technology has rapidly gained acceptance, and as more and more highly useful features continue to be added, the attractiveness of the technology is bound to increase.

As Lisman pointed out, as the technology continues to evolve, we may be nearing a point when online data rooms make sense even if you're not contemplating an M&A transaction. "We have an online data site we have kept alive even after we completed the due diligence process," he said. "It's becoming a virtual storage room that you keep updated. You can do it yourself; you don't need a third party. It's very inexpensive to keep this thing alive after the deal. When someone is traveling, they can have easy access to information they need."

According to Hartzell, technology of this type tends to be adopted by 80% to 85% of the market, so a small percentage of M&A deals will continue to be done without online data rooms. "It's really a question of deal size," said Lisman. "Smaller deals are generally done through private negotiations, and you don't really need to set up a data room. Also, with smaller deals fewer people get involved in the due diligence, so logistically it's not that hard to do it with a physical data room."

While online data rooms may never put a complete end to the due diligence paper chase, they certainly have significantly improved the process for those who choose to take advantage of the technology. We advise staying abreast of advancements in this arena so that when your next deal comes along, you'll already know whether going online with your due diligence makes sense for your company.

ANY DOWNSIDE?

Do online data rooms have any negatives attached to them? Hal Schwartz, who has considerable experience with both the old and new methods, believes something is lost when the personal contact that was part of the physical data rooms goes away. "I had an instance in which I was representing a buyer and the person who was responsible for the data room offered to take us out to lunch," he said. "Over lunch I found out about a very important due diligence item that wasn't in the data room. Now, maybe a question would have been raised about it and it would eventually have come to light. But it's just as probable that it never would have come up. Not having that opportunity for a casual conversation can be a negative. "Also, you may lose the opportunity to get a feel for the business," he added. "Once we went to a data room that was set up at the seller's offices, and we saw several empty offices and noticed people going home at 4:30. You can't pick up on things like that if you're not there to see it."

Eric Lisman suggested that perhaps the biggest downside of online data rooms is that now buyer expectations have been raised. "As with all technology, what it ends up doing is changing everybody's expectations," he said. "People feel that because of the means of communications, they have the ability to ask a question and you'll be able to pull out a file and get it to them immediately. So this technology does create more demands on the seller."

Laura Kevghas is a principal at Mirus Capital Advisors, Inc. Mirus is a middle-market investment bank that specializes in advising companies on strategic mergers and acquisitions. By combining a proven process, industry and transactional expertise, creative thought, and personalized service, Mirus has completed hundreds of transactions for both public and private companies. Mirus is a registered broker-dealer and NASD/SIPC Member. For more information, visit www.merger.com.

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