

## VIEWPOINT

ISSUE 29

## BEYOND THE USUAL SUSPECTS: WHY BUYERS OUTSIDE YOUR INDUSTRY MAY PAY MORE FOR YOUR COMPANY

by Jameson Grant

### WHY THIS MATTERS:

- Companies outside your industry may want access to your customer base, your product and service offerings or your geographic location for strategic reasons – and be willing to pay higher multiples than your competitors.
- A wider pool of buyers means more competition – often leading to higher valuations.
- You can maximize the value of your company sale by thinking outside the box about potential buyers.

*As a CEO in a competitive industry, you know who's likely to buy your business. You've been watching these companies since the day you opened. You've tracked their every move. You've followed their successes and failures. You may even know their senior managers personally. And why not? There are only a few of these companies – the leaders in the very same industry you've staked out. If anyone's going to buy your business, it's one of these companies.*

*If you've been thinking along these lines, you're not alone. Nearly every CEO who considers selling his or her company starts by assuming that potential acquirers will come from inside the industry. In reality, buyers from outside your immediate line of business may offer a better deal.*

*In this month's Viewpoint, we'll talk about why strategic buyers from outside your industry may, in fact, significantly outbid your competitors, present some case studies of successful cross-industry transactions and show you how to increase the rewards of selling your business by widening the pool of potential buyers.*

### BULLS-EYE! AN EXPANDED APPROACH TO TARGETING BUYERS

At Mirus, we think of potential buyers as a series of concentric circles – like a bullseye target. However, unlike in archery, it's often the periphery, not the center, that's the most interesting part of our target.

That's because the center of the target contains the most obvious acquirers, companies that are in the same industry as yours, serving the same kinds of clients with the same sorts of products and services. You already know these companies. You can probably draw up a short list of these firms off the top of your head. Yet even though these candidates are easy to identify, you do your company a disservice if you do not consider other kinds of companies.

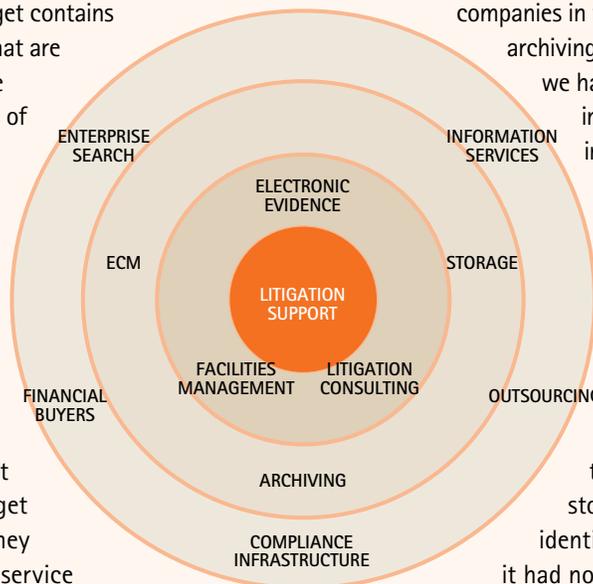
So to expand the circle, we ask a series of questions. We look at our clients' customers and think about what other sorts of companies might like to get access to that customer base, even if they don't have the same sort of product or service offerings. We think about the products or services our client provides and try to identify companies that might want to offer those products and services to their customers. We also think about geography. A company with a strong presence in, say, Boston, might be attractive to an acquirer looking to raise its profile in New England. In these cases, the businesses should be complementary, but do not necessarily have to be the same.

You might wonder why we spend so much time looking for a wider pool of buyers. Essentially there are two reasons. First, and most obviously, more buyers mean more competition for any given target and, in general, higher prices. Yet there is another even more important difference. Buyers within a target's industry generally expect to pay a multiple on earnings or multiple on revenues that is consistent with industry standards. Buyers from outside the industry, however, are not merely buying more of what they have. They are making a strategic inroad into another area of business, whether it is an entrée into a new market or access to a valuable customer base. As a result, these buyers may not be constrained by an industry consensus on appropriate multiples as they value a target. They are making an acquisition that they hope will transform their business, and that may be worth more to them than the going price within the industry.

## CREATING DEMAND FOR CORE PRODUCTS

Now let's look at how this kind of exercise might work with regard to a specific company. We'll start with Daticon, a well-established provider of electronic discovery and document conversion services based in Norwich, CT, that was recently acquired by Xiotech.

As you'll see, litigation services companies sit at the center of this diagram. These are the "obvious" acquirers, companies in essentially the same business as Daticon. A bit further out, Mirus identified companies in related businesses, such as electronic evidence management, litigation consulting and facilities management. It is only in the third concentric ring that we get to



companies in the electronic compliance management, archiving and storage industries. Further out, we have possible matches in compliance infrastructure, enterprise search and information services.

Daticon is an interesting case because it was sold in a public auction process, which allows Mirus to disclose bids from various companies. It attracted a bid from Xerox Corporation, a document management company which would fall quite near the center of our diagram. However, the winning bid came from Xiotech, a storage equipment company that Mirus identified as a potential buyer even though it had not previously been actively involved in electronic discovery or litigation support.

The critical point was that Daticon's electronic discovery services required a great deal of disk storage, to archive vast quantities of emails, memos, documents and other data sources. It also demanded a good way to manage and selectively retrieve documents out of this enormous pool of information. Xiotech saw Daticon's core business as an opportunity to enter a higher value added business than disk manufacture — and, as a side benefit, to generate additional demand for its data storage products. As a result, it was willing to pay more than companies directly involved in Daticon's business, outbidding all competitors with a \$30 million offer. Its bid exceeded Xerox's final offer by \$3 million.

## ENHANCING OFFERINGS TO EXISTING CUSTOMERS

Now let's look at another company that was recently acquired by a firm outside its industry, DxCG, a health care software company. DxCG's main business was developing software that helps healthcare providers, payers and employers to forecast healthcare costs. By understanding these costs, companies can more effectively negotiate insurance premiums, set rates for treatments and budget for care. DxCG had grown rapidly. When it came up for sale in 2004, it had more than 175 clients, including Blue Cross Blue Shield of Michigan, Highmark Blue Cross Blue Shield, Kaiser Permanente, and Pacific Business Group on Health.

About a year before it was sold, Mirus had advised DxCG on an offer from another health care software company, but the deal had not been consummated. Interest in DxCG's software remained strong, however, and we continued to evaluate and communicate with a wide swath of potential acquirers — health care companies, software companies, and other more tangentially-related businesses.

Eventually, through these efforts, DxCG received an offer from Insurance Services Office (ISO), a company started to serve a consortium of insurance companies. ISO had emerged as a leader in providing risk management tools to a broad

spectrum of clients not just in the insurance industry, but in finance, real estate, government and human resources. Even though the company had not, up to that point, operated in the health care space, DxCG's health care cost models seemed like a natural fit into its suite of data analytics offerings. Buying DxCG would give ISO a foothold in risk management in an area that had become increasingly important to its clients: health care cost management. Because of the deal's strategic importance, ISO was willing to pay a premium over the original same-industry bid, allowing DxCG shareholders to maximize the value of their holdings.

## DIFFERENT COMPANIES, COMPLEMENTARY TECHNOLOGY

Sometimes companies acquire targets outside their industry not to gain access to products, customers or markets, but to obtain complementary technology. That was the case when PixelVision, a leading developer of LCD technology, began to look for a strategic buyer.

PixelVision's main business was serving financial traders with high-end flat panel displays; however, in developing this business, the company had generated 26 discrete, differentiating technologies. These technologies were protected by six patents, including a patent for analog-to-digital image conversion that allowed digital display devices such as projectors and LCDs to be connected directly to the analog CRT jack on a PC. After identifying all of these technologies, many having numerous applications, Mirus brainstormed with the engineering team to identify additional applications—outside the financial vertical—for the technology. Mirus then presented these technologies in the offering memorandum.

Ultimately, the buyer for PixelVision was not a display company, but a switch company. Cybex, now Avocent (AVCT), was the leading manufacturer of analog KVM switches that allowed a

single keyboard, display and mouse to operate multiple computers in a server room or network operations center (NOC). PixelVision had already developed a digital KVM for its financial application that Cybex could use in the NOC market (a multi-billion-dollar market opportunity). It was this application, teased out in the Mirus brainstorming session, that resulted in Cybex coming to the table with a strong offer.

Similarly, when Tellabs, a maker of data, voice and video transport, switching/routing and network access systems, bought DSP Software Engineering, technology was the main draw. At Mirus, we identified DSPse proprietary digital signal processing software as an important tool in Tellabs' strategy to develop voice-over-IP communications capabilities, a dynamic and fast-growing segment of its core business. We highlighted this technology in our presentations to Tellabs and elicited an attractive winning offer for DSPse.

## LOOKING OUTSIDE THE BOX FOR BUYERS

All these examples point towards one core principle: when looking to sell a company, the best offer may very well come from outside your immediate industry. These buyers often have compelling strategic reasons for purchasing companies peripheral to their core business – whether to access new customers, sell additional products and services to existing customers, fill gaps in proprietary technology or expand into new distribution channels and markets. Because they are making strategic acquisitions aimed at transforming their companies, these buyers may be willing to pay more for your business than your closest competitors.

The key to identifying potential buyers is to think expansively about your company's products, its clients, its technology and its marketplace strengths. Then you can look both within and outside your core business for companies that might benefit from what you have to offer.

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*At Mirus, we've helped dozens of companies widen their universe of potential buyers and seek out attractive offers from acquirers in related, complementary or even completely different businesses. If you'd like to find out more about our bulls-eye approach and how it might work in your specific situation, please contact us.*



**Jamie Grant** is a partner at Mirus Capital Advisors, Inc. Founded in 1987, Mirus Capital Advisors is a middle-market investment bank that specializes in merger advisory, capital-raising services, fairness opinions and valuations to entrepreneurs, corporations and professional investors. By combining a proven process, industry and transactional expertise, and personalized service, Mirus has completed hundreds of transactions for both public and private companies. Our affiliate, Mirus Securities, Inc., is a registered broker-dealer and FINRA/SIPC Member. For more information, visit [www.merger.com](http://www.merger.com).

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