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A Few Insiders Saw Value Before the Rally

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Investors might have been tipped to the current rally in stocks by the recent behavior of a few corporate insiders.

In the past few weeks, a number of executives have offered to take their public firms private by purchasing all the outstanding shares that they don't currently own, indicating to some analysts that stocks are deeply undervalued.

"To me, this is consistent with what we're seeing in terms of insider activity," said Michael Painchaud, director of research and principal at Market Profile Theorems. "Insiders are stepping up more aggressively to buy stock as opposed to sell stock."

On Monday, **Quintiles Transnational** (QTRN:Nasdaq - news - commentary) , which provides testing services to drugmakers, said its chairman, Dennis Gillings, had offered to buy the firm for $1.34 billion, or $11.25 a share, representing a 35% premium over last Friday's share price.

That offer comes on the heels of a similar proposal from the CEO and president of trucking firm **Landair Corp.** (LAND:Nasdaq - news - commentary) . The two executives made a formal offer Friday to buy the company for $18.6 million, or $13 a share in cash -- a 25% premium over Thursday's stock price.

And in late September, **Dole Food** (DOL:NYSE - news - commentary) CEO David Murdoch offered to purchase the remaining 76% of that company's outstanding shares for $1.3 billion, or $29.50 each, after other efforts to increase the share price failed. Investors have since objected to the offer, saying it is too low.

"If you have the head of a company looking to buy all the shares that are out there, they obviously must think the shares are cheap and have a lot of upside potential," noted Thomson Financial research analyst Kevin Schwenger.

Before the announcements were made, Dole was trading 25% below its 52-week high, while Quintiles were off by 57% and Landair was 16% below its high of $12.45.

Painchaud said these management-led buyouts correlate nicely with his data, which show more positive insider activity over the last two weeks. He noted that insider buying has increased and insider selling has abated in a broad range of sectors recently, but that the technology group has seen some of the best action.

Still, not everyone is convinced that corporate executives have suddenly turned more bullish. Schwenger noted that insider buying overall has fallen since it spiked up in August, and that "sentiment is still fairly neutral."

Meanwhile, some analysts point out that a management buyout isn't always a sign that shares are undervalued. In fact, some companies may choose to go private to avoid scrutiny from the **Securities and Exchange Commission**, which has become much more intense in recent months.

Larraine Segil, partner at the Lared Group and professor of executive education at Caltech, said Martha Stewart, who has a controlling interest in **Martha Stewart Living** (MSO:NYSE - news - commentary) , could potentially buy back all the outstanding shares not only because they are 70% off their high, but also because a public-to-private transaction would preclude the firm from future regulatory action. Martha Stewart is currently under investigation for her sales of **Imclone** (IMCL:Nasdaq - news - commentary) , which prosecutors allege were based on insider information.

Even if companies have nothing to hide, however, some firms may find the costs of being a public entity now outweigh the benefits. With share prices down sharply over the last two years, liquidity has proven to be elusive. At the same time, new regulations -- most notably the Sarbanes Oxley Act, which tightens corporate disclosure standards -- have increased compliance costs.

New laws also subject CEOs to greater liability and give shareholders more power to prosecute officers and directors. The fear of civil and criminal penalties could drive some smaller companies out of the public arena.

"Working in a public environment is counterproductive for people who are transacting business," Painchaud said. "Why deal with constant inquiries from the SEC? It's energy draining."

Whatever the reasons behind a management buyout, analysts say they are generally positive for investors -- at least if they ultimately work out. Jonathan Moreland, director of research at InsiderInsights.com and a contributor to *TheStreet.com's* sister site *RealMoney.com*, said some executives have little intention of actually going through on an MBO. But, much as a company might announce a share buyback program, management buyouts are sometimes floated simply to boost confidence and raise the share price. "They may be trying to just talk up the stock," he said. "If they go through with it, that's great."