Surviving the Tech Tsunami

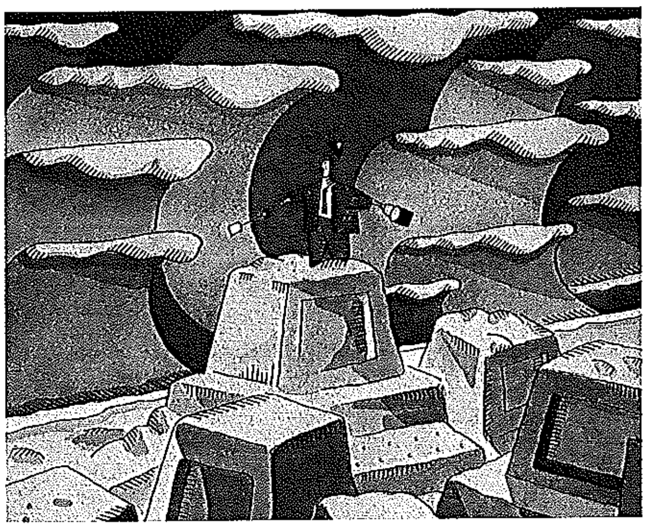
An Entrepreneur's Story of Perseverance and Flexibility

By J. SMOKE WALLIN, '93

HIS IS MY TAKE ON THE TSUNAMI called the Internet boom and bust of 2000. Much has been, and more will be, written about this special time in history. As the founder of eSkye.com, I raised over $58 million, hired and fired more than 120 people, including many of my Owen friends, fought the Venture Capitalists and bought them out, and survived to tell the tale today. Here is my version of events and lessons learned so far.

Calm Waters: A Little Background

I was always interested in technology and thought I would start my own business. In seventh grade, I won second prize in the Manatee County (Florida) science fair for a solar system BASIC program I wrote, running on a Commodore64 (as in 64 kb). When I read *Atlas Shrugged* in eighth grade, my fate was sealed as a devout follower of the John Galt way. I had numerous fits and starts in high school and college in creating little businesses. When in 1988 I joined my future ex father-in-law's Indianapolis liquor distribution company—after a lackluster college career at Cornell University—I figured I had all the basic training I needed (having



closed Johnny's and Dunbar's more than my fair share those four years).

I spent most of 15 years helping to build National Wine & Spirits (NWS, www.nwscorp.com). I was active for many years in the industry and was chairman of the Wine & Spirits Wholesalers of America (www.wswa.org) in 2003-2004. At the time I joined, National had revenues of $150 million and was the leader in Indiana. After stints in store merchandising, sales, brand management, and as leader of the team that started a bottled water business (Cameron Springs sold to Nestle in 2000) I attended Vanderbilt. I became de facto CIO of NWS during my last semester. NWS had purchased the smallest liquor distributor in Chicago (at $90 million in sales) in 1991, my first year at Owen, and had recently closed on one of the largest (at $200 million in sales). NWS was having a crisis in managing their information systems staff. I stepped in as the only person who knew anything about technology. I had weekly updates from my direct reports faxed to me at the Owen library, as no one at the company had e-mail at that point, while mine was limited to the VAX system run by Vanderbilt. While I fancied joining Boston Consulting Group out of business school (I was our finalist that year in the interviewing process), the lure of helping to build a large family enterprise at a senior level drew me back.

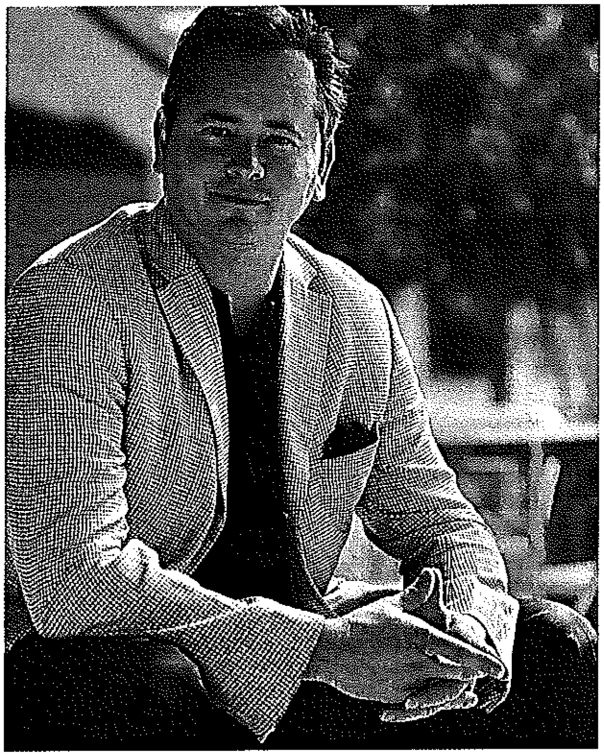
Fast forward to 1999: After six years of hyperactive growth, NWS had more than $1 billion in annual beverage transactions and operated distribution businesses in four states, as well as all 50 states with our beer marketing company. I was the CFO of the company, and we had just completed a $110 million public bond offering that recapitalized the business.

J. SMOKE WALLIN, '93, the 1998 Owen Distinguished Alumnus, is an 18-year veteran of the wine and spirits industry, and a seven-year veteran of the technology industry. He has served on the boards of two publicly traded companies, and is the founder and chairman of the Wine Industry Technology Symposium (www.wineindustrytechnologysymposium.com). He is the active father of four children, and the oldest of seven siblings, three of whom are Vanderbilt alums. Smoke and Anitra reside in Indianapolis one-half time with the kids and in Sonoma County near his customers the balance. He is an avid snowboarder and former remedial surfer.

Between 1998 and 2000, MORE *than $350 million of* VENTURE FUNDING *went into Internet* START-UPS *in the beverage alcohol industry. Of the many high profile companies started then,* eSKYE *is the only one left* STANDING.

Leading up to this point, I led the corporate group that created new businesses under the umbrella of our existing distribution business. By 1999, these new business ventures accounted for $550 million of NWS's total volume. Our technology group had created many new applications and was widely viewed as the industry leader in using technology effectively.

When the family chose to hunker down and discontinue the acquisition and growth strategy that we had successfully executed over the past decade, it gave me just the excuse to venture out on my own and start eSkye.com. What follows is a part of my story of the events that occurred during that interesting moment in time, and a brief epilogue.



Smoke Wallin continues to serve on the boards or as an advisor to numerous private start-ups and is chairman of the Foundation for Entrepreneurship and Experiential Learning, which under his leadership grew to more than $10 million last year.

DANIEL DUBOIS

Riding the Wave: Founding and Funding

I founded eSkye with Andrew Lobo '93 and Clay Wallin '97 to bring technology to the wholesale wine and liquor industry and its suppliers and retailers. This is an industry that was created by two Constitutional amendments (1919 and 1933) and over 50 different sets of local laws and regulations. The distributors are, almost without exception, second, third, or fourth generation businesses. All have been very successful financially, and as a result many have had limited need to innovate or leverage technology in their business. With EBITDA margins of 6-9 percent, these are some of the most profitable distribution businesses in the U.S.

eSkye's model was simple. We wanted to create a B2B hub whereby restaurants, bars, and liquor stores could purchase all their liquor supplies from one site. These orders would flow to whichever local distributor had the rights to a given brand in that territory. Thus we were working with, not against, the entrenched interests.

We recruited top talent. Key Owen Alums who joined our start-up efforts included Andrew Lobo '93 (now head of strategy at Sports Authority), Donna Zavada Wilkensen '93 (head of HR at the Indiana Pacers...btw Donna, how was managing Artest?), Eduardo Benzious '00 (Diageo in Brazil), Billy Huger '93 (hedge funds in Atlanta), Curt Castelinet '93 (engineer in Denver), Duane Williams '93 (BCG in San Francisco), and Clay Wallin '96 (VP Sales at eSkye). Other Owen alum investors included Robert White '93 (manager at NWS), John Baker '94 (manager at NWS), Nicholas Whitcombe '92 (investment banker in New York), Frank Hughes '93 (bank president in Chattanooga) and Drew Nygard '93 (consultant). Nashville natives Orrin Ingram and Robert Lipman were, and continue to serve, on our board of directors.

After an initial seed round of key individuals and friends of mine, we set out to raise some real funding in the summer of 1999. Importantly, our view was that this industry took a long time to develop as it is, and that changing it through technology would also take a long time. In October, we closed on $6.5 million of equity for our nascent business. One-third of the round came from liquor distributors, one-third from venture capital including Draper Richards, H&Q (now JP Morgan), Blue Chip, Monarch, and the other one-third from individuals. These were heady times for dot-coms, and B2B was the hottest of all segments, with public offerings for Vertical Net, Purchase Pro, Chemdex, among others skyrocketing. Valuations of even private efforts like WebVan, which raised $1 billion, were out of control.

One of the VCs who invested with us said we should buy a boat so we could entertain recruits we were trying to hire. He was convinced that this was a success factor at one of his fund's holdings. Andrew and I looked at each other in amazement. Never had we heard such silliness coming from the mouths of supposedly serious business people.

We launched our service to retailers and restaurants in Chicago and Michigan in September 1999, just four months after starting the business. By early 2000, it was clear that the effort would take longer and require much more capital than originally anticipated. Plus the markets were looking favorably on B2B at that point, so we decided to raise a much larger round of financing.

The key to any financing is getting a lead. The rest is really easy in filling out a round. But getting that lead can be elusive. At the Chase H&Q conference in Snow Bird, we successfully cornered a potential lead partner at Softbank and gave him our pitch. At the same conference, we cornered a lead partner of CMGI's @Ventures. Both agreed to meet with us later that week, one in Palo Alto, one in Boston. @Ventures was first. They offered us $50 million on the spot for a 25 percent interest in eSkye. The next day, Softbank heard our pitch in Boston. Shortly thereafter, they committed $100 million for 40 percent of eSkye. We agreed to pursue Softbank, as they had the best international network, and given the global nature of the drinks industry, this was attractive to us. They were arguably the most desirable fund in the world to have as a backer of any technology company at this point in time. After due diligence in March, mostly during the NCAA Final Four Indianapolis, at which we entertained our Softbank guests, we were set to close in early April. They told us, "You guys are one of the top 10 companies we have seen," and "We have never had a deal get this far and then not close." After much haggling all around, Softbank agreed to be cut back to only $75 million, and we were able to squeeze in another $25 million from others, including JP Morgan and many individual investors. The behavior of some investors was interesting, as they vied with each other to be included in the deal.

By the end of April, the NASDAQ market crashed. Softbank backed out at the last minute as the market deteriorated. They actually pulled all term sheets of companies that they had not closed on the same day. We were devastated. We had to scramble to find replacement funding. All those frantic funds and investors, who were screaming bloody murder when they were being cut out because of Softbank, were now not returning calls.

We then realized that our opportunity was still there, that we were the best in our space, and that the crash would impact our inferior competitors much more than us. Sure enough, we got right back on track and closed our $48.5 million round within two months. It took all of our team's persuasive powers to convince JP Morgan to step up and lead, given their existing investment and the fact that they wanted a lot more of the deal than Softbank was willing to allow. With only two weeks of cash left in the bank, we closed on the first bit of what would end up being a $48.5 million round for 40 percent of eSkye. This funding would turn out to be the last significant B2B exchange deal done in the world.

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An Entrepreneur's Rules of the Road

Ready. Fire. Aim. Victory belongs to the bold.

1. You must be absolutely committed to your idea/business. No obstacle is insurmountable if you are fully committed. Perseverance will trump almost anything.
2. Success is based on your ability to recruit and maintain the very best talent.
3. Flexibility in how you achieve your goals is critical.
4. Never take yourself too seriously. Business is not war, and there are much more important things in life.
5. Have faith. At the end of the day, no matter how hard you prepare and work, there are many factors outside your control. There is a higher power that will determine the outcome. When things look darkest, count your blessings and have faith.

SURVIVING TECH TSUNAMI

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Tides Turn: Shifting Sands

Fresh with funding, we set out to fulfill promise of our business. We hired some of the leading people out of the industry, the star liquor buyer from TGI Fridays, and 10 key executives from world spirits leader Diageo. Our business model of taking a small transaction fee on every distributor order along with selling marketing (advertising) to brand owners, and charging a small subscription fee to retailers had something of a chicken and egg dilemma to it. Distributors would participate, but only if enough retailers actually wanted the service. Retailers wanted it, but would only use it if we had all or most of the brands in the market, and suppliers with huge budgets would spend against the channel, but not until a significant number of retailers were actively using the service. Even against these forces, we were successful at getting distributors in 37 states to participate. We had numerous retailers including TGI Fridays, UNO, Marriott, Hyatt, and many independents initially sign up and participate in our pilot launches. With the capital in place, we thought we had the time to develop the business over the long haul.

As the financial markets continued to fall, the financial community became increasingly panicked. A memo went out at one of our largest investors giving the blanket directive to look throughout their portfolio of venture deals, identify anyone with cash, and then "go out and get the cash back." eSkye was one of the few dot-com start-ups that had not blown their cash nine months after raising it. As a result, we got a lot of attention by the VCs as they attempted to recoup their investments.

Our view was that they had invested a minority share in a private company. They had not lent us the money. They had three out of 10 board seats. We were just getting started with our business, and just because it was slow going and the financial markets were bad, this did not warrant us ending our pursuit.

The result of these diametrically opposed views was a nearly year-long battle between our "long term" investors and management, with the board stuck in the middle. The board hired Nashville native Jim Neal, a Vanderbilt Law School graduate, to represent them. The VCs had aggressive New York counsel.

It seemed like the longest year of my life. There was incredible pressure to shut the business down and distribute the cash. I was still a director and EVP of NWS and could have gone back there or done something else. And yet we persisted. When an independent investment bank recommended liquidating, we thought it was all over. In spite of this, we had a burning desire and sense that if we just stuck it out and survived, we could make a great and lasting business.

In the midst of this, we had a VC negotiation scheduled for September 11, 2001, in New York City. A couple of days before the meeting, it was rescheduled for Chicago. Thus we found ourselves at O'Hare airport the morning of 9/11 watching the horrifying events unfold on CNN. After that, the fight seemed to leave the VCs. We convinced them that we were committed to remain and fight to continue the business indefinitely.

By the end of the year we mutually agreed on a buyout, and by February 2002 had purchased the shares of the dissident VCs and any shareholders desiring to exit. The terms of the settlement are sealed. We had weathered the onslaught of the financial community and were free to pursue our business.

2001-2003 were tough times in the software industry after the boom years of the 1990s and 2000. Management and the board spent most of 2001 in the VC fight and not building the business. We had to abandon our B2B exchange for lack of revenue generation. Very few major purchases were being made by industry in general as we repositioned the company to provide software and services to the beverage industry using our original software as a core offering. To survive these slow and difficult times, we cut our staff down from a high of 110 to a low of fewer than 10 employees. We had to be flexible with our evolving business model.

Epilogue

Between 1998 and 2000, more than $350 million of venture funding went into Internet start-ups in the beverage alcohol industry. Of the many high profile companies started then, eSkye is the only one left standing.

Today, eSkye is the leading provider of software and services to the global beverage alcohol industry. We have five of the top 20 wineries in the world and more than 200 wineries using our solutions to make or sell their wine. More than 150 distributors are connected to our Web-based network, and eSkye has numerous strategic consulting engagements with industry players. Customers include Constellation Brands, Diageo, Fortune Brands, Foster's, Pernod Ricard, and some of the top independent wineries in the world. eSkye is growing organically and actively pursuing our acquisition strategy. We have grown our revenue 685 percent over the past three years.

We are in reach of our financial goals, and have remained committed to our founding principles of integrity and hard work. While the eSkye story is still being written, I can confidently say, in spite of tough times and against all odds, perseverance and flexibility prevailed. **VB**