Cash-Rich Seek Deals; May Emerge Mightier from Downturn

By Jackie Sindrich

New York, New York, Oct. 18, 2001 - The weakening economy that's inspiring many companies to trim down to survive is leading Corporate America's powerhouses in the other direction: Fatten up while smaller competitors are struggling.

The giants of U.S. industry, such as General Electric Co and Tyco International Ltd., are starting to use their deep pockets to continue to grow, either through acquisitions or by expanding existing operations, when many others are being forced to pull back.

The Sept. 11 air attacks have accelerated the process by driving many companies into a lockdown survival mode, leading to a lengthening of the economic downturn that was already taking hold. That could lead to a sudden boost in the control of key markets by some of the largest companies, market experts said.

"Companies that have good balance sheets are in a much better competitive position than even a few months ago," said Jim Glassman, a fellow at the Washington-based think tank American Enterprise Institute.

Not every company is rushing to do takeovers. Even some cash-rich companies worry that the economic outlook is too foggy and they've decided to put planned deals on hold. But others are seeking bargains as pinched rivals are forced to sell at prices they might not have considered before, said Victor Caruso, a partner at Gordian Group L.P., New York-based financial services firm that specializes in mergers and acquisitions.

There's growing evidence that companies are getting better bargains when they do deals. The average premium over market price paid by companies doing acquisitions has fallen sharply. So far in October, target companies have received an average premium of about $873 million, according to Thomson Financial Securities Data, about half of the $1.54 billion average last year.

Some of the strongest companies are snapping up the bargains, or beefing up expansion plans:

- General Electric, the world's largest publicly traded company, showed that it is far from riding out the downturn in the bomb shelter. It recently paid $1.98 billion in cash and stock for No. 2 U.S. Spanish-language television network Telemundo Communications Group last week.

- The No. 1 producer of aluminum, Alcoa Inc., is in talks with Australian miner WMC Ltd., in a sign that Alcoa is poised to cement its dominant position in the world markets for aluminum and alumina, analysts said.

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- Retail giant Wal-Mart Stores Inc. is gaining more market share. Its same-store sales have risen consistently, and the company said recently it will continue with its ambitious plan to open about 230 stores next year, its largest-ever increase in new retail space.

- The fast-growing No. 7 U.S. airline Southwest Airlines, the Dallas-based low-cost carrier, has decided to operate its full schedule of roughly 2,800 daily departures, while other U.S. airlines have cut capacity by about 20 percent since September 11.

Meanwhile, the failure of some weaker companies could lead to further consolidation in their respective industries. In steel, debt-mired giants Bethlehem Steel Co. and LTV Corp. have filed for bankruptcy protection from creditors. Birmingham Steel Corp. also said Wednesday it is not generating enough cash flow to pay $291 million of debt due April 1, and still hasn't reached an agreement with lenders.

The bankruptcy and shutdown of privately-held Renaissance Cruises last month will mean reduced competition in the cruise line industry, which is already fairly concentrated. Though the Florida-based company held only about 3 percent to 4 percent of the market, its exit is expected to support prices of bigger rivals such as Carnival Corp. and Royal Caribbean Cruises Ltd. , analysts said.

BE MERGER-WARY

The pervasive uncertainty in the economy could cause some companies to hold back on deals, even as the strongest companies, which can afford to take risks, plow ahead. Even putting a pricetag on a deal can be difficult with the economy in such a state of turmoil, said Caruso.

"Everyone's economic model has turned a little bit upside down. What a seller thought was a reasonable price before to finance a deal may no longer be possible," he said.

There are risks in snapping up businesses from cash-strapped companies in the current environment, experts say. Some may be buying into the same problems that led to the selling of the operations in the first place

"The merger game has been a suckers' game and has been the downfall of a lot of organizations," said James Brock, an economics professor at Miami University and author of "Dangerous Pursuits: Mergers and Acquisitions in the Age of Wall Street and The Bigness Complex."

Caruso cited Sears, Roebuck & Co. as a prime example of expansion plans backfiring. While still ranked as the No. 1 retailer, it expanded into real estate, insurance and stock brokerage through the 1980's, while its core retail operation suffered. By 1992, Sears shed almost all of its non-retailing businesses to refocus on retail, but by then Wal-Mart had taken over the industry lead.

"If you look at so-called weaker companies, you see that their previous mergers and acquisitions played a role in their weakness," said Brock.

Stuart Gilson, a professor of finance at Harvard Business School, said the U.S. economic and legal systems are well-equipped to get rid of the losers and become more efficient. But in this recession, it is more difficult to pick out the winners from the losers, he said. The fast-changing fortunes of technology companies, for example, make it harder than ever to bet on the future.

The telecom industry, for example, is founded on technologies -- broadband and fiber optic networks -- that themselves face uncertain prospects.

"When all sectors are having the same problems, it's much messier to sort out. You almost you don't know where to place your bets," Gilson said. "I'm predicting it's going to be much longer in this recession to sort out the strong from the weak."

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