

## Articles

### "Why Aren't More Companies Going Private?"

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How quickly times change! Just a few years ago companies rushed to go public to cash in on the insatiable demand of investors for speculative stocks. Today many of them have failed. More than 14,000 public companies trade; many of those perceive little benefit in being public.

Paul Allen's proposed buyout of Plains Resources underscores the recent increase in going private transactions, but given the thousands of public companies, the volume of going private transactions remains small. "Going private" means simply no longer being registered as a public company with the SEC and no longer being actively traded. The exact structure of the going private transaction varies---the usual forms are a cash tender offer, a "cash out merger", or a reverse stock split. Most transactions are for cash. For profitable companies many going private transactions involve management teaming up with money sources to buy the shares held by the public. For small companies with very small public participation, however, the cost of buying out public shareholders may be minimal.

#### LET'S GO PRIVATE!

The reasons for going private often appear compelling.

- **Lower legal and accounting costs.** Being public is expensive; the Sarbanes Oxely reform legislation (SOx) has made costs soar, particularly for accounting and legal costs. Direct external expenses are often estimated at \$500,000 to \$1,500,000 even for small public companies.
- **Elimination of major internal costs.** Internal costs are substantial. Senior management spends 10-20% of their time addressing SEC matters and "market support" activities. SOx compliance makes this more demanding than ever. Internal costs of being public also range from \$500,000 to \$1,000,000 for most small companies.
- **Out of the limelight.** By going private, a veil is placed on the most sensitive of the company's information. Competitors, employees, customers and suppliers can no longer find public SEC filings a fertile source of information.
- **Taking Care of Business.** The diversion that public company status imposes on management is eliminated; management can spend full time running the business and thinking long term. Long range thinking is discouraged in public companies since consistent quarterly results are the measure of success.
- **Let's Make Some Money!** Most managers have a good idea where their business is going. If a company is doing well and going private can be of monetary benefit to management, management will consider it. Companies in out of favor industries, companies with unfairly low valuations, and highly liquid companies will find themselves targeted by others if management does not seize the opportunity for themselves.

#### GOOD IDEA, BUT...

Going private is a daunting task, particularly given the practical and regulatory issues. Most transactions take more than six months to complete. There is a lot of work, and transactional costs are high.

- **Structural Limitations Narrow the Candidates.** Few companies fit the mold required to go private. Equity requirements are much higher now, and buyout transactions often involve complex capital structures.
- **Lawsuits Are Almost Certain.** Going private in most instances involves litigation claiming inadequacy of the buyout price. The most spectacular recent example involves the Quizno's sandwich chain; the judge ruled that the \$8.50 buyout price was woefully understated and that the fair value of the stock was \$32.50!
- **It's Time Consuming and Expensive.** To protect the investing public, an elaborate process has developed to become private. If a company wants to pursue a going private transaction, all of the following actions must be taken:

An independent committee of the Board of Directors has to be formed.

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The independent committee evaluates the fairness of buyout proposal. To do so, it must engage independent legal counsel; hire independent investment banking advisers; evaluate the fairness opinion rendered by the financial advisers, review alternative transactions; and follow detailed processes to sustain the committee's decision if challenged.

SEC filings are required, principally a Schedule 13E-3, with much of the required information may involve difficult fulsome disclosures.

Projections furnished by management to the board or the independent committee or its advisors must be disclosed, destroying a great deal of the privacy sought in going private.

- **The Company's Business is Disrupted and Managers Cannot Attend to Business.**
- **The Management May End Up with A More Severe Master.** The funding sources for buyouts have rigid financial requirements. New financial partners frequently minimize new capital investment and insist on maximizing cash flow, which is often dedicated to debt reduction rather than to enterprise growth. The history of buyouts is littered with discouraged executives who found their new "masters" much more difficult, demanding and intrusive than the public ever was.

### SO SHOULD WE GO PRIVATE?

Going private may be a real opportunity for some issuers. Each company is different; for some companies, going private makes sense even given the time, expense and difficulty. The candidates for that kind of transaction are few. In any event, if the process begins, it must be performed with great care and foreboding.