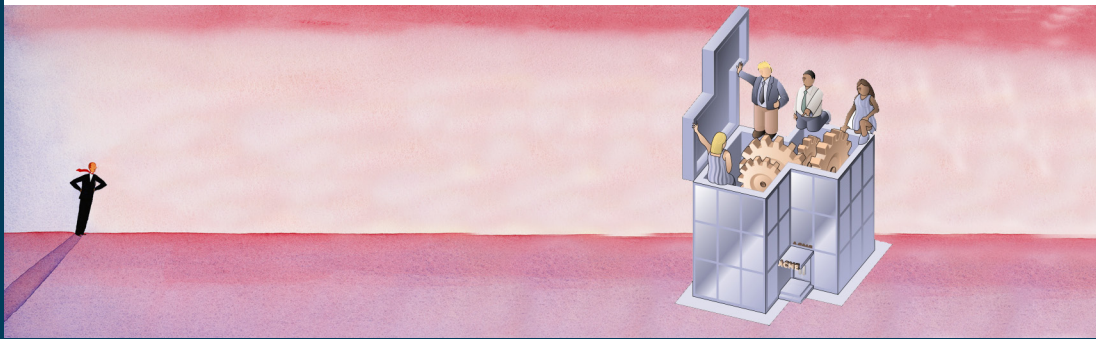


Why Due Diligence Often Doesn't Get It's Due



Looking under the hood of a prospective acquisition candidate, whether in the physical security space or elsewhere, is a necessary step in the M&A process. Anyone who has been through the process is sensitive to the need to dig into the financials, the legal review, the intellectual property, customer interviews, management background checks and the environmental issues. That said, while these issues are potential deal breakers, they often are not the ones that, on hindsight, caused the deal to fail to meet its objectives. While research indicates that 70 percent of all large deals fail to create significant shareholder value, the problem rarely lies with the traditional due diligence factors.

At Phare we believe the key to success lies in several elements: the true strength in the market of the company's products and services, the power of the management team, the attractiveness of their go-to-market strategy, and the fit of all of these factors into the acquiring company's strategy. Assessing these factors requires not only an in depth knowledge of the physical security market, but also the operations management experience necessary to "smell the smoke".

The Five Questions Your Team Should Ask Before Due Diligence Is Complete

"Do you understand the industry well enough to evaluate the product/service?"

The security industry is not a copy of any other industry we know. Historically fragmented and with little analyst coverage, the security market combines risk adverse buyers with major computer system purchases. Overlaying it all is a constant wave of consolidations and new entrants. Deciding whether a new product or service really has promise in the security space requires not just a high level industry view, but a deep dive into the product and it's competition. Take, for example, a wireless CCTV offering that compensates for network performance by reducing video quality. Good technical solution for webcams, but likely to be unacceptable to security buyers who increasingly value image quality above all else.

Traditionally, due diligence efforts used customer interviews to help judge the company's products and services. Necessary and useful to be sure, but is it enough? To judge how they feel about past transactions, perhaps. To anticipate what future product requirements are, however, requires interpretation. Henry Ford once remarked "If I had asked them

what they wanted, they would have said faster horses". Similarly, service organizations can be judged by past customer's experiences, but the requirements for future skills and service offerings are unlikely to be uncovered with typical customer discussions. We believe that the quality and effectiveness of such an investigation is greatly enhanced if the process receives the guidance of an industry expert who understands the needs of an end user and the right questions to get at tomorrow's requirements.

"Are you bucking a trend?"

Today, IP based cameras, open architecture, smart cards, video analytics, and convergence with network security are all hot market trends in the security product space. Similarly, service organizations see the trends of e-sales and e-support, vendor consolidation, and changing value propositions. Understanding the market well enough to not only see today's trends but to see the choices for future paths requires a real marketplace understanding and a continuing level of analysis. Not that we are suggesting that all opportunities need to be at the bleeding edge of technology or the next trend in service. Understanding, however, exactly where a

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firm's offerings stand in their life cycle is crucial to seeing their long-term value in the marketplace. That understanding will also help to anticipate whether the company and team are well positioned to profit from those trends.

"Can your team evaluate their team?"

Particularly when technology is involved, team performance is hard to evaluate. A team that lacks the knowledge to develop the riskier parts of the technology is typically very optimistic and often very convincing. Passion survives ignorance.

Looking at development team performance requires a "been there, done that" sense for where the risks lie, and an ability to dig through the technical jargon to judge if the team sees those risks. Also required is the experience level to evaluate the development processes and assess their ability to control technical and schedule risk.

"Great idea, but can the channel sell it?"

The number one rule of channel selection is to find out how the end user wants to buy and give him that option. Unfortunately, we are in period of change with the security channel: IP based products are straining the skills of the traditional security dealer channel. IT integrators have those skills, but sometimes lack not only security knowledge, but security end user relationships. Some end users would like to disintermediate the integrator channel; others want to use a single integrator on a national basis. Whatever the chosen channel is, a manufacturer needs to make sure that his choice is a good fit for the needs of his product and services. A manufacturer's intelligent camera may look like a great idea until you realize that camera installers won't have the laptop computer required to set it up. Would someone without a security experience base catch a fatal mistake like that?

"Will anyone be willing to tell you this is a bad idea?"

We have seen many deals go through due diligence. Even in the most sophisticated organizations, we see deals take on a life of their own. The momentum is hard to resist once senior management has a

target in their sights, and the entire team shifts from careful investigation to making the deal work. While no experienced team would purposely ignore a red flag item, the temptation will be to get creative on judgment call matters such as sales and expense synergy, or projected growth rates. Even an independent consultant can fall into this trap in his zeal to please his customer. Phare understands that this is an essential part of the value that we bring to the table; an honest and un-biased view of the deal.

Why a Consultant?

Acquisitions by their very nature often take a management team outside of their area of expertise, and into adjacent or even outlying market segments. Competent management teams can deal with this given time; unfortunately, that is the one thing they generally don't have. More and more we are all caught in the tyranny of the urgent. Consultants bring an outside view to the organization, additional bandwidth for a team already stretched thin, and the knowledge aggregated from the experience of other companies. A consultant, as a partner to upper management, is often the only way for due diligence to receive its due.

Why Phare?

Phare is in a unique position. With significant expertise in the security industry, security technology, and senior level manufacturer management, we see all sides of an issue. The world is full of technical consultants that you would never let near one of your customers. There are plenty of due diligence experts that do not understand the security industry or its end users. There are an abundance of management consultants that do not understand why a successful strategy in the security industry is not a simple copy of another industry's playbook.

We get it, and we are ready to be your partner in successfully solving some of the most difficult challenges of your career. Our work is guaranteed to meet your satisfaction.

Call Phare Consulting or contact us at info@phareconsulting.com