Entrepreneur

A CEO's Lessons in American Capitalism

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SelectBooks, Inc.

Chapter One

Touching on the Brink of Fantasy

March 2000	Dow 10921.90	NASDAQ 4572.83

On March 7, 2000, my wife Nancy Marinoff and I hopped into our car and headed to the airport. The drive to Washington Dulles was 45 minutes from our house on the Potomac River in historic Old Town Alexandria, Virginia. Sterile, cubical buildings from three to ten stories high lined the Dulles Toll road. They shimmered in the early morning sunlight, each reflecting off one another. Inside, the spate of new high tech companies operated at Internet speed. The Washington Metropolitan area, particularly the Northern Virginia landscape, had been inundated in the last five years with high tech companies born out of the Internet and Telecom booms. In fact, this region had gained national acclaim as being the next Silicon Valley. On September 1, 1995, Mark Warner, then Managing Director of Columbia Capital, wrote in an editorial for the *Richmond* (VA) *Times-Dispatch:* "Not since Thomas Jefferson acted as a one-man research and development center at Monticello has Virginia been such an exciting center of technological growth, creativity, and innovation. And not since those days has Virginia had a clearer opportunity to take the lead in an American Revolution—this time a revolution of technology." [1]

We passed the offices of some real heavyweights along the way, including Oracle, AT&T, Sprint, Cable & Wireless, and Siemens, their huge corporate logos illuminated along the tops of their buildings. I couldn't believe we were about to be inaugurated into Washington's elite, joining these telecom tycoons. I was overwhelmed to think how far we'd come.

Just before we arrived at the airport, I saw our glowing Net2000 Communications sign suspended outside of our corporate headquarters. Net2000 Communications was another sterile, five-story, rectangular building constructed of pre-fab cement that filled the space between five rows of glass windows. It was one of the most unattractive buildings on the block, but as the adage goes, "location, location, location." We had a prime spot, directly on the Dulles Toll road, a heavily traveled thoroughfare going to and from one of the country's busiest airports. Our heady sign glistened in the sky and received the exposure any emerging company would long for. Our location undoubtedly enhanced our evolving brand in the Washington metropolitan market.

The closer we got to the airport, the more excited I became. Nancy would finally see how privileged we were when our private jet greeted us 100 yards from where we parked. As we walked into the Signature terminal—a separate location from the commercial flights, which made flying painless—we quickly came upon our opulent jet.

For the last three weeks, my CFO, Don Clarke, and COO, Mark Mendes, and I had been preparing for this day. We had spent a considerable amount of time on this plane with the three-person flight crew. We had flown to Europe and around the country, bouncing from place to place and making our pitch to institutional investors including Fidelity, Putnam, Invesco, Wisconsin State Pension Fund, and many others. As part of our roadshow, we had been planning for today's landmark event of our Initial Public Offering (IPO).

The jet was a beautiful Gulfstream III—a nice sized plane as far as private jets go. The interior sparkled with elegance. The combination of light Italian wood, beige leather, and gold plated fixtures intertwined to create an atmosphere of wealth and comfort. There were eight individual seats and a three-person couch, all thick and well cushioned like the couches at the lobby of a Four Seasons. In essence, the jet was immaculate.

Don, Mark, and I were spoiled after having flown around in luxurious freedom with a limousine waiting for us at each destination. Now we were sharing the lavish accommodations with my wife, my fellow executives, and Net2000 co-founders.

At times, our rapid ascent seemed surreal. We were filled with awe knowing that our small private company we founded with only $200,000 about six and a half years ago had defied the odds of startup fate, and was now becoming a public company. In a discussion about exit strategies and, specifically, initial public offerings, the Oklahoma City *Journal Record* says, “The chances of a venture going from start-up to an IPO are slim. Each year more than 600,000 new companies are launched” and only 5%, or 30,000, of these companies receive the initial round of financing (seed money) that enables them to continue building the company. “In round numbers, only 10 percent, or 3,000, of these companies eventually receive institutional venture capital, and then only 10 percent, or roughly 300, of those companies successfully complete an IPO.”[2]

It was March 7, 2000, and we were headed for the NASDAQ headquarters. We landed at Teterboro airport in northern New Jersey just outside of Manhattan. Teterboro airport caters to private jets, as it is closer to business districts than the larger, commercial airports. As was standard procedure at the time, two black stretch limos greeted our group of top Net2000 officers and their respective spouses. We were whisked away to midtown Manhattan to begin our day.

Located at 43rd and Broadway in the heart of Times Square, the cylindrical NASDAQ building stood tall, blanketed by a large electronic display which wrapped around the facade. The display provides up-to-the-minute financial news, market highlights, and advertisements. Known as the NASDAQ MarketSite Tower, the screen ascends eight stories high and flickers its media on Times Square 24 hours a day. As we approached NASDAQ, the MarketSite Tower was beaming with Net2000 Communications’ name and logo. Our lil’ ole’ company was exposed in bright lights in the busiest square at the global epicenter of the business world.

In a press release announcing the opening of the new NASDAQ MarketSite Tower on December 28, 1999, former New York City Mayor Rudi Giuliani said, “I can think of no better place for the new NASDAQ MarketSite Tower than right here in Times Square—The Crossroads of the World. This is a great addition to the New Times Square, and will no

doubt become one of its greatest attractions. The MarketSite Tower serves as a symbol of New York City’s leadership in finance, and is another example of what makes New York City the Capital of the World.”[3]

The $37 million NASDAQ MarketSite facility is a glitzy showcase. On street level, one long window replaces a would-be wall, allowing passersby to peer in at the live broadcasts similar to NBC’s “Today

Show with Katie Couric." Inside, the main room has high ceilings and an immense electronic board strapped along another wall that highlights the current trading prices of thousands of NASDAQ listed companies. Three unmanned robotic television cameras faced three different reporters who stood ten feet apart with their backs to the massive electronic board. Each reporter rattled off a concatenation of financial information. Some reporters spoke English while others spoke Spanish, French, or other languages. Networks such as CNBC, CNN Headline News, CNNfn, Bloomberg, BBC, and Reuters used the MarketSite digital broadcast studio to transmit their live market updates. This was an impressive state-of-the-art environment—a technology mecca—appropriately serving as the nucleus of NASDAQ.

At 9:30AM, a plexiglass podium was rushed to the center of the room—a sign the NASDAQ was opening. Mr. Bob Kelly, a sophisticated and genteel man, welcomed Net2000 as a new NASDAQ member and invited me to join in opening the market that day. Although all NASDAQ trading is computerized, and there is no physical location where trading actually occurs (as there is with the NYSE), Bob Kelly and I pointed and clicked a remote control device to symbolize the "opening" of the market. A few moments later, the entire room was filled with heavy applause—not all for Net2000 though. The big board behind me indicated that NASDAQ had hit 5000 for the first time in history!

That moment lives as a permanent fixture in my memory. I was giving a brief speech about being a newly listed NASDAQ company, and the big blue board behind me showed the NASDAQ had reached 5000.13. With the NASDAQ below 1400 as I write this, that day often seems like eons ago.

Our next stop was Goldman Sachs—our lead investment banker and underwriter. The institutional trading floor at Goldman Sachs was one open room. About a hundred brokers were sitting at small desks lined up side by side, with three large screen terminals in front of them—like a scene from *Wall Street.* Each broker was energetically working multiple phone calls, tracking three different terminals simultaneously, and several were standing up shouting orders. Each broker was dealing with large institutional investors around the globe, and the pace was truly frenetic.

Just before 11:00AM, our lead banking contacts Matt Fremont–Smith, Prem Parameswaran, and Eric Muller led our entourage of fifteen to a vantage point in the center of the trading floor so that we could watch the electronic ticker tape.

My anxiety was increasing as we anticipated NTKK's opening trade. I could feel my pulse quicken. We had no idea at what price NTKK would initially trade. We knew the institutional orders were set at $20 per share as we had negotiated that price with Goldman Sachs after our successful IPO roadshow. At this point, we all placed friendly wagers on the Day One closing price, and we'd been told that our employees in each office had pools going as well. Amidst the chaos of the Goldman Sachs trading floor, we watched NTKK go out—the first trade was at $34, and it quickly ran to $35, $36, and $37. Within minutes it hit $40.

With over 2.5 million shares each, my partners and I calculated the math instantly. A price of $40.00 per share placed the value of each founder's shares over $100 million. In my case, including my unexercised stock options, my Net2000 stock was valued at nearly $130 million. And with 36 million total shares outstanding, Net2000's valuation was at $1.5 billion. We were ecstatic—this was unbelievable! The cheers got louder and louder and we tried to absorb every moment.

After about an hour, the group headed back over to NASDAQ's MarketSite. I had a full day ahead of me with interviews scheduled on CNBC Power Lunch, Bloomberg, Yahoo!, CNNfn, and CNN Moneyline with the venerable Lou Dobbs.

Lesson 1: An IPO Is Not a Liquidity Event

Conventional wisdom has it that an IPO is a great liquidity event that allows a company's founders, senior management, and venture investors to sell their stock and cash out. This couldn't be farther from the truth. In actuality, an IPO places far greater restrictions on these parties' ability to sell shares. Although an IPO creates a currency in the company's shares, or a platform from which to distribute shares in exchange for cash, the core company leaders are most often the last to see the money.

Most underwriters will insist on a six-month lock-up period, during which founders, executives, or venture investors can't sell their stock for six months starting from the day of their IPO. In order to prevent price volatility, the SEC regulates the sale of restricted securities, including quantity limitations, manner of sale, and filing procedures. Beyond this six-month period, all insider trades are filed with the SEC and are often misinterpreted by the investment community as a sign of loss of confidence in the company. Therefore, company insiders who sell a significant amount of shares—even if for reasons of portfolio diversity—place downward pressure on the stock price. As a result, long after the IPO lock-up expires, most executives and insiders can only sell a modest amount of stock each quarter. Additionally, if any of these insiders are aware of ongoing merger and acquisition discussions, then they are deemed to possess insider knowledge or "material non public information," and again are restricted from selling shares.

So how can you gain liquidity from an IPO as a founder or insider? There are several ways to offset these restrictions and each should be given strong consideration:

1. If the IPO is successful and there is an over allotment of shares being offered at the IPO, insist to the underwriters that you sell shares in a pool. This over allotment is referred to as the "Greenshoe," in which you are able to sell shares at 15% increments in the event of an oversubscribed IPO (described in more detail in Chapter 8).

2. Negotiate upfront with your underwriters that you will sell some shares at the IPO as a means of portfolio diversification—especially if you're a founder who has devoted many years to building the company and have not previously sold any stock. The founders of Google used this tactic in their IPO.
3. Consider selling shares before the IPO. It's possible while growing the company, particularly if the company is healthy and performing well, to convince venture investors, angel investors, or other wealthy individuals to buy some of your shares. Make it clear to them that if you put a million or more in the bank, you could alleviate personal financial pressure, thereby allowing you to better focus on growing the company.
4. Consider an exit strategy just prior to an IPO. A company on the verge of going public is usually at the pinnacle of its life cycle up to that moment. A strategic buyer will often be willing to pay a premium for the company, so this is an ideal time to sell. It doesn't hurt to test the market to determine your company's value. If a deal is consummated, and the acquirer's stock is part of the consideration, the restrictions on selling usually won't be nearly as stringent in most cases.
5. The above suggestion also applies in the quarter immediately following an IPO—another critical stage to consider in selling the company (more on this in Chapter 8).
6. Trading pools: many investment banks offer wealth management programs that allow senior executives to place their shares into a pool with executives' shares from other public companies, and thereby form a hedge against depreciation. You can often collar your stock—locking in a guaranteed floor price per share. Be aware that this also restricts you on the upside, as a ceiling is part of this type of arrangement.
7. Programmed trades allow you to report to the SEC that you will regularly sell stock at the same time(s) each month regardless of market conditions. For example, you may establish a program to sell 5,000 shares on the first Monday of each month, or 2,000 shares per week at the market open on Friday.

8. Of course, if market conditions remain strong, a company can sell more shares to the public following an IPO via a secondary offering—a vehicle that allows venture investors, executives, and other insiders to register and sell shares more freely.

The interview at CNBC's "Power Lunch with Bill Griffeth" went well. They introduced me as "The CEO of the high profile IPO of Net2000." Back at the NASDAQ, I sat on a stool in front of the huge electronic board with an earpiece and faced one of the three robotic cameras, while corresponding with an unseen Bill at their studio. I felt comfortable and confident, and responded to the questions.

As I arrived at the studio for CNNfn (CNN's financial news station), I was a little uneasy. The thought of being live on CNN was unnerving. I took deep breaths to feel more relaxed; I certainly didn't want to appear nervous on live national television. As writers and editors were frantically working the phones and banging away at their computers, I waited patiently. Before I knew it, I was walking toward the set where I saw the anchors whom I would sit adjacent to, once the producer gave me the cue.

The interview went well and only lasted a couple minutes. It amazed me how even the media got caught up in the flavor of the month, a sign of the times. When the market was up and soaring, they were ebullient and flattering. Right before our IPO, *Washington Technology* touted, "Net2000 nearly doubled its revenue during the past year, jumping from $9.4 million in 1998 to $18.7 million as of Sept. 30, 1999. Net2000 landed the number sixteen spot on *Washington Technology*'s "Fast 50" list, up from number thirty-one the previous year—the largest jump by any company."[4] Of course, when the market went south, the same individuals became media sharks, ready to pounce on any executive whose company was missing forecasts or expectations, or whose stock was declining. This phenomenon is endemic of our society. People often have a herd mentality. When things are great, they jump on the bandwagon; when things are down, they criticize and second guess. That's one of the reasons I admire and respect fellow entrepreneurs so much—for their true leadership, perseverance, and never say die attitude. Entrepreneurs stay focused on the mission at hand and aren't phased or distracted by thousands of naysayers.

Net2000 closed that day at $36.25—a first day gain of over 80% for our institutional investors and a 200% increase over our initial filing price. This was a strong beginning given that NASDAQ finished down 175 points that day. I was extraordinarily proud of our company and the heights we had climbed.

Lesson 2: Don't Get Caught Up in the Hype—Remain Rational

When things are great, and your company is on a roll, it's very easy to get distracted by the media, investors, investment bankers, and the throngs of new friends and supporters. When a company has tremendous upward momentum and positive press, senior management can certainly get caught up in the hype. And taking a company public can be heady for first time executives. Be careful not to believe your press clippings—you're never as good or as bad as you'll get credit for. As you get more press, advice from a new cadre of convincing Wall Street investment bankers, research analysts, large institutional investors, and other constituencies will tempt you to go in many different directions. But maintain focus, be conservative, and trust your gut instincts. Remember how you built the company in the first place and stick to those fundamentals. At the end of the day, nobody knows your company or your business better than you. Be skeptical of the "talking heads"—the so-called experts or gurus.

As we relished our newfound public status, our investors and management team were extremely bullish on our future upside, and we weren't particularly interested in advances from suitors who expressed an interest in potentially buying us for a significant payout. In hindsight, any one of our suitors would've likely paid a substantial premium (more than $500 million in cash) for our company, and it would have been a grand slam from our modest beginnings. Our board of directors, management, and private equity investors, however, had such an impenetrable faith in our company's value proposition and our business model that we continued to focus on growth and expansion. After all, we anticipated better days and an even better return for investors ahead, believing, with conviction, that we could grow the business to a billion-plus in revenues.

Lesson 3:
Be Humble

Leading and managing a fast growing business can be quite a heady proposition. The number of folks singing your praises on a daily and weekly basis can be staggering. It's quite easy to get caught up in the hype and start to believe them. Moreover, as your personal net worth escalates, one can get the feeling of invincibility. And we've all seen that money can change everything. Unfortunately, money changes a lot of individuals too. Fortunately in my case, my modest beginnings and my mother's stern discipline taught me to be nice and respectful to everyone—no matter what the circumstance or who the person is. As such, as my personal wealth ascended, my approach to life and anyone I encountered remained balanced. I've witnessed a steady combination of ultra successful people who are very nice, well grounded and down to earth as a well as a large number of arrogant jerks. As you accelerate past your goals, I urge you to remember your roots and always be mindful that things can happen in life and your vast possessions can be snatched from you in the blink of an eye. Don't become an insecure, insincere jerk—be humble.

Lesson 4:
Timing is Everything

Timing is crucial in business. When there is an opportunity to merge, sell, or pursue other strategic opportunities, it could be prudent to lessen the downside risk and potentially sacrifice some of the upside by carefully evaluating exit or sell opportunities. In hindsight, we should have focused more on the opportunities to sell or merge our company. Even selling or merging at a discounted price from our all time high of $40.00 per share would have been a big success and a significant return for the private equity or venture investors, as well as for our founders and management team. Take the sure success—that solid base hit as opposed to swinging for the fences.

Brian Keane, Managing Partner at Claris Capital, long-time Wall Street investment banker, and former President of high flyer Aether Systems, where he orchestrated numerous acquisitions, says, "What it boils down to is the management team's view of the long-term value of the company versus the offer in hand to acquire it." He does warn that, "Entrepreneurs are by nature optimists, so their view of the future might be a little rose-colored."

Mark Cuban and numerous entrepreneurs have generated considerable wealth by exiting at the right time.

Upon our return to Dulles Airport on Wednesday, March 8th, dozens of Net2000 employees welcomed us like heroes. As we exited our jet, they greeted us with balloons, placards, posters, and ear-to-ear smiles. We felt like rock stars. The following email from one of our first venture capital investors captures the essence of the moment following our IPO:

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- - - - - - - Original Message - - - - - - -
From:   Marc Benson [mailto:marc@mavf.com]
Sent:   Wednesday, March 08, 2000 12:14PM
To:     Thomas, Charlie; Clarke, Don; ‘Mark Mendes’
Subject:    Mega Congratulations
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… to you guys and your whole team for a truly outstanding job. You have graduated from the minors to the big leagues and I have no doubt that you will continue the NET 2000 winning tradition. It has been an absolute pleasure working with you, and as always if there is anything we can do to help, please don’t hesitate to call.

PS—at yesterday’s prices NET2000 returned more than our entire fund and we have 24 companies left in MAVF III. Needless to say, you made our day …

All the best
Marc Benson*

* Marc Benson was one of the partners at Mid-Atlantic Venture Funds, the first venture investor to fund our Series A round. Marc and Mid-Atlantic also participated in our Series B round, so he was directly involved in our IPO. But Mid-Atlantic did not sell shares, as they were restricted. The return Mark alluded to herein was not realized.