

## TURNAROUND, HERE WE COME

Companies position themselves to soak up pent-up demand when the economic fog clears up.

BY DAVID MCCANN

**F**or many companies, experiencing the recession involves hanging on in survival mode — dumping costs, squeezing bucks out of working capital, and praying for an economic turnaround to rescue them in 2010. But since business is all about maximizing opportunities, even companies that continue to thrive are pushing hard to make sure they'll take full advantage of a bounce-back.

In many cases the effort consists of forging ahead with new products, services, and pricing in a time when controls on corporate costs will continue to be tight, regardless of improving fiscal health. Recent interviews with senior finance executives at three companies — Hughes Communications, McAfee Inc., and Sabrix Inc. — revealed a strong bent toward adapting their offerings to customers' shifting buying preferences.

A big opportunity for Hughes, a provider of high-speed satellite internet connections, for instance, lies in the 10 million to 15 million North American consumer "households" — including small businesses — in areas where there's no access to cable, DSL, or cellular broadband service. The company currently has about a half-million subscriptions within that market.

Making hay out of that opportunity requires a big capital investment. Hughes announced last month that it finalized a deal for the construction of a second satellite, at a cost of \$400 million, to handle new subscribers. That amounts to almost 60% of the company's \$676 million revenue for its North American broadband service — including both consumer and enterprise customers — for the 12 months ended March 31. Worldwide revenue was just under \$1.1 billion.

But there wasn't much doubt that the cost would be justified, said Hughes CFO Grant Barber. Before April 2008, when the company launched its first dedicated satellite, all of its capacity was served through leased transponders on satellites owned by other operators. The cost of providing service that way is about \$25 per customer per month. But for subscriptions handled by its owned satellite, that cost drops to \$6 or \$7. "The cash-flow gen-

eration from owning your own satellite is staggering," Barber told CFO.com. And there's lots more left to save: Hughes still leases about 112 transponders in North America at a cost of \$160 million annually.

The key to another huge profit opportunity is that the new satellite, slated to be launched in 2012, is expected to have at least 100 gigabits of storage space — 10 times more than the existing one has. As that satellite gets filled, monthly per-customer costs could shrink to microscopic levels, relatively speaking. "For the same service offering, our cost could drop to a buck or two," Barber said. "At that point our margin will have gone from \$43 [with leased transponders] to \$66."

That difference in margin will really prop up the bottom line if the company continues at its current rate of revenue growth, which Barber said has been about 17% to 20% per year. The pace has barely slowed during the recession, something that surprised Hughes executives.

In fact, they delayed finalizing the satellite deal, which was announced last September just as the economy was melting down. They waited until they were confident that demand for the company's services would not be severely affected. "When the economic crisis hit, we wanted to be careful not to mis-time that event," said Barber.

The goal was to start work on the new satellite soon enough to be ready to launch a few months before the first one reached capacity. The executives also want to have enough time to position and test it before it's needed to start absorbing demand. Having it ready too early would force the company to needlessly pay the fixed operating costs on the second satellite; merely delaying the launch wouldn't really be an option, because a contract with a launch company must be nailed down nine months to a year in advance.

But completing the satellite late would be no better. That's because the company then would have to again lease costly transponder space to handle excess demand. "We couldn't take a risk of being months without capacity in the market," Barber said. So the company

made an equity offering in May 2008 in which it raised \$100 million to help fund the development when the time was deemed right. Fortunately, the company's stock price was around \$50 at the time, compared to about \$21 today.

Still, Hughes executives didn't know what effect the economic downturn would have on new subscriptions, making it risky to pull the trigger on the development deal too soon. Sensing a customer marketplace in which there would be reduced appetite for up-front costs, the company created an alternative pricing plan with an activation fee of only \$100 instead of \$300, counterbalanced by a \$10 higher monthly subscription fee.

As a result, Hughes had record fourth-quarter subscription sales and even stronger performance in the first quarter of this year, when there were 53,000 new customers for a 14% year-over-year increase. More than half of the new subscriptions have been under the new plan. "It showed that catering to a more conservative market was the right thing to do in the current marketplace," Barber said. The growth sealed the company's decision to wrap up the satellite deal.

### Down Payment on the Future

Similarly, with the number of system and network security breaches rising steeply, McAfee hasn't seen any falloff in demand for its security software. To the contrary, net revenue for the publicly traded company grew to \$448 million in the first quarter, up 21% from last year's Q1. More than half of that increase was attributable to several acquisitions the company made, but organic growth amounted to \$31 million in the quarter.

While McAfee has reined in many areas of spending to keep its cost structure in line with other software companies, it's using some of its cash for major upgrades to its IT infrastructure, enterprise resources planning system, and customer relationship management system. The goal, in part, is to be ready for an economic upswing. "We're able to spend more now because of the market conditions, but we're also looking to be positioned to handle accelerated growth when the economy gets better," said Keith Krzeminski, senior vice president of finance and chief accounting officer. "To not do it would be to risk forgoing that growth."

The CRM upgrades, for example, are designed to make sales forecasting and order processing easier so that the sales force can spend less time working with internal technology and more time selling to an expanding market, Krzeminski said.

He acknowledged that because business has remained so brisk, the company has considered that there may not be as much pent-up demand for security software as there could be for some other kinds of applications. Still, McAfee is positioning itself to benefit from an expected continuation of tight cost controls.

A key goal of the acquisitions has been to assemble a broad array of security tools and combine them with McAfee's existing products on an integrated platform. That will allow the tools to be managed from a single command post and let customers realize savings by reducing the number of security vendors they deal with, according to the company's pitch. "It's a play to customers' needs — they're looking for the highest level of protection at the lowest possible cost," Krzeminski said.

### Hurrying to Market

Current results are more mixed for another software vendor, Sabrix. During the recession many potential customers are putting off decisions on whether to buy the company's core product, an application that calculates sales and use taxes as an add-on to enterprise resource planning systems. "They're saying they just need to see what the next quarter looks like before they do anything," said Jeff Stephens, CFO of the privately held company.

At the same time, though, the company is seeing increased demand for a tax-compliance outsource service it launched in 2007. The service not only calculates the tax, but also prepares the returns. Coming soon, according to Stephens, is an added service that will file the returns with jurisdictions and make the payments.

That's one of several services Sabrix is hurrying to get ready well in advance of previous timelines. "We've pulled some things in years ahead of the original roadmap," Stephens said, "to take advantage when people start spending again." Not that they'll be spending wantonly. After the economy clears up, the company believes businesses will still be very careful with costs. Demand may therefore grow for outsource services, which typically cost less than enterprise solutions.

The urgency to bring new services to market grew out of an executive meeting last October. "Companies were talking about survival, but that didn't sound like it should be our goal. We talked about what we had to do to thrive when this thing turns around," said Stephens.

Another plan was investment in human resources. Sabrix had decided earlier to merge its two operating divisions and eliminate redundancies in sales, engineering, administration, and customer support, which pared the work force by 10% to 15%. But the company has approved enough open positions to bulk back up by more than 5% in order to take advantage of the availability of good people, especially those with technical skills, who are out of work.

The company also boosted its spending on advertising and marketing, to get out the message about its outsource services.

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