

White Paper

Business
Sale Series

VIRTUAL DATA ROOMS:

An Indispensable Due Diligence Tool

Transaction due diligence has evolved dramatically as cloud-based services have become ubiquitous and inexpensive. The result has been that data room capability is available to an ever-wider range of users.

Today's virtual data rooms (or "VDR's") are designed to facilitate fast, efficient and inexpensive transaction due diligence. They are an indispensable tool for deal teams and are now essential to a successful sale process. They are very secure, provide comprehensive access control and activity monitoring and they allow simultaneous access by a virtually unlimited bidders at any given time.

Healthy competition in this market has continued to drive innovation up and pricing down.

This White Paper is one of several instalments of Osprey Capital's Business Sale White Paper Series.

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The Virtual Data Room

One of the most important objectives of for the seller of any business (or “Vendor”) is to expedite the transaction due diligence process as much as possible.

TIME IS YOUR ENEMY:

The longer the due diligence process takes to complete, the greater the likelihood that the transaction will fail

There are many reasons that a long and lethargic due diligence process is bad for the Vendor. It is primarily about increased risk of:

1. Leaks that the business is in a sale process, which can undermine the confidence of employees, customers, suppliers and other stakeholders;
2. Misuse of sensitive information about the business by potential bidders in the sale process;
3. Business performance changing materially and other surprises, which can create gaps in value expectations between the Vendor and bidders. Negative surprises will cause bidders to reduce their valuations. Conversely, positive surprises may cause Vendors to increase their value expectations; and
4. Deal fatigue and bidder frustration/distraction.

For decades, the best sale processes utilized “data rooms”, which were just that, physical spaces that are stocked with the due diligence materials that are required for bidders to complete their transaction due diligence. These spaces accommodated multiple bidders, albeit sequentially, to facilitate the speedy completion of bidder due diligence. Technological advances have since rendered the physical data room obsolete.

This paper provides an overview of VDR's, including what they are, how they are applied, who provides VDR services, security, cost, setting them up, using them and closing them down when the process is complete.

A. The Original “Data Room”

Before the VDR, confidential information required for due diligence was gathered in hard copy and physically placed in a secure room, (hence the name ‘Data Room’). The data room could be anywhere but was most often located on the premises of one of the Vendor’s advisors and could contain many thousands of pages. Because of the expense of the physical facility and personnel support

requirements, these data rooms were only practical for large transactions.

Potential bidders and their due diligence teams had to travel to the data room’s location. Each potential bidder had to schedule a time and take their turn to get access. Travel and scheduling increased the overall transaction costs and the sequential nature of bidder access caused the due

diligence phase to drag on for several weeks and sometimes months.

Access was carefully controlled and only granted to potential bidders once all of the information had been gathered and organized. Staffing and resources were required to ensure security and that protocols were followed by potential bidders. Savvy bidders were often able to infer significant information about the process by the physical state of the data room and also by tricking junior staff in the data room to disclose details about the others in the process.

The data rooms usually had amenities in them for the purchasers' due diligence teams to do their work, including photocopiers, fax machines and other office equipment required to support the due diligence teams. Although the physical data was carefully arranged, much time was often wasted by the users in locating and correlating information. Documents were frequently missing, misplaced or mislabeled, particularly after several teams had viewed them.

B. What is a Virtual Data Room?

A VDR is a site on the secure server of a VDR provider (or "Provider") that the Vendor's staff and advisors control and populate remotely with data to be accessed by the potential buyer(s) and their accountants, advisors, lawyers, etc. as a part of their overall due diligence process.

Providing Data	Physical Delivery of Paper	Remotely Provided Digital Copies
Access	Physical Office Limited Access	24/7/365 Global Access
Storage	Paper at a Physical Location	Secure Server
Security	Locks, Keys, Log Books & Sentinels	Secure Server, Access Control
Tools	Calculators & Notebooks	Compatible Systems and Features
Activity Monitoring	Log-books & Subjective Tracking	Digital Access Logs

The chart above highlights some core benefits of the VDR over the original physical data room.

C. Wider Applications of the VDR

VDR's have found a wide variety of other applications where document sharing in a secure environment is required. A few examples include:

- Due diligence for divestitures, acquisitions, mergers
- Joint venture or post-merger integration
- Financial restructuring and bankruptcy
- Consulting assignments

This paper will focus on VDR use in the context of the due diligence process for business divestitures and acquisitions.

D. Choosing the Right VDR Provider

In recent years VDR services have become more sophisticated, competitively priced and tailored to each application offered. Consequently, while still not appropriate for all situations, the VDR option has become viable for an increasing number of smaller and less complex transactions.

Arranging for the VDR and populating it with the required data is typically the responsibility of the Vendor. So it is the vendor (on the recommendation of their advisor) who selects and contracts with the Provider.

Your transaction could be impacted if your Provider does not deliver flawless service, so select with care. While price is important, it should not be the primary factor. You should confirm service and capabilities and always obtain and check references.

To access our VDR Provider Guide, click [here](#).

E. Security

Security is a key element of a VDR. Documents are usually encrypted during

transmission and storage. In addition to the usual protection from external unauthorized access, the two main security elements are access rights and tracking.

An 'Access Right' or permission, allows or restricts a user's ability to navigate the VDR, i.e. to view all or only certain documents. Access Rights to the VDR are granted individually for each user and are user name and password protected. Who is allowed into the VDR and which documents they are allowed to access is controlled by the Vendor and/or their advisors. Access can be given, withdrawn or changed almost instantaneously. The right to grant or withdraw access must be carefully restricted to specific person(s) on your deal team.

VDR users can be grouped or designated (e.g. buyers' executives or staff, accountants, advisors, lawyers, etc.). The VDR's system logs when each user accesses each document. If required, the activity log in of the VDR can later demonstrate when specific documents were viewed, by whom, when and for how long.

F. Cost

Charges vary between Providers but terms are usually negotiable, particularly if you have not used them before, as the Providers know that you will be reluctant to switch (if they give good service). Most Providers will charge a flat monthly fee based on the expected document volume but find out exactly what's included and more particularly what is not/optional.

While an advisor can make a recommendation and the arrangements, typically the Vendor contracts with the Provider directly.

If the fee is not all inclusive, some of the additional charges may be for:

- Initial set-up charge

- A surcharge for exceeding the agreed overall file size or number of pages stored
- Support usage beyond stated limits
- Exceeding the agreed time the VDR is to remain open

G. Setting Up a VDR

Remember how *time is your enemy*? You can really save a lot of time by getting prepared and organized early. The best VDR's facilitate fast, efficient and effective bidder due diligence. They are easily-navigated, have rational file structures with logical sub-folders and address all relevant aspects of the business.

The Provider will typically walk you through the initial set-up of the data room prior to the initial upload. Be sure to retain control of all the functions/data of the VDR (this can be jointly with the Vendor and the advisors), this is especially applicable to authorization of access permissions and security levels.

While you can stage the release of information, assume that the successful bidder will want to view all information that could be relevant to the valuation and risks of the business. An incomplete VDR typically results in significant disruption and wasted time as personnel scramble to address ad hoc requests. Hasty preparation of these materials also can undermine management credibility if the material appears to be carelessly prepared.

No matter how much you work on preparation, there will of course be the need to update, add or delete data as the due diligence process progresses. Activity logs will be generated by the VDR's own systems.

To access our VDR Setup Guide, click [here](#).

H. Using the VDR

Using the VDR is all about populating and finding information. So an easy to use and intuitive system backed by a top notch search engine and prompt expert support are the

underlying key features for keeping the bidder(s) happy. That said, these features work best if the data is stored in a clear and logical way that facilitates the system - so a well thought out initial setup and data labeling are also very important.

As already discussed, you can restrict any user's access to any document but you can also allow (or disallow) information to be printed or downloaded. Downloading is usually requested by analysts who do financial or business modelling and want access to your spreadsheets.

A feature that disallows screen shots is often available. We strongly recommend that you use it. Any screen shots will not be recorded, so you can't follow or control what is being copied. Equally important, the system cannot

log a screen shot, which means that you could lose control of following usage and confidentiality.

I. Closing the VDR

Prior to closing the VDR, a copy of all the data and the system's access log information will be made and delivered to you by the Provider. This makes it available in the event of a later dispute or other reason.

When a buyer has either withdrawn their bid or the transaction is concluded, the access rights of their users are cancelled and any copies that were previously downloaded by them will become illegible by using the "Revoke documents remotely after being shared" feature.

Conclusion

The VDR gives the deal team the tools to disseminate massive amounts of due diligence information to multiple parties in parallel, and do so in a controlled fashion. This keeps the due diligence process moving forward, while allowing the deal team to monitor bidder access and activity. When there are several buyers, this becomes crucial as it can help ensure that all bidders move along in parallel.

The VDR's global accessibility also facilitates the advisors' ability to market a business to the full national and international universe of potential strategic and financial buyers. Accordingly, a VDR is a strong complementary tool in maximizing value through the sale process.

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White Paper

About The Author

Mr. Kossowski has over 35 years finance and investment banking experience in Canada and internationally. Prior to joining Osprey Capital he was with TD Bank Financial Group and TD Securities Inc., where he gained experience in most segments of domestic and international banking and finance, including commercial, corporate and trade finance and investment banking at a senior level.

Over the years he has helped hundreds of companies of all sizes with their domestic and international finance and investment banking needs.

He speaks Portuguese, German and Spanish and is a Fellow of the Institute of Canadian Bankers. For ten years Mr. Kossowski taught advanced courses at various banking, accounting and Canadian regulatory and government organizations.

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About Osprey Capital Partners

Since its foundation in 1998, Osprey Capital has become one of Canada's leading independent mid-market investment banking and financial advisory firms. Osprey Capital has more than 15 professionals with offices in Toronto, Calgary, Winnipeg, British Columbia and Nova Scotia.

This national platform is extended globally though our membership in Globalscope, a leading international group of corporate finance and business advisors, with 41 members operating on every continent in 32 countries, supporting clients in cross-border transactions.

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