

# Alternative Universe

YOUR WEEKLY ROUNDUP OF  
Hedge Fund &  
Private Equity  
MARKET NEWS

This Week » December 19, 2005 » Volume 3 » Issue 30

## The Cost of Being Public

BY MARC RAYBIN | Scanning the financial news in the waning days of 2005, one cannot help but be struck by the size of private equity exits in the last year. If this was the year of multi-billion dollar funds, 2005 was also the year of big exits. However, not all of the news was rosy, according to industry observers.

The sale of satellite operator PanAmSat by Kohlberg Kravis Roberts & Co., The Carlyle Group and Providence Equity Partners for \$3.2 billion, 3i's and Veronis Suhler Stevenson's \$2.3 billion exit of yellow pages company YBR Group and Bain Capital's sale of Canadian yellow pages company Advertising Directory Solutions for nearly \$2.1 billion are examples of what was a rather robust year for private equity sales.

Still, not everyone in the private equity community is convinced 2005 was such a banner year for exits.

"In 2005, there has been virtually nothing happening in the IPO realm," says John Taylor, director of research for the National Venture Capital Association. "What we have is a case of the kids having gone to college and mom and dad were expecting the kids to go off into the world and work, but now, the kids have come home for another year before going out."

Taylor uses this illustration to show the NVCA's concern about venture capital firms opting to make late-stage investments in portfolio companies rather than taking their investments public. For the 11 months ending Nov. 28, the NVCA reports a miniscule 39 portfolio companies having IPO'd, compared with 93 having gone public in 2004.

Taylor is not certain what the

While there were successful IPOs in 2005, regulatory issues forced some to remain private

impetus behind the IPO slowdown is, but he suspects it has mostly to do with the cost of compliance with disclosure regulations, namely the Sarbanes-Oxley Act of 2002.

"The rule of thumb that I have seen is, even for a relatively small public company, it is about \$2 million a year [to be in line with the law]," says Taylor. "If that is true, these companies just do not have the bandwidth in their financial statements."

In Taylor's view, why take on the unnecessary financial burden of going public when the firm can hold onto the portfolio company

into the later stages of development?

The question becomes whether or not listing a portfolio company on a stock exchange is really worth the burden.

"There are very few new companies where a \$2 million hit to the bottom line is not going to be noticed," Taylor says.

Taylor will not place the entire blame for the lack of IPOs on Sarbanes-Oxley. To be sure, there could be other reasons. Taylor acknowledges it generally takes up to three years for a portfolio company to be ready for a public offering. Considering sales for information technology companies, which generate a significant share of IPOs, reality did not pick up again until late 2003/early 2004, next year could be the start of private equity firms going to the public markets with

those types of portfolio companies.

"In some cases, it is a matter of the company simply getting its financials in better shape and having more of a track record so they can justify higher valuations," says Taylor. "We will not know what really is running the show until a year from now and we see what these companies ultimately do."

While Taylor decries the lack of IPOs in the venture market, there are investors in the private equity industry who struck gold by going public.

For Mitchell Hollin, a partner at LRR Partners since 2000, taking portfolio company Heartland Payment Systems (HPY) to the New York Stock Exchange was well

worth the cost of Sarbanes-Oxley compliance.

"It is the cost of doing business," says Hollin. "We viewed the attractiveness to the public market [compared] to the other markets justified that expenditure."

Heartland, which is headquartered in Princeton, N.J., provides credit card processing services.

The company has more than 70,000 merchants as customers and does \$21 billion in processing volume. According to Hollin, the business went public in August with a market capitalization of approximately \$500 million and that number has grown to around \$800 million. Hollin focuses on making investments in financial services, information technology and outsourced business services. He also serves on Heartland's board of directors.

Hollin agrees with Taylor in that the size of the portfolio company is

CONTINUED ON NEXT PAGE

"It is the cost of doing business," says Hollin. "We viewed the attractiveness to the public market [compared] to the other markets justified that expenditure."

## Financial Sponsor Backed Exits and Offerings

November 2005

This chart displays the number and value of global financial sponsor backed exits and securities offerings during November 2005, according to Capital IQ. The data is divided by sector and includes both buyout and venture capital firms. This data is intended to help market participants follow exit and refinancing activity sponsored by private equity firms. Values are in \$mil. Learn more about Capital IQ at [www.capitaliq.com](http://www.capitaliq.com)

November 2005

	no. of deals	value of deals
Energy	5	\$1,030.33
Materials	9	\$475.41
Industrials	41	\$2,875.09
Consumer Discretionary	37	\$16,172.22
Consumer Staples	4	\$50.40
Healthcare	11	\$2,499.67
Financials	10	\$1,727.13
Information Technology	48	\$2,022.14
Telecom Services	1	\$0.00
Utilities	2	\$2510.00
Total	168	\$29,362.39

Year to Date 2005

	no. of deals	value of deals
Energy	83	\$667,599.63
Materials	164	\$36,880.21
Industrials	478	\$89,803.35
Consumer Discretionary	398	\$119,982.89
Consumer Staples	73	\$10,012.76
Healthcare	255	\$28,975.02
Financials	169	\$68,307.03
Information Technology	553	\$70,877.00
Telecom Services	29	\$38,340.07
Utilities	21	\$77,411.64
Total	2,223	\$1,208,189.60

### About Capital IQ

Capital IQ, a division of standard & poor's, provides high-impact information and workflow solutions to over 1,000 leading financial institutions, advisory firms, and corporations. Its solutions are based on the capital IQ Platform, a unique combination of global private and public capital market data and technology that enables end-users to draw deep market insights, generate better ideas, leverage relationships, and simplify workflow. Clients can deploy the Capital IQ

Platform either as a standalone solution or seamlessly integrate its components into existing business applications and portals via systems integration and custom data feeds. For more information, please visit capital iq's web site at [www.capitaliq.com](http://www.capitaliq.com).

CONTINUED FROM PREVIOUS PAGE usually the determining factor in whether or not to go public.

"It is purely the byproduct of the scale of the business," says Hollin.

"The bar has been raised substantially, so smaller companies do not have the public company option."

Valued at approximately \$800 million, the price for being a public company for Heartland is not as drastic as it would be for a company the size Taylor is talking about.

LRR Partners is based in Philadelphia and focuses on making middle market investments in the mid-Atlantic and Eastern regions of the United States. The firm, which was founded in 1999, has more than \$600 million in capital under management and typically

makes investments as high as \$40 million.

Heading into 2006, both Taylor and Hollin have similar outlooks on what to expect.

Although Taylor does not foresee a return to the rapid-fire M&A heyday of 2000, he does envision the New Year bringing good tidings for exits.

"I see gradual improvement going forward," says Taylor. "In 2006, we will have companies that are more mature and are better positioned to go public or be acquired."

Hollin, who is cautiously optimistic about 2006 exit strategies for the private equity space, thinks investors today have become more rational about the use of leverage. Although there

is a lot of cheap debt floating around the marketplace, Hollin thinks investors will continue to avoid irrational exuberance.

"Fundamentally, I think we have a reasonably healthy economy that is supporting a reasonably stable capital market," says Hollins.

Taylor and the NVCA link the future of the IPO market as a viable exit strategy for venture capital firms in 2006 with what lawmakers determine on Capitol Hill regarding disclosure laws for public companies. Taylor knows changing Sarbanes-Oxley and other laws on the books is not on the fast track.

"I think the folks in Congress are starting to see what the cost is [of going public], especially for these emerging companies," says Taylor. "I think there is an awareness that things maybe went too far [and] there are things out there that can be done differently."

"I see gradual improvement going forward," says Taylor. "In 2006, we will have companies that are more mature and are better positioned to go public or be acquired."