



Reader,

This is the ninth edition of BlueLake Partners' Newsletter – ***The Perspective from BlueLake***. The Newsletter is published periodically and focuses on and analyzes trends in the sectors we follow: Software, Semiconductors, Enterprise Storage Networking and Communications. We hope you find it informative and thought provoking, and we welcome any suggestions or thoughts you might have on the content. Please feel free to pass it along to others that you think would find it interesting.

Sincerely,

BlueLake Partners, LLC

Straight to the Point

- **This could happen to you**
- **Voracious appetites in SAN and ECM markets**
- **Watch for signs in your market space**
- **Don't let the window slam**

You will not be surprised to learn that BlueLake pays a lot of attention to the level of M&A activity, especially in the high tech sector. In these days of full disclosure, we guess we should point out that M&A is one of the things that puts bread on our table. That behind us, we can continue.

You may recall that our last newsletter focused on the overall increase in M&A activity over the last fourteen months and the reemergence of the strategic acquisition. Well, the heat has just been turned up a notch, and not even our little friend Mickey Mouse is

safe from an attempted hostile takeover.

On top of the general increase in M&A activity, we have observed an interesting phenomenon in two of the software sectors that we follow closely. Until somebody tells us they already have the name, we'll dub it the “Feeding Frenzy Phenomenon”, and it is the subject of this issue of *The Perspective from BlueLake*. The reason we want to write about it is that, as they say on the bad old radio dramas, “This could happen to **you**...” And if it does, you could make a lot of money.



We took a look at what has been happening for the last year or so in two software segments, storage area networking (SAN) and enterprise content management (ECM), and noticed that the big guys have been on something akin to a feeding frenzy gobbling up their smaller-mouthed competitors. We mentioned in our last newsletter that strategic acquisitions in the tech sector often are done to position the buyer for the next generation of product, platform or environment. These don't really feel like that.

Instead, by and large they represent an attempt to round out the buyer's product offering more expeditiously than undertaking a major internal development effort, and whereas the "next-gen" kind of acquisition (last month) frequently has its genesis in the offices of the strategic planners or the big-picture development folks, this one takes place because the sales, marketing and customer service people spot the need and bring it back to the office.

Binges like this usually take place in enterprise software markets that are growing and have major players pitching their products to big customers. Most of the products competing against each other are sound but lack a few pieces – user interface, audit capability, ease of administration, reporting, and so on, across the feature/function spectrum. The sales people are out competing against each other and either (a) win by partnering with specialty software companies, or (b) lose to competitors who are partnering with... When you lose a few multi-million-dollar procurements, the cost of acquiring a small but strategic company starts to look more reasonable.

Here is how it seems to happen. Everyone in the industry is pretty much aware of the potential acquisition candidates, but no one wants to spend the money. Acquisitions take time and effort, and people who live in a different part of the organization than the sales and marketing people do them. Then one of these attractive partners gets bought. Suddenly the acquisition pool is smaller and everyone realizes that these companies won't be around forever. The thought of trying to sell without these partners is unpleasant. So the feeding frenzy starts. "Buy 'em now before they're all gone!"

We'll give you some data below, and wrap it up at the end.

Storage Area Networking

The SAN market is huge and fast growing. The Gartner Group has projected it to be a \$4.3 billion market by 2006, up from just \$1.2 billion four years earlier. What's not to like?

In late 2002, Cisco Systems (Nasdaq: CSCO) decided it had to participate and announced its intention to acquire privately-held Andiamo Systems, a developer of intelligent storage switching products. That deal just closed on February 20th of this year with Cisco paying \$750 million for the 44% of the company it didn't already own.



VERITAS Software (Nasdaq: VRTS), who had purchased OpenVision Technologies in 1997 and acquired the Network and Storage Management Group of Seagate Software two years later, further extended its end-to-end storage management and utility computing capabilities with two acquisitions last year and a third already announced in 2004. Both the Jareva Technologies (\$62 million) and Precise Software Solutions (\$609 million) acquisitions were closed by mid 2003; and an agreement to buy Ejasent Inc. (\$59 million) was announced this past January 7th.

McData (Nasdaq: MCDTA), already a storage leader, made headlines last August with the simultaneous announcement of the acquisition of Sanera Systems (\$102 million) to strengthen its data center product offerings and Nishan Systems (\$83 million), enhancing its enterprise networking.

Last July, our own Hopkinton-based EMC (NYSE: EMC) joined the frenzy in pursuit of its focus on information lifecycle management (ILM) and desire to grow its software business with its bid to acquire LEGATO Software (\$1.3 billion). EMC's thrust into content management is discussed in the next section, but EMC continued its SAN buying spree with the revelation in December of its intention to acquire the privately held server and desktop virtualization company, Vmware, for \$635 million.

That's a lot of Pacman activity in one sector in the space of just over a year, not to mention a lot of money, and that's only looking at what four of the players were up to. Clearly, each company had chosen a strategy and decided that broadening its technology, product offering and market presence by acquisition was preferable to organic development.

Now let us move to another closely related software sector that has been a bit frothy of late: Enterprise Content Management.

Enterprise Content Management

Prompted in part by increasing legal and regulatory demands to store records longer, think Sarbanes-Oxley for example, corporations are looking to IT to manage enterprise content more efficiently. Again, we are going to look at four companies that have been busy over the past year or so positioning themselves to compete in this content arena. Not all of these transactions have been large in terms of absolute deal value, but sometimes the relationship of purchase price to the acquired revenue base is the more relevant metric of the perceived importance of the transaction. Let's start with Big Blue.

Back in November of 2002, IBM (NYSE: IBM) made the first of three acquisitions of privately-held companies intended to augment IBM's position in content management: Tarian Software, a provider of e-Records management software. This was followed in June with the purchase of Aptrix, formally known as Presence Online, whose forte was Web content management. The most recent, Green Pasture Software, was closed last



December and was a BlueLake Partners client. Financial details of the three transactions were not disclosed.

In August of 2003 content management software maker, Interwoven, Inc. (Nasdaq: IWOV), announced it was paying \$171 million to buy iManage, a specialist in collaboration software, to broaden its ability to permit an enterprise to use and share documents and other types of data.

Within three weeks of that announcement, Ontario-based, Open Text (Nasdaq: OTEX, TSX: OTC) agreed to purchase the European Web content manager, Gauss Interprise, for \$11 million, and in October made a tender offer for all of the shares of IXOS Software AG, a Munich-based content management player. The bid was valued at \$250 million.

“A billion here, a billion there. Pretty soon it starts to add up to some real money.” With all due respect to the late Senator Everett Dirksen, it’s still a lot of money, and it is what EMC offered (\$1.7 billion) for Documentum last October in order to solidify its position in a big way and quickly in the ECM space. Documentum had done a bit of bulking up itself, having gobbled up both eRoom Technology, a collaboration software developer, (\$125 million) and TrueArc, a records management specialist, (\$4 million) in the fourth quarter of 2002.

Conclusion

Trying to determine right now who improved themselves most with their acquisitions is a bit like trying to figure out whether two pitchers acquired by the Red Sox are more valuable than one terrific player acquired by the Yankees. One thing we can assume is that at least some of the acquired folks are feeling pretty good right now and are worrying less about the solvency of the Social Security System than the rest of us.

BlueLake’s advice to the CEO’s and board members in our reading audience is this: Keep a close eye on the acquisitions in your market space. Once the cycle begins, you have limited time to decide what to do, and you have options:

You can stay out of the feeding frenzy; stay private and avoid being acquired. A potential benefit is that your competitors will be swallowed up by larger players and you will be able to retain your focus when, perhaps, they will not. A potential downside is that you may lose partners who now have to work only with the companies with whom they just became affiliated, and your competition will have more resources – funds and a broader reach – than before.

You can decide to enter the feeding frenzy and put your company “in play.” Advantages are that if this is done right – the company story told well and some competition among potential acquirers created – you may be able to achieve a premium purchase price for your firm and be priced as a strategic acquisition rather than a formula-driven one. The possible downsides are well-known: reduced or lost independence, a need to fit into a



non-entrepreneurial environment, and a focus on integrating your product with other enterprise products which may have flaws or unfortunate legacy characteristics.

A third possibility, hard to achieve, is to obtain an investment and partnership with a large player. As a prelude to complete acquisition, this option may be useful. But you may be stuck with a minority investor who ceases to care about you but won't allow you to partner with other firms, and no liquidity event is in sight. It can be awkward.

One thing is clear: when the feeding frenzy starts in your industry, you have limited time to decide what to do. The window opens, followed by a lot of activity, and then the window shuts. The finite number of acquirers have made their choices, and they're done. Focus your attention on the situation, because it is a temporary phenomenon, and your time to deal with it is fleeting.

As Fitzgerald says in The Rubaiyat of Omar Khayyam:

“The Moving Finger writes; and, having writ,
Moves on: nor all your Piety nor Wit
Shall lure it back to cancel half a Line,
Nor all your Tears wash out a Word of it.”

The feeding frenzy is of short duration; be alert to it; take advantage of it; deal with it. Don't be left behind futilely hoping to lure it back.

— *Bill Luke and Peter Miller*

About BlueLake Partners: BlueLake Partners is a boutique investment bank focused on providing merger & acquisition advisory services, raising growth equity capital and providing other financial advisory services.

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