

Sunday, May 26, 2002

San Francisco Chronicle

Sailor seeks cache of dot-com cash

[Kathleen Pender](#)



Russ Silvestri, a former Olympic sailor, thinks you can still make money in crippled dot-coms.

No, Silvestri didn't get smacked in the head with a boom.

He's trying to take advantage of a little-known fact: Hundreds of companies that went public during the stock market bubble are still sitting on piles of cash, in some cases more cash than their stock is worth.

Of course, they're far outnumbered by companies that burned through every dollar and closed shop. But they're out there, if you know where to look.

Last fall, Silvestri went hunting for companies with "negative enterprise value." These are companies whose cash and marketable securities exceed their stock market value and long-term debt combined.

Theoretically, you could buy one of these companies, pay off its debt and still have more cash than you paid, thus turning a profit.

Most companies have positive enterprise value because investors assume they'll be worth more in the future. But when investors lose faith in a company, its enterprise value sometimes goes negative, creating an opportunity for so-called vulture investors.

Typically, these investors buy a stake in the company and might wage a proxy fight. Depending on their ambition and success, the dissident shareholders might gain control of a company and sell or liquidate it. Or they might settle for a board seat and try to force management to slash expenses, pay a cash dividend or take other steps to boost shareholder value.

Silvestri's search turned up 750 companies with negative enterprise value, including about 150 in Northern California. The list included companies like Cosine Communications, Tut Systems, Avant Go, Vicinity, Copper Mountain Networks and Versata.

After investigating dozens of them, he set his sights on Cotelligent Inc. of San Francisco, which started as a technology consulting and staffing firm but is trying to reinvent itself as a "provider of mobile business solutions and Web services."

On March 31, Cotelligent had \$23 million in cash and virtually no debt. Its roughly 15 million shares trade at 50 cents each, or \$7.5 million total.

Theoretically, you could spend \$7.5 million to get \$23 million.

There's just one problem: Like about half of U.S. companies, Cotelligent has adopted a poison pill that would make a hostile takeover prohibitively expensive.

"If I get to 20 percent of the stock, the company can double everyone else's ownership but mine," Silvestri says.

Undaunted, Silvestri's tiny San Francisco investment company, Skiritai Capital, spent \$338,000 to buy 626,000 shares, or 4.2 percent of Cotelligent. With investment partners, he controls 5.3 percent.

Most of the money came from Silvestri's bank account. He worked for Robertson Stephens for 10 years, mostly in venture capital services. He left in 1999 to train for the 2000 Olympics in Sydney. He placed sixth sailing in the 15-foot Finn class.

Afterward, Silvestri worked at a hedge fund for a year but quit to start his own company. "I was used to being skipper of the boat," he says.

He named his company Skiritai after the Spartan warriors who "were first into battle and rarely entered a battle they could not win."

Silvestri, 40, is running for one of Cotelligent's three board seats at the company's June 11 shareholders meeting.

"Our objective is to urge Cotelligent's board of directors and management team to immediately pursue a sale, liquidation or recapitalization of the company," Silvestri's proxy statement says.

Silvestri hopes to unseat Debra Richardson, who joined the Cotelligent board last August. She is dean of the computer science school at UC Irvine.

The other directors are James R. Lavelle, Cotelligent's founder, chairman and chief executive; and Tony Frank, a noted local businessman who was chief executive of First Nationwide Bank and U.S. postmaster general.

Officers and directors control 16 percent of Cotelligent's stock.

If he wins, Silvestri hopes he can persuade Frank, who has been on the board since 1993, to side with him and overturn the poison pill.

Frank is out of the country. Richardson did not return phone calls. Lavelle declined to comment but referred me to his letter to shareholders.

In it, he writes that Silvestri and his firm "are going to wage a blitzkrieg proxy fight. . . . We met with Mr. Silvestri three times and discussed with him our views of the company, its prospects and the reasons why we thought a liquidation of Cotelligent would not maximize value for all stockholders. All the while, he continued to accumulate his nearly 5 percent block and secretly plot his attack."

In his proxy statement, Silvestri describes the meetings differently:

"During three separate meetings that we have held . . . over a period of only 18 weeks, Cotelligent's management described three different strategic plans for the company. . . . Mr. Lavelle adamantly refused to consider any alternatives where a third party or the Cotelligent stockholders would get HIS cash."

Cotelligent has a familiar-sounding story. It went public in 1996 and grew by acquiring small information technology consulting and staffing firms.

In 1998, it earned \$6.4 million on \$245 million in revenue and moved to the New York Stock Exchange. In 1999, it earned \$15.3 million.

After Y2K, however, the IT services business shrank. In June 2000, Cotelligent sold its staffing business for \$131 million, paid off its debt and refocused on IT consulting for e-businesses.

But the consulting business "had become a lot more challenging, and we weren't as nimble as some of our competitors," says Tom Green, a longtime director who was asked to leave the board last year.

Cotelligent lost \$43 million in 2000. Last year, it lost \$15 million on \$46 million in revenue. Its stock was booted from the NYSE last fall and now trades over the counter.

Its greatest asset, says Silvestri, is its cash. Most of it came from the sale of its staffing business and a \$6.5 million tax refund. The company will get an additional \$7.5 million tax refund this year, thanks to President Bush's economic stimulus package.

Other tech companies are sitting on piles of cash because their investment bankers encouraged them to sell more stock than they needed.

"If you're the investment banker, you don't want to raise \$30 million for a company, you want to raise \$150 million because you get paid a percentage," he says.

Although some companies with negative enterprise value have viable businesses, others would be better off shutting down and returning cash to shareholders.

A handful of companies -- such as HearMe and Garden.com -- have done just that. A few others would like to distribute cash to shareholders but can't because of pending lawsuits.

Most companies won't do anything unless an outsider comes in and shakes things up. But there aren't a lot of dissidents willing to wage a proxy fight.

"It's not easy, and it's fairly expensive," says Pat McGurn of Institutional Shareholders Services.

The legal fees can be enormous. But if a sector gets cheap enough, you'll see the vultures come out. It happened in the 1980s with energy firms, and it's starting to happen now in technology, McGurn says.

Steel Partners of Beverly Hills is waging a proxy battle at Liquid Audio, a Redwood City firm that makes software for delivering music over the Internet.

McGurn says dissidents have been winning more proxy fights in recent years, and their success rate could improve, given the disenchantment with corporate boards and management.

"It used to be, the burden was on the dissident," McGurn says. Today, "a lot of times, the burden of proof is on management."

Last year, dissident shareholders seeking one or more board seats won proxy fights at nine companies and lost at 13. However, at 19 companies there were settlements that resulted in a dissident getting one or more seats.

"A lot of these things end up settling when the incumbent board figures out they're going to lose," McGurn says.

He adds that dissident shareholders play an important role in the marketplace.

"Every ecosystem needs carrion feeders," McGurn says.

And he means that in the nicest way.