

Driving Shareholder Value in Sell-Side Transactions with Virtual Data Room Best Practices



INTRODUCTION

A first-year MBA student can attest to the fact that a more efficient marketplace will generally work to optimize transaction value for any given seller. From that perspective, the more potential buyers there are who have unimpeded access to the seller, the greater the market efficiency. Therefore, in order to maximize shareholder value in a sell-side M&A transaction, a seasoned financial professional is required to devise the overall strategy for achieving this state of efficiency.

A small but crucial part of this overall strategy to maximize value for the seller in an M&A transaction is the use of best-practice technology in the due diligence process. The widespread adoption of Virtual Data Rooms (VDRs) as the best-practice standard for technology to aid in the due diligence process is evidence of a changing tide.

This paper will discuss the role VDRs play in maximizing the value for exiting shareholders upon a liquidity event. The topics we will cover include:

- Maximizing the information flow to potential buyers
- Accelerating the deal cycle
- Gauging the legitimacy and analyzing the behavior of potential buyers
- Reducing direct transaction-related expenses
- Minimizing post-close contingent liabilities
- Mitigating uncertainties which drive buyer hold-backs

In a sense, the shareholders of private companies have had the entire notion of a successful exit strategy redefined in recent years. While IPOs were once the favored choice of exit for successful companies facing a liquidity event, an abundance of available private equity capital, combined with the potential liabilities imposed by Sarbanes-Oxley 404, has led most sellers to consider exit options that lie beyond the public markets. Chief among these are M&A transactions.

The robust market for M&A has, in turn, driven rapid advances in the technology employed to streamline transactions. The most notable and widely used best-practice technology is the Virtual Data Room.

MAXIMIZING THE INFORMATION FLOW TO POTENTIAL BUYERS

Today's M&A professional would have difficulty believing the pre-VDR logistical nightmare that existed for sellers scheduling and making available the appropriate due diligence materials for a transaction with multiple potential buyers. Imagine 30 potential buyers, all traveling to a physical data room to examine boxes of documents. Diligence needed to be scheduled at different times; and due to confidentiality concerns, there often could not be overlapping days. As for the buyer, because there were no advanced searching techniques, its representatives could spend hours looking

through scores of documents to find those which warranted further examination. At times, it was like looking for a needle in a haystack. The deal cycle often became so protracted that, eventually, a seller would be forced to limit the number of potential buyers just to move the deal to close in a reasonable timeframe.

VDRs effectively removed the roadblocks that physical data rooms placed along the path of due diligence. Sellers can now securely host due diligence documentation online in an organized directory structure, making it possible for virtually any number of invited guests to review the materials. Thus, VDR technology lifts the ceiling on the number of potential buyers with whom a seller could be advancing talks.

ACCELERATING THE DEAL CYCLE

“Time Kills All Deals”

Being able to simultaneously entertain more potential buyers is only one part of driving the most efficient market possible in sell-side transactions. Having information in an easily accessible form so that buyers can make informed bids with greater confidence is another. The intuitive directory of the data structure that is found within a VDR is a great improvement over the physical data room and its stacks of bankers boxes filled with hardcopy documents.

One main advantage to hosting due diligence materials in a VDR is the time-savings resulting from the application of advanced searching techniques across entire document sets. For example, searching by keyword allows sellers to communicate information to buyers more quickly and more efficiently.

It is estimated that, on average, the use of a VDR for diligence purposes shortens the duration of deals by 30 days or more. In addition to speeding up the document review process via more efficient search tools, many VDRs:

- Alert relevant parties to updated material
- Allow for efficient Q&A directly from the browser

Lastly, the typical VDR can be set up in one or two days—which is extremely rapid implementation for any best-practice technology.

GAUGING THE LEGITIMACY AND ANALYZING THE BEHAVIOR OF POTENTIAL BUYERS

Understanding how serious buyers are can help the seller better manage the time and effort that should be invested in engaging with a particular potential buyer. Not only can VDRs allow a more focused effort to be directed toward the relevant buyers, they can help the seller determine whether access to confidential information should be denied to buyers whose legitimacy has come into question. Through the creation of a report featuring an audit trail of user activity, VDRs can show sellers which documents

a given potential buyer spent time reviewing.

Armed with information about the behavior of potential buyers, sellers are in a better position to optimize the outcome of transactions.

REDUCING DIRECT TRANSACTION-RELATED EXPENSES

Utilizing a VDR solution for due diligence instead of traditional means equates to a reduction in direct expenses. These expenses include real estate costs for the physical storage of materials, shipping, scheduling, and other administrative costs involved in hosting visitors to the data room or sending materials out to prospective buyers.

From the buyer's perspective, direct expenses eliminated by VDR use include travel-related expenses and salary or hourly charges associated with the professionals conducting diligence. Although difficult to determine the exact proportions in which the parties will share the expense reduction benefit, it is clear that any reduction in a buyer's expenses allows for more potential available capital to be put toward the purchase price.

MINIMIZING POST-CLOSE CONTINGENT LIABILITIES

A significant source of post-close seller liability is related to the seller's disclosure obligations. Given the large volume of material which must be made available in the diligence process, even a bona-fide seller could inadvertently omit a key piece of information.

Working with a Virtual Data Room can help a seller organize diligence information in such a way that the risk of non-disclosure is minimized. Additionally, detailed activity tracking reports allow sellers to maintain records that demonstrate whether or not key pieces of information were reviewed by the relevant parties or made available for review.

MITIGATING UNCERTAINTIES WHICH DRIVE BUYER HOLD-BACKS

Just as the use of VDRs brings benefits for the seller by helping mitigate post-close liabilities, it can benefit buyers by alleviating any doubt they might have about full disclosure.

Uncertainty is the main factor that drives the desire for buyer hold-backs and the use of contingent pricing mechanisms. The more quickly and effectively information can be shared with buyers, the more their uncertainty may be reduced. Eliminating the possibility of post-close surprises can help make buyers more tolerant of shifting a higher portion of deal compensation to cash at close.

CONCLUSIONS

In the past decade no technology has had a greater influence on the deal-making process than the Virtual Data Room. While the VDR can help all stakeholders in any given transaction, it is the seller who derives the greatest potential benefit: first, by using the VDR to make the purchase process occur under more beneficial market conditions; and second, by using the VDR as a tool to influence transaction value.

To recap, some of the benefits the seller may enjoy from using a Virtual Data Room are:

- Maximizing the information flow to potential buyers
- Accelerating the deal cycle
- Gauging the legitimacy and analyzing the behavior of potential buyers
- Reducing direct transaction-related expenses
- Minimizing post-close contingent liabilities
- Mitigating uncertainties which drive buyer hold-backs and contingent pricing mechanisms

Further, the industry's leading providers of VDR solutions have developed this best-practice in such a manner that sellers can rely on world-class security and service. Regarding security: The gold standard in hosting online financial data is the use of a SAS 70 Level II certified facility. Regarding service: To accommodate the nature of most deals, service should be available outside normal business hours in the form of 24/7/365 support.

In addition to helping sellers save time, effort, and money, a Virtual Data Room can help them optimize the price and timing of payments for any given transaction. The VDR is quickly becoming a must-have and must-use technology enabler for streamlining the M&A process.



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