



Do Not Disturb; Is life really better without Sarbanes-Oxley and quarterly earnings calls? Three public companies that went private say yes.

By Susan Greco

January 2005

David Hochberg, a current vice president and former director of Lillian Vernon Corporation in Rye, New York, doesn't give much thought to the Sarbanes-Oxley Act of 2002 these days. Worries about recruiting more independent board members to satisfy new stock exchange listing standards don't bother him either. Nor is he concerned about answering questions about quarterly earnings reports. And Hochberg doesn't have any regrets about shedding these old duties. "Investor relations was 25 percent of my job before. Not any more," he says. Not since Lillian Vernon went private in July 2003 with the help of New York-based private equity investment firm Ripplewood Holdings LLC in a deal valued at \$60 million.

Ask RWD Technologies, Inc., chief executive officer Laurens "Mac" MacLure if he misses having to document internal controls under section 404 of Sarbanes-Oxley or having to certify the company's financials or bring outside directors up to speed. Baltimore-based RWD went private in 2003. "The last year has been absolutely delightful in not having to worry about the composition of the board and the criteria of Sarbanes-Oxley and the tight reporting requirements," says MacLure.

Envious of their freedom? You're not alone. Nearly one in four of the 85 companies surveyed in 2004 by the Milwaukee-based law firm Foley & Lardner said it was considering going private because of the cost of recent governance reforms. Depressed stock prices can be an even more powerful motivator, making it easier to buy back publicly traded shares. "Things like section 404 push more companies to want to go private, but it all comes down to economics in the end," says Ian Cookson, a corporate finance director at Chicago-based consultant Grant Thornton LLP, who has studied the rise in companies announcing privatization plans since the passage of Sarbanes-Oxley.

More businesses-especially those backed by private equity capital-are making those ideas a reality. In 2003 some 99 public companies announced their intention to go private through buyouts involving financial acquirors, according to Los Angeles-based FactSet Mergerstat LLC, which tracks mergers and acquisitions. (Deregistering through reverse stock splits is also an option, especially for smaller companies.) That number represents a nearly 100 percent increase over 2002. In 2004 the pace of those deals slowed, according to some analysts. But last year stood out for \$1 billion-plus transactions-involving companies such as Cox Communications, Inc., AMC Entertainment Inc., and US Oncology, Inc.-that lifted private deals out of the financial ghetto of small cap "distressed" stocks and into the respectable neighborhood of the Fortune 1000.

Is the grass really greener on the other side of the public-private fence? Two years after the passage of Sarbanes-Oxley seems like a good time to find out, especially while the stock market treads water and the private equity markets are still flush with money.

The three companies profiled below—RWD Technologies, Quintiles Transnational Corp., and Prophet 21, Inc.—have all gone private in the past two years. Each business has a very different story, but they sound a common theme: They like life as a private company better. Going private doesn't mean forgetting about good corporate governance, but businesses can now cherry-pick the practices that suit them best. On the basis of conversations with directors, officers, and advisors who worked on these and other going-private deals, a few specific lessons stand out:

It gets worse before it gets better. For the roughly 6 to 12 months that it takes to complete a going-private transaction, the time and expense of complying with Sarbanes-Oxley and related laws only grows. There's more Securities and Exchange Commission oversight, more reporting, more threats of shareholder lawsuits, and more reliance on special committees.

"The going-private transaction is really the 800-pound gorilla of the securities world," says John Russell, general counsel and board secretary at Quintiles, a Durham, North Carolina-based contract research firm. "The laws and regulations make it more difficult to buy [the company] back from the public than to sell it to the public."

The board changes, although not completely. Often the existing board is dissolved on the day shareholders approve the buyout. Afterward, the role of the board inevitably changes when, typically, the majority of directors are investors and executive-owners. Such boards are not likely to meet as regularly or for as much time. Independent directors are also rarer on private company boards. **Mitchell Hollin, a partner at LLR Partners, a middle-market private equity fund based in Philadelphia, says that he and his partners like to have some independent directors on the boards of the 16 private companies that LLR has invested in. "Whether it's one or two or three depends on the size of the board. It's not going to be a majority," he says. LLR requires nonmanagement directors on the audit and compensation committees for all its boards, he notes.**

You get a fresh start, but you're still on the hook for past performance. Being private doesn't protect you from any financial misstatements your business made as a public company. (That's one reason outgoing directors on the special committee in charge of evaluating the going-private deal typically negotiate a "tail policy" on their D&O insurance. It guarantees coverage for years after they're gone.) And going private is no time to brush aside accounting disputes. In 2003 Warrantech Corporation, a Bedford, Texas, provider of service contracts and warranties, attempted to go private during an SEC review of the company's financial statements, but three months later abandoned the effort in order to "focus on resolving outstanding accounting issues," according to a company statement. (Warrantech is still public and has restated the last four years' financial results.)

You can't completely escape Sarbanes-Oxley. Once a company is private, the CEO and CFO no longer have to certify the financial statements as per Sarbanes-Oxley, right? Yes, but. **Private equity firm LLR Partners, for example, doesn't require the executives in its portfolio to certify the numbers—but deliberate misrepresentation of financial results would be grounds for termination, says Hollin. He also notes that some lenders required their own versions of signed certifications long before SOX came into existence.** Other banks are relying on auditors' heightened standards to sniff out problems that can lead to fraud and misstatements, says John Vail, a corporate partner at Quarles & Brady in Chicago. "Auditors are using these standards for private and public companies," Vail notes.

Plus, if you ever want to go public again or merge with a public company, you can only hide from Sarbanes-Oxley for so long. "I'd be very surprised if any private company does a 404 audit," says Foley & Lardner corporate and securities partner Thomas Hartman in Washington, D.C. "But the company may put in the controls if it's thinking about going public or being acquired."

Company: RWD Technologies, Inc. (Baltimore).

The deal: \$11 million buyout by chairman and president Robert Deutsch of the 35 percent of shares he did not already own.

Completed: September 2003.

RWD Technologies founder Robert Deutsch, 80, had several reasons for wanting to make his technical consulting firm a private company again, according to his CEO. First was the company's sagging stock price. "With the stock options underwater, the purpose of being a public company was defeated," says CEO MacLure. Then the advent of Sarbanes-Oxley provided "the final impetus" to go private, MacLure says.

Among the most time-consuming SOX requirements, MacLure says, were the certifications of financials by the CEO and chief financial officer. In addition to the time spent preparing the financial statements, the 12 members of RWD's internal compliance committee each spent four to eight hours per quarter reviewing the numbers.

"It's been a huge relief" for the company to get a break from SOX, says MacLure. The consulting firm has returned to positive cash flow and profitability in its first SOX-free year, he says.

It wasn't only Sarbanes-Oxley that grated. At least one of the new stock exchange rules didn't sit well, either. Deutsch says that he didn't want the majority of the board to be independent directors. "Most [outside] directors are part-timers, and we have a complex business," Deutsch explains. "We're making decisions that can make or break a company, and [the outside directors] just don't have the background to help us. They're bystanders." Now the RWD board has no nonmanagement directors. "The meetings feel much different," says MacLure. "We don't have to spend all this time reporting to outside board members." He adds, "Before, we'd spend three-quarters of meetings reviewing what had already happened. . . . [Now] we still look back, but we spend more energy on where we're going and how to get there."

Another noticeable change: The board reviews the company's performance in real time, but the company can take more time to finish its annual audit, since it is no longer under any disclosure deadline. The CFO can be more proactive because he can spend less time on the "care and feeding of the board and audit committee," MacLure says. He estimates the business has eliminated at least \$1.5 million in costs associated with being public, with the biggest savings in directors' fees, travel, and D&O insurance.

"We do feel liberated from Sarbanes-Oxley," says MacLure. "However, we still believe in good corporate governance, and SOX will probably creep back into our lives, because it's a standard bankers expect us to adhere to. . . . We'll have a brief respite [from the regulations], maybe for another year or two. When we increase our line of credit, we'll have to comply again with SOX requirements."

Company: Quintiles Transnational Corp. (Durham, North Carolina).

The deal: a \$1.89 billion buyout by a company founded by chairman Dennis Gillings and One Equity Partners LLC.

Completed: September 2003.

Quintiles GC Russell notes, "If your motivation is to get to a point where you're not governed by the securities process and regulations, I think those days are over." His company went private because it wanted freedom from Wall Street analysts, not regulation, he says. If there was a deciding moment, it came in July 2002, when Quintiles announced a transaction with Eli Lilly and Company to copromote a new drug "which we thought was revolutionary," recalls Russell. "But after the deal was announced, our stock went down." The next month, CEO and chairman Dennis Gillings told the board that he was interested in taking the company private.

But the process wasn't easy-or cheap. Fees and expenses connected to the transaction totaled about 5 percent of the deal value, or \$100 million over 14 months, according to the company's proxy. Advisory fees and expenses topped the list at \$51 million. Within weeks of Gillings's proposal in October 2002, seven shareholder suits were filed, charging the board with breaching its fiduciary duty by entertaining the chairman's initial offer of \$11.25 per share. In the end, though, the chairman and his backers sweetened their offer to \$14.50 a share; the company settled the shareholder suits after the offer price went up.

Ironically, after the last share was tendered and QTRN ceased trading on Nasdaq, Quintiles was, well, not quite private and not exactly public. Because of its public debt, the company's reporting requirements haven't substantially changed. While the board no longer holds conference calls with financial analysts or annual meetings for shareholders, the company must still file quarterly and annual financial reports with the SEC.

How far a company like Quintiles must go to comply with Sarbanes-Oxley is something of a gray area. "It's not a free pass from SOX," says Keith Higgins, a corporate and securities lawyer at Ropes & Gray in Boston. "You have to show internal controls over financial reporting. When you file a 10-K, you have to address the effectiveness of internal controls. . . . If you don't comply with all the requirements, you risk being liable for misleading statements."

Russell says the company has addressed such concerns. "We've been working on section 404 steadily," in anticipation of the company's first 404 audit in 2005, he says. "Section 404 is like in school when they said, 'Show your work.' We were doing most of it all along."

Company: Prophet 21 (Yardley, Pennsylvania).

The deal: a \$76 million management buyout led by Prophet 21 CEO Chuck Boyle, Thoma Cressey Equity Partners, and LLR Partners. Completed: January 2003.

Prophet 21 CEO Chuck Boyle says he took his distribution-management software company private because he wanted it to get bigger faster. As chief executive, he was eager to expand Prophet's sales by snapping up several rival businesses. "Management had desires to take a more aggressive growth strategy than the board," he says. However, two directors, chairman John Meggitt and his wife, Dorothy Meggitt, were also the founders and majority shareholders. **And the chairman, who was 71 years old, was "very risk-averse," says investor Mitchell Hollin of LLR Partners. "Whereas the management team wanted a growth engine." John Meggitt says that he became more cautious as he approached retirement and was "anxious" to see the company sold to "the benefit of all shareholders, including myself."**

Boyle says that Prophet's new board is better-suited than the old to oversee the company-although there is one fewer independent director-because the new directors have "a lot of business experience with growing through acquisitions." **The board includes Boyle, LLR's Hollin, and two partners from Chicago-based Thoma Cressey. Chairman Orlando Bravo of Thoma Cressey helped recruit two new independent directors: Marcel Bernard, a former**

president of Motorola Canada Limited, and Paul Olson, a former executive vice president of Sterling Commerce, Inc. "I never would have gotten them on my own," Boyle notes.

Still, says Boyle, the board's approach to governance hasn't changed dramatically. "At the board level we do a lot of the same things as before," he says. "We have an audit committee, a compensation committee. Both boards focused on direction, helping management develop the best strategy. Outside directors were well informed before, as they are now, and they're encouraged to challenge management." The real change, he says, came for the five members of the management team, who now hold a larger stake in the private company than they did in the public one.

Eighteen months after going private, Boyle says Prophet 21 is doing better than ever. The company has carried through on its acquisition plans, snapping up five rival software firms. "We have doubled our customer base and profits, and we have dramatically higher sales," says Boyle, who projects 2004 revenue of about \$75 million, up from \$43 million in 2002.

Is there anything Boyle misses about public life? "No, nothing," he says. "We like being private."

Freelance writer Susan Greco (susangreco@earthlink.net) is a former senior writer at Inc. magazine and coauthor of *Customer Chemistry* (McGraw-Hill, 2002).