

TECHNOLOGY ACQUISITION UPDATE

Using Acquisitions to Transform a Company

by Thomas V. Metz, Jr.

Network Associates, WorldCom and NEBS have totally transformed their businesses through acquisitions. Acquisitions enabled them to broaden their markets, deepen their penetration in existing markets and leap into new market areas.

McAfee Associates was a virus software company with revenues of a paltry \$20 million in 1992. Eight acquisitions later in 1999, Network Associates boasts revenues of \$1.1 billion and a \$2 billion market capitalization. Under CEO Bill Larson's direction, the company has completely reinvented itself into a firm that is now the tenth largest independent software company and the world's largest independent network security and management software company.

In the beginning, Long Distance Discount Service (LDDS) was a small reseller of long distance telephone service based in Mississippi. Sixty-eight acquisitions over the past four years have transformed the company into a global provider of communications services. Today, the firm known as MCI WorldCom, provides customers around the world with a full set of data, Internet, local and international communications services over its own seamless "local-to-global-to-local" network. The company has \$30 billion in revenue and operations in 65 countries.

New England Business Service (NEBS) is a \$260 million direct mail marketer of software, business forms and supplies for small businesses. During the past two years, the Company acquired four businesses and transformed itself from a forms company to a diversified provider of small business products

and services. Revenues grew from \$250 million to \$450 million and the company's market capitalization doubled to almost \$500 million. Acquisitions have been an important part of the company's strategy for redefining itself and broadening its markets.

Acquisitions have the unique potential to transform companies. They can be a means to enter a market or bring capabilities to the organization that it finds difficult or time consuming to develop. An acquisition can swiftly expand product or service offerings without taking the time or risking the capital required for internal development.

Acquisitions generally fall into three groups: (1) domain strengthening -- deepen the firm's presence in an existing domain, (2) domain extending -- broaden that domain in terms of products, markets or capabilities, and (3) domain exploring -- bring the company into entirely new areas.

The examples that follow describe three companies that were able to change their behavior, break their current business molds and capture new opportunities.

NETWORK ASSOCIATES

The journey began for Network Associates back in 1989 when John McAfee founded a

virus software company called McAfee Associates. By 1993 McAfee had become a desktop utility company with revenues of \$31 million. Late that year Bill Larson joined the company as its president and undertook a series of acquisitions to fuel growth and beef up its arsenal of computer security products.

By 1995 McAfee had grown to a network tools company, having acquired Brightwork Development, Automated Design Systems and Saber Software. In 1996 the company extended its focus from the desktop to the workgroup with the acquisitions of Vycor, Jade K.K. and FSA Corp.

The company took on its current name, Network Associates, after McAfee and Network General merged in a \$1.3 billion transaction in 1997. Now McAfee had become an enterprise systems management company, selling a full range of network-related programs.

Network Associates acquired Pretty Good Privacy, a maker of E-mail encryption software. This acquisition moved the company from protecting local networks from virus attacks to providing enterprise-wide data security. They also acquired Helix Software to bolster its position in the diagnostics market.

Network Associates solidified its position in the security market by swallowing the number two firewall vendor, Trusted Information Systems, in a \$300 million stock swap. Dr. Solomon's Group was a leading British provider of anti-virus software tools with strong market share in Europe. With this acquisition, Network Associates enhanced its enterprise security products and increased its European market clout.

Magic Solutions International, a developer of help-desk software, was acquired in 1998, enabling Network Associates to capture customers at the lower end of the help-desk software market, and eventually move them to higher-end products. Network Associates' strategy of integrating product lines enabled the company to transition from virus software to desktop utilities to workgroup utilities to enterprise systems management.

MCI WORLDCOM

LDDS began as an upstart company led by a former high school basketball coach. The

company leased wide-area telecommunications service (WATS) from AT&T and resold long-distance time to small businesses. LDDS expanded operations through internal growth and acquisitions. The company went public in 1989 and subsequently acquired a long distance reseller (Advanced Telecom) and two full-service long distance providers, MCC and Resurgens.

Acquisitions, although expensive, became the fastest and lowest-risk means to grab new markets. Building an infrastructure was not a realistic option because of the extremely long time commitment. Management was predisposed to acquisition. In 1994 the company enhanced its international capabilities and data service offerings by acquiring IDB WorldCom. With the purchase of WorldCom Network Services for \$2.5 billion, WorldCom gained 10,000 miles of fiber optic cable and 1,000 miles of microwave transmission facilities, enabling the company to serve large companies with both voice and advanced data capabilities. In 1995 the company changed its name to WorldCom. Revenues totaled \$3.6 billion, up from \$100 million in 1989.

WorldCom acquired MFS Communications (parent of UUnet) for \$14 billion, a 60 percent premium over market. Assets included a transatlantic fiber-optic network and UUnet's large Internet backbone. WorldCom gained transmission and switching facilities, network capacity and local network access in major U.S. cities that allowed WorldCom to connect customers across proprietary networks. It became the first communications company to offer local, long distance, international, Internet and data services simultaneously.

WorldCom completed three multi-billion dollar transactions in 1998 that added significant scale and consolidated its industry position. MCI (a \$40 billion deal) contributed complementary strengths and network operating efficiencies. Brooks Fiber Properties contributed forty local exchange markets, accelerating WorldCom's local expansion. The acquisitions of CompuServe (\$1.2 billion) and Advanced Network Services enhanced WorldCom's Internet and systems integration capabilities.

This series of savvy acquisitions created a company that provides a full range of data,

Internet, local, and international communications services over its own infrastructure. MCI WorldCom has transformed itself from a "telco" to a "commco," a fully integrated communications company.

NEW ENGLAND BUSINESS SERVICE

A management change at NEBS in 1995 opened the door for the company's transformation. New president, Bob Murray, became the architect for changing the company via acquisitions. As a forms company, NEBS saw technology encroaching on the company's products. Murray's mandate was to break out of the current mold and become a full-service provider. Two and a half years later, NEBS was a direct marketer of a broad array of business supplies and products.

The acquisition of Chiswick Trading in March 1997 boosted NEBS' presence in retail and industrial packaging, shipping and warehouse supplies. It broadened the firm's product lines and added a new type of distribution capability.

Later that year NEBS acquired Rapidforms, an \$80 million company with overlapping products. The primary benefit of this acquisition was to leverage NEBS' manufacturing capabilities, saving millions in manufacturing costs. The acquisition brought new customers and economies of scale in direct marketing.

NEBS acquired McBee Systems, bringing with it a 350-person sales force. This sales force enables NEBS to establish more personal relationships with its small business customers. Initially selling checks and check writing to small businesses, the sales force now sells a whole array of products.

THE NEED TO GROW

How do companies respond to their growth challenges? Companies need to grow their top line. Initiatives associated with growing revenue drive more value than any other action. There is a direct link between growth and shareholder value.

Companies can reshape themselves over time, using acquisitions to move from lower growth to higher-growth markets. Companies have to

look outside their traditional markets to achieve new levels of growth. Acquisitions can also add scale -- sheer size can be a competitive advantage.

TIME TO MARKET

Companies no longer have the luxury of building a business over time. In order to move into new markets and build products and services around these markets, companies must buy capabilities if they cannot quickly develop them.

Companies must achieve innovations one way or another. If you need a technology that you don't have in-house, look outside your company. It is not a sign of weakness to look outside. In fact, it is a strong company that acquires capabilities in order to deliver a full range of services to its customers. Acquisitions are an excellent way to accumulate capabilities rapidly and enter a new market. Assembling an industry position through a series of acquisitions can give a company access to markets that they could not otherwise penetrate.

© Copyright 2002 Thomas V. Metz, Jr.

T. V. METZ & CO., LLC
Private Merchant Banking

We specialize in selling technology and service companies from \$3 million to \$30 million in transaction size.

Seattle, Washington
Tel: 206-325-1971
www.tvmetz.com