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The CFO Quarterly: Third Quarter 1994

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**The CFO Quarterly:
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TABLE OF CONTENTS**PAGE**

Introduction and Summary	1
Economic, Policy and Market Trends	2
Fixed-Income Market Trends	4
Fixed-Income Liability Management Trends	10
Fixed-Income Derivative Trends	13
High-Yield Market Trends	18
Equity Market Trends	19
Mergers and Acquisitions Trends	24
Related Salomon Brothers Research Publications	26

FIGURES

1. Total Rates of Return of Selected Asset Classes, 1Q-2Q 94	4
2. Thirty-Year U.S. Treasury Yields, Jan 93-Jul 94	4
3. Yield Curve Response to Recent Fed Tightenings	5
4. Changes in Interest Rates, 2Q 94	5
5. Monthly Corporate Debt Issuance, Jan 94-Jun 94 versus 1993 Monthly Average	6
6. Principal Amount of Corporate Securities Called in the Salomon Brothers Broad Investment-Grade (BIG) Bond Index, Jan 93-Jun 94	6
7. Long-Term BBB-Rated and Medium-Term A-Rated New Issue Corporate Spreads, Jan 93-Jul 94	7
8. Issuance Volume of Put Bonds by Investment-Grade Nonfinancial Entities, 1984-1H 94	7
9. Selected Put Bond Issuances in 1994	8
10. Sample Terms for a 10 Put 5 Bond	8
11. Effective Cost of 10 Put 5 versus Five-Year and Ten-Year Bullets	9
12. U.S. Treasury Yield Curve, 17 Aug 94	13
13. The Economics in Year Five of Issuing a 10 Put 5 Bond versus Synthetic Structures	14
14. Effective Coupons of Synthetic versus Straight Put Bonds Under Two Alternative Scenarios	15
15. Effective Cost Over Ten Years of 10 Put 5 Bond versus Synthetic Alternatives	16
16. The High-Yield Market — Supply and Mutual Funds Demand, May-Jul 94	18
17. The High-Yield Market — The 12% Club, Jul 94	18
18. Total Equity Issuance, 1Q 93-2Q 94	19
19. Total IPO Issuance by Issuer Category, 2Q 94	19
20. Equity Market Capital Flows, Jan-Jul 94	20
21. Summary of Letter Stock Transactions, 1984-94	20
22. Number of Announced Stock Buybacks, 1Q 93-2Q 94	21
23. Volume of Stock Buybacks, 1980-93	21
24. Selected Recent Open-Market Repurchase Program Announcements, 12 Apr-23 Aug 94	22
25. Stock Buyback Strategies by Number of Announced Transactions, Aug 93-Jul 94	23
26. Ten Largest Merger and Acquisition Deals Announced in the Second Quarter, 1994	24

INTRODUCTION AND SUMMARY

Economic, Policy and Market Trends

- The European and Japanese recoveries will broaden over the next year, and the U.S. economy likely will expand at a 3%-3.5% annual pace in the coming months. Inflation should remain muted next year in virtually all industrial countries.

Additional Fed moves should take the funds rate to 5.25% during the winter as monetary policy easing in Europe nears its end. U.S. fiscal policy will remain moderately restrictive while continental European fiscal deficits remain high. Japanese fiscal stimulus should help to produce a modest upturn later this year.

Fixed-Income Market Trends

- The fixed-income markets drifted lower in broad trading ranges during the second quarter of 1994. Uncertainty about the strength of the U.S. economy, Fed policy, political tensions, and unpredictable commodity and currency markets sidelined investors and, ultimately, issuers. Financing spreads remained historically narrow and converged across sectors. In the current rate environment, the put bond structure has enjoyed a renaissance with more than \$1.5 billion of volume from issuers of diverse credit quality.

Fixed-Income Liability Management Trends

- Despite the rise in interest rates since the beginning of the year, many industrial and financial companies have accelerated significantly their debt-retirement programs. This activity largely reflects improving economic conditions, accelerating mergers and acquisitions, deleveraging and improving corporate liquidity and competitiveness. Moreover, managements have focused on eliminating restrictive covenants and retiring debt opportunistically.

Fixed-Income Derivative Trends

- The current market environment can be characterized by a steep yield curve, up to five years, and high volatility — compared with historical standards. As such, view-driven issuers can swap their fixed-rate debt into floating or can sell interest rate options to lower their funding costs, provided that their views materialize. Issuing put bonds or creating synthetic put bond structures are two strategies that may help issuers reduce their funding costs.

High-Yield Market Trends

- Primarily because of weak mutual fund inflows and rising Treasury yields, many B-rated high-yield bonds are now being priced to yield at least 12%.

Equity Market Trends

- Equity offerings continued to slow dramatically as the number of stock buyback programs increased in the second quarter. The initial public offering (IPO) market increasingly comprised the following: real estate investment trusts (REITs); foreign issuers; and subsidiary carve-outs. Despite market gyrations, the net inflow into equity mutual funds remained positive in the first half of 1994. "Letter stock," also known as alphabet and targeted stock, remains an alternative to equity carve-outs.

Mergers and Acquisitions Trends

- Mergers and acquisitions activity reached its highest level since 1989, totaling \$235 billion for the 12-month period ended June 30, 1994. Large transactions continued to dominate the market in a few industries, with regulation remaining the primary driver of activity. Competition for acquisitions is strong as cash resurfaces as an acquisition currency and friendly transactions involving strategic buyers dominate the marketplace.

ECONOMIC, POLICY AND MARKET TRENDS

Question 1 *What is the economic growth outlook for major industrialized countries?*

Answer 1 The European and Japanese recoveries will broaden over the next year, rising gradually to the potential pace of growth. In contrast, the U.S. economy will likely expand at a 3%-3.5% annual pace in the coming months — still above potential — and should decelerate over the next year to its potential pace, reflecting, in part, the impact of higher interest rates. Stronger-than-expected export demand and lower interest rates are improving the European growth outlook, but the moderate upturn will not prevent some additional increase in European unemployment to record highs. The Japanese economy is showing signs of recovery in housing, consumption and public investment, but falling business investment and weak net exports continue to constrain growth. Inflation should remain muted next year in virtually all industrial countries.

Question 2 *What are the economic policy prospects for major industrialized countries?*

Answer 2 After a fresh round of tightening the Fed funds and discount rates by 50 basis points each on August 16, the Federal Reserve is expected to be on the sidelines "at least for a time, to meet the objective of sustainable, noninflationary growth." Nevertheless, encouraged by still-robust growth and the weak dollar, additional Fed moves should take the funds rate to 5.25% during the winter.

U.S. fiscal policy will remain moderately restrictive and is expected to decline moderately during the coming year. However, new spending initiatives — such as health care reforms — could rekindle concerns about the appropriateness of U.S. fiscal policy.

Monetary policy easing in Europe is nearing its end — and U.K. tightening may begin this year — while continental fiscal deficits remain high. In Europe, gradual recovery will focus attention on the need for structural fiscal consolidation, labor market reforms and economic deregulation. At the same time, the large gap between potential and actual output should continue to depress average European Union (EU) inflation to a 30-year low in 1995. West German inflation appears headed down to the Bundesbank's 2% target by early 1995.

Japan's fiscal stimulus has helped to restart growth, and the Bank of Japan will keep short-term rates unchanged. Fiscal stimulus should help to produce a modest upturn later this year. Sustained yen strength is maintaining the policy direction toward deregulation and trade liberalization.

Question 3 *What is the market outlook?*

Answer 3 The recent severe tiering of European bond yields will diminish only if the high-deficit, high-debt countries restore fiscal policy to a sustainable path. Japanese Government bond yields will drop somewhat further. In the United States, although a renewed weakening of the Treasury market remains a risk, new Fed tightening and prospects of decelerating growth will flatten the yield curve later this year and set the stage for an eventual rally. The U.S. dollar will stabilize, following its recent swoon, aided by central bank intervention and higher U.S. short-term rates.

Still-solid U.S. economic growth — spurred by employment and income gains — will hold up long-term Treasury bond yields in the coming months. However, additional Fed tightening, together with the prospect of decelerating growth, will halt the sell-off and flatten the yield curve. Eventually, slowing growth should support new yield declines. Despite still-falling European inflation, new bond rallies will be limited by stronger growth, still-high fiscal deficits and U.S. market developments. Low U.K. inflation and an improved medium-term fiscal outlook will not halt a preemptive rate hike as early as late this year, as the British authorities seek to prevent a new deterioration in inflation expectations.

Financial markets in Greece, Sweden and Italy remain vulnerable unless policymakers move swiftly to restore fiscal policy to a sustainable path. The backup in ten-year Japanese Government bond yields is reversing as data point to moderate growth and no inflation. The dollar's slide versus European currencies and the yen will be halted by a combination of new Fed tightening, official intervention and still-solid U.S. economic growth. Eventually, the yen is expected to weaken to ¥108/US\$, before stronger Japanese growth helps to underpin the Japanese currency.

FIXED-INCOME MARKET TRENDS

- **The fixed-income markets entered a period of transition in the second quarter of 1994.** Although the losses of the first quarter were extended (see Figure 1), most markets settled into broad trading ranges with investors and economists trying to assess the direction of both the U.S. economy and Fed policy.

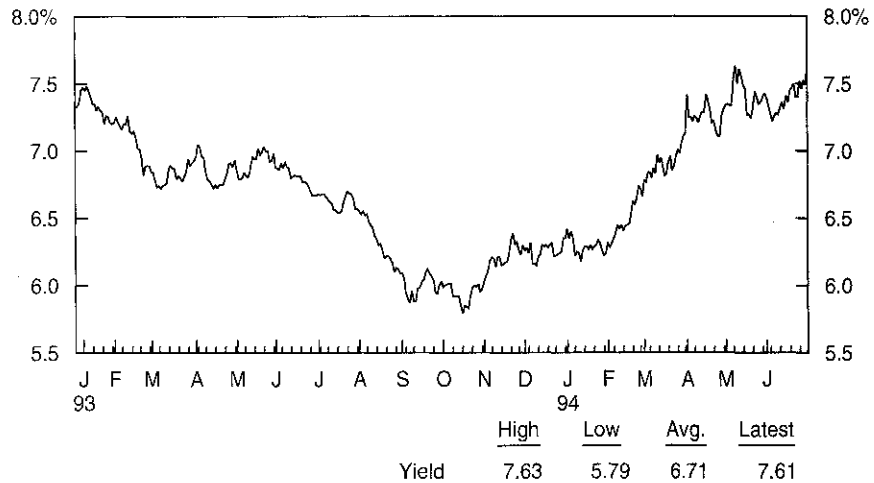
Figure 1. Total Rates of Return of Selected Asset Classes, 1Q-2Q 94

Asset Class	2Q	1Q
Treasury	-1.04%	-3.03%
Corporate	-1.41	-3.24
Mortgage	-0.54	-2.10
High Yield	-0.45	-2.09
Emerging Markets	-1.50	-19.09
S&P 500	-0.34	-4.43

Source: Salomon Brothers Inc.

- The 30-year Treasury yield traded in a 52-basis-point range in the second quarter, buffeted by two increases in the Fed funds rate, often-conflicting evidence on the strength of the U.S. economy, global political uncertainties, trade tensions, and volatile currency and commodity markets (see Figure 2). At the recent Federal Open Market Committee (FOMC) meeting on August 16, the Fed again decided to increase the Fed funds and discount rates by 50 basis points each (see "Economic, Policy and Market Trends"). It appears that the past two Fed actions benefited from a brief but frank statement that the policy shift was "sufficient at least for a time" (see Figure 3).

Figure 2. Thirty-Year U.S. Treasury Yields, Jan 93-Jul 94



Source: Salomon Brothers Inc.

Figure 3. Yield Curve Response to Recent Fed Tightenings

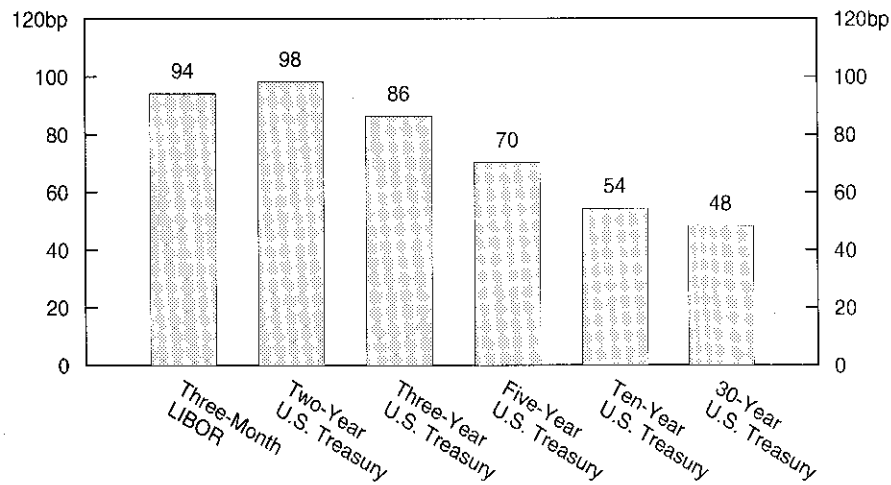
Rate	18 Apr 94	17 May 94	16 Aug 94
Fed Funds Action ^a	+25bp	+50bp	+50bp
2-Yr. Treasury	+20	-10	-9
5-Yr. Treasury	+21	-17	-14
10-Yr. Treasury	+20	-18	-15
30-Yr. Treasury	+13	-19	-14

^a The May and August Fed actions were accompanied by a 50-basis-point increase in the discount rate. bp Basis points.

Source: Salomon Brothers Inc.

- The Treasury yield curve continued to flatten in the second quarter, but the shorter end of the curve actually reached record steepness. The spread between the 30-year Treasury yield and three-month LIBOR narrowed by about 46 basis points, with most of the flattening occurring in the longer end (three to 30 years) of the curve (see Figure 4). In fact, the slope of the short end of the curve (LIBOR to two-year Treasuries) reached an historical high of 164 basis points in early April, compared with an average spread of 35 basis points over the past ten years. (See "Fixed-Income Derivative Trends" for the impact of this steepness on funding strategies.)

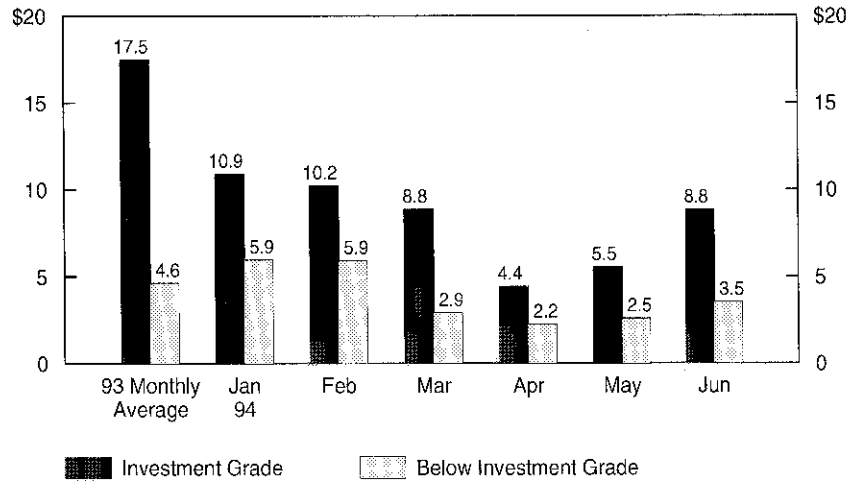
Figure 4. Changes in Interest Rates, 2Q 94



bp Basis points. LIBOR London Interbank Offered Rate.
Source: Salomon Brothers Inc.

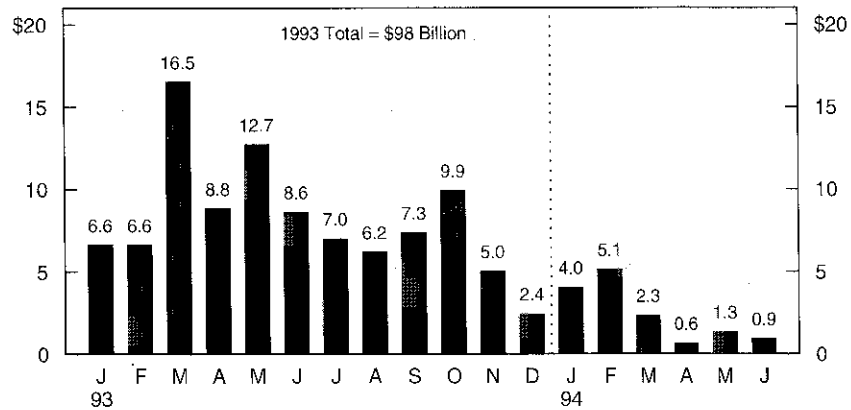
- **Financing activity slowed in the second quarter as issuers joined bond buyers on the sidelines.** An improved Treasury market in early June precipitated a brief spike in activity, but nowhere near the frenetic pace of the previous year (see Figure 5). Landmark deals in the quarter included the UAL recapitalization (\$741 million of debt and \$410 million of preferred stock) and large Yankee offerings: a Global bond for the Republic of Finland (\$1.5 billion) and floating-rate notes for the Republic of Italy (\$1.5 billion). At the same time, bond redemptions slowed to a trickle, with higher rates reducing refinancing opportunities (see Figure 6).

Figure 5. Monthly Corporate Debt Issuance, Jan 94-Jun 94 versus 1993 Monthly Average (Dollars in Billions)



Source: Salomon Brothers Inc.

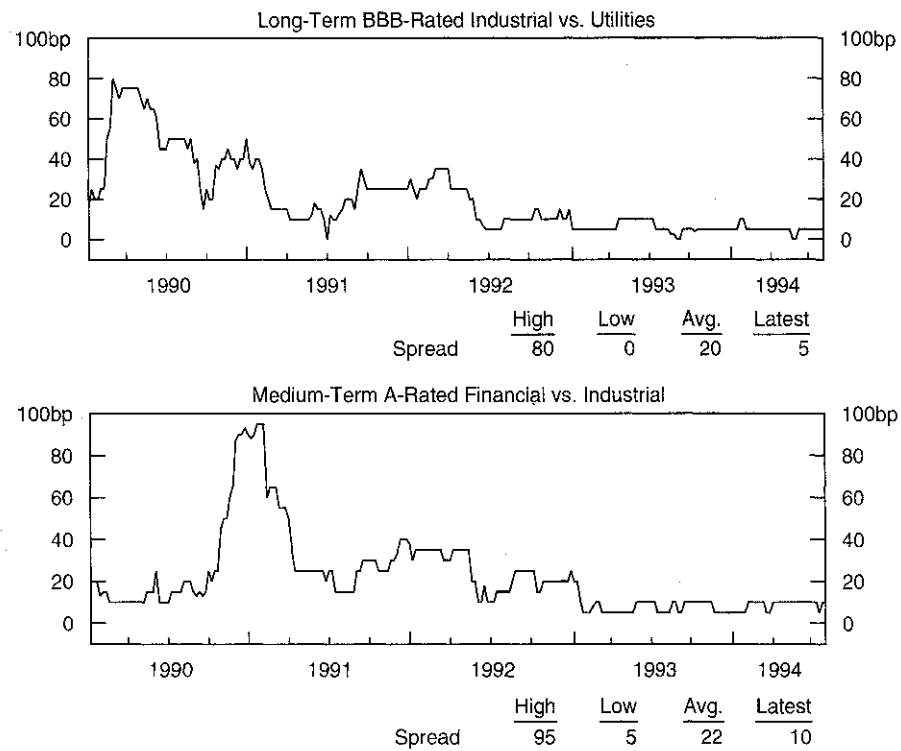
Figure 6. Principal Amount of Corporate Securities Called in the Salomon Brothers Broad Investment-Grade (BIG) Bond Index, Jan 93-Jun 94 (Dollars in Billions)



Source: Salomon Brothers Inc.

• **Corporate bond spreads continue to compress — especially for industrial issuers.** The average differential in quality spreads between industrials and utilities, or industrials and financial issuers (see Figure 7) is a modest five to ten basis points. Moderate economic growth and improving corporate profitability have enhanced the perception of corporate creditworthiness and helped all corporate spreads converge to attractive levels.

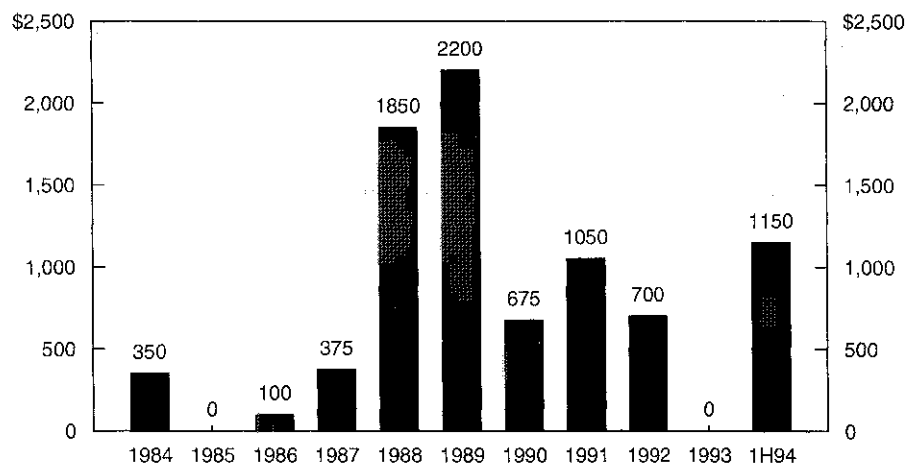
Figure 7. Long-Term BBB-Rated and Medium-Term A-Rated Corporate New Issue Spreads, Jan 90-Jul 94



bp Basis points.
Source: Salomon Brothers Inc.

- Focus of the Quarter: Put Bonds Proliferate.** In 1994, the put bond structure reemerged in the U.S. public debt market.¹ Several entities of diverse credit quality and industry type have tapped this market to reduce the all-in cost of financing and respond to investor demand for such structures (see Figures 8 and 9).

Figure 8. Issuance Volume of Put Bonds by Investment-Grade Nonfinancial Entities, 1984-1H 94 (Dollars in Millions)



Source: Salomon Brothers Inc.

¹ See *Issuing Corporate Put Bonds*, Niso Abuaf, et al., Salomon Brothers Inc, July 1994.

Figure 9. Selected Put Bond Issuances in 1994 (Dollars in Millions)

Issue Date	Principal Amount	Issuer	Rating	Coupon	Structure	New Issue Spread to Treasuries
29 Jul 94	\$200	News America Holdings, Inc.	Ba1/BBB-	8.450%	40 Put 12	130bp
26 Jul 94	100	Corning Inc.	A2/A+	7.625	30 Put 10	40
21 Jul 94	300	City of Seoul	A1/A+	7.875	10 Put 5	99
23 Jun 94	700	Hydro-Quebec	A1/A+	8.050	30 Put 12	95
08 Jun 94	200	Eastman Chemical	Baa1/BBB	7.625	30 Put 12	75
20 Apr 94	150	Columbia Healthcare	A3/BBB+	8.360	30 Put 10	90

bp Basis points.

Sources: Securities Data Co. and Salomon Brothers Inc.

By definition, a *put bond* is a traditional corporate bond where the issuer "sells" the investor an option (reflected in a lower coupon rate) to *put* the security back to the issuer at fixed dates and prices — that is, require redemption of the security. The simplest version of the put bond allows the investor to put the bond back to the issuer on a single fixed date (the *put date*) at par. We will restrict our attention to this simplest put structure.

Alternatively, a put bond can be viewed as a bond with a final maturity equal to the put date, where the holder has the right to *extend* the maturity from the put date to the maturity date at the same coupon rate. This perspective is significant, because the issuance spread of a put bond is typically quoted as a spread relative to Treasuries maturing on the put date, not the maturity date as in Figure 10.

Under either interpretation, the issuer is *selling* an option rather than *buying* an option, as in the case of a traditional callable bond. The value of the put option — as with any option — varies directly with the volatility of the "underlying security." In the case of the put bond structure, the underlying security is the issuer's cost of refinancing on the put date. Salomon Brothers Bond Portfolio Analysis Group estimates that recent put bond offerings have been priced at implied volatilities of 8%-10%. This volatility level contrasts favorably with secondary market trading levels of 4%-7% of seasoned put bonds ten months ago.

More concretely, issuers of put bonds are expressing the view that interest rates will not move dramatically from today's levels by the put date. We can illustrate this with the put bond example in Figure 10.

Figure 10. Sample Terms for 10 Put 5 Bond

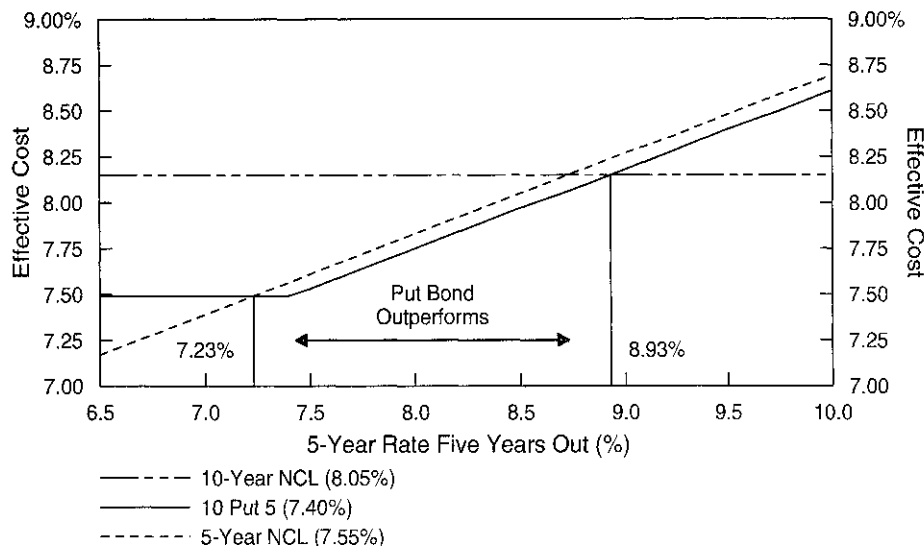
Maturity	10 Years
Put	5 Years
Five-Year Treasury	6.90%
Spread Over Five-Year	+50bp
Coupon Rate	7.40%

bp Basis points.

Source: Salomon Brothers Inc.

By comparing the effective cost of the put bond over a ten-year horizon with both the five- and ten-year "bullets," one can quantify the interest rate advantage of the put bond. (We assume that the five- and ten-year bullets are priced at spreads of 65 basis points and 75 basis points, respectively, over the Treasury yield curve.) In fact, if the issuer's refinancing cost in five years remains below 8.93% and above 7.23%, the put bond is the least-cost alternative among the three (see Figure 11).

Figure 11. Effective Cost of 10 Put 5 Bond versus Five-Year and Ten-Year Bullets



NCL Noncall life.
 Note: Numbers in parentheses indicate current coupon. Effective cost includes amortized underwriting expenses and reflects taxable equivalent yields.
 Source: Salomon Brothers Inc.

Some issuers may view the put bond as an attractive vehicle to reduce financing costs for assuming maturity risk. In particular, for issuers that expect to have the excess cash flow required to extinguish the debt on the put date, the risk of early retirement may not be onerous at all.

In contrast, some BBB-rated borrowers have included the put provision as a form of credit enhancement and price support to improve the distribution of an offering. In particular, if the issuer's spreads widen significantly, the investor enjoys a par floor under his security at the time of the put date.

From the fixed-income investor's perspective, put bonds are valuable portfolio building blocks because they enable investors to counteract the call risk that most portfolios face.² In technical terms, a put bond counteracts the "negative convexity" of mortgage-backed securities and callable corporates that causes these securities to underperform as interest rates rally.

As the market continues to wrestle with interest rate volatility, alternative structures like put bonds will continue to have appeal for both the issuing and investing communities.

² See *Bond Market Roundup: Strategy*, pp. 14-15, Greg Parseghian, et al., Salomon Brothers Inc, August 5, 1994.

Despite the rise in interest rates since the beginning of the year, many industrial and financial companies have accelerated significantly their debt-retirement programs. This activity has been caused largely by the following developments and goals:

- **Improving Economic Conditions.** The strengthening U.S. economy and successful corporate restructurings have boosted cash balances. Many companies are using this cash to retire outstanding debt.
- **Accelerating Mergers and Acquisitions Activity.** Many companies are actively consolidating their core businesses and divesting from noncore activities. Such restructurings point to a reevaluation of liability portfolios, probably resulting in debt reduction or liability restructuring.
- **Deleveraging.** Companies are still committed to improving their coverage ratios by reducing interest expense through early debt retirement. To take advantage of the relative strength of the equity and equity-linked markets, some companies have replaced debt with equity.
- **Improving Liquidity and Competitiveness.** Enhanced access to the capital markets has led companies to reevaluate the maturity profiles of their debt portfolios. To improve liquidity and financial flexibility, corporations are cleaning their balance sheets from heavy future refunding requirements by extending the maturity of their liabilities or retiring debt.
- **Declining Book Loss.** The rise in interest rates has caused some debt to trade near or even below par, eliminating the book-loss concerns of previous debt-repurchase activity.
- **Eliminating Restrictive Covenants.** Bond indentures often restrict the financial flexibility of issuers (for example, they may limit dividends, change in control, asset sales, among others). A comprehensive debt-retirement program can eliminate such restrictive covenants, freeing up the issuer to pursue its strategic objectives.
- **Retiring Debt Opportunistically.** The increased volatility in interest rates and the reshaping of the yield curve have caused relative mispricings among certain securities. Issuers can opportunistically exploit such mispricings by selectively negotiating transactions with debt holders.

As a result of the above developments, companies can target several forms of debt for retirement: bank lines; commercial paper (CP); and term debt.

Paying Down Bank Lines and Commercial Paper

Paying down bank lines and CP have similar economic and accounting implications — notwithstanding possible restrictions imposed by bank covenants. The advantages of CP paydown are as follows:

- **Frictionless (Cheap) Execution.** When paying down CP, execution costs are negligible. Moreover, unlike term-debt investors, CP investors are unlikely to react adversely to a CP retirement.
- **Favorable Accounting Impact.** Typically, CP paydown does not generate book losses or gains. Such neutral accounting impact compares favorably with retiring longer-term, higher-coupon debt, which may trade at a significant premium over book value, thereby generating a book loss and an associated decline in earnings per share.

On the other hand, the disadvantages of CP paydown are as follows:

- **No Tax Advantages.** Because paying down CP is tax neutral, companies forgo the tax advantages associated with retiring long-term, premium debt.
- **Cheapest Form of Debt.** By paying down CP in an upward sloping or steep yield curve environment, companies eliminate their cheapest source of funds.

Retiring Term Debt

Usually, companies can achieve significant benefits by targeting term debt for retirement. The following factors are critical in determining whether companies should retire term debt:

- **Positive Economic Valuation.** Retiring long-term debt and refinancing it with shorter-term debt typically results in net present value savings because of the following reasons:

- (1) if the yield curve is upward sloping, by "rolling-up" the yield curve, companies can effectively earn the difference between long- and short-term rates;
- (2) because longer-maturity borrowings have typically wider spreads to Treasuries, by shortening their borrowing maturities, companies may be able to lower their effective financing costs;
- (3) typically, this is considered a credit-neutral to positive transaction, not affecting the company's borrowing spread; and
- (4) repurchase premiums are immediately tax deductible.

- **Favorable Market Mispricings.** As a result of the high volatility of interest rates and the continued flattening of the yield curve, particularly in the three- to 30-year segment, some debt instruments may be significantly undervalued. Issuers can take advantage of such opportunities by retiring specific issues in negotiated, open-market repurchases. Complex instruments, possibly with embedded options, seem to be the best candidates for retirement. These include the following: structured notes; refundable debt; cash callable debt; and puttable/extendible debt.

- **Negative Accounting Impact.** When companies purchase long-term, high-coupon debt, the premium over book value that they pay generates an accounting loss. This undesirable accounting loss, however, may be mitigated by the tendency of both equity and fixed-income analysts and ratings agencies to treat economically advantageous events positively.

- **Investor Constraints.** Investors who are cash rich, like high book yields or have held-to-maturity securities per FAS 115 are unlikely to — or may be restricted from — participating in an issuer-sponsored debt-retirement program.

- **The Treatment of Off-Balance-Sheet Hedges.** Certain debt securities may be economically tied in to an underlying off-balance-sheet hedge, such as a swap or swaption. Typically, the hedge (the derivative security) receives hedge accounting treatment as long as it is a designated hedge against a specific liability. In other words, the changes in the value of the derivative security are not marked to market through the income statement.

If, however, an issuer decides to retire a debt instrument with an associated hedge and does not unwind the hedge, then the issuer must mark the hedge to market and flow through the associated profit or loss to the income statement. If the issuer decides to unwind the hedge, then the associated

profit or loss also is reflected in the income statement immediately. Because the loss on a hedge may overwhelm the economic benefits of a debt buyback, issuers should carefully evaluate the tax and accounting implications of buying back debt with tied-in hedges.³

Forms of Execution

In the *CFO Quarterly: Fourth Quarter 1993*, we outlined several forms of debt-retirement strategies that issuers may pursue, including tender offers, reverse Dutch auctions and open-market programs. Currently, open-market repurchase programs seem to be favored over public tender offers. This is because tender offers typically entail a premium over secondary market levels (greater accounting loss), whereas open-market repurchases can be executed discreetly and by negotiation. On the other hand, open-market programs take longer and do not achieve the same level of investor participation.

³ For example, assume that an issuer sells a receiver swaption to monetize the call option embedded in a callable bond. If interest rates fall, the issuer would call the bond at par, generating an economic profit but no accounting profit. If the issuer were to unwind or mark to market the sold receiver swaption, then it would report an accounting loss.

FIXED-INCOME DERIVATIVE TRENDS

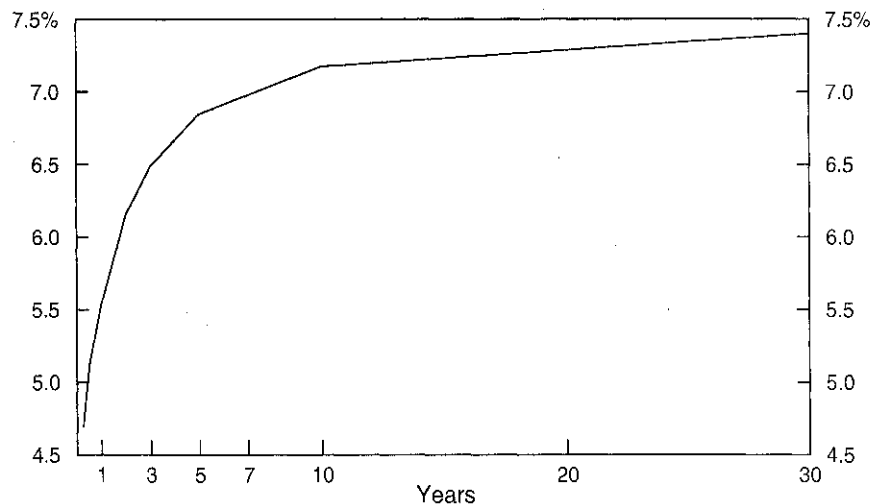
Question 4: *How can issuers reduce their borrowing costs in the current environment?*

Answer 4: The current market environment can be characterized by a steep yield curve, particularly up to five years, and high volatility — compared with historical standards (see Figure 12). As such, view-driven issuers can swap their fixed-rate debt into floating or can sell interest rate options to lower their funding costs, provided that their views materialize. We outlined various strategies designed to exploit these views in *The CFO Quarterly: Second Quarter 1994*.

Of these strategies, two, in particular, have gained recent popularity:

- issuing put bonds⁴ (see "Fixed-Income Market Trends"); and
- creating synthetic put bond structures.

Figure 12. U.S. Treasury Yield Curve, 17 Aug 94



Source: Salomon Brothers Inc.

Question 5: *What synthetic structures are similar to issuing put bonds?*

Answer 5: Two synthetic structures are economically similar to issuing put bonds: selling payor swaptions and selling receiver swaptions. First, an issuer may reduce its cost of funds by selling payor swaptions, which give a holder the right to pay a fixed rate in a predetermined swap versus a floating-rate index, such as three-month LIBOR.

To create a synthetic put bond, similar to, say a 10 Put 5 bond, an issuer:

- issues a simple ten-year bond and sells a payor swaption (cancelable strategy):
- to pay a fixed interest rate equal to the coupon of the simple ten-year bond;

⁴ For a detailed analysis of this strategy, see *Issuing Corporate Put Bonds*, Niso Abuaf, et al., Salomon Brothers Inc., July 1994.

- with a maturity equal to the maturity of the put, that is, five years; and
- with a style similar to that of the put bond, that is, a European swaption with a one-time put in year five.

On the exercise date of the put, if interest rates rise above the strike (that is, the coupon of the bond), the holder of the payor swaption exercises his option to pay fixed and receive floating. The issuer then can enter into a simple interest rate swap to receive floating and pay fixed. The economics of this outcome is virtually identical to a 10 Put 5 bond's being put back to the issuer and the issuer's having to refinance at higher rates.

Alternatively, to create a synthetic put bond similar to a 10 Put 5 bond, an issuer:

- issues a simple five-year bond and sells a receiver swaption (extendible strategy):
 - to receive a fixed interest rate equal to the coupon of the simple five-year bond;
 - with a maturity equal to the maturity of the put, that is, five years; and
 - with a style similar to the style of the put bond, that is, a European swaption with a one-time put in year five.

On the maturity date of the option, if interest rates rise above the strike, the holder of the receiver swaption does not exercise his option and the issuer issues a five-year bond at the higher interest rates. If, however, interest rates fall on the maturity date, the holder of the receiver option exercises his option and receives the above-market coupon on the swap and pays a floating-rate coupon to the issuer. In addition, the issuer must refinance at new levels. That means in any future interest rate scenario, the issuer must refinance. Assuming the company issues floating-rate debt, the effective coupon is the then five-year swap rate plus the company's credit spread over a floating-rate index, such as LIBOR.

Figure 13 summarizes the economics of a conventional put bond versus alternative synthetic structures.

Figure 13. The Economics in Year Five of Issuing a 10 Put 5 Bond versus Synthetic Structures

Issuer Strategy at Inception	Interest Rates Rise	Interest Rates Fall
Issue 10 Put 5	<ul style="list-style-type: none"> • Bondholder puts bond. • Issuer refinances for five years. • Risk: Level of Treasuries, credit spreads. 	<ul style="list-style-type: none"> • Bondholder does not exercise put. • Issuer rides out the term of the bond in original terms.
Issue 10-Year NCL and sell Payor Swaption (cancelable strategy)	<ul style="list-style-type: none"> • Swaption holder exercises his option. • Issuer pays LIBOR and receives fixed. • Issuer can swap into a fixed rate for the remaining life. • Risk: Level of Treasuries, credit and swap spreads. 	<ul style="list-style-type: none"> • Holder does not exercise swaption. • Issuer stays with 10-year NCL.
Issue 5-Year NCL and sell Receiver Swaption (extendible strategy)	<ul style="list-style-type: none"> • Swaption holder does not exercise option. • Issuer refinances for five years. • Risk: Level of Treasuries, credit spreads. 	<ul style="list-style-type: none"> • Swaption holder exercises option. • Issuer pays fixed and receives LIBOR. • Issuer refinances at LIBOR plus spread. • Risk: Level of Treasuries, credit and swap spreads.

NCL Noncall life.

Source: Salomon Brothers Inc.

Question 6:

What are the pros and cons of issuing a straight put bond, compared with a synthetic structure?

Answer 6:

The swaption market currently trades at higher implied volatilities than comparable embedded options in the corporate bond market. This results in higher option premiums for swaptions. Figure 14 compares the effective coupons of a straight 10 Put 5 structure with the equivalent extendible and cancelable strategies under a low-interest rate scenario (ten-year horizon), and a high-interest rate scenario (five-year horizon). We compute the relative savings by amortizing the received swaption premium over five and ten years, respectively.

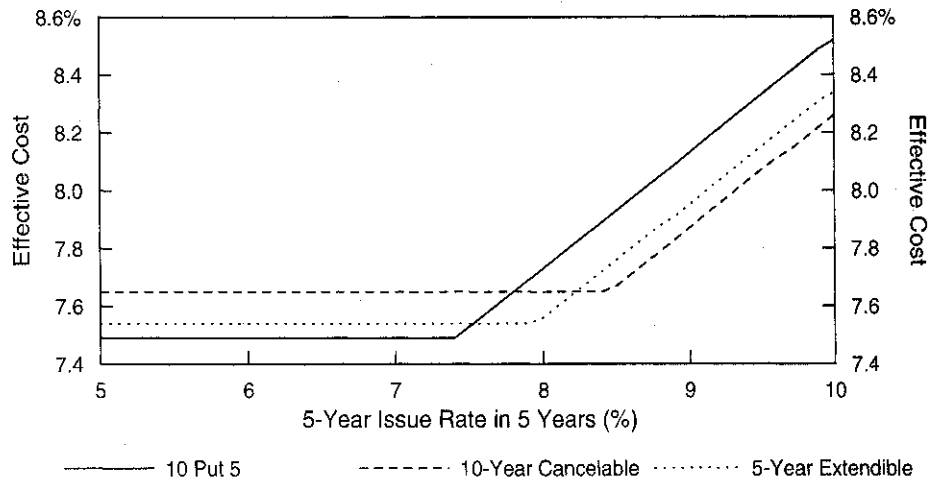
Figure 14. Effective Coupons of Synthetic versus Straight Put Bonds Under Two Alternative Scenarios

Structure	Strike	Effective Coupon	
		5-Year Horizon	10-Year Horizon
		High-Interest Rate Environment ^a	Low-Interest Rate Environment ^b
10 Put 5	7.40%	7.40%	7.40%
Cancelable Strategy	8.05	7.22	7.55
Extendible Strategy	7.55	7.10	7.45 ^c

^a Assumes bonds will get either physically or synthetically put to the issuer. ^b Assumes bonds will not get either physically or synthetically put to the issuer. ^c Assumes refinancing at year five at LIBOR plus 40 basis points. Source: Salomon Brothers Inc.

These synthetic structures are virtually, although not perfectly, identical to a conventional put bond. This is primarily because the implied option strike prices are set at different points, compared with the five-year swap rate five years out (that is, 8.32%). Stated differently, although both cancelable and extendible strategies replicate synthetic put bond structures, the extendible strategy behaves like a put bond that has a greater likelihood of being put. That is, compared with the cancelable strategy, the extendible strategy's synthetic put is more in the money. Moreover, in five years, the synthetic structure will be exercised depending on the prevailing swap rates, whereas the conventional put bond structure will be exercised depending on the prevailing corporate bond rates. That is, the strategies do not have identical implied risk characteristics regarding swap and credit spreads occurring at the put date (see Figure 13).

Figure 15. Effective Cost Over Ten Years of 10 Put 5 Bond versus Synthetic Alternatives



Note: Effective cost includes amortized underwriting expenses and are quoted on a pretax basis.
Source: Salomon Brothers Inc.

Figure 14 merely reflects the relative economics of our three strategies under two alternative scenarios. Figure 15, however, illustrates the relative economics of our three strategies under a broad range of future interest rate scenarios and assuming a ten-year horizon.

Depending on the outcome of future Treasury rates, credit spreads and swap spreads, one of the three different strategies may turn out to be superior to the others — as shown in Figure 15. Note that Figure 15 assumes a corporate reissue spread equal to LIBOR plus 40 basis points.

The swaption market also may not be very liquid for maturities beyond ten years, making it difficult to duplicate many put bond structures through the swaption market. Furthermore, the issuer's tax and accounting situation might prevent it from doing a synthetic structure.

The Securities and Exchange Commission (SEC) is considering whether to require mark-to-market accounting for derivatives with embedded written options. Depending on how broadly the SEC plans to apply the proposal, the accounting for synthetic structures such as the examples described above could be vastly affected. If applicable to these examples, the written swaptions would have to be marked to market (with the mark flowing through the income statement), while the debt would continue to be accounted for on an amortized cost basis. Overall, this may create a financial reporting imbalance, and the synthetic structure may no longer mirror the economics of a put bond issuance.

Question 7:

What are the tax implications of issuing put bonds and related synthetic structures?

Answer 7:

The tax treatment of put bonds is similar to the tax treatment of straight bonds. That is, coupon payments are treated as tax-deductible interest for tax purposes. If the issue is put back on the put maturity date, then the tax treatment is as if the bond matured on the put date. In addition, remaining unamortized underwriting expenses are expensed on the put date.

However, the tax treatment of original issue discount (OID) put bonds is somewhat more involved. Simply stated, the yield to maturity on a long-term debt obligation and the amount of OID is generally determined using the higher of the yield to put or the yield to maturity.

The tax treatment of a synthetic put bond structure (issuing a simple bond, and selling a swaption) follows these guidelines:

- similar in principle to the tax treatment of a straightforward put bond;
- however, the up-front option premium received is ignored until the exercise date of the put;
- if the option is not exercised, the premium is included in income; and
- if the option is exercised, the option premium is amortized over the life of the swap.

Question 8:

What is the accounting treatment of put bonds and related synthetic structures?

Answer 8:

If the put is at par, then its accounting treatment is similar to that of a simple bond. If, however, the put is at a premium, then the issuer should accrete a liability for the put premium over the period from the date of debt issuance to the initial put date. If the put is not exercised, the put premium should be amortized as a yield adjustment over the remaining term of the debt.

In the year of the exercise of the put, if the issuer intends and has the ability to refinance the puttable debt with debt having a maturity of greater than one year, then the issuer can continue to classify the debt as long term. Otherwise, the debt should be reclassified as short term.

Synthetic put structures, on the other hand, can be accounted for by using the principles of synthetic instrument accounting.⁵ By this approach, issuing straight debt and selling a swaption would be treated as issuing a put bond. To achieve synthetic instrument accounting, the following criteria should be met:

- the motive for the transaction is economic rather than accounting based;
- the synthetic instrument created is a familiar instrument;
- the synthetic instrument is composed of a mix of cash instruments and derivatives rather than from only one of those categories;
- the put option is an integral part of debt issuance at its inception; and
- the terms of the synthetic put structure closely match the terms of the put bond.

If synthetic instrument accounting were applied, the option premium would be recorded as a liability and would be amortized into income as a reduction of interest expense on an effective yield basis over the term of the debt.

⁵ Synthetic instrument accounting establishes an approach based on the economic substance of the overall transaction rather than separately accounting for the individual instruments that are the components of the transaction. The objective of synthetic instrument accounting is to provide an accounting treatment that matches the underlying economics of a transaction. Synthetic instrument accounting is not discussed in the authoritative literature (for example, Financial Accounting Standard Board (FASB)). Rather, it is an accounting treatment that has been applied and accepted by the accounting firms. Because synthetic instrument accounting is not authoritative, any application of it should be discussed in detail with the debt issuer's external accountants. It is important to note that synthetic instrument accounting, as well as other risk-adjusting activities such as dynamic portfolio management, are being discussed in conjunction with the FASB's current hedge and hedge accounting project.

HIGH-YIELD MARKET TRENDS

Primarily because of weak mutual fund inflows (see Figure 16) and rising Treasury yields, many B-rated high-yield bonds are now being priced to yield at least 12%. (see Figure 17).

Figure 16. The High-Yield Market — Supply and Mutual Funds Demand, May-Jul 94 (Dollars in Millions)

	Supply	Demand
	New Issues Priced	Mutual Funds Flow
May	\$2,541	\$1,146
Jun	3,493	660
Jul	1,951	(119)

Sources: AMG Data Services and Salomon Brothers Inc.

Figure 17. The High-Yield Market — The 12% Club, Jul 94 (Dollars in Millions)

Issuer	Issue Date	Coupon	Principal Amount	Description	Maturity	Issue Yield
Genmar Holdings (144A)	7/13/94	13.50%	\$100.0	Sr. Sub. Nts.	7/15/01	13.50%
Grupo Industrial Durango SA de CV	7/14/94	12.00	150.0	Notes	7/15/01	12.00
Malette Inc.	7/15/94	12.25	125.0	Sr. Sec. Nts.	7/15/04	12.25
Telex Communications	7/15/94	12.00	100.0	Sr. Nts.	7/15/04	12.00
Harvard Industries, Inc.	7/19/94	12.00	100.0	Sr. Nts.	7/15/04	12.00
1st Nationwide Holdings (144A)	7/20/94	12.25	200.0	Notes	5/15/01	12.25
Aftermarket Tech. (144A)	7/22/94	12.00	120.0	Sr. Sub. Nts.	8/01/04	12.00
Marcus Cable Operating Co. L.P.	7/22/94	0/13.50	413.5	Sr. Sub. Disc. Nts.	8/01/04	13.50
Scott's Liquid Gold Inc.	7/22/94	10.00	12.0	1st Mtge. Bonds	7/01/01	12.00
Clean Harbors Inc.	7/29/94	12.50	50.0	Sr. Nts.	8/01/01	12.50

Source: Salomon Brothers Inc.

- **A Two-Decision Market.** From November 1992 through February 1994, the high-yield market enjoyed unprecedented weekly inflows of \$200-300 million per week into the high-yield mutual funds, which powered a huge rally in high-yield bond prices and a profusion of new issues. More recently, with both short- and long-term interest rates up, this flow of funds has been negative in many weeks and only mildly positive in most other weeks — not exceeding \$230 million since June 15. Given the increase by the Federal Reserve in short rates on August 16, we do not see any evidence that this trend is likely to reverse itself soon. Therefore, when buying new bonds, high-yield portfolio managers must make not one but two decisions: (1) Should I buy this bond? and (2) What should I sell to raise the cash to buy this new bond?

- **The 12% Handle.** The first symptom of this difficult two-decision investing is the proliferation of new issues with 12% coupons, 500 basis points or more over the Treasury curve. Even bonds with lower coupons are being issued at yields significantly in excess of price talk. New issue coupons of 12% and higher have been a rarity since 1989, when the market shut down as Drexel Burnham Lambert collapsed. These coupons are even more surprising today, given that the yield on the ten-year Treasury has declined from 7.92% at December 31, 1989, to 7.27% at August 8, 1994.

EQUITY MARKET TRENDS

- Equity offerings continued to slow dramatically in the second quarter of 1994 as market participants attempted to assess the implications and impact of the Federal Reserve's repeated interest hikes.

Figure 18. Total Equity Issuance, 1Q 93-2Q 94 (Dollars in Billions)^a

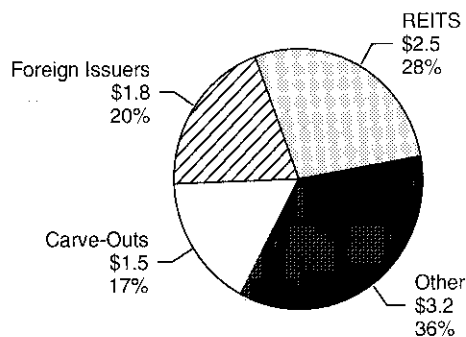
	2Q 94	1Q 94	2Q 93	1Q 93
Common Stock and Convertibles	\$8.1	\$15.1	\$17.7	\$13.9
IPOs, Excluding REITs	6.6	6.3	9.7	7.0
Initial Public Offerings of REITs	2.5	2.0	1.1	0.4
Total	\$17.2	\$23.4	\$28.5	\$21.3

^a Equity issuance excludes Rule 144A transactions and closed-end investment funds. IPO Initial public offering. REIT Real estate investment trust.

Sources: Securities Data Co. and Salomon Brothers Inc.

- **The IPO market increasingly has comprised REITs, foreign issuers and subsidiary carve-outs.** Twelve REIT IPOs were completed in the second quarter, raising \$2.5 billion in gross proceeds (see Figure 19). Foreign issues were boosted as European privatizations efforts contributed Tele-Danmark and Pharmacia, while Mexican issuers lead the charge for Latin America. Equity carve-outs in the second quarter included Case Equipment by Tenneco, raising more than \$330 million, and Santa Fe Pacific Gold by Santa Fe Pacific, raising more than \$250 million.⁶

Figure 19. Total IPO Issuance by Issuer Category, 2Q 94 (Dollars in Billions)



IPO Initial public offering. REIT Real estate investment trust.

Source: Securities Data Co.

- **Despite market gyrations in the first half of 1994, the net inflow into equity mutual funds has remained positive** (see Figure 20). Investors have been conditioned to buy on market weakness.

⁶ See *The Issuer's Guide to Equity Carve-Outs*, Peter Blanton, et al., Salomon Brothers Inc, July 1994.

Figure 20. Equity Market Capital Flows, Jan-Jul 94 (Dollars in Billions)

	Equity Issuance ^a	Mutual Fund Net Inflows	Difference
Jan	\$6.4	\$17.6	\$11.2
Feb	8.2	14.4	6.2
Mar	8.4	6.6	-1.8
Apr	6.4	11.3	4.9
May	4.3	11.8	7.5
Jun	6.6	7.7	1.1
Jul	3.8	6.5	2.7

^a Excludes investment funds.
Source: Investment Company Institute.

• **Letter stock⁷ (also known as alphabet and targeted stock) remains an alternative to equity carve-outs despite recent negative press and the vote down of Kmart's proposal to create letter stock for its specialty retail business.** For example, as a part of its plan to purchase Biosurface Technology Inc, Genzyme Corporation recently announced that it also planned to combine the acquisition with an existing unit to create Genzyme Tissue Repair, which would be represented by a new class of letter stock.

Investors and the financial press have tended to focus on the fact that there is no legal separation of the various businesses of the company. While letter stock creates separate classes of stock, the outside creditors of the company ultimately have access to the assets of the company as a whole. Furthermore, the board of directors is responsible for segregating and separately managing the assets, liabilities and cash flows of each group and paying dividends accordingly. Thus, letter stock may increase the potential for conflicts of interest and raise various corporate governance issues for board members.

Letter stock is most appropriate in situations where a traditional equity carve-out would lead to tax deconsolidation, lower credit ratings and substantially higher administrative costs.

Figure 21. Summary of Letter Stock Transactions, 1984-94 (Dollars in Millions)

Parent	Letter Stock	Issue Date	Current Equity Market Value ^a	Current Public Float ^a	Pct. of Shares in Public Float
General Motors	EDS	19 Oct 84	\$17,118	\$11,298	66%
	Hughes	18 Nov 85	14,696	3,527	24
USX	Steel Group	15 Apr 91	2,914	2,914	100
	Marathon Group	15 Apr 91	4,979	4,979	100
	Delhi Group	25 Sep 92	201	129	64
Ralston Purina	Continental Baking	17 Jun 93	118	65	55
RJR Nabisco	Nabisco	Withdrawn 23 Jun 93	NA	NA	NA
Pittston	Minerals	6 Jul 93	184	184	100
	Services	6 Jul 93	1,205	1,205	100
Kmart	Specialty Stores	Withdrawn 3 Jun 94	NA	NA	NA
Genzyme	Tissue Repair	Pending	NA	NA	100

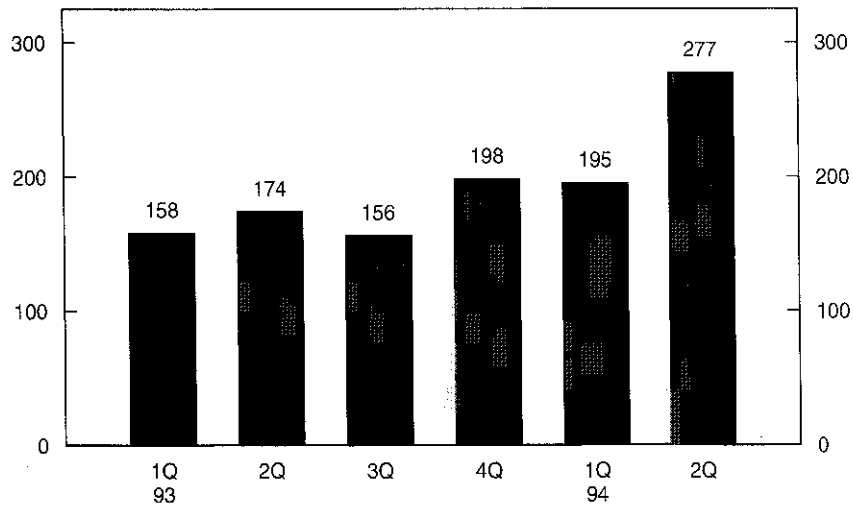
^a As of August 17, 1994. NA Not applicable.
Source: Salomon Brothers Inc.

⁷ The expression "Letter Stock" is used here in the context of a separate class of equity security, for example, General Motors class H stock, as noted above. The conventional legal meaning of "Letter Stock" refers to restricted stock whose sale may only be effected through prior registration or under the provisions of SEC Rule 144.

- In the second quarter of 1994, the number of announced stock buyback programs increased by 42% to 277 from 195 in the first quarter (see Figure 22).

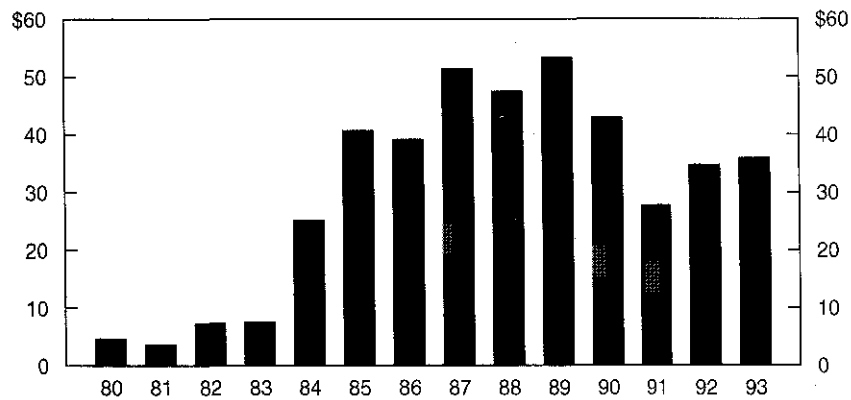
The dollar volume of stock buybacks declined in the early 1990s as the stock market rallied; however, stock buybacks once again are back in vogue (see Figure 23). The improved economy has added to company coffers, and companies are more optimistic about the prospects for future earnings growth. In addition, many stock prices remain depressed, offering "investment" opportunities to corporate buyers.

Figure 22. Number of Announced Stock Buybacks, 1Q 93-2Q 94



Source: Securities Data Co.

Figure 23. Volume of Stock Buybacks, 1980-93 (Dollars in Billions)



Source: Standard & Poor's Compustat Services, Inc.

Open-Market Repurchase. By far the most common buyback strategy has been the open-market repurchase (including negotiated block trades) (see Figure 24). This strategy provides the company with the greatest flexibility with respect to price, timing and size of the program. In this case, the firm is not required to announce when it is repurchasing shares or even that it will be in the market.

Most notably, many financial institutions have approved new share-repurchase programs reflecting both their stronger capital positions and a desire to manage their overall capital position.

Figure 24. Selected Recent Open Market Repurchase Program Announcements 12 Apr-23 Aug 94 (Dollars in Millions)

Date	Company	Value	Percentage of Outstanding Stock
12 Apr 94	Bank of New York	\$134.4	2.7%
13 Apr 94	United Technologies	288.0	3.6
19 Apr 94	First Interstate Bancorp	500.5	7.9
19 Apr 94	First Union Corp.	678.8	8.9
19 Apr 94	US Bancorp	148.5	6.0
26 Apr 94	Dean Witter Discover	152.5	2.3
26 Apr 94	US Healthcare Inc.	290.6	5.1
29 Apr 94	Corning Inc.	282.4	4.5
04 May 94	Salomon Inc.	490.0	9.1
09 May 94	FPL Group Inc.	318.8	5.3
09 May 94	Fleet Financial Group Inc.	221.3	4.4
09 May 94	Perkin-Elmer Corp.	163.5	13.6
12 May 94	Textron	266.9	5.4
13 May 94	First Chicago Corp.	237.4	5.2
18 May 94	Great Lakes Chemical Corp.	146.3	4.3
27 May 94	Chemical Banking Corp.	370.0	3.9
27 May 94	Student Loan Marketing Association	328.0	9.7
06 Jun 94	Merrill Lynch & Co., Inc.	398.0	4.7
15 Jun 94	Chase Manhattan	336.0	4.5
16 Jun 94	Pioneer Hi-Bred International	171.3	5.7
22 Jun 94	Hasbro Inc.	143.1	5.7
22 Jun 94	Tyson Foods	327.2	10.1
22 Jun 94	UST Inc.	557.5	9.8
27 Jun 94	VICORP Restaurants	135.4	5.3
28 Jun 94	Knight-Ridder	154.5	5.5
28 Jun 94	Rubbermaid	411.0	10.0
01 Jul 94	First Virginia Banks Inc.	99.6	8.3
06 Jul 94	Microsoft Corp.	348.0	3.0
11 Jul 94	Bausch & Lomb Inc.	103.3	4.7
13 Jul 94	Carolina Power & Light Co.	236.3	6.6
13 Jul 94	Huntington Bancshares Inc.	102.3	3.9
14 Jul 94	Seagate Technology	172.4	9.4
14 Jul 94	Tyco International	137.4	6.3
19 Jul 94	Wells Fargo & Co.	861.1	9.8
20 Jul 94	Intei Corp.	855.0	3.6
20 Jul 94	Sherwin-Williams	193.5	6.9
22 Jul 94	Wachovia Corp.	159.4	2.9
25 Jul 94	National City Corp.	263.8	6.6
26 Jul 94	Norwest Corp.	255.0	3.2
27 Jul 94	Union Carbide Corp.	277.5	5.3
28 Jul 94	American Home Products Corp.	570.0	3.1
28 Jul 94	Franklin Resources Inc.	114.0	3.6
28 Jul 94	Golden West Financial Corp.	124.0	4.6
01 Aug 94	Tandy Corp.	280.3	10.5
04 Aug 94	Marriott International Inc.	134.4	4.0
11 Aug 94	Gannett Co., Inc.	248.1	3.5
12 Aug 94	Unitrin Inc.	485.0	19.3
16 Aug 94	Genuine Parts Co.	350.0	8.0
16 Aug 94	TJX Cos (Zayre Corp.)	100.0	6.5
18 Aug 94	Cisco Systems Inc.	168.0	2.5
18 Aug 94	Coca-Cola Enterprises Inc.	172.5	7.7
18 Aug 94	Variety Corp.	156.4	9.3
22 Aug 94	Firststar Corp.	103.0	4.9
23 Aug 94	Morgan Stanley Group Inc.	278.0	5.2

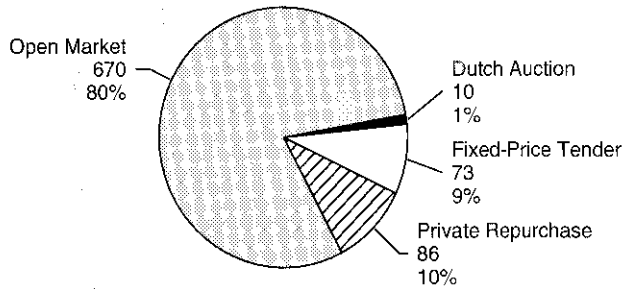
Sources: Standard & Poor's Compustat Services, Inc. and Securities Data Co.

Self-Tender Offers. There are two basic forms of self-tender offers: fixed-price and Dutch auction. In a fixed-price self-tender offer, a company offers cash or securities for common stock at a fixed, predetermined price. A tender offer document is distributed to all shareholders, and notification is made in the press. The offer must remain open for 20 business days, during which every shareholder has an equal chance of participating.

In the second quarter, CBS announced a \$1.14-billion fixed-price self-tender offer. The tender offer was conditional on Loews Corporation's tendering at least one million of the three million shares it owned. Concurrent with the announcement, CBS Inc. terminated merger negotiations with QVC Inc. involving a stock swap valued at \$1.17 billion after Comcast Corporation made an offer to acquire QVC.

On May 9, 1994, Transamerica Corporation announced a Dutch auction self-tender for 4.5 million shares, or approximately 6% of its common stock, for \$48-\$55 per share. This was the company's third buyback program in 12 months. Transamerica had previously purchased shares through open-market repurchases. Moody's, Standard & Poor's and Duff & Phelps all recently reaffirmed the company's ratings, despite the increased leverage because of the stock repurchases. The Dutch auction offer closed on June 6, 1994, with Transamerica accepting 72% of the 6.3 million shares tendered at a price of \$54.75 per share.

Figure 25. Stock Buybacks Strategies by Number of Announced Transactions, Aug 93-Jul 94



Source: Securities Data Co.

- **Mergers and Acquisitions (M&A) activity remains strong.** Almost 1,600 transactions totaling \$57 billion were announced in the second quarter, bringing the total for the 12-month period ended June 30, 1994, to \$235 billion, up from \$127 billion in 1992. This represents the highest level of activity since 1989.
- **Large deals in a few industries continued to dominate the M&A market.** Of the 1,600 transactions announced, 12 billion-dollar deals made up almost half of the total dollar volume. Health care, media, telecommunications, and financial institutions remained the industries with the most volume. These same industries have dominated M&A activity for the past 18 months, largely reflecting changing regulation and technology.

Figure 26. Ten Largest Merger and Acquisition Deals Announced in the Second Quarter, 1994 (Dollars in Millions)

Date Announced	Acquisitor/Target	Industry	Value	Type
02 May 94	Roche Holding AG/Syntex Corp.	Health Care	\$5,307	Tender/Merger
23 May 94	Sandoz AG/Gerber Products Co.	Health Care	3,676	Tender/Merger
30 Jun 94	Burlington Northern, Inc./Santa Fe Pacific Corp.	Transportation	2,693	Stock Merger
23 Jun 94	Conseco Inc./Kemper Corp.	Financial Institutions	2,544	Cash/Stock Merger
04 May 94	LDDS Telecommunications/WITel	Telecommunications	2,500	Divestiture
03 May 94	SmithKline Beecham Corp./Diversified Pharmaceutical	Health Care	2,300	Divestiture
03 Jun 94	Cox Cable Communications/Times Mirror Cable TV	Media	2,296	Divestiture
14 Jun 94	France Telecom SA, Deutsche Telekom/Sprint Corp.	Telecommunications	2,026	Minority Interest
23 Jun 94	Elf Sanofi SA/Sterling Winthrop — Prescription	Health Care	1,825	Divestiture
16 Jun 94	Comcast Corp./Maclean Hunter Ltd — US Cable	Media	1,270	Divestiture

Note: Includes stake of purchases of \$100 million and greater.
Source: Investment Dealers Digest.

• **Regulation remains the primary driver of activity.** The second quarter saw continued activity in the media and telecommunications industries, where activity has remained strong for some time. The information superhighway caused a rash of mergers in the cable sector beginning in 1993, and the effects are now starting to be felt in areas such as programming and wireless. While telephone company interest in cable cooled in the first quarter because of impending reregulation, the second quarter saw several large cable deals take place, including an acquisition by US WEST. This activity represents a vote of confidence despite Washington's intervention. The pending telecommunications bill, which addresses ownership restrictions between local and long distance phone companies, has helped prompt a rush to form national wireless networks. The second quarter saw announcements by MCI/Nextel, US WEST/Airtouch and Bell Atlantic/NYNEX to develop larger networks with a single-brand image to compete with the AT&T/McCaw combination, which is expected to receive final approval by the end of 1994.

Also noticeable is the increase in health care transactions. This activity is occurring in all sectors of the industry — from the large pharmaceutical deals (which constituted three of the ten largest transactions announced in the second quarter) to health maintenance organization (HMO) combinations. Much of this consolidation activity can be attributed to the pending health care reform, while competition and global consolidation are also contributing to the combinations.

- **Competition for acquisitions is strong.** Several controlled auctions for large companies in a variety of industries produced significant buyer interest. Competition also has caused several buyers to disrupt existing deals with higher bids. Examples include Comcast/QVC and Conesco/Kemper.
- **Cash has resurfaced as an acquisition currency.** In the wake of a weak and volatile equity market, the percentage of stock-based deals has declined significantly. Only 17% of the announced transactions used stock as consideration, compared with 41% in the first quarter. In bearish equity markets, acquirers are less interested in using their undervalued stock currencies to make acquisitions. Likewise, target companies find it difficult to value stock in times of significant volatility. In addition, commercial banks have demonstrated a voracious appetite for acquisition financing, making cash more available.
- **Most deals in the second quarter were friendly transactions involving strategic buyers.** Only two hostile transactions totaling \$100 million (0.2% of total activity) were initiated in the second quarter. This figure excludes Comcast's tender for QVC because it was launched on July 1. In addition, a mere 2.6% of the deals announced involved financial buyers. This demonstrates corporate managers' continued use of M&A as a way to achieve corporate objectives in a cost-effective and timely manner. In some industries with rapidly changing dynamics, acquisitions can form the only means of survival.
- **Looking forward, we see continued strong levels of M&A activity.** As the factors driving M&A continue, so will the deals. Health care transactions likely will continue, as evidenced by activity thus far in the third quarter. We also see ongoing activity in the telecommunications, media and financial institutions industries.

- *Bond Market Roundup: Strategy*, Greg Parseghian, et al., Salomon Brothers Inc, August 1994.
- *High-Yield Market Color*, Max Holmes, et al., Salomon Brothers Inc, August 1994.
- *Comments on Credit*, John Lipsky, et al., Salomon Brothers Inc, August 1994.
- *Derivatives Bulletin*, Richard Klotz, et al., Salomon Brothers Inc, August 1994.
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- *Issuing Corporate Put Bonds*, Niso Abuaf, et al., Salomon Brothers Inc, July 1994.
- *Corporate Strategy and Model Portfolio*, Joseph Bencivenga, et al., Salomon Brothers Inc, May 1994.
- *The Universal Shelf — The CFO's Toolbox*, Niso Abuaf, et al., Salomon Brothers Inc, April 1994.
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- *Bulletin on DECS: Mandatorily Convertible Securities*, Larry Wieseneck, et al., Salomon Brothers Inc, January 1994.
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