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THE INSIDERS | A MERCURY NEWS SPECIAL REPORT

How Portal insiders reaped huge windfall

EXECUTIVES, BOARD MEMBERS MADE MILLIONS WHILE INVESTORS LOST THEIR SHIRTS

Portal Software CEO John Little, right, sold Portal stock worth

$127.5 million

while his company's value dropped

99.5%

By Chris O'Brien and Jack Davis
Mercury News

The executives and board members of Portal Software have had more success selling their stock than they have running the company.

Since Portal of Cupertino went public in May 1999, 21 insiders have cashed in $704 million in stock. During that time, the company has sold only $616.2 million of its billing software and services.

That's not a bad payday considering Portal has never been profitable, its revenue has evaporated, half its employees have been laid off and its stock is about to be delisted by Nasdaq. Facing several shareholder lawsuits, Portal also recently was named in a congressional investigation into manipulation of IPOs by investment banks.

When Portal went public at the height of the stock-market bubble, it looked like the kind of entrepreneurial success that has fueled the Silicon Valley mystique. Instead, it turned out to epitomize a dark side of the late-1990s tech boom in which investors, tantalized by the Internet's promise, ended up losing their shirts while insiders made a windfall.

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Second in a three-part series

COMING TOMORROW

Reform advocates clamor for changes in a system that let insiders cash out billions in stock.

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Portal is an example of how critics say insiders can reap enormous rewards even when their companies perform dismally.

The use of stock as compensation "leads to a focus on short-term gain rather than creating long-term value and the security of employees," said Charlie Cray, director of the Citizen Works' Campaign for Corporate Reform.

Internet pioneer

Portal was founded in 1985 by John Little, a Princeton graduate who had seen an early demonstration of the Internet. He came to California and spent the next decade trying to build a company around this new technology.

Little sold commercial access to the Internet and later developed a billing software product for his company called Infranet. By the mid-1990s, Portal began to focus on selling Infranet to telecom companies.

By then, companies were going public at a blinding pace. Portal raised less than $18 million in venture capital in two rounds before Goldman Sachs took it public.

On May 6, 1999, Portal completed its initial public offering of stock, raising $56 million. The stock shot up, rising from $14 to $37.38 on its first day of public trading.

After the IPO, Little still held 18.9 million shares, or 25.2 percent, of the company. He eventually unloaded $127.5 million in stock through May 4, 2001.

Among the other big winners were Portal's board members:

■ Arthur Patterson, co-founder of Accel Partners, sold $79.4 million in stock owned by his family partnership and an additional $3.1 million he owned.

■ Ed Zander, at the time president of Sun Microsystems, sold $4.9 million.

■ David Peterschmidt, CEO of Inktomi, sold $7.3 million in Portal stock — crumbs compared to the $90.5 million in Inktomi stock he cashed out.

By late 1999, Little was worth more than $1.3 billion on paper and was named by Forbes magazine as one of the 400 richest Americans. He appeared on a bicycle on the Oct. 11 cover of the magazine under the headline, "The Billionaire Next Door."

Little experienced firsthand the resentment this newfound wealth caused. In October 1999, he was at the Hotel De Anza in San Jose attending an Inktomi party when he ran into conservative pundit Dinesh D'Souza.

In the introduction to his book "The Virtue of Prosperity," D'Souza wrote that as they chatted at the party, Little told him that he had recently been on a plane reading the Forbes issue with himself on the cover when the passenger next to him began to complain that "Internet brats" were making so much money.

"I've had my time in the wilderness," Little later told D'Souza in relating the anecdote. "Show me someone who had been at it as long as I have. Show me somebody who's worked as hard as I have. Show me someone who's taken the risks that I've taken. Then if they haven't seen any rewards, then if they want to complain, I'm willing to listen."

Little, 45, declined through a representative to be interviewed for this article.

How insiders benefit

In retrospect, some regulators and politicians say there may have been more than hard work and innovation behind the surge in IPO prices that became a staple of the boom.

Critics calling for reforms on Wall Street have pointed to a number of practices ingrained in the financial system that may have ultimately benefited insiders selling their stock. Those strategies tended to inflate IPO prices, giving insiders more opportunity to sell their shares and pocket huge gains.

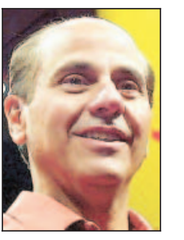
The U.S. House Committee on Financial Services released a report Oct. 2 that said Goldman Sachs and Credit Suisse First Boston took companies public too early in order to generate banking fees, may have illegally underpriced IPOs so shares would soar on the first day of trading and then issued positive research reports to get investors to buy even as stock prices fell. Goldman and CSFB have denied the accusations.

Among the 14 Goldman clients the committee examined was Portal Software.

Portal's stock rose 167 percent — $23.38 a share — on its first day of trading.

Such huge first-day spikes generated great publicity for fledgling companies.

But Charles Elson, director of the Center for Corporate Governance at the University of Delaware, said that if Goldman and other banks had priced their IPOs higher, the companies going public could have captured more of that windfall.



Zander

Portal apparently needed more cash than its initial public offering raised. A few days after the May 6 IPO, Portal announced it had sold 3 million shares to Cisco Systems and 380,000 shares to Andersen Consulting at $13 apiece to raise an additional $43.9 million.

It was a sweet deal for Cisco and Andersen, considering Portal's stock was trading at $31.62 the day before it was announced. The news drove Portal's stock up another $9.38.

As the stock rose that summer, insiders at Portal couldn't cash in because they had agreed to a standard 180-day "lockup" period.

But four months later, Goldman agreed to let them out of that lockup period early. Portal sold 5 million more shares to the public — including 2.8 million shares held by insiders. While the company raised an additional $79.5 million in this second offering, insiders sold $101.2 million worth of stock.

Portal's stock peaked at $83.94 on Feb. 24, 2000. The stock then began a steady slide to $6.75 on Nov. 22, 2000, when Portal reported disappointing quarterly results. A Goldman analyst downgraded Portal for the first time that day from his recommended list to "market outperform" — still the equivalent of a buy rating.

But while Goldman continued to tell investors to buy, insiders at Portal were selling. By the time of the downgrade, Portal had been public only 18 months and insiders had already sold more than $695 million in stock.

Since then, Portal's revenues have plummeted, from a high of $81 million in the final quarter of 2000 to $30.2 million in the most recent quarter. The company has restructured three times and fired 870 employees on its way to reducing its workforce to 600 by the end of this year.

And five lawsuits have been filed against the company alleging securities fraud for the way its IPO was conducted.

Portal is in danger of being delisted from Nasdaq because its stock price has been at around $1 a share for so long. Once worth more than $1 billion, the more than 35.1 million shares of Portal currently owned by CEO Little are now worth $38.6 million. The company recently offered to reprice options for everyone except Little.

On Nov. 19, during Portal's conference call to report third-quarter results, an analyst asked Howard Bain, Portal's chief financial officer, how many staffers had benefited from the repricing of options. Bain drew a big laugh when he said:

"Oh, I would say probably most employees — with the exception of John, who is wiping a tear from his eye here!"

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