Impact of market changes on business

Panel Discussion

Framing the context for this panel session, Don Stevens, director of the Institute for International Business, quoted a speaker from the Global Executive Forum of a year ago. "IT is responsible for the shift in our lives. Between the old and the new is this wonderful period of turbulence where we're figuring out what this new order is. We're not in a bubble economy, but we're in a frothy economy, hundreds of millions of bubbles bursting and forming. There's a large opportunity to build businesses that over a longer period of time are going to have high margins by investing significantly right now."

Said Stevens, "That was the thinking in enterprise formation a year ago, when we could more clearly see the promise of these new technology companies and the potential changes and impacts on our lives rather than their value as a going enterprise. The purpose of this panel is to look back on the changes that have occurred over the past year when NASDAQ was riding high at 5,000 and technology and the new economy were strong."

The panelists: Steve Halstedt, Centennial Ventures; Seth Blumenfeld, WorldCom; Pat McGarvey, Credit Suisse First Boston; and Peter Kendall, Coors Brewing Company.

Convergence and consolidation
Steve Halstedt - Venture capital

Steve Halstedt is managing director of Centennial Ventures, a Colorado company he co-founded in 1981. He works with entrepreneurs to develop large scale business opportunities. Halstedt is a recipient of the Ernst & Young "Entrepreneur of the Year" award in the category of Supporter of Entrepreneurship. He earned a B.S. in management engineering at Worcester Polytechnical Institute and an M.B.A. at the Amos Tuck School of Business Administration, Dartmouth College.

Centennial Ventures makes investments in the field of electronic communications, the convergence of three traditionally separate industries: computers, media and communications. "This convergence is driven by technology, mostly digital computing technology, but also complementary wireless and optical technologies. It's a $2.5 trillion a year business, growing at roughly 8 percent a year," said Steve Halstedt, managing director.

"What Centennial does is try to figure out simple ideas riding on great waves of change. We've noticed that if you get on those waves early enough, you don't have to be smart to make money, you just have to be there. It's not so hard to figure out the trends, or at least their general direction and general magnitude. What's really hard is to figure out the implications that flow from the trends.

"From 1980 to 1995, it took five to seven years to build a business if you happened to ride the right wave of change and had a simple idea. From 1996 to 2000, we had what I call MTV investing -- your capital for nothing and high valuations for free. After three years, virtually any company could go public based on a future discounted cash flow analysis. Valuations were such that you had to have better than perfect execution in order to ever achieve the values that the public markets were giving you."

But the dynamics changed in the year 2000. "NASDAQ went down 40 percent and it's gone down more since. The telecom indices were down 50 percent, the venture backed public companies were down 80 percent. Today, most of those companies that are still alive are thinly traded retail stocks.

"In our portfolio in 2000 we had three companies that went public. We ended up with 24 million shares of publicly traded stock. They went from a valuation of $500 million to $100 million. The only good news was
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we were still above cost, which is the good thing about venture investing because you start early in a company's growth.

"What private equity investors are doing today is supporting their own portfolio companies in order to prevent failure. They're looking for few new ones to fund.

"In some cases, we're seeing mergers of fully funded equals. This lets them take advantage of economies of scale and grow the business faster together than they could separately. Where companies must raise equity capital they're doing so at much lower valuations.

"So there is a tremendous amount of consolidation among the good companies. Other companies like many of the dot-coms that did not have clear business models that would lead to profits, and/or did not have strong management teams to execute those plans, have simply gone out of business. Those that have had valuable tangible and intangible assets have been bought for pennies on the dollar. That process is still going on, but it's reaching a crescendo.

"The next companies that are going to fail are those with fully funded plans that haven't been executed. They consume their capital and then are forced to either merge or sell out. We think this process will continue through 2001.

"We think that the first quarter of 2001 will be worse than the fourth quarter of 2000; the second quarter of 2001 will be worse than the first quarter of 2001, but by early next year we'll see a significant amount of recovery.

"What's going to happen in recovery is that all the investment money that's sitting on the sidelines will flow to the apparent winners, the companies that are still standing. As a result, those companies are going to be far stronger, more profitable and more attractive companies than they would have been under the previous set of circumstances.

"We have been in a hyper-competitive environment with so much capital out there that there isn't any innovation that comes along that can't be copied very quickly. In a given market segment, you don't have too much money chasing too few deals. You've got too many deals addressing the same market opportunity, which is now much reduced from what it was.

"So what's going on now is consolidation as everybody recognizes that those markets are not as big as they appear to be. This is not the first time this has happened. It happened in the early '70s, in the early '80s and in the transition from '89 to '90. It's typically two or three years that you go through a very difficult period of time. Some industries will go through a period of four to six years of difficulties before they're able to come back through innovation."

Challenges for start-ups

How does a business get started in the current environment? "The good entrepreneurs have gone to what we call fully funded plans. That means they have a plan that can produce a positive cash flow with their existing resources. To the extent that they have to go into the marketplace to raise money to implement that fully funded plan, they're raising money at a fraction of what the last round's valuation was, typically 30 percent. There are exceptions, but they are special cases."
Mergers and transformations

*Seth Blumenfeld – Telecommunications*

*Seth D. Blumenfeld* is president of International Services and Correspondent with WorldCom, responsible for directing the company’s international affairs. Blumenfeld is an executive committee member of the U.S. Council for International Business; a member of the State Department Advisory Council on International Communications and Information Policy; and a member of the Global Executive Board, Institute for International Business, CU-Denver, among others. He holds a Doctor of Jurisprudence from Fordham University Law School.

The year 2000 dealt a major disappointment to the company, formerly known as MCI WorldCom, when it became apparent that its proposed merger with Sprint Corp. would most likely not be approved by either U.S. or European regulators, said Seth Blumenfeld.

WorldCom and Sprint are the No. 2 and No. 3 long-distance telephone companies in the country; the price tag of the merger was put at about $125 billion. Federal Communications Chairman William Kennard voiced his opposition immediately after the two companies made the announcement on Oct. 5, 1999. Kennard said the mega merger would be bad for competition in the long-distance market, and, therefore, bad for consumers.

The companies claimed that the merger would reduce operating costs by billions of dollars, savings that could then be used for innovations that would benefit consumers.

Early in July 2000, the U.S. Justice Department moved to block the merger, laying out conditions that WorldCom and Sprint decided were not in their best interests. This, together with objections from the European Union and the spectre of protracted litigation, caused the two companies to cancel their plans and go their separate ways.

Commenting on these events, Seth Blumenfeld said, "The FCC had a relatively new chairman whose experience was in broadcasting and his knowledge of the common carrier business was limited. They finally told us that they would be willing to approve the merger provided we sold off Sprint's Internet backbone. We decided not to do that. Sprint was our entry into the wireless PCS cell phone business, so it hurt us to have to cancel the merger."

WorldCom, with operations in 65 countries, is going through a transformation, he said. "We are no longer a telco. We generate some $30 billion from telco services. But we have taken the route of re-engineering via a tracking stock that will bear the MCI name and trade separately from the WorldCom stock. The MCI stock will reflect the performance of our long-distance service. The WorldCom stock will be pegged to the results of our data operations, which is the faster-growing part of the business."

"We're the largest Internet provider in the world and it's our Internet broadband and high speed data networks that are going to bear the WorldCom moniker.

"The Internet has taken a long time to become a commercial vehicle versus a consumer vehicle. The growth and value of the Internet for business is not the fact that people need to find out what the ski conditions are or how the New York Yankees won the pennant 20 years ago. What we envision the Internet to become is a vehicle for corporations to reinvent themselves, to be able to make their businesses significantly more profitable through Internet and Intranets."
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"How do things look in the year 2001? I think it's going to be slow, but good. You can't transform yourself very quickly if you want to do it right. But the demise of the dot-coms is certainly going to help traditional value companies.

"We're still growing very nicely; we've increased our customer base and our revenue. As far as our stock is concerned, this is not going to be a quick turnaround. And a lot of the recovery will depend on consumer confidence, interest rates and how and when people get back into the market. But from a pure business point of view, we've been doing very well.

"There are tremendous consolidations taking place in the telecommunications industry all over the world. In spite of the Telecommunications Act, regional operators have been trying to protect their turf from the proliferation of new, alternative carriers. I think that the best of breed will have to get together in order to compete. I think once they do consolidate, some of them may be successful.

"What will help us is this: With the frenzy of new companies being formed, I believe that the private venture capitalists will be sitting on the sidelines for some time in the future. They are going to look hard at their investments in terms of what they want to get out of them. We've already seen a complete dry-up of the IPOs; those glory days are over. I think that most companies are going to go back to the basics of running their business and transforming their business to meet the needs and wants of the customer."

Private equity investment

Patrick McGarvey

Patrick J. McGarvey is managing director with the Private Fund Group at Credit Suisse First Boston. He joined the Private Fund Group of Donaldson, Lufkin and Jenrette in the spring of 1998, and before that was a director of Merrill Lynch where he specialized in structured products and the placement of private equity and other alternative investments. He was also with Goldman Sachs & Co. for 10 years as vice president in the Fixed Income division.

McGarvey holds a B.S. from Cornell University and an M.B.A. from the Kellogg School at Northwestern University.

Pat McGarvery talked about the world of private equity investing, which last year was a $150 billion business. "I live in a small subsector of the global capital markets in which we raise private equity money for fund managers and for people who own private companies. This business is unlike investing in a public company where you are a passive shareholder with little recourse if something goes wrong."

McGarvey described the subsectors that comprise the private equity industry.

"Venture capital. Venture capitalists start new companies and foster the rapid growth of young companies. This sector has higher risks and, if successful, higher returns.

"Distressed debt and equity. These are opportunities to invest in either the debt or the equity of companies that have done something wrong and have financial distress or operational or management distress. With skilled managers, some of these companies can be turned around and become healthy, successful enterprises."
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"Industry focused. These opportunities are focused on a more narrowly defined industry or geographic sector like telecom, energy, health care, Internet, etc.

"Real estate. These are opportunities to invest in all types of direct real estate holdings or real estate companies. Examples range from development of raw land to redevelopment and repositioning of existing properties.

"Hedge funds. This is long- and short-leveraged investing in public companies and is slightly different from the rest of the private equity world.

"Growth capital. Similar to the venture capital world which seeks to invest in emerging companies that are creating new products and new services.

"The private equity industry is typified by two things. One, investors usually have control of these companies in one way or another. These controls relate to management, to strategy, to financing. If something goes wrong with these components, management can aggressively make changes. Second, these companies are highly leveraged.

"Private equity has gone from a small cottage industry of less than $10 billion in 1990 to $150 billion in 2000. Most of the money is raised and invested in the United States for two key reasons. We have the most developed capital markets and pension system, and we have a reasonable and actionable legal system.

"The venture capital sector is an example of the rapid growth in the overall private equity market, doubling almost every year from 1994 to 2000. The high return realized in the NASDAQ market and venture capital partnerships lured capital from endowments, foundations, pension funds and high net-worth individuals. During the year 2000, $100 billion was raised solely for venture capital, which was approximately the same amount raised during the previous 10 years combined. This dramatic increase in fund raising led to extraordinary competition for venture-backed companies and resulted in skyrocketing valuations. Fast forwarding to today we can observe the market forces correcting for these past excesses.

"There may be negative impacts on venture capital sources as a result of these downturns. We raised $150 billion for private equity funds last year and we'll raise probably half of that in 2001. One of the reasons is that institutional capital has a very rigid asset allocation model. So there will be a period where fund managers will wait and see how much capital they get back from their current investments before they reinvest.

"But ultimately I think the informed institutional investor will be there for the long run."

Consistent growth

Peter Kendall - Global brewing

Peter M. R. Kendall is senior vice president and chief international officer at Coors Brewing Co. He has held leadership positions with McGraw Hill Companies and Pepsi Cola International in Europe, Hong Kong and New York. Prior to Pepsi, he worked six years for McKinsey & Company, the management consulting firm in New York. Kendall holds a B.A. in industrial and labor relations from Cornell University and an M.B.A. from the Wharton School of Business, University of Pennsylvania.
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Coors Brewing Company is the third largest brewer in the U.S., with sales in over 20 countries. In 2000, more than 24 million barrels of Coors products were sold worldwide. This translates to 7,920,000,000 12-ounce bottles of beer.

According to Hoover's Online, Coors achieved one-year sales growth in 2000 of 17.4 percent, and net income growth of 19.2 percent. In contrast, No. 1 brewer Anheuser-Busch had one-year sales growth of 4.8 percent and net income growth of 10.7 percent. The sales growth for No. 2 Miller Brewing in 2000 was 0.8 percent.

Coors was not represented at last year's Forum on high-tech, "but I wanted to have a perspective of a traditional company and how this last year has treated them," said Don Stevens.

"A lot of the lessons and ideas that we've talked about today also have application to the beer business, albeit in a little different way," said Peter Kendall.

"Brewing is one of the old economy's oldest industries. It is one of the most geographically diverse and least consolidated of the consumer businesses. In the soft drink industry, Coke and Pepsi account for around 60 percent of the global soft drink business. But Anheuser-Busch, the biggest brewer in the world, is doing less than 10 percent of the total volume in the global beer market.

"Coors has had consistent profit growth for the fifth consecutive year. As far as our stock is concerned, there is a correlation between the performances of NASDAQ in relation to Coors' stock performance. As NASDAQ went down, Coors stock went up; when NASDAQ goes up, Coors stock goes down. Our market cap went up about 35 or 40 percent in 2000, similar to that of Anheuser-Busch."

Don Stevens observed, "I saw Peter as the key to this panel, because if people had switched their holdings from Internet stocks to companies like Coors, they would have doubled their money and avoided the decline in the tech sector."

The downturn in the New Economy has had other benefits for Coors, said Kendall. "We were losing a lot of our best people to dot-com companies and clearly the decline has turned that around. So the human resource impact has been positive; we've been able to attract candidates and keep our high performers. Also, there's no question that technology suppliers in some areas are more focused and hungry. I get calls and letters every day from software companies looking for clients."

As for the future, Kendall said, "The outlook for 2001 is an unknown. The potential for recession or stagnation is a concern. If either of these things develops, the beer market will be affected. The fact is that the consumer goods market in just about every part of the world is connected to growth in disposable income. Disposable income is connected to the amount of money people have to spend on entertainment, of which beer is a big component.

"The international market outlook is mixed. We expect growth in beer consumption to come from the developing countries in eastern Europe, Asia and South America. In the higher-margin developed economies, such as the U.K. or Germany, the beer market is flat or declining.

"There is a trend to lighter beers away from ales, which is obviously positive for us because Coors produces lighter, more drinkable beers.

The NASDAQ decline has created market volatility, he said. "It's a lot more volatile than it used to be, even for companies like PepsiCo and Coke. But the dot-com frenzy of the last few years has forced
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Coors to take a hard look at a number of new technologies that apply to our global supply chain, web-based purchase information exchanges and consumer web site development, particularly outside the U.S.

"We're taking the lead outside the U.S. in creating a consumer web site that provides information about Coors' products without encouraging irresponsible beer drinking."