LBO tale harbinger of trouble

WHEN THE MACHINE STOPPED:
A CAUTIONARY TALE
FROM INDUSTRIAL AMERICA

BY MAX HOLLAND
Harvard, Wiley, 352 pages, $32.95

REVIEWED BY PATRICIA LUSH

As Robert Campeau struggles to pull his corporate empire out from under a mountain of leveraged-buyout debt, Max Holland's tale of the demise of Burgmaster Corp., following the leveraged buyout of its corporate family, is a timely read.

Burgmaster's story also could provide ammunition for members of the U.S. Congress as they ponder legislation to curtail such use of debt.

In 1978, when Kohlberg Kravis Roberts & Co. engineered the $355-million (U.S.) deal to take out Houdaille Industries Inc. (the conglomerate that owned Burgmaster), it was the biggest LBO to date. A decade later, in the latest record-setting buyout, RJR Nabisco Inc. went private for $25-billion.

In an LBO, the buyers finance most of the acquisition cost and use the assets of the target company to back high-interest loans. Until that debt is retired, the cash flow needed to service it becomes all-important. One misstep by management or an unexpected hit from external forces can send the company plunging into the abyss.

The LBO was not the only cause of Burgmaster's demise. Mr. Holland says, but the California-based machine tool manufacturer might well have survived were it not for its crushing weight of high-interest debt.

Mr. Holland is a Washington-based freelancer affiliated with The Nation magazine. His telling of the Burgmaster story is sufficiently compelling to offset his plodding, journalistic writing.

Burgmaster was the creation of Fred Burg, a Czechoslovakian immigrant, a machinist by training and an inveterate tinkerer. On nights and weekends away from his dry-goods store he invented a flexible tool holder that would increase accuracy and cut time in machining metal parts.

He began producing "Roll-flex" in his garage, then hailed a suitcase full of them to every manufacturer who used a lathe. The orders piled up and by early 1945, he was in business.

Over the next two decades, with his son and son-in-law, he built Burgmaster, developing a line of high quality, innovative machine tools and a reputation for outstanding customer service. By 1965, 240 employees were generating annual sales of $9.6-million and more than $300,000 profit.

In 1965, Houdaille Industries made a compellingly attractive offer for the company. It seemed like a good idea at the time, but within six months, cracks began to appear. Decisions made by corporate headquarters in faraway Buffalo frequently ran counter to Burgmaster's best interests.

Thus in 1969 came a second move that would contribute to the tool maker's demise: Houdaille sold some of its most advanced technology to a Japanese compa-

ny in return for access to the market in Japan. That decision would echo through the 1970s as the Japanese, using technology acquired from U.S. tool makers and subsequently refined, took an increasing share of the U.S. market.

Then in 1979, a group of investors took over Houdaille in an LBO. They couldn't know that North America would shortly be hit by the worst economic slump since the Great Depression. In 1981, machine tool orders fell to less than half the level and interest rates soared, pounding companies that carried heavy debt loads. Houdaille, leveraged to its earlobes, staggered.

About the same time, the U.S. dollar soared skyward, aiding the Japanese takeover of the U.S. machine tool market. By 1982, Japanese companies were the source of 60 per cent of all the machining centers sold in the United States. And machining centers were the lifeblood of Burgmaster's business.

Desperately seeking relief, Houdaille spent two years and $1.5-million pursuing an intensive — an ultimately futile — challenge to Washington to impose trade penalties on the Japanese tool makers.

By 1985, Burgmaster's finances, market share and reputation were in tatters. Attempts to sell it failed and finally, Houdaille closed its now-shrivelled subsidiary and auctioned off its equipment.

Mr. Holland wraps up his tale with an impassioned attack on leveraged buyouts. "Burgmaster came to epitomize the corporate consequences of an economic environment where debt is more profitable than equity, speculation more lucrative than enterprise."

The LBO, far from being the elixir that rejuvenated Burgmaster, enfeebled it, Mr. Holland says, and there seems little doubt that it is a harbinger of bankruptcies to come.

Patricia Lush is a reporter with Report on Business.