The Predators' Ball Study Guide

The Predators' Ball by Connie Bruck

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Plot Summary

The Predators' Ball by Connie Bruck is the fascinating story of Michael Milken who became known as the Junk bond King and eventually was brought down by charges under the RICO act. Milken and his wife both grew up in Southern California. He attended the Wharton School for an MBA and began to work at the investment banking firm of Drexel Firestone in Philadelphia. This is the beginning of his phenomenal career which made him a multi-millionaire.

Bruck tells the story of the junk bond dealers and the fabulous deals they made. The junk bond market was created by Milken just as the hostile takeover financed by junk bonds was a Milken creation. Corporate raiders came into being with Milken at the head. Milken always did it his way, no matter what the rules were. He always charged his customers premium prices but he always came through for them. They were willing to pay in order to use his services and finances.

The Predators' Ball is a yearly event at the Drexel firm. It is formally known as the Drexel High Yield Bond Conference and is usually held at the posh Beverly Hilton Hotel. There are presentations and meetings with the leaders of industry and government. There are also parties and meals. Drexel customers can meet each other at these meetings which fit in with Milken's usual modus operandi where customers, and Drexel, held each others debt and equity. The Predators' Ball allowed them to become acquainted and to learn about the latest innovations in the junk market.

Bruck introduces the reader to the players at Drexel as well as the participants in the junk market, including some of the biggest corporate raiders like Ron Perelman and Carl Icahn. The book looks at what factors motivated them and how did they rise to the pinnacles of industry. Most of them started out from modest beginnings, went to school and ended up in mergers and acquisitions and became very wealthy, but Milken didn't show the trappings of wealth. He lived in an unpretentious home in Encino and he and his wife both avoided the jewelry and furs lifestyle. He encouraged his staff to do the same, even though they made hundreds of millions of dollars with him. They kept New York hours at their Beverly Hills office as Bruck presents his rise at Drexel to become known as the King of junk bonds.

The book also covers some of the war stores of the different raids. There is the Triangle-National Can deal, the Icahn-TWA deal and the Perelman Pantry Pride and Revlon deal that resulted in the involved parties becoming the biggest corporate raiders in America with deal worth billions of dollars. Miken made it look so easy. On the way to the top, rules were bent and eventually Milken and Drexel come under investigation by the SEC and the U.S. Attorney's Office. Milken was charged under the RICO act in the end.

Part 1: Chapter 1, The Miner's Headlamp

Part 1: Chapter 1, The Miner's Headlamp Summary and Analysis

"In the third week of March 1985, the faithful, fifteen hundred strong, came to Beverly Hills to pay homage to Michael Milken, the legendary junk-bond guru of Drexel Burnham Lambert whom many of his followers called simply 'the King'. For the next four days, they would savor the world he had created for them.... Their destination was the Beverly Hilton, where the annual Drexel High Yield Bond Conference - by now known as the Predators' Ball - was being held, just a few blocks from Drexel's West Coast Office" (Prologue, pg. 10).

The book begins with Michael Milken beginning his two hour bus commute to work at the Wall Street firm of Drexel Firestone from his Cherry Hill, New Jersey home. He could take the train and be more comfortable but then he would run into other Wall Street people and have to talk to them. Milken doesn't want to meet any Wall Street people and have to engage in small talk, so he avoids them by commuting via bus. Milken worked as a low-rated bonds trader. He began his career at Drexel in 1969 when he spent a summer working at the firm while he was in graduate school at Wharton. This was the time period when the firm from transitioning to computers so they quickly hired him to help with their problems, since he already had an accounting background. Milken was distinguished by his attitude. Most of the back-office people had high school educations but were rich in their years of experience in the business. Milken was gruff with them, not willing to listen to other points of view. He was not good in working in group situations.

Milken spent two years working at Drexel on a part-time basis while he attended Wharton. Even though he was poor in group situations, he was known for his intellect as he moved around the firm working on various projects. His biggest contribution at the time was a study of the securities delivery system which cut the delivery time from five days to one. This meant lower costs for the firm due to less interest payments. Graduating from Wharton in 1970, Milken began working full-time at Drexel on Wall Street where he eventually made the move from head of research for fixed-income securities to sales and trading.

Even though Milken was intelligent and sharp, he didn't have the Ivy League credentials to be employed by some of the top firms on Wall Street. Drexel was a part of J.P. Morgan at the time but had to separate due to the enactments of the Glass-Steagall Act in 1934. J.P. Morgan went into commercial banking and Drexel went into investment banking. The Philadelphia based Drexel had merged with the Wall Street based Harriman Ripley and Company and in 1970 when Drexel Harriman Ripley had financial problems, they were saved by a deal with Firestone Tire and Rubber Company and became Drexel Firestone.

Milken was a bond trader and it was bond trading that held the fascination for him. Bonds are a form of straight debt in which the bond holders receive fixed payments of interest until the principal is repaid. There are also bonds known as convertible debt where the bonds can be exchanged for other securities, like stocks. The strongest companies are rated as triple A by companies like Standard and Poor's and Moody's and are considered to be almost risk-free. The triple A rated companies are known as investments grade companies for this reason. Companies that are not as strong carry lower ratings as its bonds trade at a discount from its par value and their bonds are sometimes referred to as deep discounted bonds or fallen angels. In addition, there was also what was known as Chinese paper which referred to the bonds that came into being during highly leveraged takeovers.

These were the bonds that Milken was fascinated by. He read and was impressed by the Hickman study, an analysis of bond yields by W. Braddock Hickman in which Hickman found that if a low grade bond portfolio was put together in the right way, it would have a higher yield than a high-grade portfolio. Hickman supported Milken's position and began to popularize low-yield bonds. Milken did his research on the company's whose bonds he traded even though low-yield bonds were looked down upon by Wall Street. Milken showed consistent profits in his trading which is why the high-grade bond selling people couldn't get him fired.

A series of crises hit the Wall Street firm in the early 1970s and by 1972 Drexel Firestone was also experiencing financial problems. This resulted in a merger with Burnham and Company with the new firm being Drexel Burnham. At this time Milken was thinking of leaving and the new management gave him a $2 million position to keep him with the firm. Milken earned 100% profits his first year with this new arrangement. His group would receive 35% of the profits and this arrangement lasted for fourteen years. Next Milken wanted his own independent unit for trading low-yield bonds, with its own staff and support organizations, like research. He wanted low-yield bonds to be its own specialty. Drexel, Burnham gave Milken what he asked for and it became known as 'The Department', a firm within a firm.

Milken began to build his fortune by buying the bonds of troubled companies in addition to buying REITs, or real-estate investment trusts. These were like mutual funds that consisted of real estate instruments like mortgages. Milken would decide which ones he thought would be profitable and buy them, a practice that sometimes made Drexel Burnham management nervous. Milken had many happy customers, among them Carl Lindner, Saul Steinberg, Meshulam Riklis and Laurence Tisch many of whom dealt in the debt and equity of each others businesses. Most of them engaged in cashless deals engineered by Milken in which they used bonds in exchange for a company's stock in the acquisition process. Riklis claims to have been engineering these kinds of deals before Milken. Riklis, Lindner and Steinberg eventually all took their respective corporations private with the help of Milken.

Part 1: Chapter 2, Dr. Feelgood

Part 1: Chapter 2, Dr. Feelgood Summary and Analysis

While Milken is forming his relationships with the four customers, a Bostonian named Fred Joseph begins to work at Drexel Burnham in 1974. He becomes Milken's ally and public face in the coming years as Milken prefers to avoid the press and public. Joseph is the one who finds and hires the talent for the company. He is known as the Dr. Feelgood of Drexel.

By 1975, Drexel Burnham had little investment banking business since most of the major customers had fled. They did not have the best of reputations among employees in the Wall Street area and many of their own employees were ones that didn't work out at other firms. This was the Drexel Burnham that Fred Joseph came to and this was the company he said he would turn into a top notch firm in fifteen years. He selected medium-sized emerging growth companies as a niche in the market since many of these companies were without investment bankers due to events in the investment banking industry. Joseph developed his own strategy of hiring from the smaller firms so that new employees would think of it as a step up and not a step down.

Among other things, Joseph re-designed the compensation plan coming up with a formula that resulted in a larger bonus pool based on the fixed amount of the operating profits of the department. Salaries were kept at modest levels with the big money coming out of the bonus pools. Joseph met Milken after several months at the firm. Milken was trading REITs at the time. In 1977 they decided to work together to provide an 'edge', a niche for the firm. At this time Lehman Brothers Kuhn Loeb had just underwritten several issues of low-grade bonds and this was the market that Milken was very interested in since equity offerings were not even an option for the segment of the market that Drexel Burnham was targeting. Milken was offering this segment of the market a new kind of debt instrument that was less restrictive with no principal due for ten years. This kind of debt was subordinated to senior debt, or loans from banks. It was separate and the bondholder could always sell his bonds whenever he wanted. Drexel earned 3-4% of the principal as its commission, much much higher than the seven eighths of a percent earned on high-grade bonds.

Milken and Joseph created high-yield funds as a manner of diversification for the bonds. One of these was First Investors Fund for Income, or FIFI, which was the first of many. These were the funds that they marketed across the country reaching certain customers. These funds had a higher yield than Treasury bonds. Other companies, like Fidelity, began to offer the same kind of funds. Drexel dominated the market in junk bond funds from 1978 on. The 1976 merger with Compagnie Bruxelles Lambert resulted in the firm now called Drexel Burnham Lambert. Junk bonds were now big business that would make many people, among them Milken, very wealthy.

Part 1: Chapter 3, Transformation

Part 1: Chapter 3, Transformation Summary and Analysis

Milken tells Drexel Burnham Lambert that he wants to move his bond operation unit to Los Angeles in 1978 since both he and his wife were from that area. He also wanted some distance between himself and some of his higher ups. This move would cost the firm millions of dollars and it would be harder for the firm to keep tabs on Milken. Since Milken was responsible for almost all of the firm's profits, they couldn't say no to him. Not only did Milken make the move to the West Coast, he convinced most of his staff to make the move to Los Angeles. These staff members were millionaires because of working for Milken; they weren't about to not go with.

Milken and his wife made the trip to California via car. While they were enroute, the market changed with the warrants, or options to buy stocks at a given price known as the exercise price, rising. Milken saved Drexel's position by calling from every phone booth he came into contact with on the way to California. The problem was taken care of by the time they arrived in California. Their new office was on Avenue of the Stars in Century City and the day it opened was July 3, 1978. There wasn't even a sign on the door with the company's name which didn't bother Milken in anyway. The staff kept New York hours which meant they began at 4:30 a.m.

Milken and his wife bought a home in Encino where they could be close to family. They lived in the old guest house on what was once the Clark Gable-Carole Lombard estate. Within a few months of his arrival, his brother Lowell left his Los Angeles law firm to work at Drexel and manage the family assets which by this time were worth between $25 and $50 million due to the investments Milken had made. Lowell would also manage the assets of the high-yield group. He would also find tax shelters for them. Lowell was gruffer with the staff than Michael was and had the reputation of being his brother's hatchet man.

Milken dealt with portfolio managers who were looking for bonds to invest in. He could impress them with his knowledge and memory for details about every bond there was. There was a shortage of junk bonds since the demand was greater than the supply. "Less than two years after Drexel had issued its first junk-bond offering for Texas International Company, then, a market with well over $2 billion in new issues had been created. Companies were lining up to issue the bonds. Buyers were clamoring for them. And Milken, with his core group holed up in Century City, was the undisputed patriarch of this new universe" (Chapter 3, pg. 56).

One of the people who went to see Milken in Century City was Steve Wynn, the then owner of the Golden Nugget casino in downtown Las Vegas. Milken helped Wynn raise the funds he needs to build in Atlantic City. At this time, investment banking houses wouldn't deal with the gambling industry and Milken knew that if Drexel did the deal for

Wynn, they could probably have the whole gambling industry. Wynn, who ended up selling the Atlantic City property, made hundreds of millions of dollars on the deal. Wynn would later be the one who provided the entertainers and stars for the Predators' Ball.

Part 1: Chapter 4, Merge with Mike

Part 1: Chapter 4, Merge with Mike Summary and Analysis

Fred Joseph used a consultant named Cavas Gobhai and had a three-day meeting at the Barbizon Plaza in New York. The purpose of the meeting is idea generation. The purpose of the group is the consideration of all ideas, even the far-out and the flamboyant, instead of just the conservative that are usually all that most business meetings allow. The subject of this meeting was that corporate finance and high-yield bonds were one and the same thing. This was an important topic since the changes that had occurred in the investment banking industry in the 1970s in which firms became highly competitive and business moved around.

People at the meeting felt that things should be a little better balanced at Drexel where more people shared in the business acts and the profits. Everything revolved around the Milken group and Milken traded not only for customers, but also his own account and his group's account. The people at the meeting were asking if they should be more like Milken, who took an entrepreneurial approach which means he risked the capital of the firm in various deals instead of just the money of clients (which is known as institutional). The group decided they wanted to be more entrepreneurial, but not has entrepreneurial as Milken. Most all of their goals and decision centered around Milken and how to work closer with him and to have him manage an investment fund for their corporate finance group.

In the next five years, Drexel became a powerhouse in the investment banking world, along with Milken, with whom the firm was identified. What Milken did was more akin to the British notion of merchant banking where a firm used its own capital in deals. This meant that the investment banking company had equity stakes in most of the companies that it financed. Part of the practice at Drexel in the 1970s and 1980s was to take warrants as part of the fee for the deal. Drexel's logic was that because they were doing more high risk deals, they deserved to share in the profits from them for the risk they were taking. They also functioned as a mechanism to prompt Drexel to perform better if a deal looked like it was going bad.

The Milken philosophy was to go after businesses that were owner-managed. He claimed that there was a difference in the actions and behavior of owner-managers and employee-managers. Both Milken and Joseph claimed that the owner-managed business was the one they wanted and the ones they targeted. Milken and Drexel ended up with equity and debt stakes in many of these companies and with many Drexel people sitting on the boards of these companies. Drexel's clients would also hold debt and equity in each other's businesses.

Drexel, at this time, was a privately held firm. If it went public, Milken could never function the way he did with his need for secrecy. For example, the investment fund he

managed for the Corporate Finance group was done in such a way that it was set up as a general partnership with no disclosure to the partners. Milken would only tell Joseph what he bought for the fund, yet the members had total liability if anything happened. Milken's importance to the firm and his need for secrecy is why it remained private. Milken did not own stock in the firm until they made a special deal with an instrument that became known as a Western convertible, a bond with a warrant, to induce him to buy in. Milken was the largest single stockholder by 1986.

Drexel kept growing its junk bond business, even when other firms were cutting back during recessions. By 1981, Drexel was responsible for almost all of the junk bonds in the market. The only competition Drexel had by this time is from Merrill Lynch and the competition was minimal. Drexel was also known to engage in some dirty tricks against their competitors, like changing the location of meetings without telling them. These practices continued until the mid-1980s. Many different kinds of instruments were devised and developed by Milken and Joseph to keep the market going during recessions. There were things like bonds that would give protection against falling stock prices, etc.

In the 1980s some of Drexel's dealings became known. In the Flight Transportation deal, Drexel financed the business that provided charter jet service in the Caribbean. Right after the offering, the FBI came in because the company didn't have any jets. The fraud was on the part of Flight Transportation and not Drexel, who hired an investigator to check out clients in future offerings. In the American Communications Industries (ACI), the company didn't have any assets that could be sold and the prospectus indicated that the company might not have the earnings to pay the interest on the bonds. ACI defaulted on the first interest payment in early 1981.

Other Drexel clients were also having problems making interest payments during the recession of 1981-82. A special committee, the Special Planning Committee, was formed to deal with these problem clients, most of whom were high risk since that was Drexel's niche in the market. They came up with a way to alleviate the pressure on their clients to meet the interest obligations by creating an unregistered exchange offer. This was a way of using stocks or bonds to meet the interest obligations. The bondholders basically had no choice but to accept them since the alternative was the bankruptcy of the company which would leave them with totally worthless paper. Securities law allows companies to exchange new paper for old without registering the offering. This allowed Drexel and the junk bond issuers to avoid default.

Part 1: Chapter 5, The Cloister at Wilshire and Rodeo

Part 1: Chapter 5, The Cloister at Wilshire and Rodeo Summary and Analysis

Drexel's junk bond business continues to grow through 1983 to $4.690 billion. In February, they underwrote $500 million in new issues in a ten day period. In April there was the $400 million for MGM/UA Entertainment Company and then $1 billion for MCI Communications in July. Milken was nervous over both of these deals because of the size. They had never done anything so large and Milken would never but back the amount of a deal once it was agreed upon. As a result of this, customers trusted him and felt indebted to him. Drexel would take the paper that it couldn't sell and this lead to the development of HITS, a high yield mutual fund that Drexel formed. HITS was the outlet for the paper that Drexel bought in various deals.

In 1983, the Milken group moved from Century City to a building at Wilshire Boulevard and Rodeo Drive. The property was leased to Drexel from an investment group that bought the property which included Milken and his brother. There were also investment partnerships that were to be registered with Bear Sterns possibly without disclosure to Drexel, which would put them in violation of securities law. Drexel eventually changed their policy to prohibit employees from having such accounts at other firms. The Milkens formed many more of these partnerships in the early 1980s, some just for family others involving other people. They also formed Belvedere Securities, a Chicago brokerage firm that traded the body of the bond separate from its coupons. This is a process known as stripping and resulted in huge tax benefits because there was no law that covered the stripped Treasury security. The stripped security is basically a zero coupon Treasury bond. The coupons, are known as strips, Tigers, Cats, Cougars, etc. In 1982 the tax laws were changed which minimized the tax benefits of such transactions.

Milken's staff claimed that he brought out the best in them. Any member of his core group that was with Milken for five years or more is worth at least $20 million. They felt that they performed at their best for Milken because he would accept nothing less. He was thought very highly of by his staff. But Milken was still publicity shy. He still refused to have his picture in the Drexel annual report and didn't have a formal organizational structure in his unit, which came out in questioning by the SEC. The example Milken set in his own work practices are what held his people together.

Part 1: Chapter 6, The Air Fund

Part 1: Chapter 6, The Air Fund Summary and Analysis

Milken's employees weren't the only ones benefiting from doing business with him. Customers were becoming quite wealthy because of doing business with Milken. Fred Carr of First Executive and Thomas Spiegel of Columbia Savings and Loan were two such people. Carr signed-on with Milken as soon as Milken was located in California buying two-thirds of all the junk bonds that Drexel sold that year. Carr continued to buy Drexel offerings and made First Executive into a sound and innovating company with assets of $12 billion within ten years.

Spiegel's father bought the Beverly Hills based Columbia Savings and Loan in 1974 when it was in trouble, and like many thrifts Columbia experienced more problems during the 1970s and 1980s. In order to help out the thrifts, Congress enacted legislation allowing them to make commercial loans and to make investments in corporate securities, like junk bonds. This legislation opened up a whole new market to Milken. The state chartered thrifts could invest as much as they wanted in junk while the federally chartered thrifts had a ceiling of 10%. Spiegel decided to go into junk bonds with the money he had from his long term debt issues and eventually had his own research staff for his junk bond investments. Spiegel, the highest paid thrift industry executive, eventually had the Federal Home Loan Bank Board looking at his activities. The lowered the amount of his compensation and were looking at the fact that he was financing his junk bond purchases with federally insured funds. While other thrifts were losing money, his was highly profitable in 1986.

Milken was behind the success of both First Executive and Columbia. Both experienced tremendous growth due to junk bonds and both had Milken as a shareholder. "What set First Executive and Columbia apart from other institutions and companies with which Milken was playing his multiplicitous roles by 1983 was the degree of their metamorphosis. Others had benefited from Milken's performance, but they had not been so utterly transformed from flounderers to titans - and titans whose sustenance, in large part, continued to come directly from Milken. The bigger their appetites for junk became, the more useful First Executive and Columbia would be - ultimately functioning as enormous appendages of Milken" (Chapter 6, pg. 93).

As usual, Milken customers became holders in the debt and equity of other customers, like Lindner, Steinberg, Riklis and Posner. Their high yield bond investments paid much more than long-term Treasury bonds. Most of the companies that Milken dealt with profited from the deals that Milken put together for them. In order to keep them earning money, Milken and Joseph and to keep coming up with new ideas, which is how they became interested in mergers and acquisitions. This area was the rage of the Wall Street investment banking firms after deregulation. Hostile corporate takeovers became popular in 1974 when International Nickel Company raided ESB. This was the beginning of many hostile raids.

The market crashed in 1974 which resulted in low prices and a lot of bargains among companies. The following inflation raised the value of assets but not stock prices so it was cheaper to buy a company than to start out from scratch. For a corporation interest on debt is tax deductible while dividends are not. Both corporations and investors prefer the higher bond interest payment to dividends. Other things that happened in the 1980s was a relaxation of antitrust restrictions which lead to multitude of mergers. The change in the tax laws in 1981 also favored the M & A binge which occurred because of the increase in cash flow which put companies in a better position to service debt. This also made them more attractive to corporate raiders.

Drexel wanted to find a way in to the M & A market. They had no portfolio of Fortune 500 clients that they could arrange mergers for like other Wall Street firms did. Joseph felt that Drexel needed to enter this market in order to become a top class firm. He couldn't achieve his goal of making Drexel a world-class institution without going into M & A. Drexel began selling junk bonds in leveraged buyouts in 1982. A leveraged buyout, or LBO, occurs when the buyers use the company's assets to borrow money for the purchase and then pay off the debt with the money from the acquired company. In the 1980s, LBOs were used to take public companies private. Drexel then began to raise the financing required for LBOs. This was called mezzanine financing which was a form of unsecured debt. If Drexel and Milken could do the financing in a friendly takeover, then they should be able to do it in an unfriendly takeover.

The discussions of how to do finance hostile takeovers took place at the Beverly Wilshire Hotel under the direction of Cavas Gobhai since they were not as simple as friendly takeovers where the participants could let financiers know about the deal. They also compiled a list of the top names in M&A even though they knew there was no way to lure any of them to Drexel at that time. Drexel labeled their idea the Air Fund or the highly confident letter. This was basically a bluff at the time, saying that had $1 billion for hostile takeovers. Within a few weeks they found an experimental subject in T. Boone Pickens with his Mesa trying to take over Gulf Oil.

Part 2: Chapter 7, Triangle-National Can: Kingmaker

Part 2: Chapter 7, Triangle-National Can: Kingmaker Summary and Analysis

There is a big meeting at National Can on April 2, 1985 after a Drexel financed group made an unsolicited cash offer for the company's shares. The raiders were headed by Nelson Peltz and Peter May who were also at the meeting. Milken was on vacation in Hawaii and could not be reached at the time and there were limits as to what Peltz and May could agree to. On April 4 they agreed to a purchase price of $42 per share. The takeover was successful.

The mechanics of the Drexel mechanism was that Drexel would announce in the highly confident letter that it felt it could raise the amount of money needed to finance the take over. It would also obtain commitment letters from its buyers where they promised to buy junk bonds that the shell corporations would use to pay for the take, using the assets of the target as security. This mechanism worked in the American Natural Resources (ANR) deal where Oscar Wyatt and Coastal Corporation made the acquisition. Many of these LBOs result in a corporation that is laden with debt, as in the National Can case. The shell company, Triangle Acquisition Corporation had an eleven to one debt ratio after the deal. National Can had a good year so the takeover was successful.

The Milken backed takeovers worked because the raiders were backed by pools of capital. Peltz and May were in the food business. Peltz grew up in Brooklyn and after some college at Wharton, he entered the family food business which sold frozen food to institutions. He became interested in acquisitions, including a company called Flagstaff, which he and his brother took public. This is how Nelson met Peter May who was an auditor at Peat, Marwick, Mitchell and Company. Nelson Peltz hired May to work for him at Flagstaff where they did acquisitions financed by debt. Peltz wanted to be a part of the Hollywood scene and tried to buy a block of Columbia Pictures. He wasn't taken seriously when he contacted Herb Allen about acquiring Columbia stock. When Flagstaff was sold in 1978, May and Peltz took what remained and had a company called Trafalgar.

Peltz met Milken in 1979 but struggled through the early 1980s. He became interested in Triangle Industries in late 1982, attracted by the company's cash flow and cash flow is one of the most important items in LBOs. Peltz knew that even Milken wouldn't do much for him unless he had some cash flow. He approaches Jeffrey Steiner, an Austrian Turk former oil trader who went into the take-over business. Arthur Goldberg, the head of Triangle, met with Steiner in New York at the Plaza while Peltz waited outside. Steiner dropped out of the deal due to his personal situation of divorce but Peltz had the in he was looking for an in April 1983 purchased 29% of Triangle's shares.

Peltz and May almost bought Beverly Hills Savings but withdrew from the battle. The institution was eventually closed down and reopened as a federally chartered savings and loan, having suffered huge losses in junk purchased from Drexel. The institution was suing Drexel for damages. Milken decided to help Peltz and in July 1984, underwrote $100 million in junk bonds for Triangle. For its services, Drexel received warrants amounting to almost 12% of the company. This was the beginning of the big blind pools that Milken would raise for his customers.

In 1984 New York businessman and developer Gerald Guterman began to acquire Triangle stock. He wanted a seat on the board but Peltz said no. By the end of the year he was acquiring more stock and filed with the SEC that he was attempting to take control. The matter was suddenly settled when Guterman sold his stock back to Triangle and Peltz went on to meet with Milken.

Victor Posner was another player on the scene at this time. He was involved in the National Can takeover attempt. He had been quietly acquiring stock on the open market for several years. When National Can's Frank Considine tried to work out arrangements to avoid the take-over, he ran into opposition from Posner, who didn't want his own position affected. Posner told the board that he could buy them out and they worked out an agreement but Posner kept stalling. At the time, Drexel was trying to help keep some Posner properties from bankruptcy since a large amount of the Posner paper was held by Milken customers.

Peltz was the one who wanted the National Can deal. Drexel had offered it to other customers, like Carl Icahn and Henry Kravis. Icahn expressed some interest but they had to top the management buyout offer. They had to buy the stock of Posner in order to make the deal. Drexel refused to finance Posner who was looking around for other sources of financing to do the National Can deal. This financing fell through when one of Posner's companies filed for bankruptcy and Victor sold his National Can shares to the Triangle group. Drexel began raising commitment letters for their part of the financing and would receive approximately $25 million in total fees for the deal. This was one of the first hostile takeovers and most of the Milken regulars, like Karr, Lindner, Riklis, Spiegel, and Perelman were involved in buying the bonds. They were all listed on the commitment letter submitted to the SEC.

"Probably more serious, in terms of noncompliance with SEC rules, is the way these bonds changed hands after they were bought. Through the debt in the big hostiles was raised through private placements, the bonds were issued with registration rights and were supposed to be registered with the SEC within a timely period, generally three to six months. Then they would become public securities and could be traded freely. Until that time, the underwriter could sell the bonds for investment purposes, not with an eye to reselling them. The purpose of this regulation is to prevent a widespread distribution of the bonds, which would effectively circumvent the registration requirement" (Chapter 7, pg. 133). Since the registration of the securities does not take place for quite a few months, there are many substitutions from the original group on the commitment letter so many of the bonds were resold before being registered. There was enough liquidity in the market for investors to do this before the registration of the securities took place.

The process wasn't illegal as long as the investors said they had no intention of reselling the bonds when they bought them.

The National Can deal was agreed on in April. Due to falling interest rates, much of the debt was retired by September, 1986. The company was strong and profitable.

Part 2: Chapter 8, Icahn-TWA: From Greenmailer to Manager-Owner

Part 2: Chapter 8, Icahn-TWA: From Greenmailer to Manager-Owner Summary and Analysis

Carl Icahn was one of the new breed of takeover specialists, especially hostile takeovers. He began working with a group of investors but by the 1980s, was doing takeovers on his own, with maybe some limited partners who had no control. He began by working at several different Wall Street firms before borrowing money from his uncle to open his own, Icahn and Company. Many of his earlier associates, including Alfred Kingsley came with him when he opened his own firm and they specialized in arbitrage and options trading. They would simultaneously buy and sell a bond and lock in the price differential between the buying price and the higher selling price. With options, they would buy one security and short another at the same time, with their profit being the price differential. This arrangement lasted until 1973 when Kingsley left the firm, and then returned in 1975. When Schnall decided to move to Connecticut, Icahn suggested in leave the firm also.

Icahn and Kingsley went on to accumulate 4.9% shares in firms and then sold for a profit. The 4.9% was below the SEC reporting limit on 13D disclosure documents. In 1978 Icahn won a proxy fight for Baird Warner which was then a REIT. A proxy fight occurs at stockholder meetings where the management team is voted out or to attract investors to an undervalued company. Proxy fights were one of Icahn's forte's at this time. A 1979 proxy fight got him a seat on the board of Tappan from which he then maneuvered the sale of the company to AB Electrolux. He made almost $3 million on the deal. He strongly supported proxy fights to force a sell-out.

Icahn was one of the first practitioners of greenmail, the practice of a selling back a company's stock at a higher price than other stockholders could receive. Icahn felt that the stock was truly undervalued and that his selling price reflected the true value of the stock. In the Hammermill Paper Company matter, Icahn was honest about wanting the company for the purposes of making a quick profit - he didn't know anything about the paper business. Duval, the CEO end up suing Icahn and hiring an anti-takeover specialist and fighting Icahn. Hammermill was a proxy fight that Icahn lost with a settlement finally reached in July, 1980. Icahn still made a profit of $9 million on the deal.

Marshall Field was successfully taken over by Icahn in 1982. Marshall Field fought back charging Icahn with RICO act violations. This is the Racketeer Influenced Corrupt Organizations Act. Icahn, the suit charged, had earned his money from a pattern of racketeering and was using it to take over Marshall Field. While this was going on Fields entered into a merger agreement with Batus, Inc., a British retailing firm, which paid Icahn almost double what he paid for the shares. He moved onto other companies with

his style of greenmail until June 1984 when he actually acquired a target called ACF, a railroad car leasing company. Much of the purchase price came from the sale of some of the company's divisions.

Icahn said that this was his objective all along, to acquire the target. "He no doubt meant this. In a stock market where companies were as undervalued as many were in the early eighties, it was feasible - if one chose the right companies - to gain control, sell off parts in order to pay for the cost of the acquisition, and be left with the best part of the company almost for free. Over the long term, it would be far more profitable than grabbing a quick greenmail" (Chapter 8, pg. 162). Icahn was the kind of customer that Drexel was looking for. Most other firms wouldn't handle him and he would be willing to pay the price to the investors of junk bonds.

With the Phillips Petroleum situation, Drexel decided they wouldn't use greenmail, even though it has been successful in other cases. Drexel tried to find a real buyer for Phillips. The only one they could find was Carl Icahn, who began quietly buying Phillips stock right after they announced their recapitalization plan. He decided to wage a proxy fight at the shareholders meeting to defeat the plan and hired Donaldson, Lufkin and Jenrette, Inc. for that purpose. Icahn suggested that Drexel give him a commitment letter for financial the acquisition of Phillips. This would mean that Drexel would agree to commit its own capital, something unheard of at the time. This practice would soon become known as 'bridge financing' and it began with a Drexel letter using the words 'highly confident'.

The Phillips tender offer represented the first time an offer had been tendered with financing in place and without the use of banks. The plan was that Icahn would execute a hostile leveraged buyout financed the company's cash flow used to pay the debt. Phillips didn't take Icahn seriously and Icahn allowed Drexel to move to the next phase, that of collecting the commitment letters. Drexel raised the $1.5 billion in forty-eight hours. Icahn wouldn't allow them to raise more at this time, since it was still several days before the proxy fight at the shareholders meeting. The proxy fight was won by Icahn which triggered the poison pill, a defense mechanism that makes targeted companies less desirable, but it was voted down by the shareholders. In the end, Icahn sold his stock for more than twice what he bought it for.

After the Phillips deal, Icahn continued to do his own mergers. Even though he didn't always use Icahn, he was always meeting Drexel at various targets. They were on opposite sides with TWA, since Drexel had a policy of defending the victim client. The roles became known at the Predators' Ball, when Icahn started asking probing questions of the TWA Chief Financial Officer, Robert Peiser. Joseph told Icahn that Drexel couldn't support him. Icahn began quietly buying TWA stock and owned 20% by the time he filed his first 13D. TWA tried to enjoin him from buying more stock.

Icahn was attracted to TWA by its cash flow even though TWA told him it could end overnight due to strikes and terrorism. TWA convinced him that his plans for partial liquidation was not good but could not win an injunction against him so Icahn continued to buy stock. The only white knight, a buyer to save them from a hostile takeover, they

could find was Frank Lorenzo of Texas Air. Lorenzo already owned Continental and New York Air and the acquisition of TWA would make the new entity second only to United.

Lorenzo hired Drexel in this fight because TWA hired Salomon Brothers, instead of staying with Drexel. Lorenzo refused to initially buy Icahn stock at Icahn's price which eventually cost him the deal. The labor unions eventually approached Icahn in an attempt to defeat Lorenzo who had filed bankruptcy with Continental and cut their wages in half to make it profitable. The unions negotiated agreements with Icahn which allowed him to offer a better deal than Lorenzo. Icahn won the TWA deal and used Paine Webber to do the financing. Drexel could not obtain a required release from Lorenzo and could not represent Icahn. Paine Webber had a problem placing all of the debt and the airlines' deteriorating financial situation meant that Icahn was going to have to sell his position or renegotiate the deal. Terrorist attacks in Rome and Vienna had Icahn looking for a way out. They negotiated a new deal with Icahn leaving his money in the airline. Drexel fell short of the amount of money it committed to raise.

The TWA flight attendants picketed at the Predators' Ball in 1986. As soon as Icahn arrived at the ball, there was news of a terrorist attack on a TWA flight and he headed back to New York. Six months later the airline was on its way to recovery. Even though morale was low, the company was profitable and many said that Icahn's managerial skills came through during this period.

Part 2: Chapter 9, Pantry Pride - Revlon: The Crucial Campaign

Part 2: Chapter 9, Pantry Pride - Revlon: The Crucial Campaign Summary and Analysis

Ronald Perelman acquired control of Pantry Pride, a supermarket chain, in June, 1985, just as the company emerged from bankruptcy. Perelman was targeting Revlon and was planning to use Pantry Pride and its income sheltering tax loss to acquire Revlon. Perelman was in the penthouse of Michael Bergerac, the Revlon chairman and CEO telling him about his latest acquisition of Pantry Pride and his dreams of owning Revlon, which wasn't for sale according to Bergerac.

Bergerac had worked at ITT before coming to Revlon in 1974 where he helped negotiate the acquisitions and mergers that grew the big conglomerate. He also ran the company's European operations before being hired by Charles Revson before his death. Revlon was attracting raiders and not just Perelman since the company's stock was trading below its breakup value. Another group, called the Frates group, had unsuccessfully tried to acquire the company. Bergerac realized that Revlon was takeover bait and began to look at the possibility of taking the company private and decided the board would not approve the deal.

The renewed interest by Perelman began in 1985. Bergerac's associates told him that Perelman had never done a hostile takeover and they didn't think he would do one but they knew he had Milken behind him. Bergerac didn't know anything about Milken at the time but he quickly learned about junk bonds and Drexel. Many of Revlon's supporters in the ensuing battle did not believe that the actions of the raider's were legal. Perelman had a history of doing successful acquisitions, mostly backed by Drexel. He looked for cash flow and assets that could be quickly sold.

Perelman's biggest success story, before Revlon, was Technicolor, a film-processing company. Perelman had paid full price for the company. Others did not see it as being as valuable as Perelman did, but he sold off parts of the company ploughing the money back into the company with very positive financial results, as earnings rose. There was a lawsuit against Perelman for his actions in the Technicolor situation that was still pending at the time of the writing of this book. Among other things, there were charges of fraud and breach of fiduciary duty. When Perelman's first wife was divorcing him, he knew it was going to be messy and would involve MacAndrews and Forbes so Perelman wanted to take the company private. Perelman and his wife eventually settled for a $3.8 million cash payment and Perelman took MacAndrews private in March 1984. Drexel did the required financing for him.

The former brokerage company, Rooney, Pace Group, Inc. was the one to target Pantry Pride, which was being represented by Drexel at the time. When the Rooney, Pace

group lost the proxy fight, Drexel helped negotiate the deal between Perelman and Pantry Pride. Now Revlon was the important campaign. "In the junk-bond-takeover war, which began in earnest in early 1985 with Icahn's raid on Phillips, Revlon was the crucial campaign. That was where the most impassioned corporate defenders were unite against Milken's onslaught; where they unloaded everything in the takeover defense arsenal; and where they fought down to the wire, committed to evading Perelman at all costs to the very last moment. What they lost sight of - particularly as Perelman, by the good grace of Milken, kept upping his all-cash bid - was that Perelman's money was as good for the shareholders as anyone else's. In the end, they sought so desperately to escape his clutches that they undid themselves" (Chapter 9, pg. 203). The Revlon takeover proved the power of Milken and junk bond financing. Few hostile takeovers had been successful up to this time and many Revlon supporters did not think that Perelman could prevail.

At the 1984 Predators' Ball it became known that Drexel partner Groupe Bruxelles Lambert S.A. wasn't happy with the Drexel practice of not paying dividends and they were trying a takeover based on their 35% of stock. They worked out a deal that was agreeable to both sides and the Drexel stock increased in value as a result. The problem with the kinds of takeovers financed with junk bonds is that the entity is left with a huge amount of debt and must sell off assets to pay the high interest payments unless they have a large cash flow. Felix Rohatyn, of Lazard, noted that before the announcement of a bid for stock during a raid, the market is flushed with speculation that forces the price of the stock up.

Revlon had a team of investment bankers and lawyers to help them fight the hostile takeover bid. Among them was Arthur Liman and Simon Rifkind. Also, by this time in the mid-1980s, the other investment banking firms were becoming active in the junk bond market and trying to rival Drexel. Morgan Stanley was working with Drexel on the deal as was Chemical Bank and other establishments willing to provide funding for a hostile takeover. None were able to and Perelman's plan for the Revlon acquisition was the same as for others. He would use debt to acquire the company and then sell off pieces of the company to lower the debt, a plan which he explained in his tender offer.

As soon as the tender offer was made, Revlon sued Chemical Bank, Pantry Pride and MacAndrews and Forbes for, among other things, disclosure violations and margin violations. Bergerac was trying to strike at the mechanics of the Perelman takeover apparatus in this suit that these Perelman companies were being used as vehicles in the takeover apparatus in the use of junk bonds and none of the information was in any of the prospectus. Revlon's filings in Federal courts didn't have any effect on the takeover. They tried to defeat the takeover by issuing debt with covenants disallowing the sale of assets and the incurring of any other debt. The directors could waive these covenants. Perelman came back with another higher share price offer conditioned on 90% of the stock to minimize the effects of the poison pill. Revlon knew they couldn't win now and began to consider other options like a white knight or liquidation. They were very worried about the $42 per share offer. Perelman wanted the beauty part of the business and right after he tendered his $42 per share offer, another buyer, Adler and Shaykin, appeared for that part of the business. There was another group, lead by

Forstman Little, which included Bergerac, was interested in buying the remainder of the firm.

In order to fight these groups, Pantry Pride raised its bid to $50 per share and to $53 per share in October. The Bergerac group countered with an offer of $56 per share which was topped by Perelman with Drexel obtaining letters of commitment. The management groups kept trying to work out different deals and on October 12 the board approved one of the management schemes. The Delaware State Court rules against management and the Revlon board breaching a fiduciary duty in accepting the management deal. The board was favoring the management groups in considering the offers. The Court stopped the transfer of assets into escrow until a decision was reached. The Delaware Supreme Court also ruled against the favoritism of the board. The Revlon battle was over and Perelman achieved his dream of owning Revlon and he did it for $58 per share.

Two weeks after the Revlon deal was closed, Perelman began to sell pieces of the company. Perelman didn't stop doing takeovers with Revlon. He went on to attempt others: CPC International and Transworld Corporation are two of the more notable. Revlon merged into Pantry Pride and the new entity took the name the Revlon Group.

Part 3: Chapter 10, 'Drexel is like a God'

Part 3: Chapter 10, 'Drexel is like a God' Summary and Analysis

Since Milken was established in the United States, he began to look to overseas markets and as such, held a mini-Predators' Ball in Tokyo on November 10. The Drexel people believed that the Japanese were ready to invest in the junk bond market. They were always investors in triple-A instruments. Milken planned to use the same formula that had been successful in the United States. He would build a base of investors, and then target providing financing for small firms who he would then later help raid the bigger firms in Japanese industry. Milken though the process would be much faster in Japan than it had been in the United States.

Drexel was even described as being a god that could do whatever they wanted in the niche they were in. Drexel basically replaced the banks and the insurance companies in providing financing for their clients and in doing takeovers. Many deals would not have taken place without Drexel being able to place the unsecured debt that banks wouldn't touch. Drexel functioned basically as a monopoly in this market and the result was tremendous growth for the firm. It was the most profitable investment banking firm in the United States by the end of 1986 and it was Milken's group that was providing the growth.

Other investment banking firms tried to follow Milken's lead but couldn't. They couldn't match the junk bond deals even though they followed Drexel into merchant banking. The deals were risky. They couldn't match the profits of Drexel or the bonuses its employees were making. Even though other investment banking firms were active in the area, Drexel's market share was still more than 50%. But other firms developed new instruments or devices, like the bridge loan.

None of the other firms could tap the kind of money that Milken could or with the speed with which Milken could. They could never construct the deals in the way that Milken did in which there was very little risk for Drexel. Some firms gave up trying to imitate or compete with Drexel and just had their clients invite Drexel into the deal. The very successful Drexel announced it would move into its new officers in the World Trade Center in 1986. The building of Drexel as an institution was more the area of Joseph than Milken. This had been Joseph's goal from the beginning. Joseph was hiring in order to diversify the firm and this meant mostly hiring people away from other firms for huge salaries.

Dennis Levine was a Drexel employee who was hired by Drexel when he was passed over for a promotion at Shearson. Drexel's seven figure offer topped the list and he went to work for them. He was arrested on May 12, 1986 and charged with insider trading and agreed to cooperate with the government. This was the beginning of a big scandal that would involve people from some of the biggest investment houses. Another case

involved two Drexel employees, Robert Salsbury and Antonio Gebauer. All three had been Drexel employees for less than a year and most were engaged in crime before being hired.

Joseph hired Martin Siegel in February 1986 with a three year contract calling for $3 million per year plus extras. Siegel was suppose to bring in blue-chip clients, some of whom he brought from his former firm of Kidder. Many were introduced to Drexel and the 1986 Predators' Ball, where many were dazzled by the whole event. Many politicians also attended the ball and were the recipients of contributions, which is why none of the thirty bills introduced covering takeover in 1984-85 passed. The 1985 President's Council of Economic Advisers report studied the issue of M&A and concluded that they were very beneficial for the economy in that they improve efficiency. Other studies refuted this claim.

Eventually rules pertaining to mergers were adopted but they were easy enough for the investment banking firms to get around. The only hostile takeovers covered by the rules were those done by shell companies so it was the easiest thing to use a company that wasn't a shell and that had some kind of business. They could also get around the rules by using preferred stock instead of bonds as a means of financing. Using common and preferred stock to finance half the transaction and bonds to finance the other half is the way the Drexel side-stepped the new rules.

Part 3: Chapter 11, Proven Prophet - So Far

Part 3: Chapter 11, Proven Prophet - So Far Summary and Analysis

The debate regarding the economic advantages of takeovers continued in the halls of academia since the investment houses walked around the rules of the Fed. Some, like James Grant, the editor of Grant's Interest Rate Observer, thought that Wall Street had gone too far with junk bonds which he felt were concentrated in the hands of a few Milken people. Grant again warned the financial world about junk bonds in the Metromedia Broadcasting Corporation deal in November 1984, about the high level of debt and that resulting company might not be able to pay the debt, in terms of interest and principal. In May 1985, Rupert Murdoch purchased the television states and assumed the debt and the result was a huge increase in value within six months.

One of the most important factors in these kinds of deals was the zero coupon bond. This was basically a bond that paid no interest until maturity. This was a Drexel supported vehicle and helped many companies that could not make interest payments in the short-run. "Now, in early fall 1986, Grant was still in print, and unswerving. He articulated a theory of credit cycle in debt expansions, in which a gradual shift from vigilance to recklessness in lending and borrowing takes place, and he postulated that the current cycle had reached the reckless, or maniac, phase. In this phase, the public competes frenziedly for securities of high and higher yield - and poorer quality" (Chapter 11, pgs. 267-68).

Junk bonds were becoming poorer in quality during this time and there were more bankruptcies and defaults. The largest bankruptcy was in 1986 and was LTV Corporation. LTV was not a Drexel customer. Even though some people were nervous about the situation, there was no panic or distress selling. The thrifts that collapsed and the defaults that occurred were not among Milken's customers and it only took the junk market two weeks to recover from LTV. Drexel and Milken's operation were becoming more stable during this period but critics claimed they wouldn't be able to withstand a recession and they waited for the day to come. In the meantime, Milken began to be featured on magazine covers.

Milken did not agree with others about liquidity being scarce. He felt there was a lot of liquidity in the world - you just had to know where to look for it. Oil companies always have excess cash. The opportunities were still there if one knew where to look. Milken still strongly supported the owner-manager of businesses and three of his top clients had taken their companies private.

Part 3: Chapter 12, Milken's Money Machine

Part 3: Chapter 12, Milken's Money Machine Summary and Analysis

There were many people doing junk bond financing by fall of 1986. They would imitate Milken and some times beat him on deals by offering better prices but they could not overtake him and beat him at his own game. Many who started with Milken, like the money managers in the late 1970s, were now running their own funds. Milken would also help people find jobs when they needed them or wanted to make a change. They weren't always at Drexel. He found many people jobs with the different investment funds. People who left Drexel on friendly terms had Milken's assistance finding jobs.

Milken had a lot of pools that he could easily draw upon one of which was Atlantic Capital. The company was involved with unmonitored investments under Peer Wedvick who had a scheme to sell contracts involving housing funds. For that he needed to have an institution with a high investment-grade rating. He found one in Clarendon, a Bermuda based reinsurance company, and Kansa General Insurance Company in Helsinki, Finland. Rodrigo Rocha made the contact between Wedvick and Eerki Pesonen, chairman of Kansa. Wedvick needs the AA rating that Kansa and Clarendon had, so Atlantic Capital came into being as a subsidiary of Clarendon. The problem was that Wedvick and Rocha had no investment strategy but by mid 1984, they were investing in junk bonds but did not disclose that fact. Most investors did not ask because of the AA-rating. By fall of 1985, Atlantic Capital had to stop selling the contracts due to pressure on Kansa from Standard and Poor's and a downgrade to an A-rating.

Part 3: Chapter 13, The Enforcer

Part 3: Chapter 13, The Enforcer Summary and Analysis

Milken, in many ways, played the role of enforcer. He had to control the situation. At first it was the buyers, then it was different aspects of the situation as he control the investment fund for his group. Milken was not challenged by many people and things were done the way he wanted them done. Milken had control even though the opportunity for abuse existed. Drexel's clients paid the high fees because they knew that Milken would help them when they needed help and he took it personally if they did business with someone else. Milken was so powerful that people could not afford to insult or alienate him. Drexel gouged them with fees and high prices, but their customers made money.

Some customers received better deals than others. Carl Icahn and Samuel Heyman were in that category. Heyman was able to get Milken to give him an investment-grade rate when he purchased GAF. For Drexel, these small concessions meant more deals and more money down the road. The firm also acquired equity from the deals they took part in. Others, like Lawrence Coss of Greentree Acceptance, felt that they were the targets of hostile takeovers because they wouldn't give in to Milken. Green Tree later sued.

Another case was Wickes and Sanford Sigoloff. Wickes was emerging from Chapter 11 bankruptcy with a large tax-loss carryforward. Sigoloff thought he would use the situation to make a acquisition and decided to use Salomon Brothers. Wickes then learned that Steinberg's Reliance Financial Services Corporation had acquired 10.4% of Wickes stock. Sigoloff switched to Drexel.

Part 3: Chapter 14, Sovereign Privileges

Part 3: Chapter 14, Sovereign Privileges Summary and Analysis

Milken didn't want any fancy titles at Milken and he didn't want his picture in the annual report. He was not interested in the running of the firm. The trading floor was his office and his base of power and its location in California put quite a bit of distance between Milken and the powers that be at Drexel in New York. There was some tension between the East and West Coast operations due to the amount of money made by the junk-bond unit. "Much of the wealth that was being amassed in Beverly Hills, of course, came through Milken's investment partnerships, and while he had allowed some members of the corporate-finance department to participate in several of them, the overwhelming majority of these partnerships were for him, his brother and his group (and at least a few of them included individuals wholly unrelated to Drexel)" (Chapter 14, pgs. 299-300). Many of the others at Drexel were not allowed into these investment groups and there was some resentment because of this. When they were allowed, the distributions weren't equal. Milken and his unit basically functioned as a separate firm within Drexel.

Tubby Burnham, the firm's founder, was also a little leery of some of the practices of the junk-bond unit. An individual would ask for a specific amount of money and would be told to take more because they could raise it for him. He knew that the overfunding was wrong and was skeptical of the huge fortunes that were being made. He also knew that it wouldn't last forever.

Milken and Joseph more or less complemented one another. They both want to be at the top and were willing to work to achieve that goal. Joseph didn't often overrule Milken and Milken, for the most part, did as he pleased. All underwritings were supposed to be approved by the Underwriting Assistance Committee (UAC) which was held on a weekly basis in New York with a phone hook-up to Beverly Hills. Milken did pretty much what he wanted in spite of the UAC. He financed Ivan Boesky, an arbitrager, in some deal which basically meant that Drexel was dealing based on insider information. Drexel pretty much allowed Milken and their employees to have a free hand, but there were some rules that had to be followed but Milken did not pay much attention to the rules. His superiors knew the possibility of his profiting from insider information even though they thought the chances of being caught were slim.

Milken was investigated for insider trading in 1984-85 but was the investigation was dropped when nothing could be proven. The trading of Caesars World casino bonds were at the center of the investigation since Milken was buying them for his account and then they were announced in an exchange offer that was being done with Drexel as the adviser. The date of the purchase was questioned during the investigation. Milken well known for his memory for details was somewhat forgetful of some points during his deposition but insisted the bonds were purchased before a meeting at Caesars.

Milken and wife Lori remained totally unpretentious. They had no need for splashy jewelry and furs. Milken finally consented to having a driver after being involved in an accident. He made a lot of money but he didn't flaunt it.

Part 3: Chapter 15, Boesky Day

Part 3: Chapter 15, Boesky Day Summary and Analysis

The day after the Drexel group returned from the Tokyo bond conference, Ivan Boesky pleaded guilty to insider trading. The day was November 14, 1986. Boesky also agreed to pay a $100 million fine and to cooperate with the government in its investigation of insider trading on Wall Street. Drexel had $640 million in Boesky underwritings the records of which were placed in a closet of Drexel investment banker Stephen Weinroth. He is the man who was responsible for unwinding the positions to make the bondholders whole on their investment. Within minutes of the announcement, the SEC issued subpoenas. The trading of Milken, Icahn, Posner and Boyd Jeffries, as well as others was under investigation. As the investigation went on, it seemed to involve other Wall Street figures and not Milken and the Drexel bunch.

Milken and Drexel had underwritten quite a bit of Boesky debt. Drexel became the target of both an SEC and federal grand jury investigations. At the center of the case was a $5.3 million payment made by the Boesky organization to Drexel in March 1986. When Boesky's auditors questioned the payment, he claimed it was for consulting services. He obtained a letter from Drexel supporting his claim. The government claimed that the funds were for the parking of stock, a situation where one investor holds stock for another investor and thus conceals the identity of the owner. If this were true there would be numerous charges that could be filed against them. There are various scenarios presented for how this parking could work and be advantageous to both Boesky and Milken.

In April 1987 Boesky plead guilty to charges of conspiring to make false statements to the SEC in the Fischbach investigation. They were accused of acquiring Fischbach stock with Milken being reimbursed for losses and this was included in the $5.3 million payment. Drexel client Posner began acquiring the company's stock and agreed to a standstill agreement with Fischbach in 1980. When Fred Carr converted his bonds to stock, Fischbach bought him out. Posner claimed that the standstill was violated. Fischbach finally agreed to sell out to Posner and Drexel financed the deal in February 1985. The complaint went on to delineate other charges that were involved in the $5.3 million payment. The government was looking for the traders who were involved in the stock parking scheme.

Wall Street waited for the indictments to be handed down against Milken and Drexel. Rumors flew at the end of every trading week. Martin Siegel was charged with tax evasion and conspiracy to violate security laws. Others employed by different investment houses were charged but the charges were dropped. In the midst of this, on April 1, the 1987 Predators' Ball was held. Milken appeared well at the meeting.

Part 3: Chapter 16, The Center Cannot Hold

Part 3: Chapter 16, The Center Cannot Hold Summary and Analysis

Drexel knew they had a problem after Boesky Day. The firm was hated by many on Wall Street. The arrogance of many of their staff was working against them. The government didn't have evidence against Drexel but they were still under the strain of the investigation. It was pretty much accepted that Milken and Drexel's days of hostile takeover and Milken's raising hundreds of millions of dollars in a few days were coming to an end. Drexel's power began to ebb. It abandoned its plan to move to Seven World Trade Center. The bonds that were traded were not in the massive amounts as in earlier days and more precise records of trading activity were being kept now. Some of the investment partnerships at Drexel were closed.

Drexel lost the blue-chip clients it was trying to attract. They did not stay with the firm, even though most of their usuals did. When Drexel was brought in on some deals, it was so they wouldn't come in with a competing bidder. The company was being driven by fear now. Many employees were leaving the firm, and Joseph, who had become CEO, was worried. There were some personnel changes. Martin Siegel left the firm in February when his plea was announced and Jim Dahl was a problem because of a lawsuit by Beverly Hills Savings and Loan.

Part 3: Chapter 17, The Humbling

Part 3: Chapter 17, The Humbling Summary and Analysis

Drexel was still hanging and waiting a year after Boesky Day. Issues were being discussed in the press but nothing had come out of the grand jury yet. In October 1987 the stock market crash occurred which was thought to bring an end to the bull market. Many critics claimed that a recession would bring down the junk bond market, especially since the quality of junk had been deteriorating. "In the October 1987 crash, junk bonds did fall in price, with the average junk portfolio losing at worst about 10 percent of its value. This was not surprising, since they are really part debt, part equity, and their value tends to fluctuate with the equity markets as much as or more than with the bond markets, their key variable being less the direction of interest rates than the perceived ability of the issuer to service its debt. While investors fled to Treasury bonds, which staged a huge rally as the stock market plunged, junk bonds, which staged a huge rally as the stock market plunged, junk bonds yielded a near-record 5.5 percentage points over Treasury bonds with comparable maturities. In the weeks after the crash the market for new junk issues was scarce, even at interest rates of 17-18 percent. And a scattering of obituaries for junk began to appear in the press" (Chapter 17, pg. 345). Bond prices of the stronger bonds recovered somewhat the next month, while the weak ones didn't.

The bonds that had problems during the crash were not Drexel bonds. Fruehauf was Merrill Lynch and Southland was Salomon and Goldman Sachs. Wall Street was entering difficult times with firms starting to experience trading losses. There were a series of mergers, like Hutton with Shearson. There was a great deal of belt tightening taking place as layoffs were announce, and bonuses and overhead were cut. Drexel also experienced these things but not to the extent that other firms did. Drexel wasn't hurting as much as some of the others were. Drexel had a lot of successes during this period: Comdisco, Hovnanian, and Kinder-Care to name a few.

In the Spring of 1987 Drexel begins a big campaign promoting junk bonds. Junk bond were being billed as good for America. Junk bond financed companies were expanding their hiring when other companies were cutting back. Drexel also answered charges that junk bonds were responsible for hostile takeover by saying that less than 10% of hostile takeovers were financed by junk bonds. There were accusations about irregularities, like failure to disclose and the alerting of favored customers to upcoming deals. Drexel knew that there were violations and that they had to try to counter them. Milken began to work on the Latin American debt problem making several trips to try to solve the debt crisis. They developed a fund to help the Latin American situation.

Milken wasn't very materialistic. He believed that wealth, as well as romance, were both counterproductive and that he had to control his subordinates to protect them for these major distractions. He was a hard worker and he didn't expect anyone to work harder

than he did. He avoided the splashy Beverly Hills homes and life style and urged his staff to do the same. Milken was now trying to present himself to the world as a nice guy.

The SEC filed charges against Milken, Drexel and others in September 1988. They were charged with various violations of securities law, including inside trading, manipulation of prices, disclosure violations, fraudulent filings, false recordkeeping and defrauding customers. In spite of this, they did not suffer any major losses in clients and Milken was still in control. Drexel and Milken knew the filing of charges was going to take place. The question was when. Congress wanted the SEC to file charges and the U.S. Attorney's Office wanted them to wait until they were ready to file criminal charges. The settlement worked out was that Drexel would plead guilty to six felony counts of mail, wire and securities fraud and to pay fines of $650 million.

The case against Milken was under RICO. The Racketeer-Influenced Corrupt Organizations law. Milken had the choice of pleading guilty or going to trial. "In the end, what made Milken's defeat most poignant was that he was so betrayed. He had constructed a universe in which he made people wealthy beyond their dreams, in which he could rely on their loyalty because they owed everything to him. But he had not counted on a force more powerful than he, that could deprive his once faithful of both their wealth and their freedom" (Afterword, pg. 372).

Characters

Michael Milken

Milken works at the Wall Street firm of Drexel Firestone, as the book opens. He spends two hours commuting to work via bus from his Cherry Hill, New Jersey home. He does so to avoid having to talk to other Wall Street people that he might meet. Milken is not a social climber. He had been raised in a middle class Jewish home and did not care what kind of car he drove or what kind of clothes he wore. He was interested in bonds. Milken came from Encino in the San Fernando Valley and graduated Phi Beta Kappa from the University of California at Berkeley in 1968 with a major in business administration. After marrying Lori, he went to Wharton at the University of Pennsylvania where he obtained an MBA degree. He works at Drexel part-time while attending Wharton and then full-time at its Wall Street office after graduating. He went on to become the junk bond trading king that was behind some of the biggest of the corporate raiders until he was charged with insider trading and stock fraud by the Securities and Exchange Commission.

Carl Icahn

Icahn grew up as an only child in Queens in a family of school teachers. A Princeton graduate, he dropped out of medical school and eventually went to work at Dreyfus and Company, a job his uncle helped obtain for him. He began to trade options at Tessel Paturick and Company and moved on to Gruntal in 1964. He liked to gamble as a sideline and hobby. His uncle, M. Elliott Schnall financed Icahn and Company which opened its office at 42 Broadway. Icahn became an expert at greenmail and eventually became involved in hostile takeovers.

Ronald Perleman

Perelman was the corporate raider who acquired Pantry Pride and Revlon. He was born and raised in Philadelphia, Pennsylvania in comfortable circumstances since his father owned a metal-fabricating business called Belmont Industries. He attended the University of Pennsylvania and received his MBA from the Wharton School. His first wife Faith Golding, was from money which he managed while working at his father's business. He began doing acquisitions in 1978 when he bought Cohen-Hatfield Industries with borrowed money and then MacAndrews and Forbes. He continued to do small acquisitions, mostly backed by Drexel, including Pantry Pride and Revlon.

Victor Posner

Posner was a real estate tycoon and an early Drexel client who began buying Milken's fallen angels in the mid 1970s. He was semi-retired when he got into the acquisitions

business. He grew up in Baltimore, the son of a newspaper stand owner. His first business venture, at the age of sixteen, was demanding half of his father's news stand and when the father refused, Victor opened his own across the street and within six months had hired his whole family to work for him. Posner was involved in the National Can takeover and had to sell his holdings. Many of his properties went bankrupt and in 1986 he was convicted of federal income tax evasion. National Can went on to acquire American Can. Another Peltz-May company acquired Uniroyal Chemical Company and another picked up Central Jersey Industries (CJI). Uniroyal was taken private to avoid an Icahn takeover.

Carl Lindner

Lindner was one of the early customers of Milken. Lindner built his own business into a major supermarket chain before entering the world of finance. He acquired the Great American insurance company and began buying bonds from Milken. He had a holding company called American Financial Corporation. He was under investigation by the SEC when he became a customer of Milken and would eventually be charged with fraud and manipulation. Lindner would become the largest client of Drexel, Burnham under the promotion of Milken.

Fred Joseph

Joseph is a Drexel Burnham employee who becomes the chief ally of Milken. He becomes the public face of Milken who preferred to stay out of the limelight. Joseph came to Drexel from E.F. Hutton and Shearson. He grew up in Boston's Roxbury neighborhood and graduated from Harvard in 1968 then went to work for Hutton where he was hired by John Shad who later became the head of the SEC. When his mentor Shad lost a power struggle, Joseph departed from Hutton and went to Shearson. As the Chief Executive Officer of Shearson he was instrumental in negotiating the merger with Hayden Stone. When he wanted to go back to trading, he went to Drexel Burnham.

Saul Steinberg

Steinberg was another of the early customers. He was a fellow-graduate of Wharton and the founder of Leasco, a computer leasing business. He used Leasco paper to take over the much larger Reliance Insurance Company. Steinberg also attempted a take-over of the Chemical Bank.

Meshulam Riklis

Riklis was an Israeli immigrant who built his own empire by buying and selling companies. He controlled the Rapid-American conglomerate when he met Milken in 1970. He used one companies' assets to acquire the next company and so on, using

debt in exchange for stock. Unlike Milken in the early years, Riklis would issue the bonds directly to the stockholders, a tactic that Milken would eventually adopt.

Lowell Milken

Lowell is the attorney brother of Michael. Educated at the University of California at Berkeley and then UCLA Law School, he left his Los Angeles practice and joined Drexel when the high yield bond operations moved to California. He served as an advisor to his brother as well as managing the investments of the family and the bond group.

Fred Carr

Karr was a Milken customer in the early 1980s and head of First Executive. He was an equities analyst who took the job at First Executive because of the chance to exercise his own investment decisions even though he had no background in insurance.

Thomas Spiegel

Spiegel began as a Drexel salesman in New York when his father brought Columbia Savings and Loan Association, a teetering thrift institution in Beverly Hills that Thomas Spiegel went to work for. Spiegel used the money from the long-term debt to invest in junk bonds and became the thrifts industry's highest paid executive.

Nelson Peltz

Peltz was one of the players involved in the National Can take-over. He grew up in Brooklyn and attended the Wharton School but did not graduate. He went to work in his family's food business, which sold frozen foods to institutions and became interested in acquisitions. He teamed with Peter May and took-over Triangle Industries.

Peter May

May was raised in New York and received his MBA from the University of Chicago. He as an auditor at Peat, Marwick, Mitchell and Company when he first met Peltz. He went to work for Peltz when Peltz acquired Flagstaff and became a business partner in various takeover dealings with Peltz.

Laurence Tisch

Tisch was one of the early Milken customers and the owner of Loews Corporation. He took over the CNA insurance company in a hostile raid. He is the only one who distanced himself from Milken when Milken came under investigation.

M. Elliott Schnall

Schnall was Carl Icahn's uncle. He helped finance Icahn's company, Icahn and Company.

Alfred Kingsley

Kingsley was an associate of Carl Icahn. He attended Wharton, had a law degree from NYU and a master's in tax law. Kingsley worked for Icahn until 1973 when he left for work at F.L. Salomon.

Michel Bergerac

Bergerac was the chairman and CEO of Revlon at the time Perelman became interested in the company. Before heading Revlon, Bergerac worked for ITT and helped negotiate the acquisitions that made it into a huge conglomerate. He went to Revlon in 1974.

Samuel Heyman

Heyman was a lawyer from Harvard Law and a real estate developer. He was also one of Milken's large customers and had taken over GAF.

Tubby Burnham

Burnham was the founder of Drexel Burnham Lambert. He was the one who let Milken and Joseph do what they wanted.

Ivan Boesky

Boesky was involved in an arbitrage partnership and did some deals through Milken. It was his testimony that eventually lead to Milken and Drexel's problems with the SEC and U.S. government.

Objects/Places

Cherry Hill, New Jersey

Milken's home is in Cherry Hill, New Jersey from which he commuted daily to Wall Street by bus.

Philadelphia, Pennsylvania

Milken began working for Drexel in their Philadelphia office while he was attending the Wharton School.

Wall Street

Wall Street is the financial area of New York city where the investment banking and other financial firms are located.

Brussels, Belgium

Belgium is the home of Belgian Compagnie Bruxelles Lambert, a firm that owned the William D. Witter firm that Drexel merged with to become Drexel Burnham Lambert.

Houston, Texas

Houston is the location of the American General Capital Management, which is managed by James Caywood.

Century City, California

This is the city in California where Milken moved his bond operation unit to. His address was a skyscraper at 1901 Avenue of the Stars.

Encino, California

Milken buys a house in Encino when he moves the Drexel operation there. The Encino house is close to the Milken family and relatives.

Beverly Hills, California

The corner of Wilshire Boulevard and Rodeo Drive in Beverly Hills, right next to the Beverly Wilshire Hotel, is the new location of the Drexel offices. The building is leased to Drexel having been purchased by an investment group which includes Milken and his brother Lowell.

Chicago, Illinois

Chicago was the home of National Can, which was one of the first successful hostile takeovers. Marshall Fields in located in Chicago.

Erie, Pennsylvania

Erie is the home of Hammermill Paper and the scene of the proxy fight which Carl Icahn lost.

Tokyo, Japan

Tokyo was the site of a mini-Predators' Ball in November, 1986 as Milken decided to expand into international markets.

Themes

Value of Dreams

One of the themes throughout the book is that most of the big players came from modest origins. Some were born to money, others married money, but most came from middle class backgrounds, went to school and worked their way up. They fulfilled their dreams, but dreams can't be fulfilled unless an individual has dreams. This is a theme that is recurrent throughout the book.

Milken had dreams involved with trading junk bonds. There was no market for junk bonds before Milken. He made the market and the instruments because he had the foresight to see where a market niche was and he had the employer, Drexel, that was willing to back him and allow him to try his plan. They stood behind him when he needed them. Milken had the dream of creating junk instruments that would fill a need in the market. Fred Joseph also had a dream when he came to Drexel, that of making Drexel a top notch firm. He spent all of his years at Drexel trying to fulfill that dream. Drexel gained in respectability and grew in size to number two during his tenure. So Joseph was also fulfilling dreams when he was at Drexel.

Without dreams, people have nothing to strive for. Performance is always better when there is a goal in mind and this is what was evident at Drexel. Its main participants had goals and were working to achieve those goals and dreams.

Loyalty

Loyalty is also a theme that runs throughout the book. Loyalty is the key factor in success with Milken and his subordinates. He demanded loyalty from his people and he received it. The Drexel workers and customers were also loyal to not only Milken, but also to the firm. They stuck with Drexel though thick and thin. They paid the higher fees and commissions because Drexel and Milken delivered for them.

Loyalty was also evident after the SEC filings and the U.S. Attorney's investigation were in progress. Drexel's main customers did not desert them and go to other firms. They stayed with Milken and the company until the very end. In spite of the higher cost, Drexel always came through for them and many of them would still have been small time operators if it hadn't been for Drexel.

Loyalty was also a factor in what happened to Drexel employees who left the firm. Drexel would find a spot for most employees somewhere in their own operation so most employees didn't have to leave the firm. For those who do and were on good terms with Milken and Drexel, they would help them find a good position where ever they went. Loyalty was a factor that worked both ways, since the employees were willing to go out of their way to do their jobs.

The Value of Hard Work

The third recurring theme is an extension of the other two and it is the value of hard work. None of the characters in the book is afraid of hard work. None of them keeps an eye on the clock or works nine to five hours. Once the Milken group moved to California, they maintained work hours consistent with the New York work day. This meant that they began their day at 4:30 a.m. They would also work after the close of the trading day, in spite of the time and the number of hours they spent. Part of the reason why Milken's staff was willing to do this is that they knew that Milken would never ask them to do what he wouldn't do but he expected to be listed to when he told them to do something.

Milken was the real workaholic in the book, all though most of the other involved parties were close to him in their own behavior. Milken had to be dragged on vacation by his wife and had to finish his work by 9 a.m. so he could spend some time vacationing with his wife and kids. Milken functioned on very little sleep and would work during the night until 9 a.m. and then spend the day with his family on vacation. While working at his office he would arrived before 4:30 a.m. and would still be there in the evening some times.

Hard work is a manifestation of loyalty to the employer and hard work is also the way to fulfill ones dreams. And all of the characters in the book were hard workers and many of them who came from middle-class backgrounds, ended up as multi-millionaires.

Style

Perspective

Connie Bruck is a professional writer and senior reporter. She has had articles appear in many leading newspapers and magazines and has won awards for her writing in the area of finance. As such, she is extremely knowledgeable about financial markets and is well qualified to write a book of this nature. She is able to explain what the various situations and instruments are in a way that is understandable for the reader because she understands them herself.

The author does a good job on introducing the characters and making them seem human to the reader. She is good at explaining the different situations that arise in ways that are comprehensible to the reader and the reader has to appreciate the ease with which the author is able to explain different concepts and deals. The reader doesn't have to stumble around trying to figure out what these things are because the author doesn't. The reader is easily able to follow the events as they occur in the book without trying to figure out what the financial instruments are or how the deals are structured.

The book is written is a matter of fact way that holds the reader's interest. The story is interesting in itself so there is not much that the author has to do to hold the reader's interest.

Tone

The tone of the book is pleasant and the book is written from a third person objective point of view. The author presents the facts without emotionality, telling the story as it occurred. There are no embellishments or dwelling on details or recriminations of any kind. It is objective and to the point. There are plenty of quotes throughout the book from the different characters involved in the different deals, which makes it interesting for the reader and gives the reader more insight into the situations and the character. The book is written in such a way that makes it read like an exciting novel for the reader so much so it is hard to put the book down once you begin to read it.

The tone and writing style not only make the book more interesting for the reader but also makes it easier to read and understand. At no time is the author forcing concepts on the reader or is the reader struggling to understand the concepts or the deals. This means that there is no diversion from the flow of the action in the book because the reader can just move with the flow without any irritating interruptions of having to backtrack or look up definitions and because of this, the reader has to appreciate the style of Bruck's writing for just this purpose.

Structure

The structure of the book is simple and works quite well for the book. There is a Prologue, three parts with seventeen chapters and an Afterward. There is also an Acknowledgements section and an Index. The Prologue sets the stage for the book in that it defines what the Predators Ball is and why it is. It discusses the main characters and basically what the whole purpose of the trading business is as the customer meet with one another as well as with the investment house staff and members of government and the entertainment industry. The Predators' Ball is an annual event or is more or less like the annual business meeting.

The story is divided into three parts. The first part sets the stage for the action of the book, explaining who the characters are and how they got their start. It also introduces the reader to many of the different financial instruments. The second part of the book consists of war stories, discussing three of the big mergers that took place: Triangle-National Can, Icahn and TWA and Perelman and Pantry Price and Revlon. The third part is basically telling of how Drexel reached the apex and then began to slide because of SEC and U.S. Attorney investigations of some of the hostile takeovers and some of the practices involved. At no time does the reader have to backtrack to check on events or definitions. No other structure could work as well as the chosen one does.

Quotes

"By five-thirty each morning, an armada of about one hundred limousines glided into position around Beverly Hills. Dozens of them ferried guests from the lush green-and-pink medley of the Beverly Hills Hotel - then owned by arbitrageur Ivan Boesky, his wife and his in-laws, and completely booked by Drexel for these four nights - through the city's wide, stately, palm-tree-lined streets. Their destination was the Beverly Hilton, where the annual Drexel High Yield Bond Conference - by now known as the Predators' Ball - was being held, just a few blocks from Drexel's West Coast office." (Prologue, pg. 10)

"The universe of corporate bonds that Milken was entering consisted mainly of 'straight debt' - bonds whose holders receive fixed-interest payments, typically every six months, until maturity, when the principal is repaid. A much smaller, more arcane part of the market consisted of convertible debt - bonds whose holders have the option to exchange them for other securities, usually stock." (Chapter 1, pg. 27)

"But to convince an investor to buy a bond with a C rating you had to tell the company's story. You had to know the company's management, its product, its balance sheet, its earnings trend and cash flow - just as you would in trying to sell the stock of a little-known company. You had to convince the investor that the ratings agency had been too hidebound, or too cursory, or too blind to see that there was more to be mined in this foundering company's bonds. And, finally, you had to persuade the investor that an analysis of the assets showed that if the worst happened and the company went into default, there was a safety net of value below which the bonds could not fall." (Chapter 1, pg. 32)

"Joseph's strategy was to develop an 'edge'. And the first edge to work on, he decided, was service to medium-sized, emerging growth companies. There was nothing so original about this; many firms had such a goal. Joseph, however, believed they gave it only lip service. At most firms, when a young partner brought in a deal for a small company, the firm wouldn't support the research and wouldn't make a market in the stock; while if another young partner obtained for the firm a co-management in an underwriting for IBM, he would be promoted. Drexel, Joseph determined, would say that it wanted to build medium-sized companies, and would mean it." (Chapter 2, pgs. 42-43)

"As Milken's universe expanded from trading to incorporate the original issuance of junk, however, the bounty that as his to distribute increased exponentially. Now he had a product which would not simply allow some wealthy inventors to make a killing (buying for the upside) but could transform a dissolute financial institution into a powerhouse. And he had pools of capital that could be tapped to transform small-time entrepreneurs into major, and ever grateful, corporate players. There were many who would profit from Milken's new, expanded abracadabra powers - and who would jump to do his bidding." (Chapter 3, pg. 58)

"But not at Drexel Burnham. There, there was no war, because there was nothing about which to fight. The firm had had no investment-banking culture, and no trading culture. What had come down the pike was an almost miraculous trader who was single-handedly responsible for the profits of the firm. These Drexel investment bankers weren't proud: they wanted to be part of the Milken trading bonanza." (Chapter 4, pg. 64)

"'But by this time he saw that what he was creating was going to be unbelievable, and the profits were spilling over to the firm, in corporate finance and so forth. So why shouldn't he get his money both ways [in his percentage-of-profits deal and as an equity holder in the firm]?' He added that many members of Milken's group - who heretofore had not owned a significant stake in the firm - now followed Milken's lead. By 1986, Milken would be the firm's largest individual shareholder, owning about 6 percent of the firm's stock, according to an estimate in Forbes." (Chapter 4, pg. 70)

"The country's tax and accounting system, moreover, encourages the assumption of debt - as occurs in these leveraged takeovers - at the expense of equity. Corporate income is taxed to corporations, and dividends are taxed to shareholders, creating a double tax. It is easier for a corporation to pay interest (on debt), which is tax deductible, than to pay dividends (on stock), which are not. A company in the 50 percent tax bracket can afford to pay a rate of 16 percent interest as easily as a rate of 8 percent in dividends. And the individual investor, who has to pay taxes on either the interest or the dividend, will generally prefer the higher interest payment." (Chapter 6, pg. 96)

"But the germ of this new wildly egalitarian system - in which before long, anyone (with Milken behind him) could take over any company, no matter how large - had begun to grow about a year earlier, at yet another Gobhai session." (Chapter 6, pgs. 100-101)

"This is a homely-sounding precept, but one that would effectively function as the first commandment for the raiders of the eighties. Earnings might be unimpressive (and therefore the stock price low) but if there is a great deal of depreciation, for example, then cash flow can be high. And it is cash flow, in its ability to service debt by making interest payments, that makes a highly leveraged acquisition viable. In his original issuance of junk bonds, Milken had recognized the importance of cash flow, more than earnings, in assessing whether the leveraged companies he was underwriting would be able to meet their debt payments." (Chapter 7, pg. 113)

"National Can had asked Salomon Brothers, which had traditionally been its investment banker, to underwrite $100 million of senior debt, accompanied by a small amount of warrants. The warrants, exercisable into common stock, were intended as an equity kicker to make the bonds more attractive; they would also have diluted Posner's position slightly. Posner objected, arguing that subordinated debentures would be better. (Senior debt is more secure, since its claims on the assets of the company come before those of the subordinated debt. Also, senior debt generally carries covenants restricting the

company's leveraging itself further. Since it carries less risk than subordinated debt, it pays a lower interest rate.)" (Chapter 7, pg. 123)

"By the fall of 1986, it was clear that the paper miracle of Triangle-National Can had assumed proportions that exceeded any of its architects' expectations. All the elements that make for success in this kind of superleveraged transaction converged. In the general economic environment, interest rates dropped dramatically and the stock market went up; at National Can, earnings rose, its stock price quadrupled - and management, which was excellent, strayed." (Chapter 7, pgs. 136-37)

"At Icahn and Company both Icahn and Kingsley began mixing arbitrage with options. What they were practicing then was not risk arbitrage - where one buys the securities of a target company after a deal is announced, betting on the transaction's going through - but classic arbitrage. Icahn would buy a convertible bond at 100, convertible to ten shares of stock at 10, and then he would simultaneously sell ten shares short at ten and one eighth - thus locking in the eighth -of-a-point profit on each share. Then he introduced options into the mix, in elaborate hedging formulas that left him protected on the downside with the potential for an enormous upside." (Chapter 8, pg. 152)

"Whether or not Congress outlawed greenmail was almost not the point. The point was, one an activity was so popularized that it was front-page news, what was Carl Ichan doing in it? He had made his fortune by entering a relatively undeveloped field, taking it farther than anyone else, and then - when it got too crowded and visible - moving a small step forward, in a natural progression. He had first gone into put and calls. As that became more popular, he had mixed it with classic arbitrage. When options exploded, he had gone into risk arbitrage. Then he had decided to better control the arbitrage, by becoming the principal himself. Now it was time to become - at least often enough to given him the credibility he would need to continue his progression - the acquirer." (Chapter 8, pg. 162)

"There was certainly an economic rationale for what Icahn had done. Initially, before all the union drama, he had been a willing buyer of the airline at $18 per share, or about $600 million. When Lorenzo offered $23, Icahn had been a seller (except that Lorenzo had balked at the extra $16 million, which had killed the deal). With the $300 million of union concessions in hand, Icahn became a buyer at $24. And he stuck at $24, even though Lorenzo came in at $26, and even though the unions and the TWA advisers begged him to go to $25 in order to make the directors' decision to side with him a little easier. In Icahn's judgment, he didn't have to give that extra dollar, and, true to form, he cut the price to the hair's breadth." (Chapter 8, pg. 177)

"As Bergerac's comments suggest, Revlon was indeed a class war, between the corporate America and Wall Street elite, and the Drexel arrivistes. It was not simply a turf battle, to be sure; most of the defenders of Revlon in this fight genuinely deplored the junk-bond depredations as financial free-for-alls hurtling toward disaster, and they believed, moreover, that these high-risk players were violating the law to achieve their goals. But beneath these complaints of principle lay something more visceral: the age-

old hatred for the outsider, always exacerbated when that undesirable other dates to venture beyond his confines and encroach upon the elite's preserve." (Chapter 9, ph. 197)

"To Bergerac and his advisers, and to the rest of the corporate establishment that watched with fear and trembling, the fight for Revlon was a rude introduction to a new world. All the brainpower, clout and class connections that Revlon summoned were no match for the raw financial might of Drexel. Michael Milken had become the great equalizer." (Chapter 9, pg. 203)

"The conquest of Revlon signaled the end of an era. Those who defended it were struggling to perpetuate a way of corporate life - plush, congenial and secure, unmenaced by anyone but perhaps another corporate giant - that had lost its capacity to prevail in the economic world. The junk-bond marauders had won here, and if they had won here they could win anywhere. It had all happened so quickly that Revlon's advisers, when they spoke later about the company, sounded faintly archaic, unmistakenably out of step with the times. Milken had not singlehandedly created a new age, but he had done more to shape it than any other individual." (Chapter 9, pgs. 227-228)

"It seemed only natural by the fall of 1986 that Milken should be expanding his scope to cover the world. The home territory, where he was using junk bonds to revolutionize and restructure the American corporate landscape, was in some sense already appropriated. While there were certainly many more battles to be fought, many more giant corporations to be won, Milken's gospel had gained such currency that it was not longer the heresy of an outcast but the liturgy of Wall Street. If everyone had decided to come to his first party, mustn't it be time to start another?" (Chapter 10, pg. 244)

"All these plaudits did nothing to mellow Milken or soften his iconoclastic edge. Overriding confidence, the utter conviction of his rightness, had been his insignia even when he was a twenty-two-year-old summer intern at Drexel Firestone in Philadelphia and wanted to bring salvation to that firm's beleaguered back office. Now, after more than a decade of having preached his unorthodox gospel about low-rated bonds, after having pioneered their issuance, eliciting first the disdain and later the antipathy of the corporate establishment, Milken had the certitude of the proven prophet. That he had been so right about so much (while others were so wrong) was a point that no one who listened to the few speeches he had given in early 1986 was allowed to ignore." (Chapter 11, pg. 271)

"Drexel had started demanding its pound of flesh in equity back in the late seventies, when the firm sought warrants as well as fees in its junk-bond underwritings. But its amassing of equity took a quantum leap as Drexel moved into financing leveraged buyouts in 1983-84, and then the hostile LBOs, or takeovers. The equity in these deals is, of course, where the massive upside potential lies. And Drexel typically demanded warrants (to purchase the stock cheap) as equity kickers to help sell the bonds. It

seems, however, that much of that equity never reached the bond buyers." (Chapter 13, pg. 289)

"Even when the New York corporate-finance members did participate in the partnerships, they still felt underprivileged. Particularly once the buyout boom was under way, much of Drexel's and Milken's profits came in the form of warrants in the newly formed companies. The bulk of these were in the investment partnerships - including at least one in which corporate finance participated. But even here, where there was joint participation between New York and Beverly Hills, the warrants were distributed in unequal proportions between the two coasts, with Milken's group taking the lion's share." (Chapter 14, pg. 300)

"Drexel chairman Robert Linton, when asked in early 1986 who was the person to whom Milken answered, looked bemused for a moment and then replied, 'Kantor, Fred [Joseph] - but that's a question that never gets asked." (Chapter 14, pg. 303)

"Then came Boesky. For years, other arbs, investment bankers and traders had talked among themselves and, occasionally, on a background basis with this reporter and others about Boesky's trading on inside information. The shock that seized the Street on November 14 was not at what Boesky had done - who had not surmised it? - but at his having been caught. His prescient trading patterns had sparked SEC investigation after investigation, but until there was a cooperating witness in the person of Levine the fortress had been impregnable. Now is was falling like a house of cards." (Chapter 15, pg. 318)

"This was the Drexel - the brass-knuckles, threatening, market-manipulating Cosa Nostra of the securities world - that its rival investment bankers and corporate targets loved to hate. Drexel was already down, three months into the government investigation, we the Staley suit was filed, but a round of cheers went up in the investment-banking community. Just as rivals had circulated copies of the Green Tree complaint when it had been filed, so not - Drexel executives alleged - Salomon sent its clients copies of the Staley complaint." (Chapter 15, pg. 326)

"In the six months that followed Boesky Day, Drexel was a reminder of the old age that the higher they rise, the harder they fall. The heights that Drexel's executives had scaled had been so dizzying, and their descent was now so sudden that some felt themselves on a roller coaster." (Chapter 16, pg. 330)

"Barring an apocalypse- the chain-reaction collapse of dozens of junk-bond-financed, highly leveraged companies, which would then impact the junk portfolios of insurance companies, thrifts, pension funds, mutual funds and others - it will be ten years before Milken's legacy becomes clear. Takeovers, buyouts and restructurings would have

occurred if there had been no Michael Milken, but it is hard to imagine that they would have occurred in the size and volume that they did." (Chapter 17, pg. 347)

"While Drexel was striving to expunge from history its period of triumph and sovereignty, it was not disowning the King. It is true that in the early months of the investigations, when Drexel employees feared that indictments and perhaps the firm's collapse were imminent, there had been some sentiment in New York that Milken and his troops should be cut adrift. But as time passed without indictments, hope grew that the government was having difficulty making its case, and solidarity took hold." (Chapter 17, pgs. 350-351)

"It is possible that some of these clients continued to feel sufficiently indebted to their progenitor, that they would not abandon Milken in his hour of need. More like, through, what bound them to him was roughly the same thing that had bound them before. For toward the close of 1988, even with the SEC changes filed and the criminal charges expected, Milken still controlled this market." (Afterward, pg. 363)

"Milken was cornered; the government had won. It was the right outcome, for in this writer's view Milken had had to be stopped. But this was no straightforward morality play of good and evil. Milken had been dangerous, but he had also been one of the most imaginative, visionary financiers of our time. He could probably have had nearly as much impact as he had had upon the corporate restructuring of this country (the merits of which will long be debated) without ever violating the law. With Milken, creation had come first and his alleged lawbreaking, later. In that lies an element of tragedy." (Afterward, pg. 371)

Topics for Discussion

What does the term The Predators' Ball refer to?

What is a junk bond? How does it differ from a REIT?

How did the Drexel firm become involved with the gambling industry?

What is the difference between institutional and entrepreneurial firms? Which category was Drexel in?

Explain the mechanics of an LBO. Why were these important to Drexel?

What is greenmail? Who was one of the earliest practitioners?

What is a White Knight and what is the significance of the role played in a hostile takeover?