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VDRs

The role of virtual data rooms in the current climate

BY MUAZZIN MEHRBAN

The economic climate over the last 18 months has been turbulent, and consequently, many distressed businesses have been compelled to restructure their operations by selling off non-core divisions. But this is easier said than done, and struggling companies are expected to complete such moves as quickly and cheaply as possible in order to improve their chances of survival. Anything that can speed up the sale process is being considered, and an increasing number of companies are turning to virtual data rooms (VDRs). These digital platforms provide a secure, online repository for information, from which users can easily store and distribute documents. Indeed, in the majority of situations they are preferable to physical data rooms, which tend to be more costly and time consuming – factors that companies close to collapse are keen to minimise. So today, VDRs are used more than ever, and in more situations, and it seems that this trend is likely to continue.

Streamlining the due diligence process

VDRs are playing a role in more distressed sales as companies become aware of the benefits of making critical information accessible to select parties. Indeed, it can be a helpful component of a successful restructuring initiative. Consequently, sell-side VDRs, particularly within the distressed real estate sector, are currently in high demand. "VDR technology allows for faster and more thorough due diligence and those attributes are critical to successful deal making in any environment," asserts Richard Martin, a senior director at Merrill Datasite. "But this is especially the case during tough economic conditions where one must make the most of every opportunity and must approach deal making with additional rigour," he adds. This is also true for cross-border transactions, especially those conducted as auctions. Ultimately, it is fair to say that the increased usage of VDRs is not just a result of the current economic crisis, although it has arguably catalysed their rise.

Indeed, it is sensible for both buyers and sellers to increase the efficiency of the due diligence process where possible, regardless of the financial climate. And in terms of efficiency, VDRs generally outflank physical data rooms by virtue of the fact that they place data in a secure online location that is potentially accessible to anyone around the world. Key business information can be accessed and shared in seconds. "When restructuring experts typically assess a struggling company, critical documents may be scattered geographically across the organisation. Corporate papers, contracts, financial information, lease agreements, some paper-based and others in electronic files, may be buried in moving boxes, filing cabinets, employees' desks and computers in various locations," describes Dan Bradbary, chief executive of V-Rooms. "Because of the need to share this information with a wide variety of parties like trustees, attorneys, creditors and financial professionals, the creation of a VDR for a central document repository is essential," he continues. While physical data rooms are still in use, that use is clearly declining as companies turn to VDRs.

Practically speaking, VDRs should be up and running prior to the announcement of a deal, or in the case of a restructuring, as early as possible. In the current climate, due diligence periods have been cut from weeks to mere days, with sellers looking to offload assets at greater speed, before they run out of money to support ongoing operations. But ultimately, once a VDR is set up, it can be used for a number of useful functions. "These include, mergers, acquisitions and disposals, IPOs and secondary offerings, asset purchases, liquidations, bankruptcies, and many other transactions that require due diligence," notes Mr Martin. In addition, they can be used by a wide variety of professions. "Typical users will include buyers, lawyers, bankers, CFOs and other key advisers who use the space to study a wide variety of material – from corporate records, management data and property documentation, to insurance statements and marketing plans," he adds.

Getting the most out of a VDR

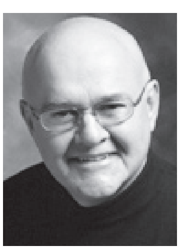
Furthermore, VDR providers are constantly updating their products to make them more effective and user friendly. For example, leading providers have implemented tools such as bulk uploading from desktops, complete with Digital Rights Management (DRM), which allows the administrator of a VDR to limit the user's ability to print, save or view documents. In addition, VDR providers are keen to improve the general accessibility of their products, and offer a range of additional tools to complement the VDR itself. Users can search by word and/or concept, allowing them to instantly locate individual documents. This feature can help speed up communication between parties and ultimately speed up the due diligence process. Other plus points include multiple bidder access, simultaneous data review, easy access to bidding history, and in general, far greater control over the data stored.

Also, VDRs are generally quick and straightforward to set up, with no unusual software or hardware requirements. Better still, the price of VDRs is decreasing, making them more attractive to smaller companies. This is just as well. Mikael Osterlund, a partner and Transaction Services Leader at PricewaterhouseCoopers, points out that in recent months, buyers and sellers have been more cost sensitive, and have been seeking cheaper data services as a result. They are even willing to share facilities on certain occasions. "The vendor can utilise existing VDR providers services in getting their due diligence information loaded to a secured and controlled shared platform. The buyer can reduce their own internal due diligence teams' and external advisers' costs and still ascertain that all teams have all the available information at their disposal," he says. Clearly, the positive factors of a VDR are numerous, but experts in the field maintain that awareness of their potential is not as great as it could be. To some extent, it is true that they are now a common feature of M&A transactions in many jurisdictions, but their usage as part of reorganisations and restructurings could be far greater. However, many believe that the economic downturn will force companies to seek cheaper alternatives when faced with these challenges, which in turn will result in VDRs becoming more popular.

The heightened distress of many companies has also increased the likelihood of litigation or legal action, creating an alternative usage for VDRs. Litigating parties with VDRs in place will have the ability to create and manage folders for witnesses, depositions, demonstratives and motions, all of which can be limited to give access to only those it concerns. This can be extremely useful. "Since multiple parties need access to certain information, it is essential to store these documents outside the law firm's firewall, due to the IT expense and potentially dangerous practice of outside counsel having access to the law firm's servers," agrees Mr Bradbary. Use of a VDR in these situations ensures that control of documents is instantly available, around the clock, both in and out the office.

Going forward, experts envisage that the use of VDRs will increase, both with respect to ongoing operations and individual transactions. It is thought that this will be notable in the US, given the new emphasis placed on regulation by the Obama administration. Consequently, there is likely to be an increase in usage from private equity funds in particular, who are under pressure to show greater levels of transparency with regards to due diligence, compliance and transparency. "The usage of VDRs for communicating and reporting to the fund's investors is going to increase substantially," predicts Mr Bradbary. "Likewise, companies are recognising the economies and conveniences of establishing central document repositories, whereby their staff are provided with controlled access, along with audit reporting and tracking, of information without regard to geographical limitations." This is confirmed by the figures, which show that the growth of VDR usage in M&A transactions has grown exponentially. Indeed, over 80 percent of deals valued over $500m now utilise VDRs, says Mr Martin. And in mega deals, it is highly unusual for a VDR to be omitted from the process. However, VDRs are less prominent in the mid-market and below, although the number of users is growing. Overall, the usage of VDRs has tripled in the last two years, and analysts expect this to continue, as more businesses become aware of the benefits that VDRs have to offer.

Although smaller companies are still to be convinced by the benefits, the future of VDRs appears robust. Their security and ability to provide a superior service to physical data rooms is without question. There are, of course, ongoing concerns that VDRs do not guarantee that abuse of the system will not occur, but this problem tends to be even more prevalent when using even the most closely-monitored physical equivalents. VDR providers will be keen to advertise the benefits their system has over physical alternatives, especially among smaller businesses, where the adoption of VDRs has been slower. Ultimately, the growing popularity and more widespread use of VDRs is proof in itself that they are becoming an essential tool for deal advisers and related professionals. Their popularity in large scale deals has underlined the credibility of VDRs among dealmakers. The entire sale process has become shorter and more direct, negating the need for travel and other associated costs. As well as being a cheaper and time saving alternative, VDRs provide a solid framework in which companies can communicate with minimum levels of disruption – a particularly useful attribute given the added pressure businesses are facing the current economic downturn. ■



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Prior to founding Due Diligence Online, LLC, Dan Bradbary was an Angel investor in & served as a corporate officer of several start-up medical device / diagnostic / pharmaceutical companies. Earlier in his career, Dan Bradbary was the Founder and CEO of Project Management Services, Inc., an Atlanta based 150-person management consulting firm with a Fortune 500 client base, including such firms as AT&T, Delta Air Lines, DuPont, IBM and Motorola. He sold this firm in 1997. As a result of his investment and project management background, he developed and founded Due Diligence Online in 2004. The concept of virtual data rooms was a logical and natural result of his own experiences.

Dan holds an MBA from Georgia State University in addition to a Bachelor of Civil Engineering degree from Georgia Tech.