Chapter 4

EXTERNAL GROWTH BY ACQUISITIONS, JOINT VENTURES AND MERGERS

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4.1 OVERVIEW

Much of Informatics growth as a corporation has been attributable to its successful efforts in making acquisitions of other companies and products, in organizing joint ventures to pursue new markets and businesses, and in entering into a merger when necessary to enhance its development. This chapter describes Informatics history in making acquisitions, joint ventures and mergers. Section 4.1 provides a broad view of the company's continually evolving approach in this area. Section 4.2 describes in detail each acquisition of a company or major unit thereof, or of materially all of their assets and employees. In such cases the former organization ceased to exist as an operating entity. Section 4.3 describes in detail the acquisition of products, whether through outright ownership or through rights to market and develop. In such cases the selling organization continued to operate. Section 4.4 discusses joint ventures with others (in which Informatics was not initially the majority owner) and any acquisitions made by such ventures. Section 4.5 recounts the merger of Informatics and Equimatics. Finally, Section 4.6 presents a summary and evaluation of all this activity.

This chapter is primarily concerned with the business and legal aspects of the venture. In most cases operating and technical matters are discussed in other appropriate chapters.

4.1.1 The Evolution of Informatics Philosophy of External Growth During the 1960's

Although the company's pre-formation business plan, **Prospectus for Corporation** D(1), did not address the subject, Informatics pursued acquisitions and joint ventures relatively early in its life as a means of expanding its business base and product and service markets. At first, acquisition efforts were purely opportunistic, but gradually and slowly became more refined and focused as the corporation learned from its previous experiences.

Informatics, through the initiative of Walter Bauer, recognized that the areas of proprietary software products and information processing services would become a major growth market for independent software services companies. Bauer also recognized the need for financial creativity to minimize the problem of providing the large capital investments required to enter such businesses. To pursue this business area during early years, the company sought opportunities for the commercial acquisition of other businesses with potential products or unique services that would allow it to enter new proprietary services markets. The company's **Corporate and Marketing Objectives** for 1965, for instance, proclaimed:

> We will continue to investigate opportunities for mergers and acquisitions. Those companies which appear to be especially attractive at this time are those which broaden our technical

> capability and our sales base, especially in the area of proprietary service packages for commercial use.(2)

By 1965 Informatics had acquired three small businesses in order to enter new markets. The first, Advanced Information Systems (AIS), in 1964, placed the company into the software products market as AIS was in the midst of developing generalized file management systems which would eventually lead to the creation of MARK IV. The other two acquisitions, Data Processing Systems and CPM Systems, Inc., were efforts by Informatics to enter the professional programming services market for commercial business systems and the proprietary services market by providing computerized Critical Path Method and PERT planning services for Southern California home building contractors.

Both Data Processing Systems and CPM, Inc. proved to be unsuccessful during 1965. Nevertheless, the company was undaunted by these setbacks. During 1966 Informatics became a publicly held company and recognized the value of a public market for its stock in aiding acquisition efforts by making desirable stock trades possible. This was explained by Bauer in a memo to company officers pertaining to corporate goals:

> . . . There is, of course, more than management incentives involved with the public offering. It is expected that the public and customer image of Informatics Inc. will be enhanced greatly. There will be more interest in Informatics in the public and professional communities and much greater publicity can be obtained. Also, with a public market for the stock, acquisitions and mergers become much more possible.
>
> It is important that we not eschew mergers and acquisitions simply because we have made two acquistions which have not been altogether successful. It is important that we not over-react and be unwilling to pursue this course for it can be an important aspect of company development. On the other hand, we have learned a great deal about these matters from our two ventures. It seems clear that we should not seriously enter acquisition or merger discussions unless either: 1) the operation is sizeable; or 2) it is of critical importance to the development of Informatics, Inc. The amount of management attention and lawyers' fees for acquiring a small operation is just as great as for acquiring a large one. It is important also, of course, that we examine very carefully the management capability and profitability of companies. This should be done more carefully than we did with CPM or DPS.

In the early years, the activities entailed in making acquisitions were provided exclusively by the officers of the corporation on a part time basis. In the 1960's Bauer was always the leader, supported by the chief financial officer and one of the operating officers, Werner Frank, Frank Wagner, or Richard Hill. Normally if the acquisition was consummated, it would report to the one of the latter three who was initially involved. There never was a permanent acquisition team. In the early 1970's, Lynn Jones was designated to head "Corporate Development" and, for a year or two was the principal searcher for candidates for acquisition. However, as the company decentralized its

management, this role was taken over by those line executives, first known as "company" presidents and later as group vice presidents. In such a case, an ad-hoc acquisition team was formed, consisting of the line executive, the chief financial officer, and one of the senior corporate officers. Until the late 1970's, an acquisition was rarely considered unless one of these line executives was enthusiastic about it. Later, however, Werner Frank (and subsequently James Porter) was appointed to head up corporate development and began to assume leadership in looking for acquisition candidates, sometimes independently of any line executive. When such an acquisition was made, it reported to Frank or later Porter.

In the mid-1960's, in addition to considering acquisition possibilities, Informatics became deeply involved in attempts to establish a joint venture with a European computer manufacturer in order to gain entry into the European software services market. The company's first efforts to form a joint venture with another company occurred during 1965. The corporation had been successful in winning two contracts for programming services with N.V. Philips, a very large multinational electrical and electronics company headquartered in the Netherlands with corporate offices in Eindhoven. One was for the development of a COBOL compiler for a computer that Electrologica, one of its subsidiaries, was building. Ed Myers (resident manager in the Amsterdam office) and Herman Hess (technical consultant), under Dick Hill's direction, were the primary Informatics employees providing services to Philips.

The efforts to form a joint venture with Philips, to be called N.V. Informatica, are described in Section 4.4.1 below. This first joint venture effort, although never coming to fruition and disappointing to management, did provide a lesson--to deal with <u>all</u> the appropriate people in power. Future negotiation activities always reflected this, leading to the successful agreements for the formation of TISCO, Equimatics and the acquisitions of PMI and MHDS. The desire for a European subsidiary or affiliate remained a major objective of the company:

> The formation of jointly held subsidiaries remains a possibility. Although it is doubtful that Informatica will be formed with Philips participation, this is not out of the question entirely. It is possible that the Informatica idea can be explored with other European companies. Another possibility for subsidiary formation is with Western Union. We have been recently told by Western Union that they plan to make an affiliation with a software company in the near future because they feel its is of extreme importance to their future with management information systems and computer-based communications systems.(3)

Informatics was unable to form a European subsidiary in 1965, but three years later it did so. Informatica S.A. was established on June 27, 1968 by Informatics for the purpose of selling MARK IV systems products in Europe with headquarters in Geneva, Switzerland. It was the "mother corporation" for all of Informatics later software products sales subsidiaries in Europe.

Informatics never entered into an affiliation with Western Union but did obtain a major contract with it to perform systems design for a computerized message switching system for a nationwide telecommunications network. Despite realizing the need to pursue acquisitions more cautiously after DPS and CPM, by 1966 no particular methodology or approach had been developed for searches for acquisition even though acquisitions were considered an "excellent way to get on with our business."(4)

The five year plan of 1967 set an objective of developing an acquisition model and initiating efforts to seek possibilities in the data services and computer products market. Later in the year, Bauer contacted Robert J. Kremple, head of an executive search firm, announcing the need for a qualified candidate to fill the new position of Director/Corporate Development for Informatics. This person was to be "1) knowledgeable in software and/or service bureau aspects of data processing and 2) have experience with business aspects of acquisition and inter-company marketing arrangements, joint ventures, etc."(5) Although Informatics never found a person with these qualifications, it filled this position internally when Lynn Jones was selected to serve in this capacity early in the 1970's. Nevertheless, the company did embark on four major acquisitions and investment endeavors between 1967 and 1970.

The first effort, in 1967, was an investment in ATAR Computer Systems, (AtarCSI), including the lending of Frank Wagner's services to serve as its president, which is discussed in detail in Section 4.4.2. The second endeavor, described in Chapter 8 and Section 4.2.4, involved the acquisition in February 1968 of Computing Technology Inc., a software services firm providing financial systems design and programming to New York brokerage houses.

The third effort was the formation in April 1968 of a joint venture with Information Dynamics for the establishment of Informatics TISCO in order to obtain a facilities management contract from NASA's Technical and Scientific Information Services headquarters in College Park, Maryland. As described in Chapter 7 and Section 4.4.3, this was the beginning of Informatics Systems and Services, and added 400 employees to the company in 1967 and its largest contract up to that time--$4 million in annual revenues.

In 1969 Informatics embarked on the fourth major acquisition activity in a dramatic move to enter the data services market, as discussed in Chapter 12. It involved the purchase of three California based computer service bureaus from the Rucker Company (Section 4.2.5) and a majority interest in Dataplan Corporation, a New York computer service bureau firm, discussed in Section 4.2.6.

Each of these acquisition and investment actions was based on the company's strategy to develop proprietary services and products and (except for TISCO) to enter the commercial custom services marketplace. However, with the exceptions of the data centers, these acquisitions were performed on an opportunistic basis as the possibility or potential deal confronted the company rather than being found by Informatics after a formal search. But even Rucker was seeking to sell its unprofitable service bureaus and approached Informatics. AtarCSI and Dataplan sought investment from Informatics while Computing Technology was seeking a merger and was suggested to Informatics by a third party. The formation of Informatics TISCO alone was the only acquisition or business

investment effort deliberately initiated by the company during this period in order to enter a previously planned market or service area, and it was a serendipitous idea resulting from the aggressive sales coverage of the federal market by those tireless marketeers, Werner Frank and Richard Lemons.(6)

4.1.2 External Growth During the Early 1970's

In the fiscal year ending in March 1970, the company recorded financial losses of more than $4 million. Some loss was caused by the 1970 recession, but most of it came from writing off the Rucker data centers, and the investments in Dataplan and AtarCSI. On the other hand, the company's efforts in forming TISCO and acquiring Advanced Information Systems and Computing Technology had proven to be very successful business ventures. Growth during the early 1970's was forecasted by the 1970 five year plan, written in late 1969, to result from internal development rather than acquisitions, mainly due to declining stock prices which precluded the use of favorable stock trades or raising cash from public offerings, as discussed in Chapter 3.(7) Ironically enough, in the fall of 1970 the company was also approached by Arthur D. Little and Goldman, Sachs & Company regarding a business opportunity with one of their clients which led to a major joint venture activity: the formation of Equimatics, Inc. which is described in detail in Section 4.4.4.

Consequently, by late 1970, the company changed its policy and decided once again that acquisitions and joint ventures were an important supplementary means to resume its rapid growth rate (which had stagnated due to the recession). In December a **Statement of Interest** was issued to the investment community which proclaimed:

> Informatics Inc. is interested in developing a nationally oriented joint venture activity in the data processing service industry.
>
> Informatics is seeking a partner with the following qualifications:
>
> 1. Desiring to share in the development of a sizeable enterprise in the growing data processing services industry.
>
> 2. Willing to contribute modest investment capital and/or existing data processing business.(8)

In addition to this, in late 1971, the company prepared acquisition guidelines which were issued to vice presidents. The guidelines specified that a potential acquisition should: 1) have an annual revenue rate of at least $1.5 million; 2) be profitable for the current and at least the previous two years; 3) make an acceptable impact on the corporate earnings; 4) return a minimum of 15 percent on Informatics investment; and 5) require no more than $250,000 in cash if it could not meet requirements to be purchased under "earn out" or "option" formula methods. The guidelines were further supplemented in March 1972 by the issuance of **Operations Policy No. 15: Business Plans** which required the formal preparation of a business plan for all new company ventures, internal or external, which would have either 1) a first year annual budget over $20,000, or 2) more than 50 percent of indirect labor devoted to it within any existing operational unit.(9)

In 1971 Informatics again began looking for potential joint venture possibilities abroad, as described in Section 4.4.5. It quickly developed an association with P.A. International Management Consultants, Ltd., a British management consulting firm, to explore software consulting and systems design marketing possibilities in Europe.(10)

While the company did not consider itself in the consulting business and flatly stated in its business plans that it was not interested in "pure consulting," it believed that limited consulting could lead to new software opportunities, applications and customers. A consulting firm could pinpoint new applications for software products development by its experience in assisting clients and possibly find new customers for Informatics in the area of programming services and systems implementation, hopefully in the areas of financial and manufacturing systems in which Informatics had no products until 1973.

As a result, Davidson-Kernan Corporation was retained in January 1972 to begin searching for a management consulting firm (for Informatics to acquire) with annual revenues between $.5 to $4 million, profitability for the past two years, knowledge of computer use and applications, qualifications in problem solving, self-sustaining selling capability, and special expertise in banking, stock brokerage, communications, or manufacturing. Besides these broad requirements, the potential consulting firm should have special expertise in a few of the following: management information systems, systems/procedures in information handling, inventory and production control systems, physical distribution, communications systems and data processing planning, accounting and financial systems, and financial planning. The consulting firm also had to be located in a major city, preferably New York, Chicago, Los Angeles, Washington, D.C., Denver, St. Louis, Detroit, Cleveland, or Kansas City.(11) Davidson-Kernan contacted 70 consulting firms and identified 12 of these which were interested in being acquired and which met Informatics requirements. Bauer met with the management members of several of the more attractive firms, and came out of the experience relatively unimpressed.(12)

Perhaps due to disappointment in the search performed by Davidson-Kernan, Bauer soon shifted to reliance on internal talent and resources. He appointed Lynn Jones vice president of corporate development early in 1972. By September 1972 Jones had initiated acquisition negotiations with seven companies and had identified 31 others as "future interest" possibilities. Informatics had begun looking for acquisitions in earnest. Some of the possibilities were discovered through the use of "cold contact" letters, unsolicited acquisition inquiries sent out to numerous data processing systems businesses between November 1972 and March 1973. Jones even resorted to the placement of small anonymous ads in The Wall Street Journal.(13)

In late 1972 Bauer described this effort with the following statements:

> Until recently Informatics had not had, at any time during its history, a committed plan including full time personnel, for acquisition and mergers. Until this fiscal year, no corporate officer had such an assignment; internal growth was emphasized to the practical exclusion of an acquisition program;

acquisition and business purchases were done on an opportunisitic basis exclusively.

Starting with this fiscal year, the conscious decision was made to become more venturesome with respect to external growth. The company has two basic strengths from which external growth can be achieved: a strong balance sheet and financial history; an excellent reputation in the data processing and financial communities.

To date we have looked at 317 companies, we are interested and continue to track 88, and we are in discussions with 9, despite the fact that our acquisition program is very new.

Much of our external growth will come from "purchased products" and "purchased services," quite apart from company acquisitions. We recently purchased a "COBOL pre-processor" software product [CL*IV] to complement our MARK IV product line. We are looking at several more such products and services.

We are interested in any company or business involved in information handling, or where information handling is vital to the product or service. "Information handling" can take the form of "data processing" or the newer technology of "word processing." We are prepared to expand our capitalization to accomplish this external growth and to use our working capital and cash as necessary. The above notwithstanding, it will be our philosophy to be reasonably conservative, making a number of smaller, prudent acquisitions, rather than "betting the company" on one or two. All of the acquisitions will be in the information handling products and services area (or related, as described above) and we will insist on the business being "close" to ours where synergism can be achieved.(14)

In May 1972 Thomas Taggart, Frank Wagner, and Wilson Cooper negotiated the acquisition of an exclusive license for the PRODUCTION IV software product, and eventually in 1973 negotiated the full acquisition of its owner, Parsons and Williams A.G. (discussed in Section 4.2.7). Partly through Jones's efforts, the company quickly acquired two software products. In 1972 CL*IV, the COBOL pre-processor product mentioned above in Bauer's statements, was acquired from GSI mainly through the efforts of John Postley, as described in Section 4.3.1. Another acquisition, through the efforts of Richard Lemons, expanded the business base and added to the capability of Informatics Systems and Services. This was RECOMP IV (later called CS IV), a computerized photocomposition software package designed and used by Autocomp, a small firm providing photocomposition services (see Chapter 7 and Section 4.3.2).

Corporate strategy during 1973 continued to focus on acquisitions to expand the company, particularly in the area of applications products. Declining stock prices, however, limited Informatics ability to negotiate favorable ventures:

> Through acquisition and/or merger and/or marketing arrangements, we will obtain more system products, application products and software products.
>
> Candidate areas for acquisition are: word processing, data base services, electronic photocomposition, information processing, management data systems, financial systems, manufacturing systems and administrative systems. We will, however, have to curtail our activities somewhat on the acquisition front until we have achieved a better stock price.(15)

Consequently, growth was planned to result from internal sources by increased development and marketing of MARK IV and the "bootstrapping" of custom services efforts into product development. Nonetheless, Informatics was still able to make three other small acquisitions in 1973. These were Asystance Company (Section 4.2.8), SDA (Section 4.2.9), and Knowledge Networks (Section 4.2.10). The latter two companies provided information processing and programming services which were integrated into the operations of Systems and Services. Asystance Company was acquired for its ACCOUNTING IV software product which provided a computerized general ledger accounting system.(16) In January 1974 a minor investment was also made for the acquisition of System Three, Inc., a small mail order firm and magazine publisher which sold inexpensive software products, computer accessories, and supplies to users of IBM System/3 small business computers, as described in Section 4.2.11.

But with respect to corporate development, the most significant event of the early 1970's was the formation of Equimatics Inc., a joint venture with The Equitable Life Assurance Society of the United States, which approached Informatics in September 1970. This was the first concrete realization of Bauer's plan, hitherto so often unsuccessful, to find a very wealthy partner who would assume large financial risks in return for a partnership, with Informatics contributing its technology and entrepreneural skills. As described in Section 4.4.4, agreement was reached by December 1970. Much unofficial activity took place in 1971 under Informatics auspices, but regulatory approvals held up incorporation and formal operations until December of that year. With a large investment from The Equitable, Equimatics prospered during 1972 and 1973, and eventually acquired United Systems International, Inc., as described in Section 4.4.4.1. By early 1974 Informatics equity in Equimatics was a large "hidden" asset, not on its balance sheet, which had been obtained without any cost or risk to its shareholders.

4.1.3 The Equitable Merger

In 1974 Informatics embarked upon the most significant corporate reorganization of its history by merging with The Equitable Life Assurance Society of the United States. This merger is discussed from different points of view in Chapter 3, Chapter 10, and Section 4.5. Informatics primary purpose behind it was to allow the company to continue to expand its software activities and build its business base without suffering the way a public company would if such expansion had a bad effect on earnings. The company quickly took advantage of this arrangement during 1975 by acquiring Programming Methods, Inc. (PMI) from General Telephone and Electric, discussed in Section 4.2.13. The acquisition of PMI made Informatics a major supplier of professional programming

and systems design services in both the government and commercial markets. The company also acquired Management Horizons Data Services (MHDS), a Columbus, Ohio, computer service bureau, from First National City Bank of New York during 1977 as described in Section 4.1.15. MHDS allowed Informatics to expand its data processing and timesharing services into distribution industries and so was a major step in developing specialized data services built around the specific needs of vertically integrated businesses. Both PMI and Management Horizons were "opportunistic" acquisitions. Their owners decided to sell them; Informatics heard about them through its officers wide-spread contacts, and aggressively outbid and outmaneuvered rival bidders. Both were acquired for very little cost and both were highly successful acquisitions. A small data services organization, Direct Dial Data (DDD), discussed in Section 4.2.14, was acquired from Greyhound in 1977. But, other than these acquisitions, until 1978 investments for company growth were primarily focused on internal development efforts such as the design of an on-line MARK IV product, LIFE-COMM, and improvments in ACCOUNTING IV.(17)

A shift to a more concentrated acquisition strategy occurred in 1978. After several years of depressed prices and disinterest by the financial community in the early 1970's, stock prices for independent software companies began to come back slowly. The software industry also began to mature more rapidly with several consolidations of smaller companies into larger ones and the decline of a number of weaker ones. Since Informatics was one of the largest independent suppliers of software services and products, the potential to increase its business was especially large due to the increased demand for computer services. The corporate strategic plan of 1978 saw acquisitions as a positive approach to branch out into this expanded market area by "filling holes" in the company's existing product and service lines:

> The investing public continues to show more interest and confidence in companies in the computer industry. Most data processing service firms which are publicly-owned are selling in the modest 5-15 times earnings range. Only a few high flyers like EDS and ADP are trading in the 15-30 times range. Most publicly-owned company shares have rebounded from 1974 lows.
>
> Equity markets for financing data processing service firms are nonexistent. We know of no new issues having been sold. The private placement market is probably also virtually nonexistent.
>
> Due to shortages of investment capital, consolidation within the industry continues, making acquisitions and mergers especially attractive at this point. There are quite a number of promising companies and/or products which have reached a position just short of achieving economic viability, but need the environment of a more mature management and financially sound organization in order to capitalize on their investments.
>
> Acquisitions remain an important avenue for Corporate development, despite the lack of cash and stock for issuance. In making such deals, the Corporation typically will invest

> substantial funds and thereby participate substantially in the risk of the venture. Consistent with other items of strategy as expressed here, acquisitions will be aimed at augmenting our existing areas of interest rather than breaking into new areas. Also, such acquisitions will be modest in size until our "trading material" situation improves.(18)

The five year operating plan of 1978, while not announcing plans for a specific acquisition, joint venture or an amount of planned expenditures for such investments, went further than the strategic plan in its support of an active acquisition strategy and, with a cautious eye on its owner, The Equitable, floated a trial balloon concerning the possibility of the issuing of common stock to support endeavors in this area:

> It is recognized that the best interests of the Company will probably be served by a much more aggressive acquisition strategy. In the computer services industry there are evident trends toward consolidation: It may transpire that leadership can be achieved only by a series of major acquisitions. To achieve the desired acquisitions it may be necessary to issue common stock, an action not feasible without a public market for the stock. During 1978 we will undertake detailed studies of the desirability of such a strategy, and of the pros and cons of implementing it by issuing new equity or by debt financing.(19)

In the absence of any adverse reaction by The Equitable, the 1979 five year plan did present a moderate acquisition program as predicted the year before:

> In the computer services industry, there are evident trends toward consolidation; acquisition activity has been very high among our competitors and management is of the conviction that the present position of the Company in its markets and in the computer services industry will weaken without a rather aggressive acquisition program.
>
> It is assumed that stock is issued to make the acquisitions and that the acquisitions are accomplished on the basis of pooling-of-interest type accounting, recognizing that this approach, though preferable, may not be possible in all cases.
>
> Management expects the Company will "go public" in 1979 with the sale of The Equitable holdings, all or part, to the public. This move will enable the acquisition program . . . .

Investments in acquisitions were anticipated to expand the company's offerings in products and services, particularly in the applications area. Major diversification efforts were frowned upon as the company had achieved its original goals of being a broad-base supplier of data processing products and services. There was a feeling by some board members that it was spread too thin. A large part of acquisition investments were planned for the purchase of immature but promising products (or companies owning them) which could be made profitable with subsequent development and enhancement. Four moderate sized

acquisitions were planned with one per year beginning in 1980. Each acquisition was intended to produce $5-10 million additional revenue for the company for a total of $30 million in revenues and $1.4 million additional pre-tax profit. It was further optimistically hoped that "After acquisition, each is expected to grow at an average rate of 17 percent. It is assumed that each is acquired for stock [on a pooling of interests basis], so each will not require expensive amortization and can begin to contribute profits immediately after acquisition."(20)

Consistent with the above strategy, in 1978 Informatics acquired SERIES IV, discussed in Section 4.2.16, to enter the minicomputer market, and INQUIRY/IMS and TRANS IV, described in Sections 4.3.3 and 4.3.4, both system implementation products for different large-scale operating systems. In 1980 the company made the first of four planned moderately sized acquisitions. This was the purchase of TAPS (and its entire organization), as discussed in Section 4.2.17, an on-line implementation product developed by Decision Strategy, Inc. In 1981 it made three significant acquisitions: 1) Transportation Computing Services Corporation and its subsidiary Commercial On-Line Systems Inc. (COSD) as described in Section 4.2.18, which provided data services to the apparel industry: 2) Professional Software Systems Inc. (PSS) which sold turnkey management software products to law firms, as discussed in Section 4.2.19; and 3) Management Control Systems Inc. (MCS), explained in Section 4.2.21, which sold software on small IBM computers to regional public accounting firms.

Figure 4-3 in Section 4.6 summarizes the history of Informatics acquisitions and joint ventures. The following discusses the business aspects of each. Technical and operational matters are mentioned only if they are not covered in other chapters.

4.2. ACQUISITIONS OF ENTERPRISES

This section is concerned with the acquisition of complete enterprises, as distinguished from Section 4.3 which considers only the purchase of a product or of a license to sell it. In the latter case the seller continues to operate his business. In the case of the acquisitions discussed in this section, Informatics would sometimes acquire all the stock of the enterprise, or sometimes acquire only its important assets and personnel. In such cases the seller would usually be left with a shell corporation which he would subsequently liquidate. In any event the seller would no longer operate a business materially related to the product sold.

4.2.1 Advanced Information Systems Company

The first acquisition made by Informatics, in April 1964, was Advanced Information Systems (AIS). It was acquired from Hughes Dynamics, Inc. for a tremendous bargain price. Hughes Dynamics, which was being dissolved by Howard Hughes, was to receive royalties for a five year period for any sales of two software packages, MARK I and MARK II, and paid Informatics $38,000 for assuming responsibility for the company's ten personnel, two contracts, and several outstanding proposals. One contract consisted of custom programming services performed for the Metropolitan Data Center of Los Angeles for $39,500. Another, virtually completed, was with the U.S. Department of Housing and Urban Development for the development of MARK II and its installation in five

southwestern cities. Proposals for systems design and programming were outstanding to the USADSC for $101,000, to the City of Alexandria, Virginia, for $60,000, to Douglas Aircraft for $60,000, and to Travelodge Corporation for $6,000. The two software packages, MARK I and MARK II, were two file management system programs designed for the IBM 14xx series of computers. They were never sold as packages, so Hughes never received any royalties.(21)

When IBM announced its System/360 in 1965 John Postley, founder and president of AIS, realized that a need existed for a file management system for this particular large scale computer. After finding five sponsors (at Walter Bauer's request) to support development of this software system, work began on MARK IV which was Informatics first and most successful software product. The introduction of MARK IV in 1967 led to the creation of the MARK IV Systems company and contribution of approximately $38 million in profit to Informatics from 1969 through 1982. The evolution and success of MARK IV is discussed in Chapter 9. AIS was the most successful acquisition ever made by Informatics. Frank Wagner claims that, on the basis of return on investment, it may have been the most successful acquisition ever made by any company in the computer services industry.(22)

4.2.2 Data Processing Systems, Inc.

Data Processing Systems, Inc. (DPS) was a small custom programming services company catering to the commercial market by providing programming for various business applications. Founded by Richard Nichols, who was introduced to Informatics by William Mozena, Informatics board member and the chief financial officer of Dataproducts, the company consisted of no more than a dozen programmers and was located in North Hollywood, California, a Los Angeles suburb. Informatics acquired the company for its net worth, approximately $40,000, in January 1965 with the hope that it would provide an entry into the local business programming services market. At the time of acquisition, DPS had fixed price programming contracts with Fireman's Fund, American International Pictures and Aerospace Corporation. These contracts were being performed at a loss. The first month of operations under Informatics aegis produced a $15,000 loss, $5,500 more than originally forecast. This situation prompted Informatics to terminate the operations manager and the project manager of DPS, who were not leading the contracts to successful conclusion, and to put Richard Hill in charge of the company.

Despite the quick reorganization, DPS still continued to lose money at an accelerated pace. By March 1965 it reached a stop loss figure set by Informatics, having recorded a total of $47,197 in losses in the previous four months of operation. Losses continued for the next two months; a total loss of $63,817 was generated since Informatics acquisition. It was determined in May 1965 that $38,121 of this amount was cost in excess of book value which had been capitalized. There were $35,662 of losses incurred prior to the acquisition but not recorded until after it occurred. Informatics decided to liquidate DPS in June 1965 and completed this effort by August. The only value that the company retained was three or four excellent business systems programmers who stayed with Informatics for several years. The experience was a small but short lived failure which caused Informatics to choose later acquisition opportunities more judiciously.(23)

4.2.3 CPM Systems, Inc.

In February 1965 Informatics acquired CPM Systems, Inc. (CPM stands for Critical Path Method, a system of project management) for $32,038. CPM was founded by Russell D. Archibald and Richard Wrestler, aircraft engineers who previously worked at Hughes Aircraft Corporation. When Hughes de-emphasized management services in 1963, Archibald and Wrestler left to form CPM Systems, Inc. to offer computerized CPM services to Southern California general contractors primarily involved in building homes.(24)

At the time of its acquisition by Informatics, CPM Systems, after a period of initial start up investment, had almost achieved a breakeven point, producing a small loss of $237 from revenues of $26,878 in February 1965. The small company showed a modest profit of $3,029 in March 1965 with approximately the same amount of revenues. However, succeeding months resulted in unprofitable operations. A $15,000 loss resulted from $17,690 in sales during May 1965 when a local labor strike and economic softness in the California construction market began to occur. The slowdown in new housing starts continued. CPM Systems attempted to shift its sales efforts to the food and petroleum processing industries but was basically unsuccessful in gaining interest from these and other areas. Monthly losses continued and by December 1965, when a $16,000 loss occurred on only $5,000 in sales, the subsidiary reached the predetermined stop loss figure. Informatics decided to liquidate operations.

During 1966 CPM activities were slowly phased out as Archibald tried to increase the business without much success. He also attempted to create a new service called COMSCO, for construction management systems company, to provide remote terminal access computing services to construction sites. This never got off the ground, and in May 1967 Informatics sold Archibald's employment contract to Booz, Allen and Hamilton, a consulting firm, for $10,000.(25)

4.2.4. Computing Technology, Inc.

In February 1968 Informatics acquired Computing Technology, Inc. (CTI), a New Jersey based programming services company, initially on a pooling of interests basis. Walter Bauer first became aware of CTI in June 1967 upon a tip from John H. Pender, a vice president of Baker, Fentress & Company. Baker, Fentress had originally invested in CTI, founded by Harold Richmond (president) and Dale Wolgamuth (vice president of marketing), but had decided to encourage the small company to merge with another software firm due to its unprofitability in 1967. Located in Paramus, New Jersey, CTI consisted of 110 people including a small subsidiary operation in Cleveland, Ohio (Data Processing Inc.) which provided data services such as mailing list preparation to a single trade journal publisher. The rest of CTI offered programming services to the New York and American stock exchanges and various Wall Street brokerage houses, primarily providing systems design for back office accounting systems and stock certificate transfer and control systems. Other commercial customers included Johnson & Johnson, Digital Equipment Corporation and IBM. Thirty percent of CTI's total revenues were produced by services to government agencies including the United States Navy, National Bureau of Standards, Federal Power Commission, Civil Aeronautics Board and the Department of Labor. Sales offices were maintained in New York, Boston, Washington, D.C., and Cleveland. The rate of annual revenues was approximately $1.8 million.(26)

Bauer became interested in acquiring CTI because he believed it could provide a strong market entry for Informatics into programming for the financial systems market and could strengthen the company's Northeast operations. In late June 1967 Bauer assigned Werner Frank to visit the CTI operations and to make recommendations pertaining to possible acquisition. Frank found CTI interesting but not unique as a software company and simply offered an opinion of neutrality:

> So what is the conclusion? I don't think that any of the people I met are experts in any one area of the software business. They are just plain nice guys. The custom software business has not got anything unique and big about it that would make Informatics real [excited] therewith. Their subsidiary operation is very interesting and probably can make a go of it and certainly the test for that will be available in a few weeks.
>
> So where do we go from here? I guess it depends on what the price is . . . .(27)

Apparently, after several months of negotiation, the price was right. In December of 1967 the Informatics Board of Directors made an offer of merger to CTI on a pooling of interests basis.(28)

This offer was accepted by CTI in February 1968 with final consummation of the acquisition to occur after Informatics fiscal year ended on March 31, 1968. The price to be paid for CTI was to be based upon the average annual revenues of the Informatics Northeast Division, into which CTI was merged, for the two years after this date. The total value of CTI was to be computed as 10 percent of revenues up to $2.6 million and 50 percent of revenues over this amount plus the net worth of CTI on December 31, 1967 when the deal was agreed upon. Payment was to be made in Informatics stock with 30,000 shares being the maximum payable to CTI. Additionally, Informatics agreed to provide CTI working capital upon signing the agreement to merge, give two year employment contracts to CTI's three leading principles and assume CTI's bank debts and notes. CTI in turn was obligated to issue 50 shares of its common stock to certain key Informatics employees.

The merger did not include CTI's Cleveland operations which were sold separately. Under the reorganization agreement, CTI's East Coast operations (about 60 people) and Informatics Northeast Division were to be consolidated into one enlarged Northeast organization which was to sell commercial programming services in the states of Pennsylvania, New Jersey, New York, Connecticut, Massachusetts, Vermont, New Hampshire, Maine, and Rhode Island. CTI's Washington, D.C. office was amalgamated with that of Informatics in the same location. The enlarged Northeast Division was placed under the direction of Richard Kaylor. The division soon became known as Informatics Computing Technology Company (CTC) and was divided into Communications Systems, Financial Systems, and Business Systems divisions. It is not very clear from available sources if or how the revenues were to be kept separated for purposes of the payment formula.(29)

During August 1968 it was realized that the pooling of interests method of performing the acquisition, while providing tax benefits to Informatics from the carry forward of CTI's losses, would necessitate a restatement of Informatics past financial statements and that past figures, particularly in regards to retained earnings, would be adversely affected. Since Informatics was planning for a public stock offering in the next year and a possible application for listing on the American Stock Exchange, Bauer felt that a downward restatement of the company's reported income would injure Informatics favorable reputation among financial analysts:

> It is possible that the tax benefits from CTI under a pooling would benefit Informatics operations by as much as $100,000 of after tax income per year. This could amount to as much as 20% of our after tax earnings. However, I believe that it is entirely possible, if not probable, that over the same period, our price earnings ratio would drop by a like amount or a greater amount due to the fact that our record has now been sullied. I believe that one of the strongest factors that we have going for us in the financial community at the present time is our extraordinarily clean record of ever-increasing revenues and earnings. I believe that the benefits, therefore, of treating it as a purchase outweigh the benefits of the pooling and achieving the tax benefits.

For that reason and to eliminate the formula problem, in September 1968 the terms of the acquisition agreement were restructured to provide for a simple purchase of CTI by Informatics for an approximate amount of $675,000 which included $495,000 negative net worth of CTI and $180,000 payment of Informatics stock.(30)

As described in Section 8.2, CTI turned out to be a successful acquisition for Informatics. The 60 business data processing programmers, many with experience in financial systems, gave the company its first real competence in commercial professisonal services. Under Kaylor's leadership, Computing Technology Company obtained major contracts with Dean Witter & Company for a back office accounting system and the Federal Reserve Bank of New York for a large-scale computerized money transfer system. These contracts and others with leading New York brokerage houses helped make Informatics a competent supplier of financial and business software systems. The Communications Systems Division of CTC evolved from the Federal Reserve Bank project. However, the emphasis on large, sophisticated systems, with a comcomitant conscious decision by the company to neglect the more plebian type of routine business data programming, resulted in the company missing a large market, which it did not enter until the acquisition of PMI in 1975.(31)

4.2.5. Rucker Data Centers

Three California data processing service bureaus were acquired from the Rucker Company in March 1969. Two were in Los Angeles (which were being consolidated into one, the Los Angeles Data Center located in El Segundo) and the third, Data II, was located in Oakland. The acquisition was made after several months of negotiation and after Informatics, as described in Section 12.2, decided during 1968 to enter the data services market seriously.

Informatics first Data Services Division, established under the direction of Richard Hill, had established one data center on its own, the Valley Data Center located in Sherman Oaks, during September 1968. An ambitious plan had been developed.

To implement this ambitious plan, Informatics undertook a search for established and potentially promising service bureaus to acquire particularly in major metropolitan areas. At first, the company found it difficult to find reasonable acquisition possibilities within large cities, and, in fact, Richard Hill even suggested a shift in focus of search to "secondary areas:"

> The more deeply we get into the character of the industry, however, the more we realize acquisitions in this field are rare. It is our belief that searching for service bureau acquisitions, in the five or six largest metropolitan areas, will probably prove fruitless, relatively speaking, and that our best opportunities will probably be found in the secondary areas such as Phoenix, Denver, Dallas, Kansas City, Cleveland, Pittsburgh, Seattle, etc.(32)

Nothing was turned up by the search until October 1969 when Richard Hill was contacted by representatives of the Rucker Company who inquired if Informatics was interested in acquiring their data centers and requested a closed-door meeting in a private hotel room.

The Rucker Company was a large manufacturer which had embarked on an active acquisition program and had purchased 15 smaller companies in the past three years. Among its growth investments was the Computer Systems Group consisting of two batch computer service bureaus in Los Angeles and one called Data II in the San Francisco area. They were experiencing substantial losses. According to Hill, Rucker representatives were rather secretive regarding the operating problems of the centers, allowing Informatics management to tour the facilities but not speak to any of the employees, and maintained that they did not want to injure employee morale if there were an information leak that Rucker was planning to divest itself of these operations.(33)

Informatics itself was initially suspicious of this position but also optimistic that a beneficial arrangement could be made since the centers were located in two major cities. This position is illustrated by the following statement which was made to the Board of Directors:

> The Rucker people are very reluctant to have us talk with the service bureau operating personnel. The financial information we have so far leads us to believe there are certain weaknesses in the company's structure. We cannot, however, assess these weaknesses accurately with the present state of our knowledge. However, despite all of the negatives, the computer group of Rucker is an attractive piece of property to us since it fits so well into our long range plans. We will continue to talk with the hope that something can be developed.(34)

Originally, the asking price for the data centers was 58,000 shares of Informatics stock plus one share for each $5 of after-tax earnings of the

centers. Informatics, however, pushed for Rucker to make warranties pertaining to the financial well-being and performance of the centers including accepting liability for certain losses or costs of the centers during their first year of operation under Informatics ownership. This complicated negotiations and raised the price:

> The Rucker acquisition proceeds apparently toward a successful conclusion, but the path is tortuous. One of the main difficulties in the latter part of the acquisition revolves around the reticence by Rucker to make certain warranties and accept certain liabilities. These items are gradually being resolved one by one. As a result of all these machinations, the price has changed somewhat to 123,000 shares with possibly 117,000 to come as a result of the formula.(35)

By March 1969, a final agreement was reached and signed with Universal Data Processing Corporation, a subsidiary of Rucker. Informatics shares had declined in price, so the number of shares had increased to 148,000 shares of Informatics stock, valued on Informatics balance sheet at $1,628,000 or approximately 26 times earnings. Rucker accepted a risk allocation for all major costs incurred during the first year of operation. Additionally, Rucker agreed to give Informatics an irrevocable proxy on its shares for the pending reincorporation of the company in the state of Delaware, and Informatics in turn agreed to nominate Clarence J. Woodard of Rucker to its board of directors.(36)

In the first month of operations, the data centers lost a total of $45,000. During the ensuing year, the Data Services Division lost an average of $60,000 to $70,000 per month versus planned start-up losses of $40,000. Drastic action was required, and Informatics management gritted its collective teeth and, as described in Section 12.2, rose to the challenge with a dramatic decision to get out of the business. It took some time, however, but the first Data Services Division was disbanded in 1971. At the end of fiscal 1970 year on March 28, Informatics accounted for the discontinuation of the business by recording an "extraordinary" loss from the California data centers of $2,008,000 after the effects of income taxes, as discussed in Section 12.3.

4.2.6. Dataplan, Inc.

On June 10, 1969, Informatics consummated an agreement for the acquisition of 70 percent of Dataplan, Inc., a New York service bureau, from the Interpublic Group. Dataplan, like the Rucker data centers, was purchased as one of the building blocks for Informatics first Data Services Division with the intent of establishing a business base for the division in the New York City area and to offer data services based on MARK IV and MACS (Media Account Control System), both described in Chapter 9. Informatics became aware of the Dataplan possibility in early 1968 when it was approached by John Felix Associates, Inc., a unit of the Interpublic Group, a large New York corporation composed of advertising agencies and marketing services companies. But prior to that, according to Werner Frank, the company first became aware of Dataplan when Dr. Albert Madansky, its president and a friend of Frank's, inquired of Frank if Informatics would be interested in acquisition of the service bureau.(37)

The Interpublic Group was the largest organization in the advertising industry, owning McCann Erickson, other advertising agencies, and several marketing services companies. Besides being Dataplan's owner, Interpublic was also its main customer and had originally asked for a payment of $1,600,000, all in cash.(38) After a year of negotiation, the agreement was reached for payment of $750,000 in cash and a note for $850,000 to be paid off in five years at prevailing interest.(39) Interpublic agreed to continue to do all its data services business with Dataplan and remain its major source of revenue. Interpublic was interested in selling its majority interest in the service bureau because Dataplan had been suffering financial losses and it was felt that Informatics expertise and management could improve operations and provide services at a lower total cost. Informatics saw the acquisition as an opportunity and announced "we believe we negotiated well on this matter and got what we hoped for."(40) For the first few months after the acquisition, this optimism was justified because Dataplan was modestly profitable. But in October 1969 the service bureau produced a financial loss of $9,246 on $129,000 in monthly revenues. This was the beginning of an almost continuous stream of monthly losses for the next two years which accelerated starting in early 1970. At the end of fiscal year 1970, on March 28, Informatics accounted for the discontinuation of this business by recording an "extraordinary" loss of $1,389,000 after the effects of income taxes, as discussed in Section 12.3.(41)

As described in Section 12.2.2, some of the problem stemmed from the economic recession, but much of it also resulted from disputes about services provided to Interpublic. Interpublic used these difficulties as excuses to withdraw its business and either delay or stop payment on work already performed and invoiced. This led to Informatics filing a suit against Interpublic in September 1970 for recission of the acquisition agreement, claiming that Interpublic was in default of the contract.(42) Informatics was partly successful in its legal efforts, and the suit was settled. In October 1971 Interpublic purchased back Informatics 70 percent interest in Dataplan for $50,000 plus the cancellation of the balance outstanding on the promissory note and interest thereon, amounting to about $750,000 all together. In addition, Dataplan paid Informatics about $300,000 which it owed but which had been written off. This happy outcome almost offset the losses from Dataplan recorded in March 1970.

4.2.7. Parsons & Williams (PRODUCTION IV)

In May 1972 Informatics entered into an option agreement to purchase licensing rights to industrial systems software developed and marketed in Europe by a small consulting firm known as Parsons & Williams A.G. (P&W), headquartered in Copenhagen, Denmark. The software product, originally known as IMP and renamed PRODUCTION IV by Informatics, was an entire product line for production control, shop scheduling and inventory management primarily for discrete manufacturing. Parsons & Williams were two University of California, Los Angeles, professors who had designed the automated production control system in 1963. Williams relocated to Copenhagen to develop a system (in COBOL for the IBM 360) and market it in Europe where development costs would be lower and competition would be less. A number of European installations were made, and with this demonstrable sign of market acceptance, Williams began to seek a means to market his firm's software product throughout the Western Hemisphere. At the same time, Informatics was searching for new and viable software product markets

to enter, and had identified the manufacturing industry as a rich untouched market for application software products. Among all industries, discrete manufacturing had the largest amount of annual revenues and profits, had clearly identifiable needs, and up until 1972 used computer products and services in its operations less than most other industries within the United States. Williams apparently contacted John Postley, who turned him over to Thomas Taggart and negotiations began between the two companies. These talks resulted in Informatics purchasing an exclusive right to market and further develop PRODUCTION IV in North and South America until 1977 when P&W would gain a non-exclusive right to sell the product inside Informatics territory. Informatics formed the Industrial Systems Department (ISD) under Michael Lodato to exploit this license.

This arrangement was terminated on December 31, 1973, when Informatics acquired all the assets of P&W for a small down payment in cash, plus royalties up to $1.0 million to be based on the financial performance of ISD. One of the assets was joint ownership (with a major oil firm) of Oildata A/S, a small company in Oslo, Norway, which marketed software products designed for the oil industry.(43)

Oildata A/S never amounted to anything, but ISD, as described in Section 11.8.2, was modestly successful, though it never quite reached profitability while selling PRODUCTION IV as a product. In 1977 it was discontinued as a product, and ISD was converted into a professional services organization. From 1978 through 1982 it was quite profitable and recouped most of the losses incurred from 1974 through 1977.

4.2.8 Asystance Co. (ACCOUNTING IV/GL)

In June 1973 Informatics purchased the assets of Asystance Company in Raleigh, North Carolina, for cash. The principal assets were the company's software products for general ledger and financial reporting, its customer base, and its principals, Fred Dilger and Ron Kupferman.

Asystance Company was formed in 1971 by Beaunit Corporation, a subsidiary of El Paso Natural Gas Company. It became an independent operation in June 1972 under the presidency of Fred Dilger. The company had made sales to major companies, including such concerns as International Nickel, Intercontinental Hotels, Addressograph-Multigraph, Times Square Stores, and FMC Corporation.(44)

As described in Section 11.8.1, the operation became a part of the Business Systems Division of Informatics Computing Technology Company where the product was named ACCOUNTING IV/GL. To round out the product line with accounts payable and accounts receivable systems, , ACCOUNTING IV was supplemented in 1975 by ACCOUNTING IV/AP and /AR (see Section 4.2.12). The ACCOUNTING IV product line never became profitable. In 1980 it lost $1.3 million. In 1981 the entire ACCOUNTING IV product line was sold to Global Software, Inc., a new company formed by Dilger and Kupferman, for $250,000 in cash plus a precentage of future revenues with a minimum of $200,000 and a maximum of $800,000. Modest royalties have been received from Global.

4.2.9 SDA Corporation

On June 21, 1973 Informatics acquired SDA Corporation, a privately held firm in Cheverly, Maryland, for 141,167 shares of Informatics stock on a pooling of interests basis. The stock was then selling for about $3.00 per share, but Informatics knew, but could not disclose to the owners of SDA, that it was likely that Informatics stock would soon be bought by The Equitable for at least $6.00 per share. The company had revenues of $1,027,500 and net income of $66,500 for its most recent fiscal year, ended December 1972.

SDA, which stood for Source Data Automation, was formed in 1969 by Cecil "Tex" Myatt. It provided a full range of data processing services, primarily in the development of computer data banks. It offered services in system design and implementation, system management, computer programming, data preparation, and photocomposition. The company had 120 employees. It was a major supplier of source data automation systems and services using optical character reading techniques. The firm had successfully served a number of major federal, state, and private agencies, including the National Center for Health Statistics, the Government Printing Office, the U.S. Coast Guard, the Library of Congress, the Department of Transportation, and the State of Ohio.(45)

As described in Section 7.5.3, SDA became a part of Informatics Systems and Services Company, and eventually evolved into the Publishing Services Division which, in 1982, had revenues of $5.2 million and profits of $.75 million.

4.2.10 Knowledge Networks (KNI)

In September 1973 Informatics acquired Knowledge Networks International, Inc. (KNI), a privately held firm in Washington, D.C., for cash. It had annual revenues of approximately $400,000 and about ten employees.

Incorporated in 1969, KNI specialized in information retrieval, data base management systems, legal information systems, and arbitration and mediation systems. It had developed two applications packages: JURIS (Justice Retrieval and Inquiry System), a data management system for the U.S. Department of Justice; and the Arbitration Information Tracking System (ARBIT), a timesharing and information retrieval system used by the Federal Mediation and Conciliation Service to keep track of arbitration cases, union and company data, and current and historical case studies. These services were based on the RECON-STIMS data base management and information retrieval systems developed for the National Aeronautics and Space Administration, and later improved and enhanced by KNI and subsequently by Informatics. Other customers included the Army Material Command, the Federal Home Loan Bank Board, and the National Science Foundation.

As mentioned in Section 7.3.1, it was absorbed into Informatics Information Systems Company where its personnel played a major role in the development of the RECON IV system, and minor role in helping Informatics become a supplier to the legal industry.(46)

4.2.11 System Three, Inc.

In February 1974 Informatics acquired System Three, Inc. of Los Angeles for $88,788 in cash. System Three, with annual revenues of over $500,000, was founded in 1972 as a for-profit national association of IBM System/3 users, offering problem solving, application support, information, and financial

benefits to members. By mail order the company sold disc packs and other supplies for the IBM System/3 computer under the brand name GROUP/3, plus a line of software products for System/3, including STIR, C/SORT, STAP, PROGED, and STEP. It published a monthly magazine, System/3 World, which had a controlled circulation to 12,000 users of IBM System/3.

The IBM System/3 was a very small computer used by small businesses. More than 15,000 of them were in operation worldwide, with the customer base increasing at approximately 35 installations per day. Installations often were in small cities, where costs of a visit by a supplier or software salesman were prohibitive in relation to the typical small sales.

System Three, Inc. was purchased from its founders, David Ferguson (the former president of Programatics, a systems software developer) and Gene Jacobs, and from its financial backer, Patrick McGowan, owner of International Data Corporation. The principal founder, Ferguson, conceived the idea for a "for-profit" users group charging monthly dues, which he named "Group 3." A member received a monthly magazine, System/3 World, and discounts on inexpensive software products, equipment, and accessories which were distributed by mail. Frank Wagner, the prime mover in the deal, was intrigued by such a new distribution channel for low-price software (which could not support the costs of a classical field sales force). He foresaw the huge market that could be exploited by software publishers and distributers, and which eventually developed in the 1980's for cheap microcomputer software.

After the acquisition the unit was named the Group/3 Division, with David Ferguson as general manager. Initially, Group/3 faired well under the direction of Wilson Cooper in Western Systems Company, who reported to Frank Wagner. Ferguson discontinued the requirement for dues which had proven hard to collect. He increased the magazine's controlled circulation to 17,500 and began to build up advertising revenues. Average sales of disc packs were 65 per week. Revenues from this source increased from an average of approximately $8,000 per week to $14,500 during the first seven months. This was primarily due to a switch to a different supplier of disc packs, which were more reliable and less expensive and an aggressive campaign of credit and telephone sales. Unfortunately, mail order sales of software never grew to the amount Wagner and Ferguson had hoped for, because Ferguson concentrated on his first love, systems software, instead of applications software which the market needed. Disappointed in the primary purpose of the acquisition, when sales fell off during the fall of 1974, Informatics installed a new general manager, Bill Leeds, to improve operations and financial performance.(47)

The latter step apparently worked during 1975. After some preliminary consideration of divesting Group/3, Informatics management suddenly found the small business turning around:

> Ever since serious consideration was given some three months ago to sell Group/3, that organization has been performing at a break-even level. In fact, on a marginal cost basis, Group/3 is now contributing positively to profit.

Revenues stabilized around $45,000 per month and by December 1975 operating profits increased to a record of $16,000 per month.(48)

Monthly revenues increased during the year to levels between $67,000 and $86,000, but profits declined to $1,000 to $6,000 per month. Then in August of 1976, Group/3 began selling System/3 instructional packages for new users, complete with manuals and audio cassettes, purchased from their producer. This increased revenues to $94,000, so in September a new aggressive telephone sales campaign was initiated to sell these educational packages to all sorts of Systems/3 users and potential users. Numerous orders flowed in and hundreds of the educational modules were shipped out. Suddenly and amazingly, reported monthly revenues and operating profits jumped to record highs in October. A profit of $36,000 was recorded on revenues of $205,000.

Unfortunately, this dramatic improvement was only an illusion. The new general manager of Group/3 had offered its education products for sale on a trial order basis without any obligation to buy or, for that matter, any obligation on the part of the many users who had been sent the product to return them if they decided against purchase. Since Group/3 had started as such a small operation, its accounting was done by the nearest large accounting unit, that of Informatics Software Products, where it was given low priority. Its communication with Group/3 management was poor, and monthly reports were very late. Two months after the fact it was discovered by higher management that accounting had booked the requests for trial of the products as actual sales even though no payments were received. Worse yet, under the contract with the producer of the products, he was paid upon delivery. Cooper and Wagner had not been informed of this practice but quickly became aware of it when the unexpected profit (and huge accounts receivable balance) was reported in late November, and they dug into the reasons for it. This was a classic example of over-delegation of authority without adequate controls. Management ordered accounting to book major financial reserves against potential losses resulting from uncollectable accounts receivable and unsaleable inventory:

> It appears that sales were being recorded in Group/3 without adequate contract documentation and it is expected that a sizeable number of these educational systems will be returned or worse yet they may never be paid for, in which case we will have to pay the supplier for these systems.
>
> There will be continuing analysis of this matter.

Initial reserves of $107,000 were taken for financial losses during the next three months (November 1976 to January 1977). All profit recorded during the previous year was wiped out by losses resulting from the unreturned and unpaid for products. The trial order sales were discontinued and:

> Management mistakes which were made in Group/3 have been discussed at great length with the parties involved and operating guidelines have been developed which should preclude future difficulties of the type experienced . . . .(49)

During the next several months Group/3 operated close to a break-even point with only marginal operating profits of approximately $2,000 per month against revenues of approximately $92,000. By August 1977 Informatics management decided in favor of divestiture and reached an agreement with Electronic

Memories & Magnetics in September for the purchase at market value of the hardware and supplies inventory. System/3 World (which had been renamed "Small Systems World") was sold to a publisher of trade magazines for $30,000 in October.(50) At the end of 1982 it was still being published and was very successful.

4.2.12 Computer Applied Systems Co. (CAS)-(ACCOUNTING IV/AP and /AR)

In February 1975 Informatics announced acquisition of accounts payable and accounts receivable software packages from Computer Applied Systems Company (CAS) of Encino, California, a firm specializing in the development of accounting systems. The price was $160,000 plus a percent of future sales.

Computer Applied Systems Company marketed its accounts payable and accounts receivable packages under the trade names CASAPS and CASARS. Among users were such prominent companies as United Airlines, Mellon Bank, Mercantile Trust Company, and General Telephone and Electronics. Both packages were written in ANS COBOL and were available for delivery on a variety of hardware/software computer configurations including IBM, Univac, Burroughs, and Control Data.

As described in Section 11.8.1, the new packages and the principals of CAS, Jack Friedland and Jack Sparks, were absorbed by Informatics Business Systems Division under Walter Brown. It productized the packages and renamed them ACCOUNTING IV/Accounts Payable (AP) and ACCOUNTING IV/Accounts Receivable (AR) to round out the ACCOUNTING IV product line, supplementing by then the widely accepted General Ledger and Financial Reporting System.

AP and AR were never profitable. In 1981 they were included in the sale of the ACCOUNTING IV product line to Global Software, Inc.(51)

4.2.13 Programming Methods, Inc.

On October 10, 1975, Informatics, Inc. became owner of Programming Methods, Inc.(PMI), a professional services company previously owned by General Telephone & Electronics Information Systems (GTEIS). PMI had originally been formed by employees who left Computer Applications, Inc., an early competitor of Informatics. Later it was acquired first by Riker-Maxon Corporation in 1970 and then by General Telephone and Electronics during 1972. GTEIS was mainly interested in hardware systems for computer communications, but PMI primarily provided custom programming services, occasionally in support of GTEIS hardware. It directly competed against Informatics Western Systems Company, especially in the government marketplace, and against Computing Technology Company, especially in services to New York City banks. The company also developed and sold its own software products, primarily telecommunications monitors. In 1972 Informatics Communications Systems Division negotiated a non-exclusive license to market one of these products, INTERCOMM, for maximum cummulative royalty payments of $600,000 over five years, but never sold any or paid any royalties.(52)

By 1975 PMI consisted of three main components. These were a software products development and sales group in New York City, a commercial information systems division, and a federal systems division, both of which were divided between East and West coast operations. GTEIS began experiencing large financial losses from its hardware units, which prompted General Telephone to

divest itself of it. When it could not find a buyer for the entire Information Systems Division, it resorted to selling parts of it separately. Informatics was approached by General Telephone in May 1975 and by July 1975 had reached an agreement to purchase PMI, excluding the Washington, DC operation of its Federal Systems Division and its European software leases, for the value of its net tangible assets. This involved an initial payment of $277,000 in cash, but a final audit eventually reduced the price to $235,000. All these hard assets went on Informatics balance sheet at full value. So, for practical purposes, the cost of the acquisition was zero.

Werner Frank and John Postley were primarily interested in the risky software products component of PMI, whereas Frank Wagner was excited by the profit potential of the large, risk-free commercial professional services component. Bauer's attitude was one of hedging--he saw that the potential losses in software products could be offset by the almost certain profits in professional services.

Informatics had to negotiate quickly as Computer Sciences Corporation was rumored to be interested and the senior management of PMI (consisting of George Langnes, its president and founder, and Francis Casagrande, executive vice president) were also negotiating with PMI to acquire their own company back. Werner Frank, Frank Wagner, and Al Kaplan conducted negotiations for Informatics and were highly successful in obtaining a favorable agreement. PMI was a sizeable company, adding an expected $14 million in revenue to Informatics. The software products contributed about $2 million and about $12 million of revenues came from professional services, primarily programming for the commercial marketplace. Walter Bauer crisply described the eventful acquisition with "We are at once exalted and stimulated by this growth while humbled and sobered by the challenge we face."(53)

In December 1975 General Telephone again approached Informatics with the offer of selling the European lease base of the PMI software products which were not part of the previous acquisition agreement. Werner Frank negotiated the acquisition of these leases for $60,000.

At first, as described in Section 8.6.2, substantial personnel turnover occurred as Informatics sought to reorganize and integrate PMI operations into its own. Upon closure of the acquisition, Langnes and Casagrande left PMI to form their own competing software company, Lambda Corporation, which began soliciting PMI customers for business and hiring away PMI employees. In the months just before and after Informatics official acquisition of PMI, 45 professionals left PMI of which 12 were key employees, some of whom resigned to join Lambda. Resignations continued in ensuing months, and Informatics eventually had to threaten a law suit before Lambda curtailed its recruitment efforts of PMI employees. While some programming staff was lost, Informatics was successful in developing management incentive plans to induce the remaining management team to stay, particularly Paul Connolly and Donald Toy of West and East professional services operations, respectively.

Five software products were acquired with PMI--three telecommunication monitor programs (INTERCOMM, BETACOMM, and MINICOMM), SHRINK, and CSS, (standing for Corporate Shareholder System). As described in Sections 11.7.3 and 11.8.4, the latter two products were fairly successful, and produced several million

dollars of profit through 1982. But the telecommunications products (renamed MONITOR IV), for which Informatics ostensibly acquired PMI, experienced declining sales, as described in Section 11.7.5. After losing about $3.0 million in three years, Informatics disposed of the monitor products and SCORE for $316,000. Subsequently, CSS and SHRINK produced enough profits to offset these losses.

However, as described in Section 8.6.2, the professional services operations of PMI contributed highly to Informatics performance, expanding its business in the government marketplace (services to both the federal and state governments) and in both the domestic and European commercial markets. Informatics revenues had increased 51 percent by the end of 1977; 20 percent of this growth came from PMI professional services. In the years from 1976 through 1982 the Professional Services Group contributed about $19.4 million, 22 percent of corporate profits, the largest share contributed by any single operational group.(54)

4.2.14 Direct Dial Data (DDD)

In November 1976, after nine months of difficult negotiations with Greyhound Computer Corporation, Informatics acquired from them Direct Dial Data (DDD) of Phoenix, Arizona, which provided commercial financial data processing services (which they were then buying from the Greyhound Computer Center in San Francisco) to very small users through "dealers," primarily banks. The difficulty centered around the price as compared to the viability of the business. The quality of Greyhound computer services had been so poor that Informatics was concerned that the dealers were ready to terminate. However, a survey indicated that they would give Informatics a chance to improve the service so, at the urging of Richard Kaylor, the company went ahead with the deal, paying Greyhound a small amount of cash.

The dealers sold and supported the end user, typically a very small businessman. Input was supplied over phone lines to a collector unit at each dealer, and then transmitted on Informatics network to Fairfield, New Jersey, for overnight processing. Output was printed remotely at each dealer, who then the next morning delivered it to his customers.

Richard Kaylor was the leader in the acquisition, helped by Warner Blow. Kaylor's motivation was to build up the overnight workload on the Fairfield computers. DDD was a small acquisition which Informatics saw as an opportunity to gain a foothold in the direct financial data services market for small businesses.

Upon its acquisition by Informatics, as described in Section 12.4.2.2, DDD almost immediately ran into a major business setback when its primary dealer, Wells Fargo Bank located in San Francisco, terminated its agreement for services, and began to service its customers on its own computer with (presumably) software that it had been developing.

In December 1976 Informatics decided to file a suit against Wells Fargo, claiming that Wells Fargo had deliberately misled Informatics to protect their interests until they were ready to support their customers in-house. The suit alleged breach of contract, anticompetitive actions, and actual damages of at least $300,000.(55)

DDD never recovered from this setback. Operating losses resulted and in 1978 the corporation slowly liquidated it. Finally the suit against Wells Fargo was settled for $260,000.(56)

4.2.15. Management Horizons Data Systems, Inc.

During November 1976, in a burst of quick response and action, Informatics took steps to acquire Management Horizons Data Systems (MHDS) after its parent company, First National City Bank (FNCB, later Citibank) decided to divest its Columbus, Ohio, data processing services subsidiary which was recording about $7.8 million in revenues from services to wholesale distributors. Agreement in principle was reached within a month, but all details were not settled until May 1977 when the acquisition took place. Informatics found out about the divestiture through Richard Kaylor, group vice president of the Commercial Services Group, who had associations with John Reed, the FNCB senior vice president; and other representatives of the bank.

FNCB originally financed MHDS in 1970 when John Reed was moving the bank into the "information age" in a flamboyant way. MHDS was also planned to be a "back up" site for FNCB's data processing operations in the New York area in the event of possible civil disturbances, which the bank feared due to the outbreak throughout the United States of racial riots in the summers of 1967 and 1968. In 1973 FNCB acquired 100 percent of MHDS.

The bank gave some business to MHDS, but beyond that, did not pay much attention to the data services company. It was stated that the executives in the Bank in charge of MHDS had never even visited Columbus. Over the years MHDS proved to be unprofitable; for example, in 1975 it lost $2.3 million. But it was kept in business by further investments by FNCB, which finally added up to over $15M. In 1976 the bank re-evaluated its reasons for investment in MHDS and decided to divest its holdings.(57)

Upon confirming the impending divestiture by FNCB, Informatics "moved very quickly to present them with an offer since the bidding for MHDS from Computer Sciences (CSC) and other organizations was fast and furious." Informatics won the contest, not by offering more money but by promising to build MHDS into a major corporate citizen of Columbus. (CSC and the other bidders were believed to be planning to move the processing to their other facilities, and shutdown the Columbus site.) FNCB was concerned about the bad image this would give them in the eyes of the Columbus business community.(58)

Informatics offered to acquire the stock of MHDS for book value, about $3.4 million for the net (depreciated) assets of MHDS (which included a magnificent facility). Walter Bauer demurred at laying out so much cash. Frank Wagner suggested that, since FNCB was in the business of loaning money, Informatics offer them a promissory note. FNCB agreed and financed the acquisition by making three five-year loans to Informatics at very favorable rates of interest. FNCB also gave Informatics a $3.3 million long-term contract for remote batch processing. In addition, FNCB agreed to pay Informatics $500,000 in cash to cover all outstanding debts. The bad part of the deal was that Informatics reluctantly agreed to a seven-year lease for the two 370/168 computers based upon a value of over $9 million, whereas the fair market value at the time was

about $7 million and rapidly declining. This was an unfortunate mistake caused by the intransigence of the leasing subsidiary of Citicorp, over whom FNCB had no control. The lease payments (which were operating expenses) were for several years a severe drain on the operating profit. Ultimately the profitable Data Services Division in Fairfield, NJ, was forced to take responsibility for one of the computers.(59)

As described in Section 12.4.3, this acquisition resulted in the formation of the Data Services Group under Richard Kaylor. Part of the group was the MHDS Division, later renamed the Management Services Division (MSD) under Warner Blow, vice president and general manager. Under his direction it continued to expand its business. In 1982 MSD had revenues of $10.9 million and pretax profits of $200,000.(60)

4.2.16 SERIES IV

By 1977 Informatics had observed the great growth of minicomputer use during the 1970's and determined that it should find a way to enter the market for minicomputer software. The first opportunity arose in Europe. Jeffrey Milton, Informatics vice president of the Software Products Group in charge of European marketing, was headquartered in Geneva, Switzerland. He became aware of a small company there. The two principals, Colin Oldacre and Robert Pittman, had developed a product called G.D.E.S. (Generalized Data Entry System) for the Digital Equipment Corporation PDP-11. It was an application generator for a very specific application--computer data entry and validation. John Postley, group vice president of Software Products Group, to whom Milton reported, became enthusiastic about the prospects for selling this product as part of a complete hardware/software system, and supported Milton's recommendation that Informatics acquire the company.

Negotiations were completed and the company was acquired in 1977, as described in Section 11.7.6 and both principals became employees of Informatics. The product was renamed SERIES IV, initially marketed in Europe, and then later was introduced into the USA in February 1978.(61)

The product failed in the marketplace. The price for installing such a system was much too high compared to other alternatives for data entry. So in 1980, after Jeffrey Milton had left Informatics, he proposed that he form, with the original developers, a new company called Sosy S.A., and buy the product from Informatics. This was agreed to and the product was sold to the new company in 1980 for $120,000 plus royalties on any subsequent sales.

4.2.17 Decision Strategy Corporation (TAPS)

As described in Sections 5.3.2, 6.2.2.1, and 11.5.1, Werner Frank, in the early 1960's, was probably the first person to conceive the idea and to develop programs (DOCUS and DISPLAYALL) to simplify the development of on-line applications dominated by CRT screens. In the 1970's IBM began to popularize such products and apparently the market for them was ready to expand. About 1976 Frank became aware of a new product called TAPS which not only performed this function, but also included a simple data management system, so that it was a full fledged application generator. But, in addition to that, it was designed to be portable; that is to say, it could easily be made to run on a wide variety

of computers, from large IBM mainframes through minicomputers to the then emerging microcomputers. This fitted in beautifully with Informatics desires to get into the market of providing software products for microcomputers and of the company's strength in application development tools. Moreover, it provided software which would be very useful for the then popular idea of distributed computing. So Werner Frank strongly urged the acquisition of TAPS.

However, the group vice presidents of Informatics Software Products Group, first Paul Wrotenbery and then Bruce Coleman, did not share Frank's enthusiasm for TAPS. They had alternatives and, as described below, decided to acquire INQUIRY IV/IMS and TRANS IV to provide Informatics with products to support the development of on-line, screen-driven applications. These two products did not have any of the alleged versatility of TAPS, since they ran only on large IBM mainframes and had no built-in data management capabilities. First Wrotenbery and then Coleman, however, believed that the market for them was large enough and rejected the idea of acquiring TAPS in the late 1970's.

In 1980 after the establishment of the Corporate Development Group with Werner Frank as group vice president, he observed that TAPS had blossomed and seemed to be fulfilling the promise that he had seen for it. So he revived the idea of acquiring it. It was owned by Decision Strategy Corporation, a privately owned company in New York, which was in financial difficulties. The president and CEO was Michael Parrella. Negotiations led to the acquisition, in October 1980, of all of the business of Decision Strategy Corporation for a price of $750,000, which was enough to help Decision Strategy out of its financial difficulties. Although the corporation continued as a shell, Parrella, virtually the entire staff and all of the useful assets became a part of Informatics.(62) By 1982 the TAPS Division had annual revenues of $4.9 million and a loss of $390,000. When Werner Frank resigned from the company at the end of 1982 and the Corporate Development Group was disbanded, the TAPS Division was transferred into the Software Products Group.

4.2.18 Transportation Computing Services Corporation (COSD)

In January 1981, in a continuing effort to diversify into services to vertical industries, Richard Kaylor, group vice president of Data Services Group, took the lead in acquiring the business of Transportation Computing Services Corporation (TCSC) and its wholly owned subsidiary Commercial On-Line Systems, Inc. (COLS) of New York City. It was owned and managed by its founders Lawrence Parks and Issac Lonstein. The price was $2.8 million.

COLS was recording revenues of approximately $2.0 million annually from data services, primarily to the New York-based apparel industry. It processed data for accounts receivable, inventory control, and order processing. TCSC had additional revenues of about $0.5 million from providing data processing services for the taxi industry in New York City, serving owners of fleets, associations, and the taxi drivers' union.(63)

It was renamed the Commerical On-Line Systems Division (COSD) under its two principals, and became a part of Data Services Group reporting to Richard Kaylor. In 1982 its revenues had not grown from its initial $2.5 million and it lost $1.13 million after writing off $0.4 million for amortization of acquisition costs.

4.2.19 Professional Software Systems, Inc. (PSS)

Because of the great success under John Rome and Richard Lemons of Legal Information Services (which supported the litigation activities of law firms--see Section 7.7), both men believed that an opportunity existed for further diversification by Informatics into supporting law office management. Their plan was not to supply services but to supply software and hardware to assist in the management functions of the office. After studying the matter for several years, it was decided that the development of such offerings was much too risky and an acquisition would be the better way.

Accordingly, in May 1981, under their leadership, Informatics acquired the assets of Professional Software Systems, Inc. in Phoenix, Arizona. It supplied software and minicomputer turnkey systems, doing business at approximately $5M per year and losing money. It was privately owned by Harry Pappas (an attorney who was not active in managing the business) and two brothers, William and Dennis Hankerson, who ran the company. The price was $1.1 million in cash, plus additional amounts to be earned based upon the profits of the operation.(64)

As described in Section 11.8.5, the assets of the company included a large number of software products, such as Legal Time Management System, General Ledger, Docket, and Adverse Party. All of these products ran on minicomputers supplied by the Wang Corporation, with whom PSS had an OEM agreement. The two Hankerson brothers continued to run the business for a while but were soon replaced. The company continued to lose money, and as a result Informatics, in accordance with the purchase agreement, terminated the earnout provisions. Eventually Pappas and the Hankersons filed a lawsuit against Informatics, claiming that the earnout provisions had been unlawfully terminated and that Informatics owed them a considerable amount of money based on their interpretation of how the accounting should be done and upon their allegations that Informatics had not permitted them to run the company in a profitable manner. By 1982 the lawsuit had not come to trial. Revenues had grown to $9.91 million with profits of $164,000 after writing off $274,000 amortization of acquisition costs.

4.2.20 Automated Systems Design Corporation (ASD)

In his pursuit of expansion in the information systems business, Richard Lemons, senior vice president of Information Services, took the lead in acquiring Automated Systems Design Corporation (ASD) in August 1981. The price was $450,000.

ASD provided file retrieval hardware/software systems called INFO-LINK and contract programming for several industries in metropolitan New York. The firm's file retrieval proprietary software operated on Honeywell, DEC and Microdata minicomputers running under the PICK operating system. The capability was aimed at the filing and retrieval of noncomputerized data bases such as those consisting of printed material. ASD had developed an indexing system designed for very large off-line data bases. Typical turnkey systems, complete with hardware, were priced at about $200,000. Customers for the system included media organizations, banks, and insurance companies.(65)

It was a very small group of 12 people, most of whom became employees of Informatics. Mike Marcus was brought in to head it as a part of the Information Services Group reporting to Richard Lemons. After a short time, however, it became apparent that the product was not selling rapidly enough to cover expenses, so in September 1982 the business was sold to VISCO Inc. for $100,000 plus royalties on future sales of the product. Modest royalties have been received.

4.2.21 Management Control Systems (MCS)

After James Porter joined the corporate office as vice president for corporate marketing and development in 1981, he headed an acquisition effort aimed at diversifying the corporation's software products into vertical markets. The first result was the acquisition on October 1, 1981, of Management Control Systems Inc. (MCS) of Atlanta, Georgia. Its CEO and chairman, Richard Brock, had founded the privately held company in 1975. The price was $2.5M in cash and stock. Annual revenues of MCS in 1980 were approximately $2.4 million.(66)

As described in Section 11.8.6, software products developed by MCS for IBM System/34 and System/23 computers were sold to public accounting firms nationwide through a sales force consisting of direct sales representatives and specialists in telephone and direct mail selling. The customer base was almost 1,000.

After the acquisition it was renamed the Management Control Systems Division, with Richard Brock as vice president and general manager. It reported directly to James Porter and formed the first unit of the Business Systems Group of which Porter became the group vice president. In 1982 it recorded gross revenues of $7.7 million and profits of $0.32 million after writing off $0.58 million amortization of acquisition costs.

4.3 ACQUISITIONS OF PRODUCTS

4.3.1 The CL*IV Product

By 1972 the marketing of MARK IV, though quite successful, had come up against one very large obstacle. Many managers of software development groups for business data processing had completely committed their operation to the COBOL language. They simply would not consider buying MARK IV. In an effort to capture some part of this market, John Postley, president of Software Products Company, acquired in November 1962 from Albert McComb and Ray Work of GSI Inc. of Phoenix the marketing rights to a product developed by Work, and renamed it CL*IV. The price was 11,500 shares of Informatics common stock plus 10 percent of revenues for three years. In April 1974 the shares and royalty obligations were bought back for $136,500.

CL*IV was a COBOL logic generator. That is to say, it was a language which provided the user with a convenient, short way of expressing instructions which he wished to have in a COBOL program. When this language was processed by CL*IV, it produced the COBOL program in all its verbosity. The program was productized by Software Products Company and brought to market. Unfortunately, like so many other competing COBOL preprocessors, it never achieved acceptance in the marketplace. It was soon abandoned.(67)

4.3.2 The Composition System IV (CS IV)

As discussed in Section 7.3.2, in 1973 Informatics investigated acquiring a small company called Autocomp which had developed an excellent computer program for the IBM 370 called RECOMP. This program automated the composing of materials for printing, accepting as input text into which were imbedded symbols which described what the printed page should look like.

The precarious financial condition of Autocomp convinced Informatics not to acquire it. However, as its financial condition deteriorated, Informatics proposed to the management of Autocomp that they would obtain some much needed cash by selling RECOMP to Informatics. Autocomp's board of directors were apprehensive of the negative publicity that would come from such a sale, but eventually agreed to a sugar-coated equivalent. Informatics paid Autocomp $325,000 for a perpetual exclusive license to resell RECOMP, together with the rights to hire several key employees familiar with its development, maintenance, and marketing.(68)

Ultimately, Autocomp went out of business, but as described in Sections 7.5.2 and 11.8.3, RECOMP, which was renamed Composition System IV (CS IV), formed an important part in the development of Information Services and became the cornerstone of the Publishing Services Division under Lloyd Kendall (a former employee of Autocomp) reporting to Richard Lemons.

4.3.3 The INQUIRY IV/IMS Product

The acquisition of the INQUIRY IV/IMS product has a fascinating history. At North American Aviation Peter Nordyke was involved in the development of DL 1 and IMS, a joint North American/IBM project which led to IBM's first major data base management products. At some point he formed Nordyke Associates and developed a user-oriented query language for IMS, called QL/1. He got at least two companies to try to market it and finally signed an agreement to have it marketed by COMRESS sometime in 1972 or before. COMRESS was not too successful and sold the marketing rights to Programming Methods, Inc. (PMI) in December 1973. It quickly became apparent to PMI that QL/1 was in trouble because its performance did not match the specifications, so sometime in 1974 PMI apparently stopped trying to further develop and market the product.

After Informatics acquired PMI in 1975, Software Products attempted to evaluate QL/1, because for a number of years they had an interest in building a product like it. However, copies of the code could not be found and efforts to obtain it from Nordyke or some of the customers were unsuccessful. So Informatics, influenced by PMI's poor opinion of the product's technical capability, abandoned the search.

In late 1976 Informatics Software Products began in earnest the development of its own query language for IMS. Its interest in QL/1 was rekindled when someone recognized its kinship with IN?UIRY/ims, a product of CGA Computer Associates (CGA) which was clearly competitive with Informatics own potential offering. Was it the missing QL/1? The answer was given during a visit to Informatics by Bill Witzel, an independent deal maker and an old friend of Walter Bauer and Werner Frank, who told them that after PMI had abandoned QL/1

he had persuaded Nordyke to get together with Bernard Goldsmith, the president of CGA. So CGA was now marketing QL/1 under the new name of IN?UIRY/ims! Informatics decided to assert to CGA its ownership of the product. Evidently, Informatics had a good case because no lawsuit was ever filed, and negotiations resulted in an amicable settlement. CGA acknowledged Informatics ownership of the product and turned it over to Informatics in return for 12 percent of product revenues for the first three years. The deal was signed in June 1978.(69)

Informatics spent a good deal of development funds on productizing it to Informatics standards. As described in Section 11.7.7, it was renamed INQUIRY IV/IMS and introduced to the marketplace later that year. Marketed by Software Products Group, it has had modest success. It never became profitable, but achieved nearly breakeven by the end of 1982 after losing over $0.5 million.

4.3.4 The TRANS IV Product

Since INQUIRY IV/IMS, described above, operated with the IBM IMS data base and data communications system, Informatics felt the need to have a product for use by users of IBM's popular CICS communications monitor. This it accomplished by acquiring the marketing rights from Oxford Systems Inc. for the most successful product of this type then available, UFO, which is described in Section 11.7.8. In February 1979, for a price of $100,000, Oxford granted Informatics a nonexclusive license to market the then current version of UFO under the name of TRANS IV. Informatics spent quite a few development dollars in productizing TRANS IV and introduced it to the market in September 1979. Later it became known that, at the time of the negotiations, Oxford had under development a much improved version of UFO which has since proven to be a formidable competitor for TRANS IV.(70) TRANS IV has had modest success in the marketplace, although it lost over $2 million through 1982.

4.4 JOINT VENTURES AND MERGERS

An area of external corporate development in which Informatics has been very successful has been its efforts in joining with other companies and investors in joint venture businesses. In two of these cases, Informatics TISCO and Equimatics, the joint ventures were ultimately responsible for doubling the size of the corporation and expanding its activities in new and sizeable markets. Like acquisitions, the company's efforts in joint ventures, (including the formation of partially owned subsidiaries) involved a learning experience whereby Informatics profited from mistakes and failures which enabled it later to produce successful business ventures.

4.4.1 N.V. Informatica

As described in Section 4.1.1, in the early 1960's Informatics opened an office in Amsterdam, The Netherlands, under Ed Myers, to service contracts with N.V. Philips, a huge multinational corporation. Marketing efforts to obtain more business from Philips eventually led to the idea of a joint venture software company in Europe. This potential opportunity was especially appealing to Informatics since it would give Informatics a firm entrance into the European software market. Informatics management was convinced that success there required using European employees and a partner who had a strong presence in

most European countries which Philips could provide.

Negotiations were carried out on June 29 and 30, 1965, between Walter Bauer, Werner Frank, Richard Hill, and Ed Myers of Informatics and Messrs. Breek, a very high level corporate director of Philips; Schweers, a high-level corporate officer; and de Jager, corporate vice president of data processing and Informatics principal customer in Europe. They were successful in working out a preliminary agreement for the formation of a European software company to be called N.V. Informatica. The basic terms of the deal were for Philips to guarantee an investment of $2 million over a three year period and for Informatics to contribute the technical talent and management expertise. In return for its investment, Philips was to receive 20-40 percent of the subsidiary's stock depending on the percentage of total business that the subsidiary performed for Philips. Philips initially drafted a letter of intent and expressed willingness to guarantee an initial investment of $300,000 to $500,000 to get N.V. Informatica started. This agreement, however, was contingent upon approval by Philips Computer Industries (PCI) at Appledorn, the main internal computer systems manufacturing division of N.V. Philips.(71)

Informatics objectives in making the joint venture were described as "to create a high quality software company to meet growing European demands, making The Netherlands a center for programming, and bringing capability and profits to Philips and Informatics." N.V. Informatica was projected to produce $3 million in annual revenues within a few years, serving 75 major customers with a staff of 138 technical personnel and 42 administrative and clerical employees. This was based on forecasts that the professional software services industry in Europe would increase from very little in 1965 to over $50 million in sales by 1970. Fifteen percent of N.V. Informatica's work force was to be American, provided by Informatics, in positions from senior programmers to department directors.(72)

While waiting for the approval from PCI Informatics loaned the services of Richard Hill to Philips for a period of one month free of charge. It registered to do business in The Netherlands in December in an effort to expedite the joint venture agreement. Unfortunately, dazzled by the powerful corporate personalities with whom they had an agreement, Informatics neglected to have discussions with PCI. Alas, PCI was having private discussions with Computer Sciences Corporation (CSC), one of Informatics major competitors, for a joint venture of their own. CSC was doing system programming work under contract to PCI, and had excellent rapport with the technically-oriented computer design management of PCI. Ultimately, many months later, PCI decided that the pending N.V. Informatica was in conflict with its interests, and was able to kill the deal.(73) According to Frank Wagner, Philips immediately proceeded to create a joint venture European software company with Computer Sciences. It was never a success, and eventually went out of business, but undoubtedly contributed to CSC's later success abroad.

4.4.2 ATAR Computer Systems, Inc.

One of the most interesting, though unsuccessful, joint ventures in which Informatics participated was ATAR Computer Systems, Inc. (AtarCSI). Informatics had been looking for a way to get into the remote transaction processing business without the heavy capital investment that it required. AtarCSI

provided a long-shot opportunity to do so. It was formed to provide a universal automated travel agents reservation system (the ATAR system) usually known as "ATARS," for domestic travel agents. (Often the company was colloquially referred to as "ATARS.") The opportunity arose in late 1967 when a small group of private investors first approached Informatics to become their technical partner in developing and marketing the system. The investors, a group of New Jersey businessman, included Samuel Lieben (chairman of the board and initial president), Hyman Goldman, Morris Winograd (treasurer), and Lyonel Zunz (secretary).

The vice president and founder of AtarCSI was Leonard Klarich, a young, aggressive programmer from Brooklyn with a tremendous entrepreneurial flair. He got the idea for it from previous work for IBM on the SABRE system for American Airlines and on installing the PARS reservation system at Braniff. To succeed, AtarCSI needed to obtain financing, to hire managerial and technical talent, and to persuade both independent travel agents and the leading domestic airlines to commit to using the system. The airlines had been studying the desirability of such a system for some time, through the Air Traffic Conference (ATC), the marketing part of the Airline Industry Association. The ATC was the vehicle under which the airlines could act jointly with immunity from the anti-trust laws so long as their actions were approved by the U.S. Civil Aeronautics Board (CAB). Klarich selected Informatics to provide the needed technical and managerial talent and selected the Wall Street firm of Hayden Stone to provide the financing. Both firms were offered ten percent of the company for the same bargain price paid by the initial investors.

Each of the major airlines maintained their own automated reservation systems for their own internal reservation agents. American Airlines had started installing their SABRE terminals in a few large travel agencies. The other airlines and the travel agents viewed this with alarm, as it might require agents to use separate terminals for each airline. Furthermore, service to independent travel agents promised to be poor as the SABRE reservation system tended to favor American's agents, provided slow response to other agent inquiries, and often did not carry or seemed conveniently to forget the itineraries of competing airlines. This demanded separate inquiries and call backs on the part of agents. ATARS would have serviced the entire reservation function for travel agents on a single impartial, unbiased centralized system.

ATARS was viewed by Informatics and people in the travel agency business as a unique and much needed service since no common airline reservation system for travel agents and airlines existed. If installed, it would have allowed individual agents to book plane reservations for all airlines, as well as auxiliary services such as hotel, car rental, and entertainment event reservations, on a single computer terminal connected to a nationwide network consisting of 2700 terminals. The various capabilities of ATARS included instant response to inquiries about schedules, connecting flights, seat availability, and confirmation of reservations. Future enhancements would include fare quotations, automatic ticketing, issuing of boarding passes, hotel and auto reservations, and on-line data processing services other than reservations, such as accounting and financial systems for travel agents.(74)

Hayden Stone and Informatics expressed interest, and each purchased 10 percent of AtarCSI for $2,000. Informatics assigned Irving Cohen, Informatics

Vice President/Systems Engineering, part time to assist Klarich in preliminary design and marketing. However, other competitors were very active. The airlines seemed to be dealing sole source with Univac. It became apparent that AtarCSI needed substantially more help from Informatics. The solution that was found was to appoint Frank Wagner as president and CEO in January 1968 (though he remained an officer and director of Informatics and devoted about 30 percent of his time to Informatics business). In return, the initial investors granted Informatics an option to acquire an additional 51 percent interest in AtarCSI, and agreed that the company would pay Informatics a monthly management fee for Wagner's services and minor administrative services, and commercial T&M rates for technical personnel. Later in 1968 Informatics negotiated another option with the initial investors, which could bring its ownership of AtarCSI up to 83.2 percent of the company. In return Informatics loaned AtarCSI $150,000.

Immediately Wagner hired as vice president of engineering, Lee Amaya, a nationally renowned programming manager at Lockheed, and began using Informatics technical personnel and hiring its own employees to design the computerized reservation system which was an expanded enhancement of the IBM PARS system. Its management undertook a nationwide sales campaign to the nation's airlines and travel agents. The five year plan of AtarSCI forecasted annual revenues of $15 million (including the auxiliary services) with a 10 percent profit rate. But studies showed that it was economicaly infeasible to have more than one supplier. Hence it was clear that profitability depended on AtarCSI having no competition. Investment required during the first two years to establish the system was estimated at $15 million and public financing was planned.(75) The underwriter, of course was to be Hayden Stone.

At first things went well with much momentum. Wagner and Klarich initiated a major marketing effort with a stream of ads featuring the ATARS symbol, a white rose. A film called the "A Beautiful Idea" was produced, starring Buddy Hackett (a friend who did it as a favor to Klarich) as a befuddled traveler helped by a travel agent using ATARS. An ATARS newsletter was regularly sent to 7,000 travel agents and demonstrations of the system were made at the national conference of the American Association of Travel Agents (ASTA) in November 1968. Wagner and Klarich actively sought the attention of and made presentations to the presidents and marketing vice presidents of all leading airlines. In fact, to ensure ready access, they would send a vase containing a white rose to the secretaries of airline executives before they called for an appointment.

The principal selling point was that ATARS was based on the IBM PARS system then in highly successful use by most of the airlines. Final pricing was designed to be equitable for all parties to the transactions, with the airlines paying about three times as much as the travel agents. The sales effort itself was highly successful. Wagner and Klarich first persuaded the airlines not to buy from Univac but to hold a competition to select the system. Formidable bidders against AtarCSI included Univac, Control Data, Telemax, and a consortium of RCA and Diners Club. The Steering Task Force of the Air Traffic Conference (ATC) recommended ATARS and the entire ATC agreed. Negotiations between the ATC and AtarCSI resulted in a contract with the ATC, acting as agent for its member airlines, which would become effective if 10 of the trunk airlines which carried 50 percent of all domestic air passenger miles agreed to participate in the system. AtarCSI succeeded in winning the approval of the requisite number of airlines by April 1969, gaining signatures from Alaska, Continental, Delta,

Eastern, Mohawk, National, Northeast, Trans World, United, and Western Airlines. Consequently, the contract with the ATC was activated and submitted to the CAB for final approval.

Wagner and Klarich were simultaneously conducting a marketing campaign to travel agents very suspicious of the airlines. It succeeded and ASTA endorsed the agreement in May. For the first time in history, the ATC and ASTA petitioned the CAB to approve the same filing. Meanwhile, to help get CAB approval, AtarCSI retained the prestigious Washington law firm of Steptoe and Johnson, who provided the best CAB lawyer in town, "Red" Schneider, the former general counsel for Pan American Airlines.

Confident of CAB approval, AtarCSI began to build a permanent building (now occupied by Informatics Software Products Group) on Vanowen Street in the Warner Ranch area of the San Fernando Valley, and placed an order with IBM to rent $7.5 million worth of System 360/65 computer equipment for the implementation of ATARS. While waiting for the CAB to act, it continued its preliminary marketing efforts by initiating discussions in Europe with the major international airlines, and by meeting with representatives from Hertz, Avis, Holiday Inns, and International Reservations Corporation to arrange an interface with the reservation systems of these travel service companies.(76)

Meanwhile the financing of AtarCSI and Informatics involvement with it continued during 1968 and 1969. At various times the original investors purchased stock, purchased warrants to buy stock, and loaned the company money. A private placement of $500,000 was made to Investors Diversified Services. By May 1970 capital of about $2,000,000 had been raised, of which Informatics had contributed $641,308 by May 1970. In addition, in June of 1970, $300,000 in cash had been obtained from International Reservations Corporation, a subsidiary of Planning Research Corporation, as an advance payment on an agreement for ATAR to supply services and issue warrants to it. A prospectus was prepared for a public offering of about $8,000,000 and filed with the Securities and Exchange Commission. Hayden Stone urged that the money be raised immediately, while the market was high, but the AtarCSI board decided that ethical conduct demanded that the prospectus become effective only after the CAB had approved the ATC agreement.

AtarCSI succeeded in selling the airlines and the travel agents and developing the system but ran up against a political obstacle with the CAB. The contract between the ATC and AtarCSI was filed with the CAB in May 1969. Almost immediately, the Justice Department, concerned about the monopolistic aspects of the system, filed a brief with the CAB requesting a full hearing, while Telemax, a competing company, filed its own brief claiming their system met requirements and that the granting of a monopoly was not justified. The CAB held hearings on the system in September 1969, and after months of delay ruled, late in 1970, that a thorough study and full evidentiary hearings would have to be held on the matter. This action effectively tabled any decision on ATARS since the time evolved in preparing a study and conducting hearings was at least two years, longer than AtarCSI could stay in business without additional financing.

The airlines ruefully agreed that (as AtarCSI had once suggested) they should have planned individual instead of joint contracts with AtarCSI, so that CAB approval would not be required. But it was too late. AtarCSI would have to

increase prices, there was a danger that all the previous joint action would produce a Department of Justice suit, and finally the 1970 recession prohibited the airlines from taking on new, more expensive commitments. The crowning blow came when the recession forced Hayden Stone into bankruptcy. By December 1970 the company had run out of money. No one was willing to invest more, so AtarCSI discontinued operations December 31, 1970, and was liquidated the following year. The investors lost all their investment and the major investors voluntarily put up enough additional money to pay final employee salaries, vacation pay due them, and other expenses of termination. Wagner returned to full time at Informatics. All the 30 employees were laid off, but helped by the excellent reputation of ATARS, immediately obtained better jobs in the reservations industry. Klarich became president of a small computer hardware company. Amaya became Vice President/Data Services of Pan American and evenutally chairman of the board of the Securities Industries Automation Company, a subsidiary of the New York Stock Exchange, and later executive vice president of Paine Webber.

Why did the CAB withhold its approval? Several answers have been suggested and speculated upon. One is, of course, that the potentially monopolistic nature of the system militated against CAB acceptance of it even though multiple suppliers would be economically unfeasible. Wagner says that the attorney, Red Schneider, believed that powerful lobbying efforts were carried on against the system with the CAB 1), overtly by American Airlines, which had made large investments to develop its own reservation system and planned to use it to monopolize the travel agent market, and 2) very secretly by American Express, which felt that a single nationwide computer reservation and travel services network was a threat to its own intended dominance of the travel industry. Also the airlines success in such a joint effort would encourage them to expand their ATP credit card as a competitor against the American Express credit card. Another possible answer may be suggested from remarks John H. Crooker, chairman of the CAB, made to the 1969 ASTA conference. Sympathetic to travel agents' concerns that the intended ATARS terminal rental price ($110 to $160 per month) was too high for many agents, Crooker indicated that CAB approval of the system would be delayed until the price issue was resolved.(77) ATARS never reduced its intended prices as cost studies indicated the system could not be installed in local areas for less, particularly for installations 50 miles or more from major metropolitan areas. (It is ironic that today travel agents are paying $350 to $500 per month <u>each</u> for several terminals, often from more than one airline, for service which still has many of the deficiencies that ATARS was designed to eliminate.)

In any event, the CAB never granted its approval and the system never got off the ground. It was perhaps several years ahead of its time. According to Walter Bauer, the investment in AtarSCI was strategically correct but tactically wrong since the timing required maximum cash during an unforeseen recession. Although Informatics cash investment did not exceed $700,000 (and it derived profits from a few hundred thousand in revenues for services which AtarCSI paid for) the quasi-reorganization of 1970 attributed a loss due to AtarCSI of $643,000 "after the effects of income tax."

4.4.3 Technical Information Systems Company (TISCO)

In April 1968 under the leadership of Werner Frank, Informatics entered into a agreement with Information Dynamics Corporation (IDC) of Reading (near Boston), Massachusetts, for a joint proposal to NASA for operation of the latter's Scientific and Technical Information Facility (STIF) located in College Park, Maryland. Information Dynamics, headed by David Waite, specialized in information abstracting and indexing along with micrographics services. It had served STIF on numerous occasions as a subcontractor but was too small in itself to fulfill all of NASA's needs at STIF. The NASA facility handled collection, microfilming, indexing, abstracting, photocomposing, and distribution of all research information related to space exploration and related fields and served the needs of government agencies, universities and NASA contractors in private industry. STIF was a "GOCO" (Government Owned, Contractor Operated) facility. Of interest to Informatics was the application of computers to library sciences and publishing, including the development and maintenance of a massive on-line data base of the literature.

The incumbent service company at the time of the 1968 proposal was Leasco (which had bought Documentation Inc., the prior incumbent, a company primarily interested in the development of state-of-the-art hardware for handling textual data.) According to Wagner, Leasco was a high-flying financial operation in the computer leasing business--its management knew little, and cared less, about technical problems. It was hoped that by combining the financial strength and computer software expertise of Informatics with the indexing, abstracting, and micrographic expertise of IDC (whose president, David Waite, and other principals were highly respected by the NASA officials in charge of STIF), the two companies would be able to unseat Leasco when the term of its service contract with NASA ended.

But, more importantly, the two companies believed that NASA officials were unhappy that high corporate officers in Leasco paid no attention to STIF's very important mission. They set out to convince NASA that what it needed was a technically advanced company totally dedicated to the mission of STIF. Therefore, to win the contract, rather than employing the normal prime contractor-subcontractor relationship, the two corporations proposed forming a joint venture company, called Technical Information Service Company (TISCO), 51 percent owned by Informatics, and exclusively dedicated to running STIF. Informatics offered the services of Richard Lemons, its vice president of Washington, D.C. operations, to serve as the new company's president, and proposed to supply TISCO with MARK IV (at no charge) for the rapid development of some badly needed management systems.

The proposed joint venture company was a brilliant marketing tactic to win a service contract, and it worked. Lemons was the proposal manager assisted by Waite. In August 1968 NASA awarded a $4.3 million cost plus award fee contract for a period of one year with options to renew for two more years if services were satisfactory. This was the largest contract obtained by Informatics up until that time, and with it Informatics found itself with a new subsidiary, Informatics TISCO, which was 49 percent owned by Information Dynamics.

The new company was capitalized at $50,000 but it was expected that loans from the owners of $225,000 more would be needed to finance operations. First year contract costs were estimated to run at $3,897,104, plus a fixed fee of $115,179 plus possible incentive award fees up to $266,651. Two hundred forty

employees at STIF transferred from Leasco to TISCO and approximately an additional 100 employees were hired from outside for the beginning of contract performance on December 1, 1968 under Richard Lemons. MARK IV was delivered to the subsidiary. With the beginning of the contract, Informatics backlog increased to $6,776,376, $3.7 million of which was related to TISCO.(78)

In the ensuing months, TISCO performed better than planned, receiving a 70 percent award fee for its first quarter of performance. Information Dynamics, however, which had little to do with the conduct of the STIF contract, had a change of mind and attempted to sell its interest in TISCO to Information Interscience Inc. The latter company made an offer to buy the whole company, but Informatics declined. Eventually, after some negotiating, Informatics bought Information Dynamics' 49 percent interest in TISCO in March 1969 for 17,000 shares of Informatics stock plus up to an additional 16,500 shares if the NASA contract were to be renewed until November 1974.(79) The intended joint venture became a wholly-owned subsidiary renamed Informatics TISCO, which served NASA for 12 years until 1980. (The corporation was subsequently liquidated.) More detail about TISCO and its enormous impact on Informatics is described in Section 7.2.

4.4.4 Equimatics, Inc.

The following section gives the story of the formation of Equimatics, Inc. Its participation in the insurance software and data services markets is described in Chapter 10. This joint venture was Informatics first major entry into a vertical industry market with proprietary products and services, a strategy which Informatics management had long foreseen as vital to its growth. In addition, it was another giant step away from dependence on U.S. Government business, and an entry into providing services of benefit to society. The later was becoming important because of the growing antipathy to military markets as a result of the unpopular Vietnam war.

The creation of Equimatics resulted from discussions between Informatics and The Equitable Life Assurance Society of the United States which began in the fall of 1970. The Equitable had been concerned that its vital internal data processing operations were becoming overwhelmed by new assignments and could not keep up with the growing demands of the organization for greater volumes of insurance data processing and implementation of new and more sophisticated systems. Furthermore The Equitable was also concerned that its institutionally oriented computer staff might lose expertise or fall behind the state-of-the-art in data processing in the face of the rapid increases in technology. The State of New York had recently passed a law permitting mutual life insurance companies to own "related" businesses, just as had previously been permitted for banks. Large insurance companies saw banks acquiring computer services companies and began to get similar ideas. All of this led The Equitable to seek outside computer services capability by hiring the investment firm of Goldman, Sachs & Company and the consulting firm of Arthur D. Little Inc. to perform an acquisition search for a computer services company to meet The Equitable's needs. These firms performed a study and determined that, of the acceptable candidates, Informatics was the best. They then approached Informatics in either August or September 1970 with an acquisition inquiry on the part of their unnamed client.

Informatics management was not interested in being acquired, but this was not the first time that it had been approached by such an offer from an insurance company and it was prepared to use the acquisition offer as an opportunity to explore and propose business possibilities more to its liking. During the previous year, Informatics had been approached by a representative of the Prudential, concerned about the same things as The Equitable, which had conducted its own study also using Arthur D. Little. (Wagner believes that they resold to The Equitable the knowledge gained at the expense of the Prudential). Arthur D. Little determined that Informatics was the best candidate, and George McNaughton, a very high level executive of the Prudential (who became its CEO during the course of the negotiations) came to Informatics directly with an acquisition inquiry. Bauer and Wagner persuaded McNaughton that inserting the entrepreneurial Informatics into the institutional environment of Prudential was doomed to failure. They persuaded him that a joint venture, focused on insurance industry data processing applications, would better achieve his objective. Discussions followed at Prudential's headquarters among McNaughton, Bauer, and Wagner. The Prudential insisted upon 51 percent ownership in the venture because of regulatory requirements. Informatics, based on its experience with TISCO, desired controlling interest in its business ventures and could not bring itself to agree. When McNaughton assumed the CEO position and turned the matter over to an underling, the negotiations fell apart. Afterward Informatics management changed its mind and realized it may have missed a significant business opportunity.(80)

So when Informatics was approached by Goldman, Sachs with an inquiry on the part of The Equitable, it had already "rehearsed" for the following discussions. It even knew many of the people it was dealing with at The Equitable, particularly Ruth Block and Harry Garber, since Mrs. Block was a well-known leader in the industry and Informatics had sold a MARK IV system to The Equitable's data processing services department.

Initial discussions with The Equitable occurred at its New York headquarters on September 29 and 30, 1970, with Walter Bauer, Werner Frank, Richard Hill, and Harold Richmond representing Informatics. David Harris, Harry Garber, Ruth Block, Norman Zimble (of Arthur D. Little, Inc.), and Roy Smith (of Goldman Sachs) represented The Equitable. In this meeting Informatics advocated a joint venture between the two companies which would have its primary interest in providing computer services to the insurance marketplace but which would not directly compete with either parent. This new company would develop "non-Equitable" related business of its own and would eventually have a public market for its stock. The Equitable would have 51 percent ownership at all times as required by New York State insurance laws and when the subsidiary sold stock to the public would have preemptive rights to enough additional stock to maintain its controlling interest, if it wished. Informatics would initially have less than 25 percent ownership, to avoid reporting the start-up losses of beginning operations on its corporate financial statements, but would have options to acquire up to 49 percent later in the life of the venture.

The Equitable would finance the venture, and Informatics management would contribute key personnel to the effort. It would play an active role in a market and business study for the joint venture, providing guidance on "how to set up and organize a profit making enterprise including matters relating to recruiting, accounting, personnel, administration, and the like." Informatics

would donate to the venture the use of its software products upon which to build and offer software services but not to resell directly to the open market.

By 1970 The Equitable had also begun a corporate development and investment program in which it was diversifying beyond the insurance business by acquisition of various companies in other markets as subsidiaries of Equitable Life Holding Corporation (ELHoCo) which it had set up for that purpose. The idea of a joint venture offered The Equitable the promise of solving the technical needs of its internal computing operations while at the same time offering a profit-making enterprise which would fit into its development plans.(81)

The Equitable agreed to these preliminary terms, and together the two companies agreed to pursue the idea by forming a joint venture study team. During the next four months, the study team met in both New York and at Informatics Canoga Park headquarters. By December 1970 a name, Equimatics, Inc., and a plan of capitalization for the new company had been adopted. In the development of this plan Walter Bauer and Thomas Taggart, a director of and consultant to Informatics, played a prominent part. The Equitable was to invest $6.2 million in the new company for which it would receive 283,120 shares of Class A stock which would be convertible into 70,780 shares of Class B stock. Informatics in turn would donate certain of its products, employees and technical talent to Equimatics in exchange for 50,000 shares of Class B stock and a two year option to purchase convertible stock or debentures up to $2 million, giving it 36 percent ownership before the conversion of The Equitable's stock and 25 percent ownership after conversion (or 35.2 percent ownership if it exercised its option). This gave The Equitable 51 percent ownership in Equimatics and 66 percent ownership after it converted its stock (or 55.8 percent if Informatics purchased one third of the convertible stock). An additional 18,000 shares of Class B stock were to be reserved for Equimatics management giving it 13 percent ownership before conversion and 9 percent ownership after conversion. Additionally, the new company would agree not to recruit employees from Informatics as long as The Equitable had controlling interest, unless eight years had passed with Informatics ownership less than 10 percent.(82) This complex deal gave Informatics, without any financial risk, a large "hidden asset," not visible on its balance sheet. It could suddenly appear there, at Informatics option, when and if Equimatics became profitable.

The study team also determined the directions the venture was to pursue and developed an initial long-range strategic plan for Equimatics to reach $100 million in annual sales within ten years. Werner Frank and Richard Hill, under Bauer's close direction, were the principal authors of this plan. The new company was to build upon the capabilities of its parents "without being totally dependent upon them" or competing with or duplicating their efforts by providing insurance oriented services "as a vehicle for participation in the future growth of the data processing software and services industry." Moreover, Equimatics was to seek markets and services which would be responsive to social needs:

> A strong objective of the joint venture company must be to relate the capabilities of modern data processing technology to emerging social needs. This is not to say that the profit motive is to be ignored; quite to the contrary. But, in seeking markets, primary attention should be paid to those

> areas which can result in direct, tangible social benefits--better health care, more efficient utilization of individual financial resources, better educational systems, etc. It is the aim of the joint venture to improve the social quality of life as environmental control specialists hope to improve its physical quality.(83)

With a business plan and capitalization, application was made to the Insurance Commission of the State of New York for approval of the joint venture. In the meantime, Werner Frank was selected to be the president and chief executive officer of the new company, to be called Equimatics, Inc., with David H. Harris, senior vice president of The Equitable, designated as its chairman of the board. While waiting for final approval from the insurance commission, Frank informally began looking for business and searching for a staff and a home for his new company. He found his first customer in Home Life Insurance Company which awarded a $500,000 contract for systems design of a life insurance policy processing system. A home was found in Fairfield, New Jersey, where Frank succeeded in locating a vacant building which formerly had been a computer center with its false floors and air conditioning system (required for large scale computer systems) still intact. This site would prove advantageous to Equimatics, allowing it to offer time sharing services to The Equitable's New York area offices without excessive communications costs. It eventually became the headquarters of Informatics Data Services Division after the merger of Equimatics and Informatics in 1974.

All of the foregoing activities were carried on under the corporate umbrella of Informatics because the New York Insurance Commission did not give its approval until almost an entire year later. Bauer and J. Henry Smith, The Equitable's president, signed the final agreement and Equimatics was officially incorporated on December 1, 1971. Werner Frank resigned from Informatics and was elected president and CEO of Equimatics. Bauer, Taggart, and Frank joined Equitable executives on the board of directors of Equimatics.

At the Equitable's New York City headquarters a press conference was held to announce the formation of the joint venture. At the conference the purposes of Equimatics were further explained. Smith elaborated upon the Equitable's reasons for participating in the joint venture:

> Life insurance companies today spend $1.25 billion annually for the development and operation of individually designed data processing systems, many of which represent a wasteful and costly duplication of effort. With the formation of Equimatics, we are combining knowledge and skill with financial resources to help lick this problem.
>
> The new company's early efforts will be to develop a nationwide communications network to improve the coordination of administrative and policy holder service functions between insurance company home offices and their field organizations. Although most companies are seeking more rapid and better integrated operations, present costs of communications services prevent all but the largest insurance companies from establishing their own networks.

Smith underscored his points with the forecast that life insurance companies would spend $7.5 billion annually in data processing services by the end of ten years, a six-fold increase in the present rate of expenditure. Werner Frank, speaking for Informatics and its reasons for the venture, gave the software company perspective:

> In the insurance industry, and others, many companies develop what are essentially the same systems. If a software and computer services firm is able to develop general systems that effectively meet the needs of many customers, everyone should benefit. To date, few software firms have attempted to acquire the in-depth industry knowledge and capital resources needed to do this. Equitable and Informatics together have the resources needed to provide this kind of service to industry. While we shall be concentrating in the insurance and health care areas for the present, we also see a bright future for business in other fields.

Frank further explained that Equimatics beginning activities would be spent in building a proprietary product line and establishing computer and data communications service facilities in Fairfield. He predicted that sales would be "modest in the first year--about $600,000." The company was to start business with 16 employees, and grow to a staff of 300 in three years and over 600 in five years of operation. Summarizing his colleague's comments on the venture, Bauer stated that Equitable's knowledge of the insurance field and Informatics experience in the software business should provide all the essential ingredients for success. "Together we intend to develop a company of the highest quality."(84)

Immediately, Frank set out to prove Bauer's remarks correct. He began recruiting a staff for Equimatics, including Harold Richmond who resigned from Informatics to become vice president, and Jay Callanan and Bob Wallach who came from Boeing Computer Services to head up the planned data services unit. A computer was ordered and installed in Fairfield. Soon timesharing services were being provided to The Equitable in the New York region and a contract was obtained from The Equitable to perform its Medicare claims processing. Most importantly, formal discussions began between Werner Frank and Paul Wrotenbery of United Systems International (USI) for the acquisition of USI by Equimatics. This single acquisition would place Equimatics in the forefront of software services designed for insurance applications and rapidly make the company the leader in its market.

4.4.4.1 United Systems International, Inc. (USI)

USI was formed in Dallas, Texas, in June and July 1969 from a merger between United Computer Services and Consolidated Life Systems, resulting in a wholly owned subsidiary of a holding company, The Unico Corporation. Consolidated Life Systems had been established in 1966. Its principals were Charles Barnaby, Charles Anglin, and Robert Potter, and it offered software consulting services for insurance applications. United Computer Services had been organized in 1968. Its CEO was Marion "Spec" Bradley, and it provided batch data services to the insurance industry. The formation of USI allowed the new entity to provide

an entire spectrum of computer services for the specific needs of the life insurance industry including data processing, custom programming, systems design and analysis, training, facilities management, and proprietary products.

Unico soon acquired (and ultimately changed its name to) Transport Life Insurance Company. It recruited Paul Wrotenbery and James Porter from Tracor Computing Corporation to manage USI. Wrotenbery, a Ph.D. in physics, had a number of years of experience in the computing industry and had worked at IBM where he became familiar with its insurance-oriented software products: CFO and ALIS. These products were designed for successive generations of IBM computers. CFO was a batch oriented system and ALIS was an on-line system. However, both systems did not meet the complete needs of insurance companies since they were mainly limited to policy "cycle" processing functions (the issuance of insurance policies to customers and the routine billing for them). ALIS in particular, despite IBM's large emphasis on it, had a bad reception by users of the IBM 360.

Under Wrotenbery's management, USI concentrated on providing training and conversion services for CFO and ALIS and designing proprietary software products which were enhancements to CFO and ALIS by adding extra processing functions. Three major software products were developed: Policy Issue Communication System (ISSUE-COMM), Stock and Bond Portfolio Management (Stock & Bond), and Mortgage Loan. The Equitable had purchased Stock & Bond and was one of six development sponsors for Mortgage Loan. Within three years after its formation, USI had obtained 46 customers in the life insurance industry and grew from $1.2 million in annual sales to $2.2 million. Profits increased from $118,000 to $121,000. The small growth in profits was due to costs associated with the new product development. Its workforce increased from 58 to 75 in the same period. In short, USI was successful in the beginning stages of the various forms of insurance support business which Equimatics desired to enter and develop.

During 1971 Wrotenbery sought investment funds from the Equitable for USI's software product development efforts. Already actively engaged in forming a joint venture with Informatics, The Equitable introduced Wrotenbery to Werner Frank. (Before Frank had been selected to head Equimatics, the recruiting firm of Davidson-Kernan had recommended Wrotenbery as a candidate for president of Equimatics.) Frank and Wrotenbery recognized that a number of common goals existed between USI and the intended Equimatics and that there was a great potential for synergy between them. Discussions of any joint corporate activity had to be discontinued, however, while the application for New York State approval was in process since such discussions might put the approval in jeopardy. After Equimatics was officially formed, Wrotenbery once again contacted Frank about possible mutual business opportunities. USI had developed several enhancement products to the IBM insurance systems and had reached a point where it felt that the functions of these several products should be tied together along with other planned products into one large-scale integrated life insurance processing and financial management system. The development of such a system required a sizeable investment, initially estimated to be $1-2 million. Thus Equimatics and The Equitable were likely project sponsors. For Equimatics, USI represented an on-going enterprise with expertise and customers in areas in which it was trying to enter. Discussions soon evolved into a possible merger between USI and Equimatics and a suitable agreement was reached.(85)

Under the agreement for acquisition of USI, Equimatics agreed to pay Transport Life $1.5 million in five $300,000 notes (guaranteed by The Equitable), payable at 6 percent interest, due at the end of each year beginning with the sixth year and ending at the tenth year of operations after the acquisition, and issue to Transport Life 11,000 nontransferable warrants for Equimatics stock, in lots of 2200 shares each, at an exercise price of $100 per share if Equimatics went public (which never happened). Equimatics also agreed to pay $75,000 in 4 payments to 15 former USI qualified stock option holders contingent upon their continued employment with the company and to issue 84,000 shares of Equimatics common Class B stock to USI management on a restricted basis. Transport Life was to deliver 100 percent of USI and "assure [Equimatics] profitability of certain [batch processing] facility management contracts," which referred to the fact that Transport Life, which accounted for 15 percent of all USI business, obligated itself under a five year contract to obtain all its data processing services from USI.

The acquisition of USI in March 1972 moved the timetable for Equimatics development two years ahead of plan in terms of revenue growth and product availability. Equimatics leaped from 16 employees to 75, from 2 customers to over 100, and from $600,000 annual revenues to over $2,000,000. The acquisition plan for USI summed up the less tangible advantages of the deal for Equimatics with the following:

> USI adds significantly to the future of Equimatics because:
>
> a) ISSUE-COMM is a terminal system suitable for installing on a network.
>
> b) USI's present facility management business is a good start for ultimately supporting a larger data processing system and obtaining larger processing clients.
>
> c) The other products give an entry point to the marketplace now, from a credibility point of view, and provide an opportunity to meet the customer with tangible offerings.

In the months that followed, the USI acquisition proved to be a winning move for Equimatics. Development began at USI on Wrotenbery's concept, the huge LIFE-COMM, a comprehensive modular integrated life insurance policy issuing and management system. Wrotenbery obtained development funds from several sponsors, and the Equimatics Board of directors authorized a budget for internal financial support. As described in Section 10.1.1, the product was designed and perfected and rapidly became the leading life insurance software product sold to large and medium size insurance companies. The product and consulting revenues became the mainstay of Equimatics.

But contrary to previous expectations, The Equitable did not become a major customer of Equimatics for software products, professional services or network communications, but it did become its largest customer for data services in time sharing and Medicare claims processing. The internal data processing department of The Equitable, perhaps threatened by Equimatics, refused to contract programming services to it and instead upgraded and streamlined its own operations by hiring several very talented and nationally known data processing

managers. According to Werner Frank, the original reasons for The Equitable forming a joint venture with Informatics soon dissipated.(86)

Nonetheless, Equimatics, bolstered by the USI acquisition, was a success right from its first year. According to The Equitable's internal news publication Equinews, after one year of operation it had a$3 million annual revenue rate, over 100 customers and employed 100 people. The Equitable's early pleasure with Equimatics performance was summed up in February 1973 with the following remark from David Harris:

> Equitable is only one of Equimatics clients and we have never intended that it would become a predominant customer. We expect Equimatics to grow and become an important factor in the data services industry, and this can only be accomplished by widespread recognition and a broad customer base. We do expect that Equimatics will be a substantial supplier of services to the Equitable--that was the original purpose in forming the company--but we do not expect that our share of Equimatics total business will overshadow its other efforts.
>
> We feel that the first year has been highly successful. We are ahead of our original expectations. The business is still in its infancy and has many of the growing pains of any new venture. **But so far, so good--indeed, very much so.**(87)

In its two full years of operation, fiscal 1972 and fiscal 1973 ending November 30, Equimatics had excellent financial results, compared to the plan prepared before it started. Figure 4-1 shows this comparison.(88)

The most significant advantage gained from the Equimatics joint venture is that it established a working relationship between Informatics and The Equitable whereby both managements came to know, respect, trust, and like each other. This working relationship eventually led to the most significant corporate restructuring of Informatics when it was merged with Equimatics and became a subsidiary of The Equitable. The merger allowed Informatics to embark on a long term development plan which allowed it to "plow back for investment" into itself its entire profits for a five-year period without having to pay dividends or show a return on investment to its parent company. This growth plan enabled the "new Informatics" to become a sizeable company earning over $100 million in annual revenues by 1978. The reasons for and details of this merger are discussed in Section 4.5 below.

4.4.5 Later European Efforts (P.A. Management, etc.)

Walter Bauer was ever alert to the need for Informatics to expand into the European marketplace. He became convinced that the only practical way to provide services (as distinguished from selling software products) was to have as partner(s) one or more European companies with European employees and a strong presence in several countries (see Section 4.4.1). So he, along with Werner Frank, studiously cultivated acquaintances with the heads of many companies in Britain and on the Continent. One of these was a British consulting firm, P.A. International Management Consultants Ltd. (PA), owned by a trust on behalf of its employees. Due to PA's structure a merger with

	FISCAL YEAR 1972		FISCAL YEAR 1973	
	Pre-Incorporation Plan	Actual	Pre-Incorporation Plan	Actual
Revenues	200	2,307	2,000	4,197
Profit (Loss)	(1,100)	(1,022)	(2,300)	(1,305)
Capitalized Assets	1,500	1,464	4,900	1,248
Long-Term Debt	0	1,500	300	1,500
ELAS[1] Investment	3,200	2,000	8,300	3,000

(1) Equitable Life Assurance Society of the United States

EQUIMATICS INC.

FINANCIAL PERFORMANCE SUMMARY
($000)

FIGURE 4-1

Informatics seemed difficult, but the two companies initiated a relationship by joining hands in 1970 to propose a study of European communication needs to the Conference Europeane des Administrations des Postes et des Telecommunications in 1971 with Informatics serving as subcontractor to PA for technical matters.

A formal long-range joint venture never came about, but a loose association was established in 1970. PA paid Informatics $70,000 for transfer of technical know-how. But these efforts did not lead to major business, although the association may have helped sell MARK IV in England and Australia. Fred Bacon, who was assigned to England for liaison with PA also conducted an extensive survey and made many contacts on the Continent. These were followed up by Bauer and Werner Frank. In several cases serious discussions with other European companies resulted, but in the end Informatics never found the solution to becoming a major participant in the European services market in Europe, until the Professional Services Group established its London office in 1978.

4.4.6 InfoDynamics

The construction of large nuclear power plants created the need for the management of enormous quantities of information. In surveying the possibility for providing information services to this industry, Informatics Information Services came in contact with a high level consulting firm, Management Analysis Company (MAC) in LaJolla, California, a subsidiary of Bayside Holding Corporation. MAC was engaged in providing various kinds of management consulting services to the nuclear power industry, in particular services that involved project management with emphasis on the safety of the finally constructed nuclear power plant. Conversations between MAC and Informatics led to the formation of a joint venture company, InfoDynamics, in December 1980. Informatics owned 51 percent of InfoDynamics and MAC owned 49 percent. Informatics paid into the company $51,000 for its shares and loaned it $102,000, and MAC contributed proportionately. Richard Lemons was chairman of the board of directors of InfoDynamics and Frank Wagner also represented Informatics on the InfoDynamics board.(89)

The design, construction, operation, and maintenance of all types of energy generating plants and large-scale synfuels projects constitute complex and costly undertakings whose successful management increasingly requires the effective organization, storage, and communication of vast amounts of information. InfoDynamics was formed to furnish pre-packaged and custom-designed software, as well as system development and on-site implementation services, network services, data center processing support, and turnkey hardware/software systems to meet information management requirements arising during construction and operation of power generation and synfuels plants.

It was believed that Informatics depth and breadth of experience in implementing a great many large-scale information management projects and its software and turnkey system capabilities would make a significant contribution to solving the extensive and vexing record and data management problems confronting the energy industry. It was further believed that MAC's close familiarity with the operational, economic, and technical aspects of the power generation industry and the energy field in general would assure that the services and offerings to be provided by InfoDynamics would be sophisticated and responsive.

InfoDynamics was headquartered in Rockville, Maryland, in the offices of Informatics Information Services. A liaison office was located in the MAC facilities in San Diego. Louis H. Vovakis, Informatics vice president of Information Resources Management Services, was named president and CEO. Robert C. Traylor, previously vice president and a founder of MAC, became executive vice president of the new company and soon succeeded Vovakis as president.

InfoDynamics had some modest initial success. A contract was obtained with the Public Service Company of Indiana for management information systems for a large nuclear power plant that it had under construction. However, other sales prospects proved slow to issue contracts. As the months went by the wisdom of continuing with the increasingly expensive construction of many of these plants came into question. It became apparent that the new company's market was not going to be large enough to make it profitable in the foreseeable future. So Informatics, in July 1981, sold back to MAC its 51 percent interest in InfoDynamics for its initial investment.

4.5 THE MERGER OF INFORMATICS AND EQUIMATICS

Equimatics, although smaller in size, was almost a duplicate of Informatics, its noninsurance industry parent, in its intended strategy for all types of computer services. The difference between the two was that Equimatics initially was focused on the insurance industry as a specialized market and potential customer base whereas Informatics had never limited itself to any one specific industry. By 1972 both companies offered software products, pursued custom services contracts, provided educational seminars and limited consulting services, planned to participate significantly in the data services marketplace and were exploring ways on how to enter it effectively. Both companies desired to become $100 million enterprises, and both were thwarted in their plans--Informatics by a very low price-earnings ratio for its stock, and Equimatics by a big shortfall in the expected business from The Equitable. Equimatics possessed products and a data center which had the potential to provide nationwide network computer services; Informatics possessed noninsurance products in the areas of financial, manufacturing and data base management, as well as systems implementation products--all of which could be offered through a timesharing network. The potential for synergy existed. Together the two companies could make a larger enterprise with a greater promise for growth and the ability to reach a $100 million annual revenue rate in five years.

Werner Frank first initiated merger discussions regarding the two companies. Frank persuaded David Harris, executive vice president of The Equitable, that a merger of Equimatics and Informatics would allow the former company to obtain its planned growth to $100 million in annual revenues much sooner and provide an attractive return on investment to The Equitable.

Over a period of several months discussions of the possible merger took place. Bauer was at first totally disinterested. As discussions between David Harris and Werner Frank continued, and as the matter was discussed internally, the idea of developing Informatics by re-investing profits (as a privately held company) finally took shape. Meanwhile, in spite of good growth in earnings, the price of Informatics stock continued to decline. Financial analysts were in the part of their cycle where they were disenchanted with software companies.

Bauer felt that the software industry would produce several sizeable companies in the 80's and began to believe the Equimatics-Informatics merger was the surest way to insure that Informatics would be one of those. It was a rare opportunity, seldom available to any corporate management, to be well financed and to have the right to plow back all profits into revenue growth, while at the same time not having to answer to stockholders who wanted immediate growth in earnings per share and to buyers who were unwilling to pay a good price for the stock even after the company produced respectable earnings growth. The result of the discussion and negotiations was that a suitable business plan was easily agreed upon.(90) Walter Bauer and Werner Frank were the principal authors.

The proper price for Informatics stock was a tougher problem. The stock market was very depressed, and prices for the shares of software companies were especially low. Informatics was selling in the range of $3.00 to $3.50 per share--about equal to the shareholder's equity of $3.25 per share. After many negotiations, The Equitable made its (ostensibly) "best and final" offer of $6.00 per share. On July 16, 1973, the Informatics Board of Directors voted to develop a definitive agreement for The Equitable to purchase Informatics at $6.00 per share "for the purpose of submitting such definitive agreement to the shareholders." They all felt morally bound to give the shareholders a chance to "bail out." This decision was publicly announced. Immediately thereafter several other large companies sent "feelers," hinting that they might top The Equitable offer. The most serious of these was the McDonnell Douglas Automation Company, but it never advanced a firm plan.

But some directors, notably Frank Wagner, felt that the price was too low, and that they had reservations about recommending to the shareholders that they accept such a price. Wagner believed that $8.00 was a minimum.(91) The Equitable did not want Informatics to present an offer to the shareholders unless it had the unanimous recommendation of the board. So eventually, later in 1973, The Equitable increased its offer to $7.00 per share. Then Informatics board unanimously (including Wagner) recommended, and its shareholders subsequently approved, that it be acquired by The Equitable and merged into Equimatics in return for payment of $7.00 per share for all outstanding stock. Employee holders of options for Informatics stock were reimbursed by generous cash payments tied to agreements for continuing employment. Top management agreed to five year employment contracts with a deferred compensation feature, and were given the opportunity to buy stock in the new company. An option plan was developed to motivate middle management.

Management was enthusiastic because of the ability to initiate an extensive investment program in new products and services in order to achieve its planned revenue and profit objectives, and a because of the good financial incentive plan to motivate management. The investment program was to be financed through a 100 percent reinvestment into the company of its profits for the first three years and a lesser percentage in years four and five. This "profit plowback" was to occur without the "new Informatics" having to show pretax profits to its parent, as long as the company increased its revenues and obtained a greater share of the data processing market during the investment period from 1974 to 1978.(92) The five year plan for the merged company predicted 1979 revenues of $76 million, and operating profits of $8.1 million.(93)

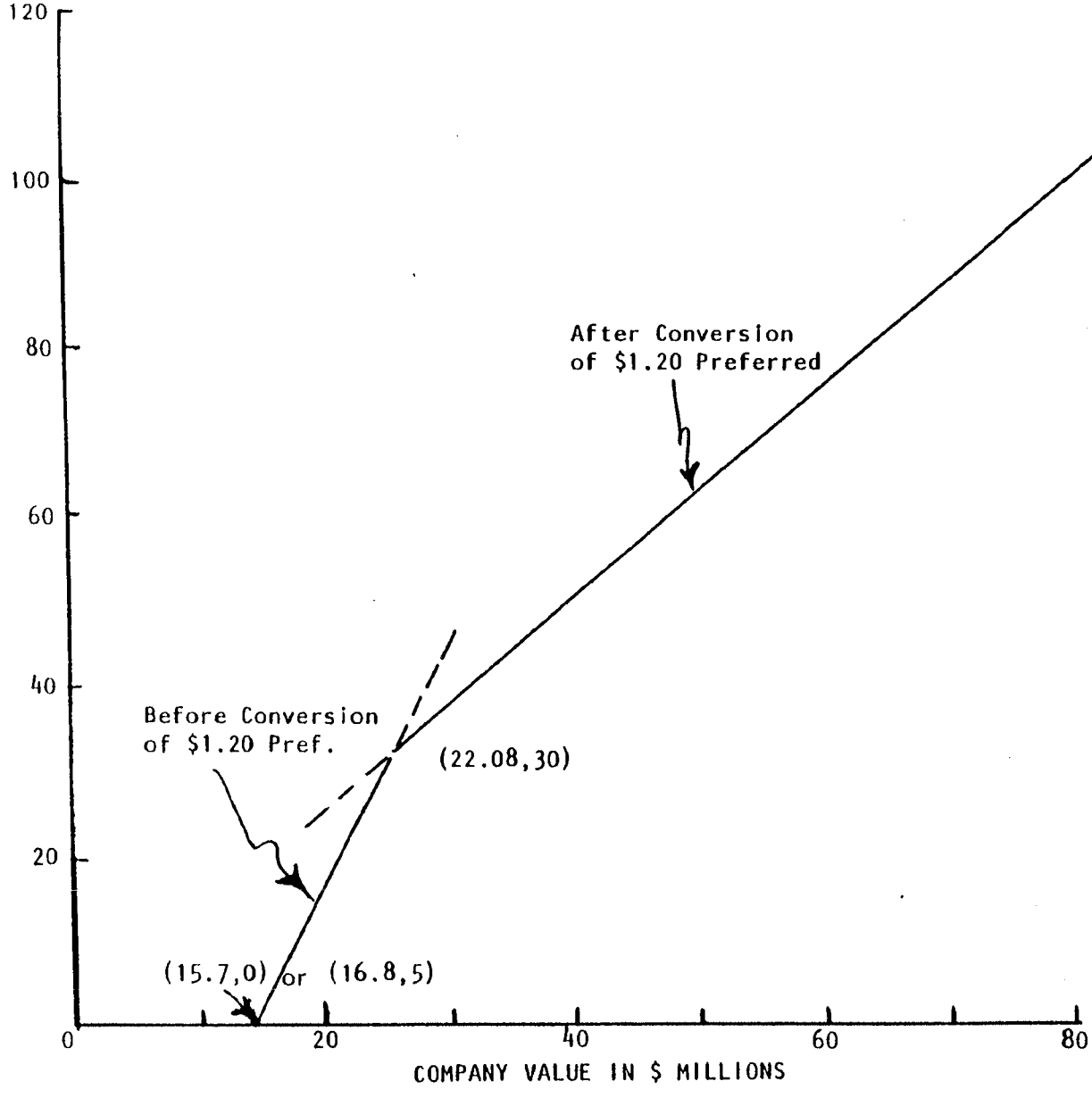
The term "operating profit" had to be used because of the form of the merger which gave rise to an unusual accounting treatment of the acquisition costs that The Equitable incurred in excess of the net assets that it acquired. These remained on the "new Informatics" balance sheet. It was decided to charge such costs to expense over five years, creating enormous pretax losses for Informatics. This procedure was desirable for two reasons: 1) Equitable Life Holding Corporation (ELHoCo) would file a consolidated income tax return so that such expenses could offset any of the profits that it expected to record from other acquisitions (it turned out that, except for Informatics, there were not many profitable subsidiaries); and 2) the expense would be gone after the five year investment period, and hence not reduce earnings thereafter when the company was expected to go public again. However, Informatics management wanted the discipline of operating to a planned profit so it used operating profit prior to such charges as a measure of its success.

The logistics of the merger were complex. On February 28, 1974, Informatics was merged, in a "reverse cash merger," into a newly created subsidiary of Equimatics Inc., ELHoCo's subsidiary. The merged company then changed its name to Informatics Inc., (the "new Informatics"). Equimatics Inc. was then liquidated into (the new) Informatics Inc. After a complex series of stock conversions and purchases, described in Section 3.6.3, the capitalization of the reborn Informatics Inc. emerged as follows: ELHoCo, a wholly owned subsidiary of The Equitable Life Assurance Society of The United States, owned 198,333 shares of $1.20 Preferred Stock, convertible into Class B Common Stock. There was a nonconvertible $2.00 Preferred Stock, of which ELHoCo owned 66,750 shares, and the management of the old Equimatics Inc. owned 3,275 shares. ELHoCo owned 66,750 shares of Class A Common Stock and Informatics management owned 39,000 highly restricted shares of Class B Common Stock which they bought for $5.00 per share.(94)

This intricate capitalization was designed to give ELHoCo voting control of Informatics but also to give enormous leverage to the owners of Class B stock, until such time as the value of Informatics reached a level that would induce ELHoCo to convert all its equity into Class B Common Stock. Figure 4-2 (95) is a chart which was prepared by Walter Bauer in 1974 to show the value of Class B Common Stock plotted against the company value in millions of dollars. It shows that the shares which management bought at a fair market value of $5.00, when the company was valued at $16.8 million, could theoretically grow in value to $30 per share if the company's value grew only to $22.08 million. After that it was assumed that ELHoCo would convert its preferred shares to Common Stock, and the ratio of a common share value to company value would take a more normal course. Goldman, Sachs invented this structure; Walter Bauer and Thomas Taggart were very influential in developing the details.

An interesting sidelight in this whole process is to observe how Werner Frank, CEO of a 16 employee company (the original Equimatics) first used Equitable's capital to acquire USI with 59 employees and then Informatics with approximately 1,000 employees. First the minnow swallowed the trout, and then the whale! But he gave up his CEO position in the process.

After the merger David Harris became chairman of the board which had a majority of members designated by the Equitable and Bauer, Frank, Wagner, Wrotenbery, and Taggart from Informatics. The new board then elected all the



LEVERAGE FOR CLASS B STOCK IN "NEW" INFORMATICS

FIGURE 4-2

YEAR	NAME	SEE SECTION	INITIAL PRICE ($000)(1)	RESULTS	COMMENTS(1)
1964	Advanced Information Systems	4.2.1	(38)	Major Success	Led to MARK IV which had over $38M profits.
1965	Data Processing Systems, Inc.	4.2.2	40	Minor Failure	Lost $70,000 prior to liquidation in 1965.
1965	CPM Systems, Inc.	4.2.3	32	Minor Failure	Lost over $100,000. Liquidated in 1967 for $10,000.
1965	N.V. Informatica	4.4.1	0	Indifferent	Formal joint venture agreement never signed.
1967	AFAR Computer Systems, Inc.	4.4.2	2	Major Failure	Write-off losses recorded as $643,000 after taxes.
1968	TISCO	4.4.3	26	Major Success	Foundation for Information Services which produced over $20M profits.
1968	Computing Technology, Inc.	4.2.4	675	Major Success	Major part of Computing Technology Company's growth during 1970's.
1969	Rucker Data Centers	4.2.5	1,628	Major Failure	Operating losses over $700,000; write-off $2.0M. Liquidated 1971.
1969	Dataplan, Inc.	4.2.6	1,600	Major Failure	Operating losses over $200,000; write-off $1.4M. Purchase later rescinded.
1970	Equimatics, Inc.	4.4.4	0	Major Success	Significantly profitable; led to Informatics acquisition by Equitable.
1970	Association with P.A. Management	4.4.5	(70)	Indifferent	Nothing important ever happened.
1971	United Systems International	4.4.4.1	1,600	Major Success	Changed Equimatics from struggling startup to power in life insurance.
1972	Parsons & Williams A.G.	4.2.7	50(2)	Indifferent	Early losses offset by later profits from professional services.
1972	CL*IV	4.3.1	137	Minor Failure	Never achieved acceptance in the marketplace. Produced small losses.
1973	CS IV	4.3.2	325	Minor Success	Cornerstone of Publishing Services Division. Produced steady profits.
1973	Asystance Co.	4.2.8	100(3)	Major Failure	$2.5M losses offset by sale price of about $300,000.
1973	SDA	4.2.9	425	Major Success	Always profitable. Contributed to Information Services growth.
1973	Knowledge Networks	4.2.10	100(3)	Indifferent	Never operated autonomously. Contributed to success of RECON IV.
1974	System Three Inc.	4.2.11	89	Minor Failure	Small operating losses and write-off on liquidation in 1977.
1975	Computer Applied Systems Co.	4.2.12	160	Major Failure	Losses included in results of Asystance Co. above.
1975	Programming Methods, Inc.	4.2.13	235	Major Success	Products broke even; professional services produced $20M profits.
1977	Direct Dial Data	4.2.14	50(3)	Minor Failure	Losses of about $200,000. Liquidated in 1978.
1977	Management Horizons Data Systems	4.2.15	3,400	Minor Success	Revenues grew. Initial modest losses; steady profits after amortization.
1977	SERIES IV	4.2.16	120(3)	Minor Failure	Losses over $200,000. Sold in 1980 for $120,000.
1978	INQUIRY IV/IMS	4.3.3	0(2)	Minor Failure	Lost over $0.5M. Almost achieved break-even in 1982.
1979	TRANS IV	4.3.4	100(2)	Major Failure	Lost over $2.0M; still losing at end of 1982.
1980	Decision Strategy Corp.	4.2.17	750(2)	Major Failure	Over $2.0M loses; still losing in 1982.
1980	InfoDynamics	4.4.6	51	Indifferent	Idea was failure. 51% ownership sold back to partner at cost.
1981	Transportation Computing Services	4.2.18	2,800(2)	Major Failure	Losses over $2.0M; later sold back to management.
1981	Professional Software Systems	4.2.19	1,000(2)	Minor Success	Revenues doubled. Initial losses offset by subsequent growing profits.
1981	Automated Systems Design Corp.	4.2.20	450	Major Failure	Losses of over $0.5M offset by sale for $100,000.
1981	Management Control Systems	4.2.21	2,500	Major Success	$300,000 profits in 1982 after amortization.
	TOTAL		Approximately 15,500	Aggregate Profit Less Losses: Approximately $70.0 million	

(1) Most numbers are approximate and before taxes except as noted.
(2) Plus formula payout, included in subsequent performance noted in comments.
(3) Precise records not available; as estimated by F. Wagner

SUMMARY OF

ACQUISITIONS AND JOINT VENTURES

FIGURE 4-3

senior officers of "old Informatics" as its management. Bauer became president and CEO of the new corporation and Werner Frank became executive vice president. Frank Wagner became senior vice president and Albert Kaplan was re-elected vice president-finance. Wilson Cooper, Richard Kaylor, Richard Lemons, and John Postley were re-elected vice presidents. Paul Wrotenbery was also elected a vice president of the new corporation. The old USI organization of Equimatics Inc. in Dallas remained intact as the Equimatics Company of the "new Informatics," under Paul Wrotenbery. The Fairfield data services division under Jay Callanan, vice president and general manager, became Informatics Data Services Division of the Computing Technology Company under Richard Kaylor. Informatics continued to operate just as it always had. MARK IV Systems Company, Information Systems Company, and Western Systems Company were unchanged. Some more formality was introduced to suit Equitable's management style, and certain acquisition activity was inhibited until the company learned how to expedite approval by the New York State Insurance Commission.(96)

4.6 SUMMARY AND EVALUATION

As can been seen from the previous sections of this chapter, Informatics has been quite aggressive in seeking external growth. Figure 4-3 summarizes these ventures. There were 32 of them in the 17 years from 1964 through 1981, an average of nearly two per year. The total of the initial prices paid amounted to approximately $15.5 million. As noted in the comments under "Results," in many cases the subsequent losses far exceeded the initial price.

The column entitled "Results" classifies these as follows:

Major Success	- Subsequent profits or value of contribution to growth of the company significantly exceeds the initial purchase price.
Minor Success	- Modest subsequent profits or contribution to growth of the company.
Indifferent	- Had no significant impact on the success of the company.
Minor Failure	- Subsequent losses were modest and/or contributions to company growth were not significant.
Major Failure	- A disaster. Total losses were very significant; in most cases operation was eventually terminated.

Applying these criteria is, in some cases, subjective; many of these ventures could be classified in an adjacent class. Be that as it may, Fig. 4-3 shows that of the 32, there were 11 successes--8 major and 3 minor. Five were indifferent. There were 16 failures--9 minor and 7 major. It is hard to say which were the greatest successes. Advanced Information Systems, TISCO, and Programming Methods Inc. would all be worthy contenders for the top places, since each led to over $20 million in profits. Nor is there any single outstanding failure. Contenders for the worst disaster would include the Rucker Data Centers plus Dataplan, Asystance plus CAS (ACCOUNTING IV), Decision

Strategy Corporation (TAPS), and Transportation Computing Services Corporation, each of which lost $2.0 to $4.0 million. But on balance, it would seem that, through 1982, the total profits from the successes significantly exceed the total losses from the failures by approximately $70 million before taxes, considerably more than the total initial prices of approximately $15.5 million.

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