foreword

I didn't come into the business world naturally; it was more of a breach birth. There was no one in my family, nuclear family, or extended family who was a business person. All my aunts, uncles, cousins, and grandparents were teachers or psychologists or dentists or doctors or soldiers or opera singers or academics of one stripe or another. My mom was a well-educated Air Force wife who supported all my Dad's twenty-five different postings and moves throughout his career and found time to write biographies of missionaries on the side. My brother and sister each made their way into careers in academia. My dad was a fighter pilot in World War II, and then a career officer in the Air Force for thirty years. He eventually retired in Hawaii and worked for a senior state Senator as his head staff person. He was a smart and organized professional, and I admired him as a kid. But about business he knew nothing, and so neither did I.

I cut out pictures of fighter planes and pasted them in scrapbooks as a kid. I built plastic models of airplanes, including my Dad's P-47 Thunderbolt. I could recite for you the details on every WW II US fighter plane, most of the German and Japanese ones, and the Italian one used successfully against spear-armed Ethiopians but nowhere else. However, if you said "balance sheet" or "profit and loss" or "sales and marketing," I was completely clueless. And none of my family or acquaintances knew this stuff, either.

Nonetheless, history is not necessarily destiny. I spent in my early years as first an Army lieutenant and then a low-level civil servant. It soon became clear to me that business had the potential to be more fun and more lucrative than writing government regulations. So I went to business school at night, and when two colleagues started a new company called

Applied Energy Services, a dumb name later shortened to AES, I happily signed on. After all, we had a million dollars of capital that had taken us a year to raise, a business plan that made little sense, and we were focusing on an industry—the independent electric power business—that really didn't exist yet. Moreover, we had a team, including me, which had never built or operated a power plant. How could we go wrong? Sometimes it's better not to know too much.

We were improbably successful. And as I kept being sent to strange places to attempt to do unreasonable things, I actually learned about business as it was really conducted. I had a wonderful time, and much of what I was doing was odd or funny or weird or all of the above. As I traveled and learned and had some success, I wanted to educate and amuse my Dad and convince him that I had made a good career choice. Since this was before e-mail, it seemed natural to write these experiences down and send them off as letters. And now these letters have become this book.

This book is about business done in the international arena, frequently in places where I would not recommend you take a vacation. I didn't know much about these places before I started being an "international business development expert," and so, as you'll see, the potential for misadventure was unlimited.

These stories are business adventures set in exotic climes. The stories are true and they certainly helped me to explain to my father what my life was all about. Over the years I have shared them with friends and they have been complimentary and encouraging. The letters are not didactic; this is not a how-to/where-to travel book. It's certainly not a typical business book. Nor is it really a memoir. Instead, it's a bit of all these. My goal is to be entertaining, and that's what my editor assures me this is.

Of course, I'm paying her to say that.

R. F. Hemphill
January 2014

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it's ok to fool around with rich people's money

June 1991

Dear Dad,

So here we are in yet another airplane, slogging along in coach class at thirty-five thousand feet, scheduled to get in to Minneapolis at 10:00 tonight so we can check into the hotel and be ready for our 7:00 breakfast with potential investors ("PI's" for short, not to be confused with private investigators, especially since the potential investors seem to do relatively little investigating).

We are exactly halfway through an intriguing ritual called the "Road Show," which in turn is a piece of the larger economic ceremony called "Going Public." Alternatively, it's referred to as an "Initial Public Offering" or "IPO," the first time you try to/are allowed to sell your company's stock to unsuspecting and gullible members of the "public," as opposed to those smart people known as "Sophisticated Investors" who buy your stock when you are still a private company. Note if you will that none of these terms—"public," "private," or "sophisticated"—actually have the real-world meaning you would suspect. Hey, we're in Big Finance Land, so it's a whole new language. As I may have told you, in February we decided it was time to subject ourselves to the tender mercies of the SEC and the harsh impersonality of the stock market, and move from private to public. We had close to 470 shareholders, and at 500 you're forced to be public, like it or not. The SEC administers the laws that force you into this unique state of being, and once you are public, there are many rules to follow that you never had to worry about before. Mostly reporting and disclosure, but now if you goof them up, you get to go to jail, which seems like less fun than Cleveland. I guess it's OK to fool around with rich people's money, but not with the average guy's dough. Sort of an odd ethical break there, and if I ever get to be a rich guy, I guess I'll be glad that this distinction isn't used for such crimes as murder, just for stock fraud.

But back to our story. Having boldly decided to venture forth where none of us had ever gone before, we knew we needed a guide. Thus we called up our favorite investment banks, Donaldson, Lufkin and Jennerette (DLJ), and J. P. Morgan: big, famous institutions that "take you public," and Tommy Unterberg (whose firm, Unterberg Towbin, helped us raise our first million in 1981 and thus earned a place in our hearts as Investment Bank of the Universe), and we started down the path.

And it's an interesting and curious path indeed. One key part of it involves preparing something called the "S-1" or the "Prospectus." Two or three folks from AES get to sit down in a room loaded with lawyers and investment bankers and write a document that is supposed to be, all at once: 1) a confessional of past sins; 2) a cigarette package/Surgeon General-type warning that even if some good things have happened in the past, only a fool would expect them to continue—so watch it, buster, if you plan to buy this stock; and 3) a trumpeting puff piece that says how great the company has been and how much better it will be in the future. Do these sound like conflicting purposes? Does it make the people trying to write the thing act schizophrenic? Does a chicken have lips? I don't really know if a chicken has lips. I guess it depends on whether you count his beak. This has always confused me.

So you go through seven or eight drafts of this pretty long document, trying to think "Marketing!" on the one hand, "Full disclosure so somebody doesn't sue our bottoms off the first time the stock price drops" on the second hand, and "Let's not make this too explicit because all our competitors will surely read this, just like we read theirs" on the third hand—which has remarkably sprouted from the middle of your chest after your sixteenth catered lunch of excessively cute sandwiches. Or is it all the Diet Coke?

The darn thing finally gets done—or more accurately, everybody gets tired of arguing—and off it goes to the SEC as a "draft" on which they are required to comment in thirty days. And despite all the high-priced talent we "hired," guess who really did all the work? Right, us! Maybe I'm beginning to figure this finance stuff out. And I didn't even get to choose the sandwiches.

Then begins the real fun: organizing the slide presentation, because for some unknown reason (unknown to me until now, but don't skip ahead), PI's want you to come make a fancy presentation to them. You ask hesitatingly, "But what will we tell them that isn't already in the prospectus on which we all labored so hard and that has been distributed to all of them?" And the lawyers thunder in chorus, "Don't tell them anything that isn't in the prospectus!" And then you ask why they let people who can't read buy stock for other people, but since you're now being flippant or maybe querulous, you're ignored.

And so the slides are made, and the presentation rehearsed and critiqued again by all the investment bankers and lawyers, while at the same time the Schedule from Hell is being arranged. "Go out, hit a few cities, do a few presentations, have a few one-on-ones, then we'll have the SEC comments back and we can 'go effective'," say the bankers. This last term is Wall Street code for "finally sell the stupid stock and get the money." I wonder to myself about the one-on-ones. Why do we have to play basketball with Potential Investors? I sure hope Michael Jordan isn't interested in the stock.

"OK," we say, "we know about traveling, we're big, just tell us where and when."

"Oh," they say, "for a small issue like this we think only Los Angeles, San Francisco, San Diego, Denver, Kansas City, Houston, Minneapolis, Chicago, Philadelphia, Baltimore, Boston, New York, London, Paris, Edinburgh, Glasgow, Frankfurt."

My, you wonder, if this were a big issue, could we add Beirut and Baghdad? How about Topeka and Santa Fe and Yorba Linda and Timbuktu, too? But it's too late, the prospectus has been sent out there to all these fund managers, the ones who actually buy the stock, and the schedulers are in control. So off we go.

Here's what they don't tell you:

» There isn't a free minute. Breakfast meetings starting at 6:45 AM, and then an endless chain of meetings (small ones with individual investors—these are the "one-on-ones" so it's not shooting hoops after all) or presentations (larger) where the three of us—Dennis Bakke, the President; Barry Sharp, our CFO; and me—present the same twenty-five slides and say the same things over and over and over.

» You get scheduled for a lot of breakfasts (with PI's) and lunches (with PI's) and dinners (with PI's), but since you're making the pitch and they're listening, they get to eat and you don't. However, since you don't have time to go to the bathroom, it all balances out.

» Almost none of the PI's has actually bothered to read the prospectus, and they seem, with few exceptions, a bloodless lot—"a buncha white guys in suits"—as one of our keepers put it. Maybe they're so busy, yeah, maybe the market's just full of new issues right now. ("We had five biotech companies in here at lunch," said one PI in Denver, "one of them doing something with bone fragments—thought I'd york.") Maybe they're all managing billion-dollar portfolios or maybe they actually can't read. As far as I can tell, we never actually really for sure talk to a person who, on his own for himself with his or her own real money, will buy and own our stock; we just talk to agents.

» The questions these guys ask are predictable but not key. "Why can't utilities do this?" "Who are your competitors?" "What are your future earnings projections?" I think the queries all come from a subscription service that circulates standardized questions to these guys. Mostly we answer politely, but after enough repetition and not enough sleep . . .

» In San Francisco a fat guy with a big walrus moustache and a goatee stands up and says with great detail and florid manner, "Pretend I'm your little old grandmother, who you love and adore, who has raised you since you were a wee baby, who worked two jobs to put you through college, etc., etc., and I, your cherished and saintly grandmother will depend on your stock for dividends to support me through the remainder of my pain-wracked life, etc., and I'm about to put all my life savings into it. (*Pause, dramatic flourish, drumroll if we could have had one.*) What do you say to me, your dear beloved grandmother, about your stock?"

» Dennis pauses thoughtfully, then answers, "Buy some shares, and get a shave."

» The obnoxious guys are just as likely to buy as the ones who tell you you're wonderful. It's totally unpredictable. For example, we had a dreadful meeting with Citicorp. We thought this would be swell, because they're our current corporate lender. They led the refinancing of one of our projects, so you'd think they would be at least receptive, but they were that finest possible Wall Street combination: arrogant ("We already know all about your business"); rude; and unprepared (they hadn't really read the Prospectus, and in fact they didn't know all about the business). They said things like, "Well, of course all this values crap will have to change once you're public." This was perhaps unwise as an introductory line, at least with us. At the end of the meeting Dennis politely suggested that they not buy the stock, at which point the two DLJ salesmen in the back of the room began sobbing. We left the meeting, and twenty minutes later they put in a big order. Go figure. Of course, they're probably the same ones who turn around and sell in a second. There is an awfully large amount of money in these here United States, and an awfully lot of less than wonderful people managing it.

» The salesmen don't do any selling. They set up the meetings with the fund managers, and they come with you to the meetings, presumably so you won't get lost. And I guess they advise someone on whether or not to have a meeting at all, although I didn't detect any particular fine screening going on. But you (we) do all the talking and answer all the questions. This is all fine, actually, as the salesmen haven't read the Prospectus, either.

» —These people don't seem to want to become our close personal friends. They don't even ask us for our business cards. We're spoiled, because most current shareholders are AES people or friends or relatives, not flinty-eyed fund managers trying to beat the S&P 500. What a shame, with us so charming and all.

» They don't ask about the two best things—the values of the company and the management practices—even though we highlight them. They're mesmerized by the numbers. For example, in Los Angeles at a breakfast meeting, Dennis was just about to start our presentation when he was interrupted in mid-sentence by a loud portly guy who said, "Wait a minute, wait a minute, what are the earnings projections?" I guess they can't read but they can count. The DLJ salesman gave him the numbers, because for some reason we're not allowed to. Of course, the DLJ people got them from us. If captured and tortured they'll probably rat us out. The fat guy looked them over and muttered, "Sounds like a growth stock to me," and ignored the rest of the presentation. And he placed a big order.

» Maybe some of them can't count, either. We spend thirty minutes with a guy from some fund. He asks how we decide to do a new project. Dennis gives our (by now) standard answer: 1) It has to be financeable, which means a coverage ratio of 1.25 to 1.35, on an all-debt basis; 2) It has to have an internal rate of return of 9% real, regardless of financing; 3) It has to provide a net present value of $50 million to the company, discounted at 15%. The guy is awestruck for some reason. He ends the meeting by saying, "I've never met a management as quantitative as you guys are!" I desperately hope that this is not true and make a mental note not to invest the pension fund with this person, since this is Finance 101 stuff. It was probably a good thing the meeting room had a name on the door and not a number.

» The investment bankers fly in First Class while we fly in coach. This seems odd. One wonders idly if they're being paid too much.

Tomorrow I finish up in Minneapolis (well, OK, I didn't know it was a big center for capital, but at least it's not January) and Roger Sant, the CEO, takes over my piece to finish the tour. Dennis, hardy soul that he is, will have done all the meetings; Roger and I will each have done half. Thank goodness that boy has so much energy.

One last funny thing: we were very clear in the Prospectus that the four AES values (fun, fairness, integrity, and social responsibility) govern how we try to act in our business dealings, and not "maximizing shareholder wealth" or other similar economic goals. The SEC lawyer did read the Prospectus during his thirty-day comment period and actually had a comment. He now wants us to move this discussion of values from where it is right now, in "Management of the Company," to another part of the Prospectus called "Risk Factors." "Boy, that's pretty funny," said one of the salesmen with us. "Our government's saying it's risky to try and do business in this country by relying on fairness and integrity." We agreed.

Love,
Bob