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Exploring whether going private is the right option

You are a CEO, CFO or on the board of directors of a small-cap public company (let's call it "The Wannabe Mine Company"). Your stock is thinly traded, you have no analyst coverage, and when the stock price does move up or down it does not appear to be linked to any fundamental element of the company's performance.

INSIDER VIEW

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To add insult to injury, you are now required to comply with the provisions of the Sarbanes-Oxley Act. Compliance costs real money, has created an internal upheaval and has made it more difficult to retain and recruit outside directors for your board. It has also become a major distraction for you at a time when you and your team could be focused on growing and improving your business.

You can't help but ask yourself: Why is Wannabe Mine a public company?

At some point in time, Wannabe Mine launched an initial public offering to accomplish any number of objectives — from providing liquidity to creating an acquisition currency.

The IPO offered a cachet that was very seductive. It was an affirmation of the company and its business plan. Are any of these objectives being met today?

The thought of being a private company, unfettered by the chains of compliance and its attendant frustrations, has become the seductive alternative for you. But how do you get there?

In most "going private" transactions, a group of senior managers or other insiders, working in conjunction with private equity groups, mezzanine lenders and senior debt providers, sponsor a transaction where they offer to acquire the outstanding shares from the public. Typically — but not always — this offer is made at a premium to the current trading value of the stock.

The current capital markets environment could not be more supportive of going private. There is an abundance of private equity capital and senior and subordinated debt available to finance these transactions. At the same time, the public equity markets have largely ignored a whole class of high-quality small-cap companies that are consequently undervalued.

Not every company that desires to go private is able to do so. There are many ingredients to a successful transaction. They include:

- Unused debt capacity.
- Significant inside ownership.
- A modest trading multiple.
- Reasonable current trading value.

The more of these characteristics you possess, the higher your likelihood of success.

A going-private transaction is more than an exercise in financial engineering. There are a number of qualitative factors and deal dynamics that, if considered ahead of time, will increase the likelihood of success.

Normally, a group of insiders will present a proposal to the board of directors or seek their permission to explore a "going private" transaction. Ultimately, the shareholders will have an opportunity to express their opinion on the transaction if and when they are asked to vote or tender their shares. In the meantime, it is up to the board of directors to ensure that the anticipated proposal is substantively fair and the process leading up to and resulting in a proposal is procedurally fair.

In order to do this effectively, the board will probably set up a special committee, comprising disinterested members. That is, it must exclude any directors who would participate with management or any other party to a potential transaction. The forming of the special committee is but one example of the formalized communication protocol that needs to be established between management and the board to preserve the integrity of the process. Until now, such communication was probably very casual and informal.

A going-private transaction, by its nature, requires the involvement of a group of insiders. Because of this perceived conflict resulting from insiders buying out other shareholders, these transactions receive extra scrutiny from the SEC and other shareholder advocates. In addition, this increased sensitivity increases the risk that these outside shareholders file lawsuits over the perceived conflict of interest between controlling parties and minority interests.

In spite of these potentially complicating factors, the ultimate reward of being a privately held company with supportive financial partners can make the pursuit of a "going private" transaction worth the effort. The ultimate success of a "going private" transaction depends upon sound preparation, which will lead to a clear understanding of the transaction's viability, risk, rewards and other implications to all of the company's stakeholders.

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