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MARKETS

Tech companies 're-potting' in US

Stock-exchange arbitrage lures private-equity, hedge funds

By Alistair Barr, MarketWatch
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SAN FRANCISCO (MarketWatch)—David Liu, an investment banker at Jefferies Broadview in Silicon Valley, calls it "re-potting," but it could also be described as stock-exchange arbitrage.

In the past two months, Liu has helped private-equity firm Francisco Partners and hedge fund giant Och-Ziff Capital Management buy out technology companies listed on non-U.S. exchanges.

The targets—software company FrontRange Solutions Inc. that traded on South Africa's Johannesburg Stock Exchange, and Hong Kong-listed Superdata Software Holdings Ltd.—are now considering re-listing on the technology-heavy Nasdaq Stock Market (NDAQ) in the U.S.

The goal is to garner a higher valuation for the companies by tapping into a larger, more sophisticated investor base in a culture that appreciates technology companies more, Liu explained.

"In Asia, the mentality is that software isn't worth much, especially when you can find copies of Windows (Microsoft's operating system) in the local market for a dollar," he said. "So there's not so much respect for certain technology companies."

In South Africa, investors are more focused on the mining and resource companies that dominate the economy, he added.

The differences show up in the valuation of similar technology companies listed on different exchanges, Liu noted.

In Hong Kong, the few enterprise software companies that are listed have price-to-earnings ratios in the low teens, while traditionally license software firms in the

U.S. have traded between 20 and 30 times earnings on average for the past two decades, he said.

"Simple comparisons like this are difficult, but all other things being equal, a technology company listed in the U.S. could get twice the valuation of a similar company listed overseas," Liu added. "It's a form of arbitrage between U.S. and overseas markets."

Och-Ziff

Arbitrage was the original expertise of Och-Ziff founder Daniel Och, who in the 1980's worked at Goldman Sachs's (GS) risk-arbitrage group alongside other future hedge-fund leaders such as Richard Perry of Perry Capital, Thomas Steyer of Farallon Capital Management, and Eddie Lampert of ESL Investments.

Och-Ziff, which oversees more than \$10 billion, has been focusing in recent years on negotiating transactions that fall between the private-equity and hedge fund worlds.

The firm has also expanded in Asia, setting aside about \$1 billion to invest in the region.

Superdata

Superdata, which has a partnership with Intuit Inc. (INTU), agreed to be de-listed in December. Och-Ziff provided the capital—almost \$50 million—to make the transaction happen.

Och declined to comment.

Jefferies Broadview, the technology division of Jefferies Group (JEF), arranged the financing for the deal, which Liu thinks may be the first buyout in Hong Kong backed by a financial sponsor.

Morgan Stanley (MS), Platinum Securities and First Shanghai were advisers on the deal too.

Superdata Chairman Anbin Cen said the company's board decided to leave Hong Kong's Growth Enterprise Market (GEM) because its shares didn't trade enough to provide good liquidity for investors and the firm wasn't followed by any analysts.

That left the company with a "relatively low valuation given the rapid growth of the business," Cen added.

Investors in Hong Kong aren't that passionate about companies like Superdata, partly because most technology stocks on GEM haven't performed very well during the exchange's short history, Cen explained.

"Very few" investors understand technology companies and find it hard to imagine firms developing into successful giants like Microsoft (MSFT), Intel (INTC), Cisco Systems (CSCO), he explained.

"They don't have Silicon Valley, so it's hard for people to imagine these tech companies," Cen said.

Going public again on Nasdaq is one of Superdata's options, he added.

Two of Superdata's largest original shareholders were Chinese investment firms with experience of taking companies public in the U.S.: Baidu.com (BIDU) seed investor IDG Technology Venture Investment and CDH, which backed Focus Media (FMCN) .

IDG and CDH remain shareholders of Superdata.

FrontRange

FrontRange, which sells customer-relationship-management software and other business applications, was acquired by Francisco Partners, a \$2.5 billion private-equity firm, in December for more than \$200 million.

Neil Garfinkle, a partner at Francisco Partners, didn't return calls asking about the deal.

FrontRange started as part of a South African conglomerate, but ended up becoming the main entity within the group.

That left its shares trading on the Johannesburg Stock Exchange (JSE), despite the fact only about 5% of its revenue comes from South Africa and its headquarters are in Dublin, Calif., east of Silicon Valley.

Almost two-thirds of FrontRange's sales are generated in the Americas and the rest from other parts of the world.

Like Superdata, the search for a higher valuation was one of the main reasons FrontRange decided to go private and leave the JSE.

"The JSE would not be able to deliver the right valuation to a company like ours: a global software firm that's growing earnings and revenue," Kevin Smith, vice president of products at FrontRange, said.

"Multiples awarded to market leaders on Nasdaq are simply higher than on other exchanges."

Going public again on Nasdaq is one of several options FrontRange and Francisco Partners are considering, Smith added.

Politics

Vibrant stock exchanges are a potent sign of a country's economic health, so there was an aura of political sensitivity over the Superdata and FrontRange deals.

Superdata's Cen said he and his colleagues were concerned about the political fallout from a de-listing when they were initially discussing the plan. But working with Hong Kong regulators on the project didn't end up being difficult, he said.

Still, political and currency risks, combined with the challenges of language and the more volatile reputation of technology companies, meant that Och-Ziff wasn't able to issue any debt to finance the Superdata deal, Liu said.

FrontRange's Smith said the company didn't confront much political pressure, partly because shareholders had seen the stock rally strongly during the 18 months before the deal with Francisco Partners.

Unlike Superdata, the FrontRange buyout was partly financed with debt.

Blueprint

Despite potential political risks, Liu is hoping to re-pot other technology companies with private-equity and hedge-fund backing and sees candidates in countries such as Taiwan and Singapore.

"We now have a blueprint for taking a company out of these markets and we're looking at this globally," he said.

Alistair Barr is a reporter for MarketWatch in San Francisco.

