

# European M&A bankers join world

The shape of due diligence is changing with the times, writes Tom Fairless

The mergers and acquisitions world is going virtual. Traditionally, M&A bidders inspect confidential data on the target company in a secure room in the vendor's offices or those of its lawyers. This due diligence is acknowledged as being crucial to the success of a deal.

However, companies are moving from physical data rooms to online venues where they can view

documents at their convenience. Bidders and their advisers are given access to the data via secure log-ons. Access can be restricted to certain documents for the first round of a bidding process, and disabled if a bidder withdraws.

Virtual data room technology started in the US, where the market is already strong. Shannon Dolan, vice-president of sales at

software company SunGard, says the systems are making headway in Europe. She said: "Acceptance in Europe is picking up. VDRs have become a key topic in the region."

Merlin Piscitelli, a director of VDR provider Merrill DataSite, an arm of Merrill Corporation, and New York-based IntraLinks, said: "Our business in Europe is 25% up on last year. The number of M&A

deals has declined globally but we have seen a massive increase in the number of data sites."

Mark Williams, a director of US printing company RR Donnelley, estimates 70%-80% of European due diligence is done through physical data rooms and agrees there is potential for growth of VDRs.

Piscitelli believes market penetration is already higher. He said: "VDRs are used to conduct due diligence on around 35% of M&A deals in Europe, with the remainder still carried out in physical data rooms. This compares with an estimated 40% penetration in the US and close to 30% in Asia."

Whatever the true figure, VDRs are on the rise across Europe, with take-up strong in Italy, France, Spain and Scandinavia. Eastern Europe is another growth region. Piscitelli said: "Countries such as Russia, and the Commonwealth of Independent States, are catching up with other financial centres in

terms of VDRs this year, as they seek to raise capital, sell assets or list companies."

Piscitelli believes penetration in Europe could reach up to 70% within five years. He said: "There will always be paper data rooms for friendly deals. The determining factor will be how much a company knows about the other company, rather than the size of the deal."

The Autumn IntraLinks Monitor, a bi-annual survey of the European M&A market, questioned 332 European M&A professionals. It found 41% of respondents expect physical data rooms to be consigned to history in just two to five years, while a further 36% see VDRs replacing the "old way" in less than two years.

Although global M&A has slowed over the past year, VDR providers are reporting buoyant business. Andrew Pearson, managing director for Europe, the Middle East and Africa at IntraLinks,

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## Banks accessorise their research

Clients are seeking alternative services to drive investment ideas, writes Shanny Basar in New York

During New York Fashion Week this month designer Christian Siriano launched a scarf design with a pocket to carry a mobile phone. Investment banks too are being driven to customise their traditional products, with research receiving plenty of attention as clients, particularly hedge funds, seek alternative services that could give them an edge over rivals.

Sandy Bragg, chief executive of Integrity Research Associates, which provides information on alternative research providers, estimates that 15% of total commissions, approximately \$1.8bn (£1.3bn), is spent on alternative research and this could increase to between 20% and 25%, or \$2.5bn, in three to five years.

A survey by Integrity Research of 60 large hedge funds and mutual funds in Europe and the UK found that 68% plan to increase their spending on alternative research with only 3% planning a decrease.

Banks are keen to secure these revenues for themselves and are offering a range of services alongside their traditional investment advice, rather than lose clients to third-party providers.

In March UBS Investment Bank bought a stake in Integrity Research to give UBS clients and analysts access to evaluations by thousands of alternative research firms worldwide. Mark Steiert, global head of equity research at UBS, said: "We acquired a stake in Integrity as we believe in open

architecture and it has a database of 1,800 providers just in the US. It is a large field to navigate and is constantly changing so an advisory capacity is valuable and a unique selling proposition."

Other banks have taken a different approach by selecting several alternative providers, which provide a complementary product to their own analysts. In return they hope clients will either trade through the bank, or pay directly for the research.

Goldman Sachs in the US was first off the blocks with the launch of Hudson Street, its third-party research platform, at the beginning of last year. In July this year Hudson Street added its 11th provider, Beijing-based research and consultancy firm JL McGregor. Tom Conigliaro, a managing director of Goldman Sachs and head of Hudson Street Services, said: "JL McGregor's combination of powerful data-collection tools, primary research capabilities, and comprehensive analysis is uniquely positioned to help our clients develop China investment strategies."

Hudson Street is waiting for regulatory approval to launch in the Middle East and Latin America, as it adds other providers to the platform. Conigliaro said: "Even though equity volumes have been slow, markets have been incredibly volatile and each month our pipeline has been consistently building momentum, so there is still strong interest in the alternative

# of virtual data rooms

said: "Business is up despite the M&A downturn. Once we reach market saturation around 2010, the adoption rate for VDR technology is likely to stabilise."

The popularity of the sites is due to speed, flexibility and lower costs. Sites can be accessed 24 hours a day and by several people at once, while documents can be rapidly and cheaply uploaded or removed. Traditional data rooms tend to allow just one bidder at a time to access the information to ensure confidentiality, and new documents must be couriered.

The IntraLinks Monitor found that nine out of 10 respondents who have used a VDR believe it reduces due diligence time by at least 10%. Three-quarters of respondents said time saving could exceed 25%.

VDRs also reduce travel costs. Pearson said: "Companies are increasingly engaging in cross-border deals and complex three-way

mergers. As complexity increases, the size of the team of specialists working on a deal also rises. VDRs allow companies to avoid the expense of transporting all these specialists to a physical data room."

Williams said VDRs save the most time for big deals, but there are also advantages for mid-cap mergers. "However, the basic set-up charge may discourage putting just 20 pages online," he said.

Pearson added: "In future, I expect all deals worth more than \$10m to use VDRs." The sites also offer a clear audit trail, which allows vendors to profile bidders by examining who has looked at which information and for how long. Pearson said: "Vendors can watch buyer activity in an auction process and gauge levels of interest."

However, several factors have slowed take-up. Dolan said: "Security was an issue, but technology has come a long way. Sponsors of data rooms can choose to prevent

participants from saving or printing data, and watermarking capabilities make it possible to discover where information originated."

Williams added: "Security is now very tight. There continue to be concerns from people who don't understand the technology, but usage will spread as financial and legal teams grow more comfortable with it."

Cost was another problem. Piscitelli said: "The perceived costs were high because VDRs are billed separately rather than as part of an overall deal fee. We are educating clients as to the value and cost saving of conducting the due diligence on a data site." Pearson said: "We are constantly investing to upgrade the platform and make it more intuitive and easy to use."



**Trends: research is customised to meet clients' needs**

research space." Goldman buys stakes in the firms that are on the Hudson Street platform.

In April Merrill Lynch launched Merrill Open Minds, initially with seven alternative research firms which specialise in extra-financial information, corporate integrity risk, federal policy, healthcare, media, energy and consumer surveys. The bank is not required to own a stake in any of these firms, but Steinert said: "We are not closed to making minority stakes in alternative research providers and expect to add best-in-class providers to augment our platform before the end of the year."

Morgan Stanley's strategy was

kick-started in April with the launch of AlphaWise, providing customised research for individual clients. AlphaWise was set up in partnership with Gerson Lehrman Group, a US company that provides a network of industry specialists. The bank can also call on an array of specialists and partners for primary research, such as providing clients with data to support an investment idea and a large position, or to investigate why their opinion is at odds with the consensus.

The AlphaWise team, which has between 30 and 40 people, had been part of the bank's research department for four years, providing primary data for the analysts valuing companies. Ajit Agrawal, head of AlphaWise, said: "The common theme among clients is that they want to increase confidence in their investment thesis and there are a variety of sophisticated techniques for doing so. We believe our data-driven primary research techniques are quite predictive."

Barry Hurewitz, global chief operating officer of research at Morgan Stanley, believes alternative research is nascent but that spending will grow over the next five to 10 years.

Traditional research, however, remains an important part of the investment process, he said. "There is a role for both sellside research and alternative research and they are totally integrated. Investors want to understand the debate that moves a stock price and sellside analysts are constantly talking to the biggest investors in those stocks. This along with having deep industry expertise is extremely valuable."

This month Credit Suisse announced a strategic alliance with Gerson Lehrman which gives the bank's analysts access to the researcher's global network of more than 200,000 specialists.

At the same time, Gerson Lehrman will include Credit Suisse equity research analysts in its network to non-buyside clients for macro-industry topics rather than providing investment advice.

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