

Chief Is Out at Refco; He Owed It Millions

By Vikas Bajaj and Floyd Norris

New York Times

October 11, 2005

Refco Inc., a futures-trading company that went public two months ago, ousted its chief executive yesterday after discovering that a firm he controlled owed the company \$430 million. Refco's shares fell 45 percent, reducing the company's market value by \$1.65 billion.

Refco said that Phillip R. Bennett, the chairman and chief executive, had been suspended yesterday, although he repaid the \$430 million in cash the same day. It said that it had hired forensic accountants to look into the matter and that it would delay its quarterly filing to the Securities and Exchange Commission.

Although Refco said Mr. Bennett was on leave, it also announced his permanent successor, William M. Sexton, who was executive vice president and chief operating officer but had recently announced plans to leave the company.

It was unclear how badly Refco had been damaged because the repayment of the \$430 million improved its liquidity. But the company seemed unsure whether there were any other problems, and investors rushed to sell. Its stock fell \$12.96, to \$15.60, in extremely heavy trading. It had been sold to the public for \$22 a share in an August offering that realized \$583 million: \$275 million for Refco and the rest for shareholders who sold, including Mr. Bennett, 57.

The company said a group controlled by Mr. Bennett apparently assumed debts owed to it by unrelated third parties, adding that some of them might have been uncollectible.

Mr. Bennett, a Briton, joined Refco in 1981 from Chase Manhattan and played a big part in transforming the firm - first as its chief financial officer and later as chief executive - from a much smaller privately held commodities broker in Chicago to a global futures operation based in New York. Raymond Earl Friedman founded Refco in 1969, and the company derives its name from his initials.

In its fiscal year ended February 2005, Refco reported \$3.7 billion in revenue and \$176.3 million in profit, compared with \$1.87 billion in revenue and \$187.2 million in profit in 2004. At the end of trading on Friday, Refco had a market capitalization of \$3.64 billion, a figure that fell to less than \$2 billion yesterday.

The \$430 million in receivables was on Refco's balance sheet, the company said, but it had never disclosed it as a related-party transaction; such disclosure is customary and required when companies have significant business dealings with executives and other employees. For that reason, the company said, its auditors from Grant Thornton had withdrawn their certification of its financial statements. A spokesman for Grant Thornton declined to comment further, saying it was bound by confidentiality agreements.

Refco was controlled by Thomas H. Lee Partners, a private equity firm, before it went public, and Lee still owns 38 percent of the stock. In a telephone interview, Scott Schoen, co-president of the Lee firm, said that neither he nor Mr. Lee, who also sits on the board, had known about the receivables until recent days. The company said it had created an executive committee of the board and named Mr. Schoen chairman.

Asked how it was that the Lee firm had not known, Mr. Schoen replied that it had "performed extensive work" on the company, adding that the auditors had also been unaware of the transactions. The auditors said only that they "recently learned of the facts" disclosed yesterday. Mr. Sexton, the new chief, said he had not known about the receivables before recent days. He said he had gotten along well with Mr. Bennett and there had been no clashes that led to his decision to resign.

Mr. Schoen said that the board earlier was disappointed by Mr. Sexton's intended departure and hurried to persuade him to stay after deciding to suspend Mr. Bennett.

Mr. Bennett, whose lawyer declined to comment, owns 34 percent of Refco, worth \$672 million even after yesterday's decline. In the initial offering, he sold stock worth \$118 million at the time. Most of the rest of the \$308 million worth of stock sold in the offering was sold by the Lee firm and its affiliates.

Receivables consist of money owed to a company by customers or others. For a separate company controlled by Mr. Bennett to become responsible for \$430 million of them, it either had to be a substantial customer of Refco - something the company would have been required to disclose - or it would have had to make arrangements with customers.

A chief executive dealing with customers in such areas, separately from the company, would also normally require disclosure, at least to the board and perhaps to the public.

When Refco went public in August, it disclosed that it was the subject of an S.E.C. investigation that started four years ago and dealt with short sales of stock in the Sedona Corporation, a software maker.

Refco said at the time that it expected a settlement of the suit with the S.E.C. that would bar Santo C. Maggio, who headed the company's securities unit, from supervising employees. It said it expected Mr. Maggio to remain with Refco.

But no settlement has been announced, and the company said yesterday that Mr. Maggio had been suspended from his post. Mr. Schoen said he was suspended because he had known about the receivables transactions involving Mr. Bennett, not because of the earlier issue that led to the S.E.C. inquiry. Mr. Maggio's lawyer refused to comment.

After Refco's disclosure yesterday, Standard & Poor's lowered its credit rating to B+ from BB- and placed it on credit watch with negative implications, indicating a further downgrade was possible. Both ratings are below investment grade.

Tom Foley, an analyst with the credit-rating agency, said bondholders and banks that had lent Refco money could use the latest disclosure to force it to repay the debt sooner than scheduled, putting Refco under financial pressure. Also, he said, "this indicates a possibility that there could be other accounting control issues."

Mr. Sexton, Refco's new chief executive, and Joseph Murphy, who was appointed president of Refco yesterday, told employees in a memo that the accounting investigation would not affect day-to-day operations.

As of Aug. 31, the company had \$648.6 million in cash. Since then, it has used about \$230 million to pay down a portion of its \$1.4 billion in debt. The figures do not include the \$430 million in cash that Refco received from Mr. Bennett yesterday.

<http://www.nytimes.com/2005/10/11/business/11refco.html>