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BusinessWeek

JULY 26, 1993 A McGRAW-HILL PUBLICATION $2.75

"RETAILING WILL NEVER BE THE SAME"

THE HOME SHOPPING REVOLUTION

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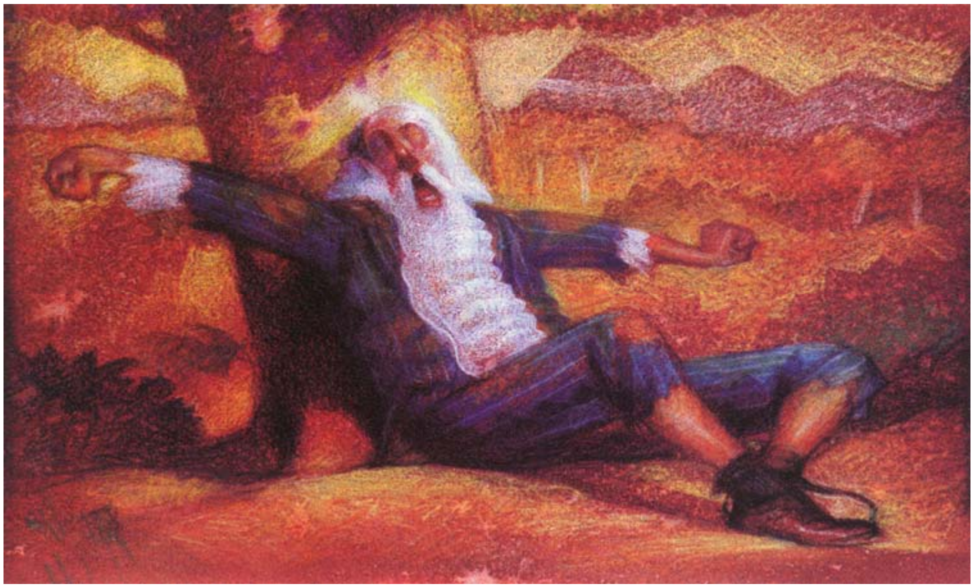


A WAKE-UP CALL FOR THE M&A CROWD

It's not quite the '80s, but activity is picking up lately

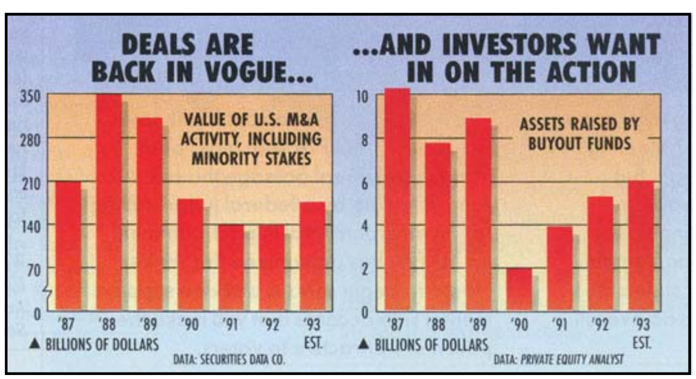
Damon Corp. was ripe for the picking: It held a strong franchise in the medical-testing segment of the hot health-care industry as well as $170 million of hobbling debt from its 1989 leveraged buyout. Rival National Health Laboratories Inc. took the bait, making a $280 million offer in June. Ten days later, normally conservative Corning Inc., which had been eyeing Damon for years, jumped in with a decisive strike—a $401 million cash offer of its own. Done deal. "We didn't want to get into a highly publicized bidding contest," says E. Martin Gibson, chairman and CEO of Corning's lab -testing business.

RJR-Nabisco it wasn't. Indeed, only with a monumental leap of imagination could this miniwar be likened to the bid-'em-up days of the 1980s. But to Wall Street investment bankers, many of whom have spent more time sharpening up their golf games than doing deals in the past three years, these are hopeful times. "I'm doing 14 deals right now," says Los Angeles investment banker Lloyd Greif. "Last year I was doing five." He's not alone: U.S. merger-and-acquisition activity is up nearly 40% so far this year, to a healthy if not giddy $87.5 billion, according to Securities Data Co. (chart).

OFF THE FENCES. The reasons? Investors and lenders-banks, pension funds, and mutual funds among them—have returned to the M&A fray, swelling the pools of capital in their hunt for higher returns. And a robust stock market is making stock swaps far more attractive. Witness the proposed $1.4 billion stock deal, announced on July 12, that will join the nation's two largest home shopping networks, QVC Network Inc. and Home Shopping Network Inc. (page 54). Nearly one-third of the year's top 35 deals so far involved at least some stock swaps, according to Securities Data.

But the catalyst for much of the deal-making has been a weak but sustained economic recovery that has turned many fence-sitters into active acquirers. Investment bankers say the recognition late last year that the economy had stabilized encouraged executives to shift gears from survival mode to growth. For some, it's easier to buy growth than generate it internally. That's one reason for the interest in Medco Containment Services, Inc., a mail-order drug company that is talking to several suitors—including, possibly, Merck & Co. (page 29).

No one predicts another M&A boom. The multibillion-dollar deals of the '80's are still a rarity, because lenders now require more equity than they did five years ago—typically, at least 25%. Many banks, chastened by losses in the last merger rush, are reluctant to take on huge deals, even in syndicates. And more than a few people still worry that the fragile economy could once more slip backward, shutting off the deal flow as quickly as it did in 1989.



Even so, the money is coming back. The recent sale of British Petroleum's animal feed business attracted not only industry buyers but 30 financial bidders as well. An investor group led by the Sterling Group, a Houston buyout firm, won the battle, for $425 million. "It's incredible that for a deal that size, 30 financial buyers would have the equity to do it," says Jeffrey R. Sechrest, the co-head of M&A at Lehman Brothers, which represented one bidder.

HUNGRY FOR JUNK. With cleaner balance sheets and shored-up capital bases, some commercial banks are lending again. When Martin Marietta offered to by some General Electric aerospace assets for $3 billion, BankAmerica and J.P. Morgan quickly came up with a the $2.2 billion in senior debt needed to complete the transaction. BankAmerica Vice-President Dan D. McCready says that the banks need to make those loans to supplement lines of business such as real estate lending and credit cards that have become less profitable.

At the same time, mutual funds hungry for high yields are snatching up junk bonds as quickly as they hit the market. And commercial finance companies such as Greyhound Financial are competing for less-risky loans, providing more senior debt to midrange deals than in the past. "The competition today is getting as fierce as it was in the late 1980's," laments Les J. Lieberman, executive managing director with Indosuez Capital, which has been making M&A loans since April of 1992.

What's driving many investors is an increasingly firm belief that the stock market can't continue to provide the high returns of the last decade. That's one reason American Airlines Inc.'s pension fund decided to pump $120 million into buyout funds during the past two years. Tom K. Lynch, a principal with pensions fund adviser Wilshire Associates, says most funds are underinvested in riskier—and higher-yielding—funds. "They're saying: 'Where do I replace those double-digit returns I got in the '80s'?" he explains.

In the end, though, the deals still have to make some sense. Indeed, preceived efficiencies and shared resources are at the heart of most of these mergers—most notably in telecommunications, where regulatory and technological shifts have made it nearly imperative for companies to seek strategic partners. U.S.West Inc. bid $2.5 billion for a 25% stake in Time-Warner's cable and film business in May. Two weeks later, British Telecommunications invested $4.3 billion in long-distance carrier MCI Communications. Both deals matched partners preparing for the advent of fiber-optic technology.

Both transactions, too, yielded the big-time fees investment bankers love. Hear the creaking? That's Wall Street learning to smile again.

By Amy Barrett in Los Angeles, with Leah Nathans Spiro and Kelley Holland in New York, Mark Maremont in Boston, and bureau reports