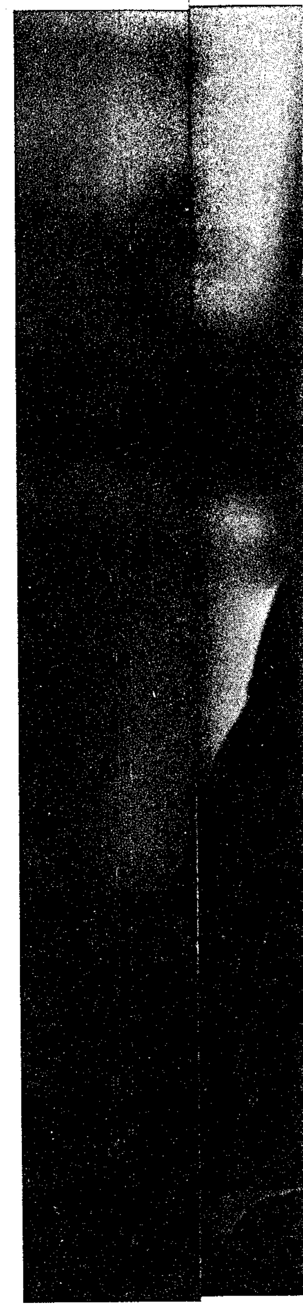


UNISYS UNDER ATTACK

Can Jim Unruh clean up the mess?

BY ALYSSA A. LAPPEN

When shareholders of Unisys Corp. assembled at the company's annual meeting last April at the Philadelphia Civic Center, the news was not good. That day, chairman and CEO James Unruh announced that in the first quarter, sales had dropped 11 percent from the year-earlier results to about \$2.1 billion. The company had also lost \$98 million. That was on top of a cumulative loss of more than \$1 billion for 1989 and 1990.

After Burroughs Corp. bought Sperry Corp. in 1986 for \$4.8 billion in cash, preferred stock, and debt, the newly dubbed Unisys seemed, for a brief time, to be on a roll. In 1987, the company earned a healthy \$578 million on sales of nearly \$10 billion. The stock rode up to more than \$48 per share, giving the Blue Bell, Pennsylvania-based computer giant a market capitalization of \$7.3 billion. In 1988, the company did even better. But Unisys began racking up big losses in 1989. By last January, the stock had plunged from its mid-1987 high to little more than \$2, for a total market value of less than \$350 million. The stock rose to only \$4.50 per share by mid-April.

Comments from many of the 400 or so shareholders at the annual meeting were savage. "This company has consistently blown it," shouted Richard A. Ash, a former Sperry programmer. "We owned the computer industry and drove IBM kicking and screaming into the 20th century by forcing them to abandon punch cards. Where is our market share now?"

Herb Neuman, a shareholder who flew in from Las Vegas for the meeting, griped, "The company cut debt by \$230 million last year—one third of its goal—but paid executives and other employees \$480,000 as a bonus for debt reduction. Breathing is not a qualification for performance." Neuman's barbs elicited loud applause.

Others expressed disgust with the company's directors. "This board has brought the company to its knees, and we're being asked to reelect the same people to run it," complained one shareholder, apparently, alarmed by the lack of an opposition slate.

Many also decried former U.S. Treasury Secretary W. Michael Blumenthal, who retired after nine years as chief executive in early 1990 to become a limited partner at Lazard Frères & Co. in Paris. Despite the chaos in which he left, Blumenthal negotiated a generous \$500,000 annual pension plus stock options for his services as a "consultant." Unruh drew fire on such points for more than an hour.

Unruh, who served as Burroughs's executive vice president of finance before the merger with Sperry, was Unisys's CFO before being named president in spring 1990 and CEO last fall. Still young-looking at 50, he seemed calm, even upbeat, in the face of the harsh criticism. "I'm very proud of this board," he told the piqued crowd. "I am singularly dedicated in

STEVEN BOLJONIS

CFO-turned-CEO Jim Unruh remains defiant in the face of harsh criticism.

1991, my first full year as chief executive officer, to initiating a visible recovery for our company and for stockholder value. I am convinced it can be done. These are very difficult times, but our company has all the fundamentals needed to successfully transform itself...to be a leading technology company in the 1990s and beyond."

Restructuring redux

But the promised turnaround has yet to materialize. In the second quarter, Unisys experienced another $100 million loss. And that was before a $1.2 billion write-off to cover plant closings and consolidations, the elimination of 10,000 jobs, a bad holding of preferred-stock investments in Memorex Inc., and a write-off of $200 million of goodwill. Add it all up, and Unisys lost about $1.4 billion in the first half on sales of more than $4.2 billion, an 11 percent drop from year-earlier results.

Unruh argues that Unisys, like other major mainframe computer manufacturers, was caught off guard by the swift changes in the market. "Let me state the obvious. I know a lot of competitors who did not enjoy any mergers who also seem to be enjoying some significant problems," he says, referring obliquely to Wang Laboratories Inc., Digital Equipment Corp., and IBM Corp., among others.

But unlike other mainframe makers, Unisys is also burdened by some $3.5 billion in debt. As we went to press, the company owed $1.05 billion to a 23-bank syndicate led by Morgan Guaranty Trust Co. of New York and National Westminster Bank PLC. Unisys also owed about $2.45 billion for notes and bonds. On a consolidated basis, Unisys sported a debt-to-capital ratio of roughly 61 percent—high for any company, but egregious for one in the fast-moving computer market. "Given the level of debt they're carrying, they're lucky to be alive," says John Gantz, executive vice president of Technology Financial Services Inc., a market research and consulting firm.

In its favor, Unisys still has more than $9 billion in assets. But the company, which paid off $300 million in 8 percent notes on September 15, must come up with another $1.2 billion by the end of 1993, in large part for revolving credit agreements.

The irony is inescapable: Unisys's ancestors literally defined modern computing—Remington Rand Corp., which was acquired by Sperry in 1955, had shipped the first commercial computer, the Univac I, in 1951. But Unisys has blundered its way into a liquidity squeeze so tight that creditors, shareholders, and former employees are all wondering aloud whether Unisys's credibility can ever be restored. As for cleaning up the company's balance sheet mess, Unruh can't afford to miss a beat as he juggles asset sales, debt payments, and working capital requirements in the face of a protracted industry slump.

Many savvy institutional investors have already voted with their feet. In the past year, for example, IDS Financial Services; Loomis, Sayles & Co.; PNC Financial; and Sanford C. Bernstein & Co. have dumped or significantly lightened their big equity positions.

Few would explain their decisions. But William Gorman, a computer analyst at PNC Financial, seemed to speak for many. "We have a sell recommendation on this because the company is focusing on solvency," he says. "And even if Unisys survives this financial crisis, it will be a weakened player in a highly competitive industry. [The company] has no market share or technologies that give it any real advantages. Although the company deserves credit for making significant progress, we continue to have concern about long-term fundamentals."

One self-described "lone wolf," Rick Martin, a computer analyst at Prudential Securities Inc., thinks it's a mistake to sound the death knell. "To be sure, this is the third major restructuring for this company in three years, but it looks like Unruh is now headed in the right direction." Martin, who is projecting a loss of $2.10 per share for 1991 (not counting restructuring charges) but a gain of $0.50 per share in 1992, points to the company's formidable cash flow, more than $1 billion a year. "Their problem wasn't generating cash, it was consuming too much of it. Debt service alone has been eating one half of their cash flow."

The shorts, meanwhile, have bet heavily against the company. In September, short sellers had borrowed more than 5 percent of the company's 161 million shares, up sharply from their 4 percent position in July.

Bon vivant Michael Blumenthal left Blue Bell, Pa., for Paris.

GIRY/REA/PICTURE GROUP

Destroying shareholder value

What really caused the mess at Unisys? Many shareholders, former executives, and others blame the unabashedly egotistical Blumenthal, who joined Burroughs in February 1980 as vice chairman and took over as CEO in September of that year, after the late Paul Mirabito retired as interim chairman. Blumenthal, who had been CEO of Bendix Corp. in the early 1970s, had often boasted of plans to build Unisys into a $20 billion company that could challenge IBM as industry kingpin.

Listen to Ray Macdonald, now 78, who reigned as Burroughs's chairman and CEO from 1966 to 1977 and remained on the board until 1980. "When Blumenthal left the government in 1979, Bill Agee at Bendix would not take him back. But four Bendix directors were also directors at Burroughs, and they gave him a job. He knew nothing at all about computers, but the board kept him for 10 years. I got off the board about six months after he came because I thought it was being run by a bunch of nuts."

(Blumenthal did not respond to *CFO*'s request for an interview; Lazard Frères maintains a relationship with Unisys.)

Macdonald blames Unisys's rapid descent on Blumenthal's acquisition spree. "Burroughs had two major computer lines designed in the 1960s, and by the 1980s, it was obvious that their effectiveness in the market was declining," he says. "Sperry's machines were designed even earlier, in the 1950s. The combined companies now have three major product lines that must be replaced, and huge write-offs still lie ahead. I wouldn't have even considered such a merger [Burroughs and Sperry]. Burroughs had enough problems of its own."

Macdonald goes on: "In addition, Blumenthal went out and took on $1.6 billion of goodwill—amounts in excess of market value—and corresponding debt to buy declining assets, including Memorex [storage systems], Timeplex Inc. [communications gear], and Convergent Technologies Inc. [workstations]. It looked dumb then and it looks even dumber now, and anyone with sense would have nixed the whole thing."

Burroughs spent more than $5 billion to buy Systems Development Corp., Memorex, and Sperry in 1980, 1981, and 1986, respectively. Unisys spent another $673 million on Timeplex and Convergent Technologies in 1988. By the end of Michael Blumenthal's decade of binge-buying, the company's balance sheet and operations were both in shambles.

Given its liquidity crisis, Unisys has been forced to sell assets into a declining market. In September, the company sold Timeplex, which it had acquired in a pooling-of-interests deal worth $330 million, to a joint venture led by Switzerland's Ascom Holding A.G. for $207 million, and observers claim the company's $350 million investment in Convergent Technologies is nearly a total wash.

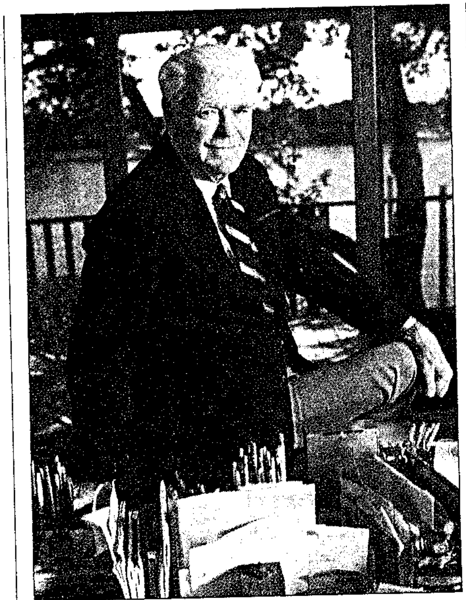
Unisys did net $550 million when it sold Memorex in 1986 to a group of executives, including New York investor Eli Jacobs. But that included $75 million in Memorex preferred, worth nothing under that company's current bankruptcy plan. And after all this shuffling—not to mention its huge second-quarter write-off—Unisys still has a burdensome $1.3 billion in goodwill on its balance sheet.

But further write-offs will require the acquiescence of the company's banks, which have already lowered its net worth covenants from $3.5 billion to $2.0 billion to allow for the first $1.2 billion write-off.

Macdonald is not alone in his vituperative remarks. Former NCR Corp. chairman Charles Exley, who was Burroughs's CFO during the mid-1970s, also had grave reservations about the Burroughs/Sperry merger. While Exley refuses to discuss Unisys's problems, he says more generally, "I am not very merger-minded. Organizational problems are big negatives with mergers, and I am not a believer in a lot of leverage in our kind of business. [An optimal level] would be about 20 percent of capital."

During Exley's losing battle to prevent American Telephone & Telegraph Co.'s takeover of NCR, he often pointed to the failure of the Burroughs/Sperry merger. At a hearing of the Ohio Senate's Judiciary Committee last December, for example, he cited the deal as one that had "led to significant job losses and multi-million-dollar losses."

Another boardroom insider who asked not to be identified adds, "Business had been growing so fast that even average



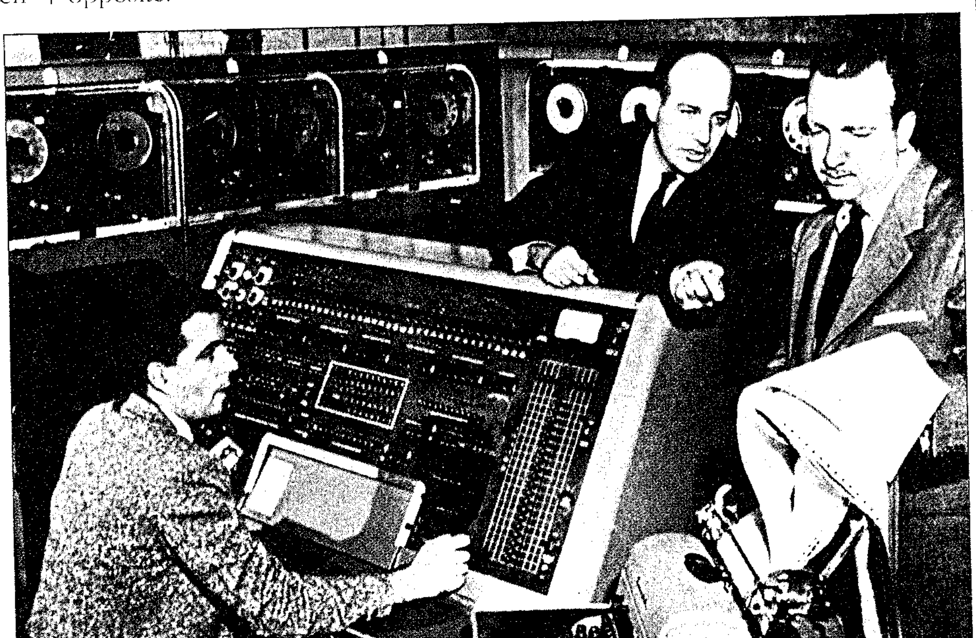
Former Burroughs chief Ray Macdonald quit the board in disgust.

companies did well. But the ball game was [already] changing when these two second-rate players merged. Burroughs should have diversified itself or sold to someone who would have used them as a niche player. They were both big companies, but after the merger, they were still small compared to IBM. There are very few situations like that where the new competitor has been able to survive. Mike [Blumenthal] said he was there to increase shareholder value. But he did just the opposite."

Unruh fights back

Unruh came to Burroughs with its 1981 acquisition of Memorex and soared to the top of the corporate pyramid under Blumenthal's wing. So it is not surprising that Unruh defends the acquisitions. "We are not in the same marketplace as we were four or five years ago," he says. "There is a tendency to look at the mergers and losses and say that one equals the other. That is just not an appropriate conclusion. There were very significant financial and other benefits that came from the merger of Sperry and Burroughs."

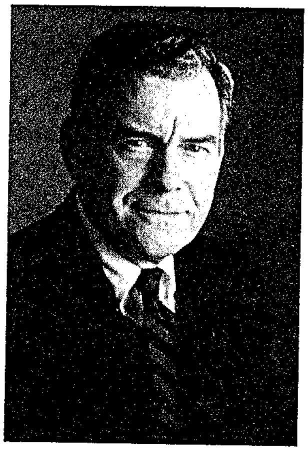
Unruh also admits there were mistakes. "If there was a negative here, it was our timing. We did not adequately foresee the speed and depth of the dramatic change in the industry ...and when the industry's transformation began, we were...all occupied with merging." The stark reality is that the rush into open systems and network computing (see *CFO*, August, page 18) means giants like IBM, DEC, and Unisys have to spend fortunes to reposition their product lines to compete in crowded markets where profit margins are relatively dismal and price wars are a constant threat. David Card, an analyst for International Data Corp., a Framingham, Massachusetts, market research firm, says, "Unisys's strategy for open systems is correct, and its mainframe technology is good. And it's not



Walter Cronkite and crew with the Univac I, predicting the outcome of the 1952 Presidential election.

TOP: MICHAEL PRICE; BOTTOM: COURTESY OF UNISYS alone in facing marketplace hurdles. But the debt problem is the wild card. Most of Unisys's major competitors don't have that worry. To compete, Unisys is going to have to hit on every cylinder."

Unruh insists that Unisys is not going to fade into the sunset. "We intend to meet our obligations," he says firmly. How? The huge second-quarter write-off turned Unisys's earnings before interest, taxes, depreciation, and amortization—or cash flow—to a negative $396 million. But add back $824 million in noncash write-offs on operations, and it seems Unisys generated $428 million in cash in the first half.



NCR chairman Charles Exley: "I'm not merger-minded."

In any case, by the end of the second quarter, Unisys had $683 million in cash on hand. Some of that was borrowed, but it will make it easy for the company to meet its 1991 debt-reduction target of $600 million.

The markets seemed buoyed by the company's second-quarter write-off. The stock, which had closed at $3.50 the day before the announcement, rebounded to $4.12 on July 24, the day after. Preferred shares, similarly, rose from $7.50 to $8.50 the day after the announcement. And the $13\frac{7}{8}$ bonds of 1992, which closed at 83 cents on the dollar July 22, rose to 88 on July 24. By early October, the common was at $4.75, the preferred at $10.50, and the $13\frac{7}{8}$ bonds of 1992 nearly 95.

Says Shelley Greenhaus, whose New York investment firm of Whippoorwill Associates Inc. began buying Unisys's distressed paper last January for as low as 50 cents on the dollar, "As it was previously structured the company was not viable long term, but Unruh realized he had to make some changes, and took the proper steps. The write-down itself should properly value the balance sheet, and with one movement it will allow Unisys, if it does a good job, to show earnings on the income statement. Before, if they did a good job, it was lost in the accounting to some extent."

Says Neil Dabney, an investment adviser with Dabney/Resnick Asset Management, in Los Angeles: "We look at things that have fallen off a cliff and try to determine whether they're like Humpty Dumpty or not. They've maintained spending on research and development. Besides, this business would not do well in Chapter 11. The values would not hold up, and the creditors and management are well aware of that."

Unisys bondholders, particularly those that bought during the price troughs last January, are understandably optimistic. Some who picked up Unisys's 8 percent notes of 1991, for example, reaped returns of more than 100 percent when the company paid off in September. Assuming that Unisys pays the rest of its debts, too, returns will also be good on the company's eight other issues.

One thing that attracted many bondholders was the bevy of nonstrategic assets that Unisys had on the shelf, ready to sell. Thus far, Unisys has raised about $500 million from the sale of $131 million of finance company receivables, 6 percent of its Japanese subsidiary, Timeplex, and a Detroit building.

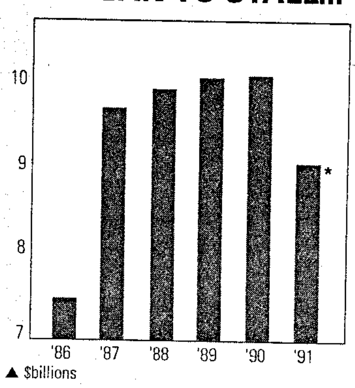
Sam DeRosa-Farag, an analyst with First Boston Corp. who has been following the company closely for more than a year, figures Unisys could raise up to $2 billion by selling Convergent Technologies, the Unix subsidiary, the rest of the Japanese subsidiary, and more real estate. Of course, that's considerably less than Unisys could get in a good market, and it may be too optimistic.

Given the weak financing market, further asset sales might be difficult to pull off. But DeRosa-Farag adds that only $1 billion worth of sales would "eliminate the liquidity problem. You don't kill a fly with a shotgun." In short, Unisys doesn't have to sell everything.

However, a recent twist in events underscores the desperation in Blue Bell. Unisys had been searching for a buyer for its defense systems business for some time, but in September switched gears and filed an offering with the Securities and Exchange Commission for 20 million shares of common stock. The unit, now dubbed Paramax Inc., contributed 20 percent of 1990 revenues. Unisys anticipates reaping $22 to $25 per share, which would generate $440 million to $500 million. If the deal flies, Unisys would also receive $332 million from Paramax, mainly to cover debt owed to the parent.

Earlier, the unit's appeal to potential buyers had been colored by contingent liability worries stemming from Unisys's involvement in the Pentagon bid-rigging scandal known as "Operation Ill Wind." The company took the heat for wrongdoing mostly by Sperry employees before the merger. But the path was cleared

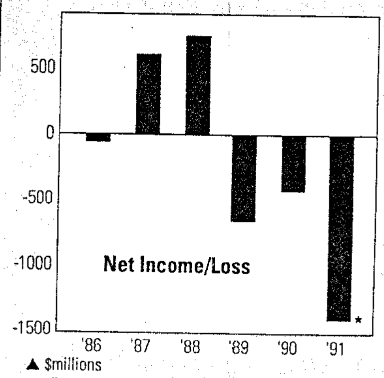
IN 1989, REVENUES BEGAN TO STALL...



*Prudential Securities Inc. estimate.

Source: Unisys Corp.

...AND THE HUGE DEBT TOOK ITS TOLL

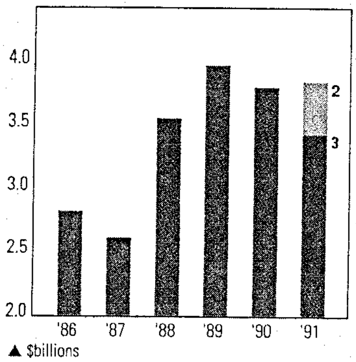


*Prudential Securities Inc. estimate (includes $1.2 billion restructuring charge).

Source: Unisys Corp.

SIMPLY STAGGERING

Unisys piled on debt[1] just before the industry slumped.



1 Consolidated.
2 Actual, first half.
3 Prudential Securities Inc. year-end estimate.

Source: Unisys Corp.

in late summer when Unisys pleaded guilty to criminal charges and agreed to pay a record $190 million in fines over seven years. A quick sale of the defense unit was then expected, but Unisys surprised observers by pursuing a potentially treacherous public offering.

Unruh is clearly banking on asset sales to help ease the liquidity crunch. He tells *CFO* he has no current plans to prepay any bonds at less than par. Nor does he have any current plans to sell new stock, even though a recent change in the par value from $5 per share to one cent could make that possible if and when earnings turn up.

But even if Unruh resolves Unisys's liquidity crisis, stockholders have considerably less to hope for than bondholders. As a group, they have lost more since 1987 than they can conceivably recover any time soon. Explains First Boston's DeRosa-Farag: "There's a big difference between what you need to service the debt and what you need for growth in equity."

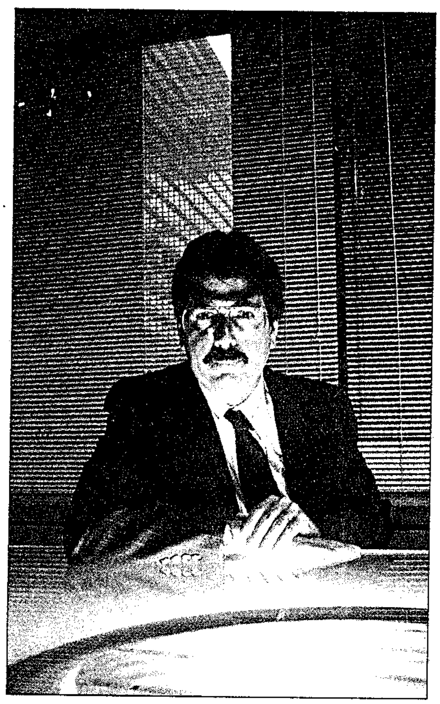
In fact, long term, it is questionable whether Unisys can survive. Says Whippoorwill's Greenhaus, "Most people on Wall Street feel the company will be there for 12 to 24 months, but will it be around in five years? The jury is still out. It depends on what new products they have and on how the economy behaves."

Many observers give Unruh some credit for doing the right things. Says DeRosa-Farag, "Management has been late, but at least they realized what was wrong and are trying to take care of it. Given the environment in which they are operating, they have shown considerable financial ingenuity."

Hollis Caswell, formerly Unisys's mainframe systems chief and currently the chairman and CEO of Hypres Corp., in Elmsford, New York, says, "Anything is possible. There have been some real turnarounds in this business. Look at Storage Technology and Data General, which have seen a resurgence after years of trouble. And Unisys has a major strength: a $10 billion [revenue stream] and a customer base that is a wonderful asset."

Unruh claims the company's $1.2 billion write-off will allow Unisys to cut costs by $800 million or so by the end of 1992. Others are not so sure. Says Caswell, "The big question is whether costs will fall faster than revenues, [because] the cuts will have an effect on marketing, engineering, and the scope of the product line."

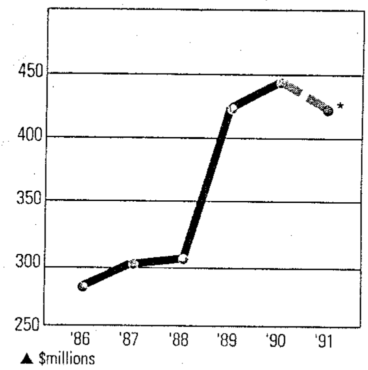
Indeed, with the company's first-half sales shrinking at the current 11 percent annual rate, Caswell raises a good point. In 1989 and 1990, Unisys's selling, general, and administrative expenses were 27 percent of sales, more than two percentage points higher than in 1986, 1987, or 1988—despite the cost-cutting program that Unruh started last year. Not a good sign. In 1989 and in the first half of 1991, SG&A was still about 27 percent of sales—even before $319 million worth of noncash write-offs on that line.



Shelley Greenhaus found a silver lining, scooping up Unisys paper for 50 cents on the dollar.

ARNOLD ADLER

INTEREST EXPENSE SOARED



*Year-end estimate by *CFO* based on first-half expenditure of $216 million.

Source: Unisys Corp.

Another problem: Unisys is continuing to lose some of its best people, who often disagree with the way that Unruh is handling cuts. Many who have left are unwilling to speak on the record, but one former corporate officer says, "Unruh participates, but he does not understand why customers buy a product. He has interfered with things that might have turned into real winners."

Unruh remains defiant. Asked if it's fair for others to question Unisys's ability to survive, he snaps, "What they think is their business. [But] we have only one objective—to build the strongest possible competitor and provide the best return to shareholders, and we can do that...by improving operating effectiveness and returning to profitability. That is my focus. We are confident we can return the company to financial health. It's a difficult process, but that is what we are about."

If Unruh succeeds, he'll be a hero. But despite his financial wizardry, the odds are stacked against him. ■

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