

Corporate Strategy by David Goldman

Merger boom: an echo of 1929?

The takeover binge is changing character as illiquidity reigns.

Three times the number of tender offers, mergers, or sales of existing subsidiaries of U.S. companies were announced during June 1984 compared with the previous month, a survey by *Executive Intelligence Review* shows.

Unlike the early spring wave of multi-billion dollar tender offers, concentrated in the oil industry, the present boom has failed to support the stock market. It appears that a qualitative change has occurred: whereas corporate managements outstrove each other in bidding up the value of stock under acquisition earlier this year, a great deal of corporate equity is now changing hands at more modest prices.

There is an unsettling similarity between the wave of bank-financed takeovers during 1984 and the bank-financed stock speculation of spring and summer 1929, although the former case involves trading of assets among corporations rather than trading of stock among individuals.

Bank credit demand resulting from lending to stock-market margin accounts drove overnight money rates to 12% by mid-1929, setting up the October crash. Foreign investors could then buy American stocks at a fraction of their past value, buying dollars at 30% under their 1929 parity.

The United States is a net debtor nation as of mid-1984. To what extent will these debts be paid in the form of a great selloff of American equities to foreigners, and at what prices?

The answer is complex. Foreign banks financed the oil company mergers, which required \$35 billion in off-

shore credits during the single month of February. The presently rising dollar has brought no perceptible foreign interest to the U.S. stock market.

But the takeover wave appears to be entering an intermediate phase showing unmistakable signs of worsening corporate liquidity, pointing to such a selloff in the not-distant future.

The change in character of mergers and acquisitions between February and June may reflect a long-awaited deterioration in the liquidity position of U.S. corporations. Led by the oil companies, U.S. corporate management took on a record amount of bank debt during the first half of this year in order to finance takeovers of existing corporate assets.

Management of Fortune 500 companies paid premium dollars for acquisitions that made no special economic sense, merely in order to avoid being acquired themselves. For the chief executives of acquiring or acquired companies, the acquisition process turned into a game of high-stakes poker, leading either to huge compensation agreements—i.e., to the management of Norton Simon when Esmark bought it out—or to the cold, where Esmark's management went after Beatrice Foods bought it out.

The celebrated case of Saul Steinberg, whose Reliance Insurance Corporation threatened to acquire Disney Corporation and was driven back (\$190 million ahead) only after Disney threatened to borrow itself into the ground and take Reliance with it, drove the whole process to a new extreme of absurdity.

The evident lack of economic sense behind most of the big mergers turned out to be a major depressant for the stock market, particularly after the large bond rating services looked askance at the huge debt-financing requirements of the mergers. Lower bond ratings reflected the higher debt-servicing burdens of acquiring companies.

Corporations, who had acquired bank debt at a staggering 22% annual rate of increase during the second quarter, paid doubly, as the demand for business loans helped to push up interest rates.

It is evident that second-quarter profit figures will have fallen, partly as a result of the acquisitions orgy. Managements are now under pressure to raise cash, and are putting up for sale subsidiaries at prices below book value—often after paying double book value for the same subsidiaries. Because the terms of the sale of subsidiaries are generally not disclosed (with good reason), it is difficult to tell how rough things are for corporations trying to pay down a substantial load of acquisition debt. However, there are several cases in which profitable subsidiaries of top Fortune 500 companies have been put on the block at roughly half of book value.

Distress sales in disguise are a pattern marbled through the merger announcements, while other firms are still making top-dollar offers.

Another ominous sign is the current bidding for International Telephone and Telegraph, whose disastrous second-quarter dividend wiped about one third off the huge firm's stock price. This is a harbinger of the next phase of the takeover pattern: Rather than selling off subsidiaries to raise cash, Fortune 500 companies will themselves be acquired at much-reduced stock prices.