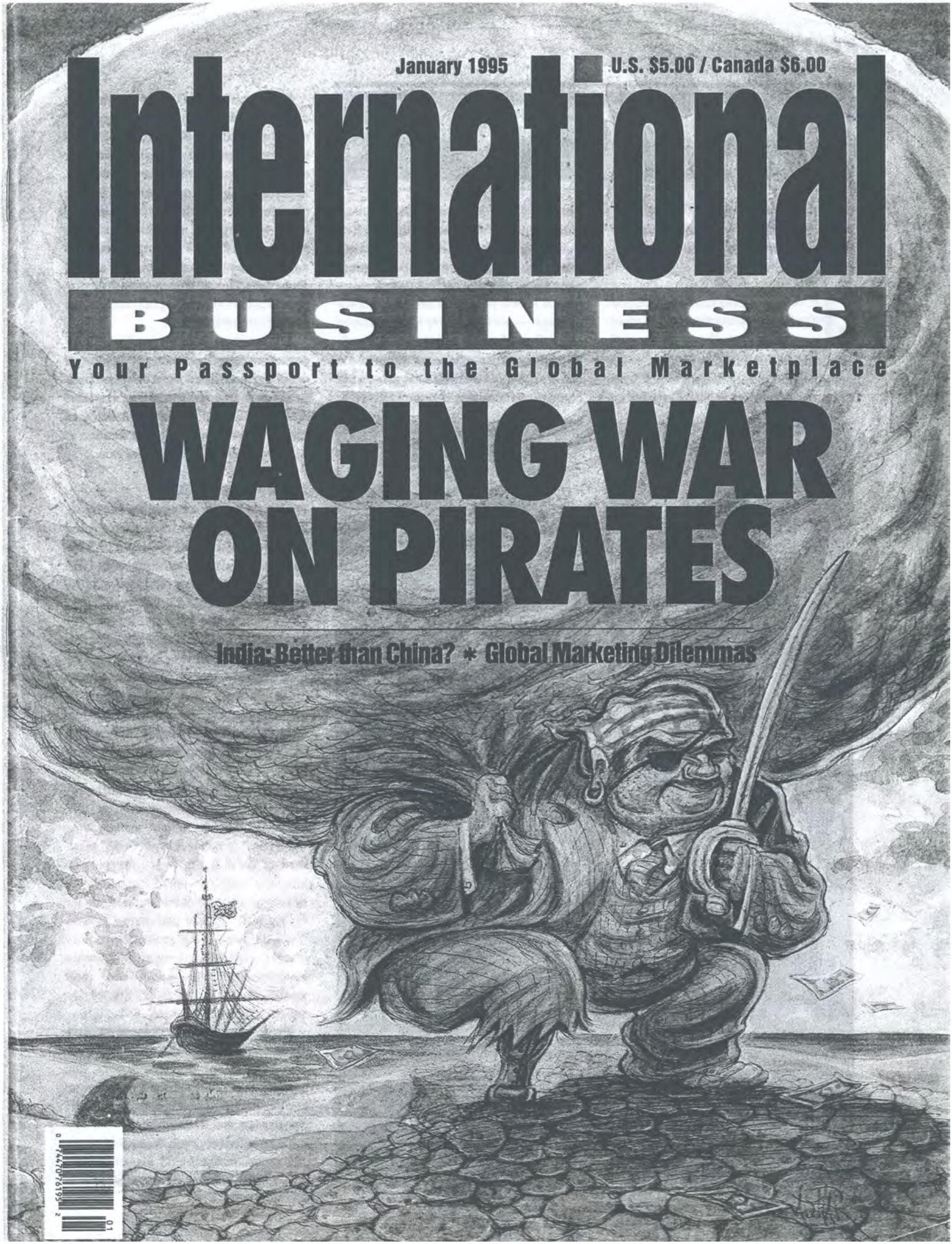
January 1995 U.S. $5.00 / Canada $6.00

International BUSINESS

Your Passport to the Global Marketplace

WAGING WAR ON PIRATES

India: Better than China? * Global Marketing Dilemmas

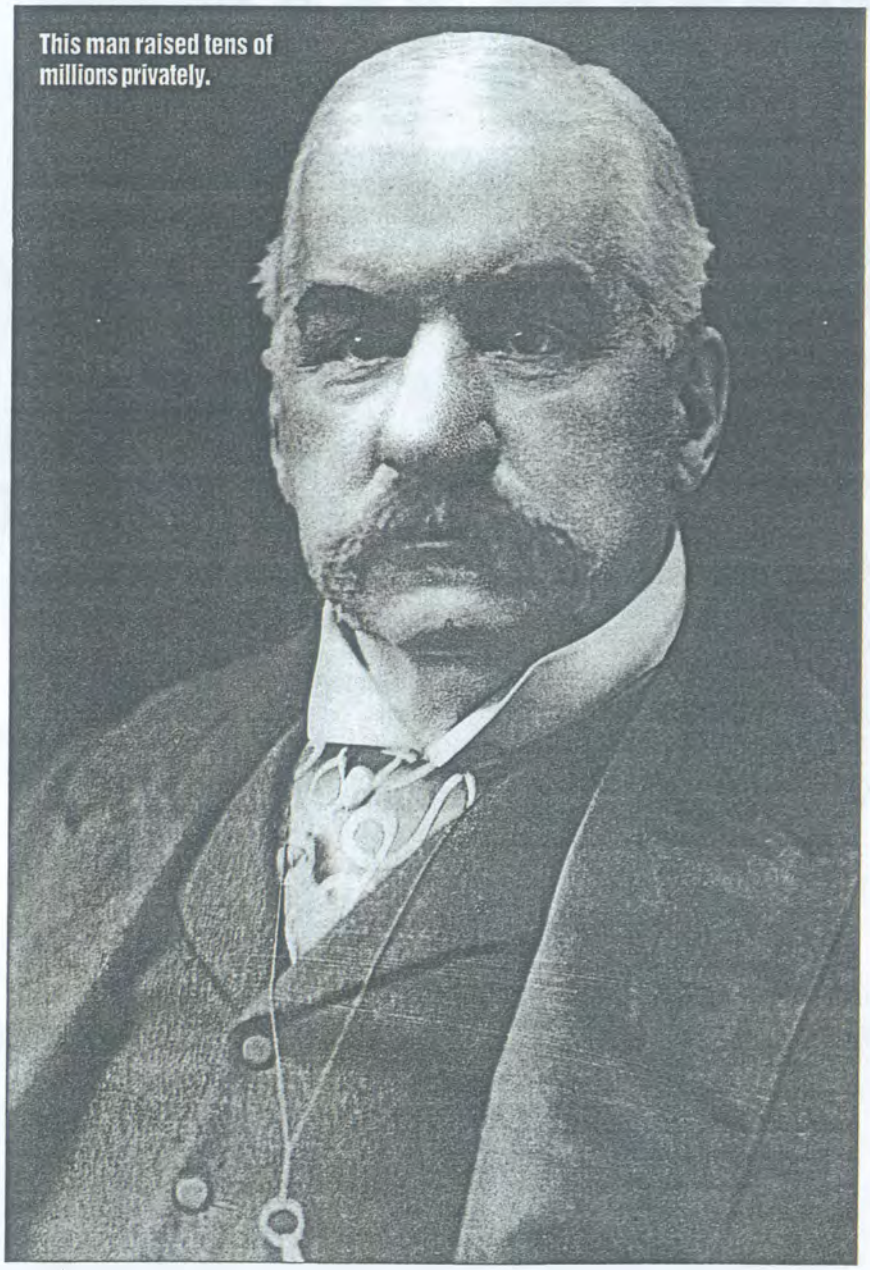


Need Money? Go Private

By Lori Ioannou

Want capital to grow? Want to forge a strategic crossborder alliance? A private placement might do the trick.

J.P. Morgan pioneered the modern art of private placements (private placements were actually among the earliest forms of financing) in 1901 when he bought Carnegie Steel to form U.S. Steel Corp. (now known as USX Corp.) from Andrew Carnegie using a $1.4 billion combination of debt and equity, much of it anted up by very rich individuals and institutions. Morgan's private-placement financing proved that such transactions — when based on sound business fundamentals — are a good way to raise money regardless of what is going on in the public markets. What it did not demonstrate is that you do not have to be a mogul or a big company to raise a lot of money privately.



This man raised tens of millions privately.

PACH/BETTMANN

More and more U.S. middle-market companies are opting to do private placements as the market for initial public offerings gets stingier and other public sources of finance become chancier and costlier. According to investment bankers, despite the relentless rise in interest rates and the rocky stock market, investor enthusiasm for privately financing companies is still very healthy. "It is not dead by a long shot," says Michael Perrot, executive vice president of Colmen Capital Advisors, an investment banking firm.

But investors are more prudent. "Companies are more fundamentally driven and are doing deals based more on sound business needs and opportunities," explains Abby Adlerman, managing director in charge of private-placement finance at Hambrecht & Quist in San Francisco.

Money Chasing Deals

That's not just investment banker hype. Private sales of stock more than tripled during the first half of 1994 to $10.5 billion compared to the same period in 1993 and are still continuing unabated, according to Securities Data Co. of Newark, N.J., which tracks the industry. Investment and commercial banks specializing in this field for midsize firms — for instance, Colmen Capital Advisors, Corestates Investment Banking and Mellon Bank in Philadelphia; and Donaldson Lufkin & Jenrette, CS First Boston Corp., Hambrecht & Quist and Normura Securities in New York — all have deals in the pipeline.

"This year the market for private equity offerings should be even stronger than 1994, because the public market is so uncertain," predicts Lloyd Greif, president of Greif & Co., a Los Angeles investment bank. "A lot of companies are putting plans to go public on hold and are opting to do private placements instead. The good news is that money seems to be chasing deals, since domestic and foreign investors-flush with liquidity-feel more confident in the predictability of the private-placement market."

Even debt private-placement markets are not suffering as badly as could be expected, given the sharp rise in rates. The amount of capital raised in the debt market has dropped precipitously with the rise in rates, but the number of deals has held up relatively well. "Companies are still accessing the [debt] market but are shrinking the size of offerings and raising

only the amount of finance they really need, not larger pools, because funding is cheap," Ms. Adlerman explains.

Valuations on private sales of stock are at near historic highs, while rates on private sales of debt notes are still attractive. Companies can lock up financing of 10 to 15 years at affordable fixed rates. Investor appetite for these issues is still big enough that even companies with below-investment-grade ratings (rated BBB- and below by Standard & Poor's Corp.) attract financing. It isn't only American institutions that are on a buying binge. Foreign institutions and corporations around the world, especially in France, Japan, Sweden and the U.K., are eager to buy stakes in America's emerging growth companies.

Leading the League: Top Managers for Straight Debt

Managers	Proceeds ($B)	No. of Issues
Merrill Lynch & Co.	9.2	193
Goldman Sachs	8.9	141
CS First Boston	7.7	270
Lehman Brothers	5.2	130
Chase Manhattan Bank NA	3.8	129

1994. SOURCE: SECURITES DATA CO.

Market Propellants

The favorable fund-raising climate is due to several concurrent trends. For one, private stock financing runs countercyclical to the public stock markets. When the public stock market is weak or nervous, the private placement market heats up as corporate fund-raisers' only other equity financing option. Last year the Dow Jones Industrial Average made wide swings between the 3,600 and 4,000 marks. Such gyrations "helped buoy investor interest and ensure good pricing of private stock sales," Ms. Adlerman explains.

Foreign investors' unwavering interest in small and midsize U.S. technology companies as well as in known consumer products companies also helps the private-placement market. "Over the last 18 months there's been a tremendous interest by the Europeans in U.S. consumer-product companies with well-known brand names," reveals Mr. Greif. Adds Ms. Adlerman: "The Swedes are targeting investments in biotechnology and the Japanese, electronics and pharmaceuticals."

Gerald Bay, managing general partner of the Vista Group, a New Canaan, Conn., venture-capital firm with $350 million under management, sums it up: "Overall, foreign investors are clamoring to get in on the deals of all-star companies with global aspirations that have strong management teams and are positioned to achieve a dominant market share in their industry niche."

That's why Integrated Network Corp., a 10-year-old telecommunications services company, canceled plans to go public in favor of a private equity offering. Because of the company's Asian ties — the company has a joint venture in China and does business in India, Korea and Taiwan — it's now actively wooing Asian institutional and corporate investors in Japan, Hong Kong, Korea and Singapore. Plans are to raise $15 million in private equity capital.

Integrated Network, however, is experienced in the private-placement markets. Over the years it has attracted venture capital from two Korean conglomerates: Kohap Ltd. and Daeyoung Electronics Industries Co. Not only did they provide capital but both helped the $40 million company make inroads in the region. Daeyoung even assembles Integrated Network's product for original equipment manufacturers in Korea. "If it hadn't been for our Asian partners, we wouldn't have had the wherewithal to access the region's markets as we had," admits Andrew H. Chapman, the company's executive vice president.

Keeping Ahead of the Fed

Companies can also refinance all or a portion of outstanding bank debt at a low rate when they sell debt privately to institutions. Rates are pegged to U.S. Treasury securities. For companies that need capital for an acquisition, or to fund purchases of plant and equipment or overseas expansion, this option is an alternative to a shorter-term bank revolving line of credit.

A midsize company can usually get 10-year fixed-rate financing at rates as low as commercial banks used to provide back in the early 1970s, on borrowings ranging from $7 million to $100 million. Ten-year deals are priced off of seven-year or 10-year Treasuries, which in early December were 7.76 percent and 7.78 percent, respectively. The rates for 10-year private debt placements hover around 1 percent to 1.5 percent above that for investment-grade credits, but can jump 3 percent to 5 percent for lower-grade credits.

Companies sitting on the fence mulling over this option are now urged by investment bankers to jump. "The sooner the better," says Peter C. Colella Jr., managing director of Colmen Capital Advisors, an investment bank that works strictly with midsize companies. Mr. Colella like most market watchers, expects the Federal Reserve to keep cranking up interest rates. Since February 1994 it has bumped up rates by 250 basis points in five steps.

Leading the League: Top Managers for Common Stock

Managers	Proceeds ($M)	No. of Issues
Merrill Lynch & Co.	4,034	20
J.P. Morgan & Co.	1,389	19
Chase Manhattan Bank NA	663	9
Salomon Brothers	530	11
Security Capital Markets Group	425	1

1994. SOURCE: SECURITES DATA CO.

Timing is everything. In October 1993, Maidenform Worldwide Inc., the New York undergarment maker that gets 6 percent of its $300 million in revenues from European sales, took advantage of the low-interest-rate environment and raised $30 million through a private sale of corporate debt notes. Even though the New York company has no credit rating, its placement agent, Corestates Investment Banking, had no trouble getting a deal with attractive financing terms wrapped up in just four-and-a-half months.

The company was able to sell 10-year notes. Maidenform's CFO, Ira Glazer, who's using the proceeds to strengthen the company's balance sheet, is ecstatic since he's been able to secure cheap fixed-rate financing that will make Maid-

enform less vulnerable to rate swings. "It will really help me plan my cash-flow decisions in the future," he says.

Financing as Foreign Strategy

From a chief financial officer's point of view the attractions of private placements are exceptional. They can be custom-tailored in myriad ways to meet funding needs. A variety of instruments can be used, from senior debt notes (the highest-ranked debt securities of a company by creditors) to common and preferred stock. Deals can even be structured as a combination of debt and equity.

Private placements are typically less costly and time consuming than public offerings.

Private placements are good for more than just raising capital. Through a private sale of common or preferred stock, a company can woo foreign corporate investors, who more often than not are looking to forge strategic alliances. That's a big incentive for companies with international business plans.

Consider Object Design Inc. The database software and services maker was able to attract two major foreign corporate investors — Italy's Ing. C. Olivetti & Co. and Holland's Philips NV — through a series of equity private placements begun in 1988. Although it's had to give up 80 percent of its stock in return for about $30 million, it's been worth it.

Not only have these corporations provided Object Design with growth capital used in research and product development, they've become distributors of its products in Europe. Olivetti and Philips have also licensed the company's core technology to develop their own proprietary products around it. And Olivetti has been instrumental in introducing Object Design to customers in southern Europe. Now 33 percent of the Burlington, Mass., company's $25 million in revenues are in Asia and Europe. "By 1996 we hope half of our revenues will be offshore," says president and CEO Kenneth Marshall.

Similarly, Sebastian International Inc., a leading hair-care product company in Los Angeles, attracted an important foreign investor — Wella AG, the $5 billion German hair-care and cosmetics product maker — through a private stock sale in excess of $50 million 14 months ago. Wella took a majority stake in the company. In return, it will broaden recognition of Sebastian's brand-name products by distributing and marketing them through Wella channels in Europe and Japan. Right now 82 percent of Sebastian's revenues (estimated at $80 million) are from sales in America; the balance are from exports.

For Petsmart, a Phoenix-based operator of 110 pet food and supply stores nationwide (with annual sales of over $330 million), its foreign investor has provided global vision. The company raised $22 million in equity capital from Carrefours SA, a large French operator of hypermarkets, through the sale of private stock. The former chairman of the French concern, Denis L. Defforey is now a board member of the company who advises on marketing and growth issues. "We're now thinking about expanding our business beyond the borders of the U.S.," reveals Donald Dorsey, Petsmart's executive vice president and CFO.

Carrefours has also helped Petsmart develop relationships with other European institutional investors. That meant when the company went public in July 1993, there was an overseas constituency of investors who knew about it. During the company's roadshow in Paris, Carrefours introduced Petsmart executives to would-be investors in Europe. "They gave us credibility with European investors," says Mr. Dorsey.

Like many companies, Petsmart successfully did an initial public offering after priming the market with a series of private placements. It did eight private fund-raisers before its lead underwriter, Donaldson Lufkin & Jenrette launched its $125 million new issue last year, selling 8.2 million shares at $18 a share, 25 percent of which were sold in Europe and Japan.

The Mechanics

Typically, private placements are less costly and time consuming than public offerings. On average they take one to five months to complete and are half the expense of a public offering, which costs 6 percent to 8 percent for debt and 8 percent to 10 percent for equity of the total net proceeds raised, including legal, accounting and syndication fees.

Private placements have other advantages. Issuing stock privately makes sense "if a company doesn't want to be in the public limelight, divulge its technology or feel hamstrung by disclosure and reporting requirements of the Securities and Exchange Commission," explains Ms. Adlerman of Hambrecht & Quist.

Private placements are not without their difficulties, of course. It is not as easy as getting a traditional bank loan. A company must put together a full-blown business plan, find an appropriate investment banking firm that will help it develop a private-placement memorandum (a detailed write-up about the company and a description of the financing), and then march in front of potential institutional investors with a good sales pitch.

Even with that it can take a long time. "For some it can be a prolonged effort of up to one-and-a-half years," says Mr. Colella. "The most important thing is to structure the deal conservatively. Don't load the company with too much debt and not enough equity and don't forecast unrealistic sales growth."

And there are other problems. For debt placements, "financial covenants can be tighter than in public deals," explains John Casale, a managing director in charge of private placements at Nomura Securities. "For example, often there are corporate restrictions on bank borrowing or on payouts of cash dividends to parent companies or shareholders."

Private stock sales have their own special drawbacks. "The major one is that a company must often sell its equity at as much as a 20 percent to 40 percent discount if investors deem that it will be illiquid for a long time and if the stake being acquired is a minority stake," points out Mr. Greif. Another is that owners must give up an interest in the company to outside investors that often take board seats and meddle in corporate strategic planning.

But such problems are obviously not deterring the growing number of companies lining up for private placements. And the lines will keep extending as long as the public markets are dicey, bank lending gets increasingly expensive, and investors at home and abroad are interested in making money from companies with good international potential. IB