

Timing Is Everything

Holding stocks was a risky game during the decline of the long-distance carriers. A better way to invest in the telecommunications market during the bubble was to be an early investor and get out before the crash. Two examples of early investors who timed the market well are Philip Anschutz at Qwest and Gary Winnick at Global Crossing. Each sold a large percentage of their holdings in their companies' stock at or near the top of the market.

Qwest's principal owner, Anschutz Company, led by founder Philip Anschutz, took away \$1.7 billion from a timely sale of Qwest stock. Virtually all of that was accomplished as the result of a \$3.5 billion sale of stock by Qwest to BellSouth in April 1999. The sale consisted of Qwest selling new shares to BellSouth for \$1.9 billion and Anschutz Company selling some of its shares of Qwest stock for \$1.6 billion¹. At the end of 2003, BellSouth's \$3.5 billion investment was worth about \$350 million, a 90% decline.

Similarly, Pacific Capital Group, headed by Gary Winnick (former associate of Michael Milken, the junk bond king) walked away with a hefty profit from the sale of Global Crossing stock. Winnick was the chairman of the board of Global Crossing. Pacific Capital sold almost 95 million shares of Global Crossing stock in 1999. During the year, the stock sold between a high of \$64.25 and a low of \$18.94. At the low end of that range, Pacific Capital's stock was worth about \$2 billion.

But for every Anschutz and Winnick, there has been a Clark McLeod and a Paul Allen. McLeodUSA and Charter (Allen's cable company) both made billion-dollar bets on the future of the network and couldn't deliver.

Investing early and timing an exit before the crash was the best way to profit from telecommunications stocks during the bubble, just like with the dot-coms. Another way to make money was for a carrier to sell itself to another carrier. The most successful CLECs during the bubble were the ones that sold out to another company at the top of the market. The CLECs were acquired at high valuations, but the currency used to purchase them was generally the stock of the acquiring company. Therefore, the actual value to an investor depended on when (or if) the received stock was liquidated. As many investors figured out in 1999 and 2000, determining where to put money after selling a stock was a tough decision. The overpriced stock that an investor sold was likely replaced with another stock that was to shed significant value in the 2000 to 2002 period.

Teleport Communications Group (TCG) is an example of a company that sold out before the peak. The AT&T stock received by holders of TCG shares after the buyout was of significantly higher quality (at least at the time). TCG never made a profit before it was acquired by AT&T in July 1998. Of course, it is possible that TCG could have begun to turn a profit before the capital wells ran dry in 2000, but the history of similar carriers suggests otherwise.

Roughly \$10.4 billion of the \$11.3 billion cost of the TCG acquisition was the swap of AT&T shares for TCG shares. A holder of 1,000 TCG common shares received 943 shares of AT&T stock. Based on AT&T's closing price on July 22, 1998, (the merger date) the 943 shares of AT&T were worth \$54,399. If those 943 shares were held

¹ Qwest Communications International, Form 10-K405, 1999

until AT&T's peak stock price was achieved six months later on Jan. 22, 1999, they were worth \$83,220. The lucky investor who sold on that date realized a 53% return in just six months after the merger. Of course few, if any investors held the converted stock for exactly that period. Those who held longer saw varying returns over the next year before the stock began its precipitous fall.

WorldCom's CLEC purchases were even more extreme examples of both the advantages and the perils of owning an acquirers' stock. WorldCom's major CLEC purchases, MFS Communications (MFS, December 1996), Brooks Fiber Properties (BFP, January 1998), and Intermedia Communications (ICIX, July 2001) were all deals where WorldCom swapped its stock for the stock of the acquired company.

For each of the three mergers described here, figure 10-6 shows the maximum holding period during which an investor that held WorldCom stock received in the merger would still have made a profit on the stock.

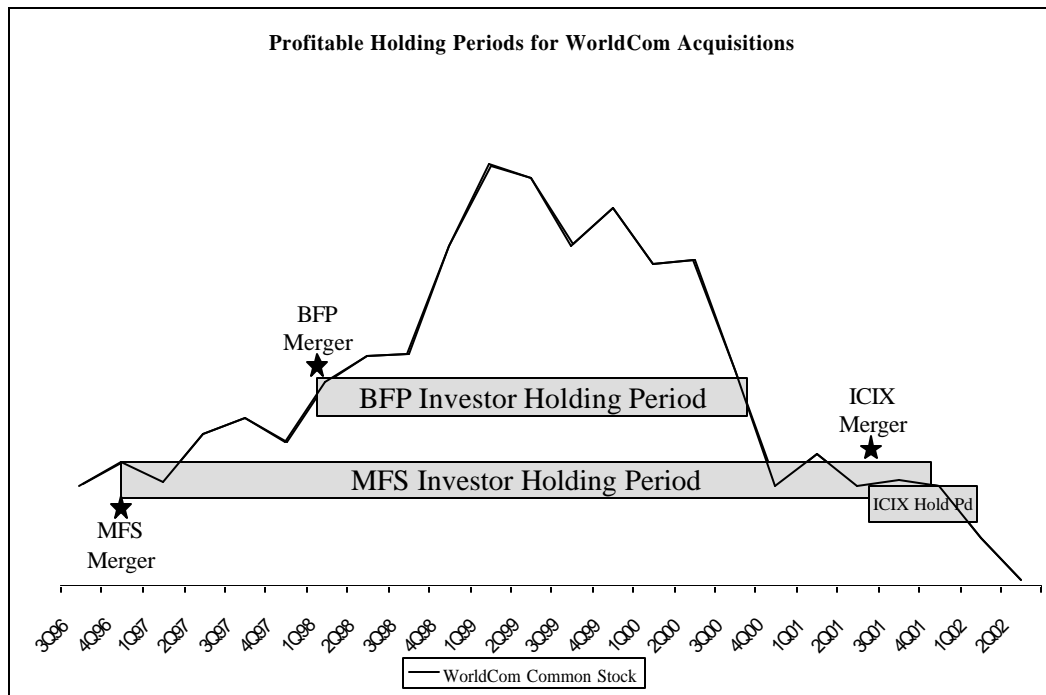


Figure 10-6. Profitable holding periods for WorldCom stock

For the MFS acquisition, WorldCom issued 411 million shares. Those shares were valued at \$26.0625 per share as of the close of the market on Dec. 31, 1996, the day the merger was consummated. An investor with 1,000 shares of MFS as of the date of the merger came into 2,100 shares of WorldCom valued at \$54,741. WorldCom's stock peaked on June 21, 1999. The shares closed that day at \$96.75. At that point, the 2,100 shares of WorldCom stock were worth \$203,175, nearly quadrupling in value. As of February 2004, those shares became worthless, but the investor who acquired the WorldCom shares had five years (depicted in figure 10-6) to decide to sell before the value of the shares finally became less than it was on the day of the merger.

WorldCom's acquisition of Brooks Fiber Properties (BFP) follows a similar but shorter time line. At the completion of the merger, 1,000 shares of BFP became 1,850 shares of WorldCom. On Jan. 28, 1998, the day before the merger was completed, WorldCom's shares closed at \$34.25, making the 1,850 shares worth \$63,362. At WorldCom's peak, the same stake was worth \$178,987, almost triple the value at the time of the merger. In the case of the BFP investors, they had two-and-a-half years (depicted in figure 10-6) to decide to sell before the WorldCom shares slipped for the last time below their value at the time of the merger.

Not so lucky were the holders of Intermedia Communications Inc. common stock. Chapter 6 describes how misbegotten this merger was from WorldCom's perspective. The same misfortune befell investors. The merger was announced Sept. 1, 2000, but not consummated until July 1, 2001. This 10-month waiting period compared to three months for the BFP merger and four months for the MFS merger. The transaction was held up by litigation with the holders of Digex stock. Digex, while majority owned by Intermedia, was a public company itself. Digex was a hot stock and Intermedia was in trouble, so there were anomalies in the relative values of the two stocks. Digex market capitalization was as much as 50% more than Intermedia's, even though Intermedia owned most of Digex's shares. Because of this anomaly, WorldCom decided to buy Intermedia and, in effect, get a discount on Digex's stock. Digex public shareholders cried foul all the way to court.

The court fight would have been all in good fun, part of Bernie Ebbers' aggressive acquisition style, except that, in the intervening 10 months, WorldCom's stock dropped by 62%, from \$36.94 to \$14.11. The share price recovered to nearly \$16 after the Intermedia merger, but from there the fat lady would continue singing for two more years until the shares were finally declared dead in early 2004. And you thought opera was long! The Intermedia shareholders had only six months (depicted in figure 10-6) to decide to sell before their WorldCom shares got lost in the vortex.