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StorageTek lenders had layoffs role

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For the Camera

A looming credit crunch appears to have been behind the decision of Storage Technology Corporation officials to slash the firm's work force last week.

Representatives of 12 U.S. banks that lend money to STC were in Boulder a few days before company executives announced that they expect a third quarter loss of more than $20 million and that they would cut its work force by 10 percent, the Camera has learned.

The firings may have been demanded by the lenders, a Boulder executive with close ties to the financial community suggested. "When you terminate 1,300 people — I'll bet you that came from the banks," the executive said, adding that some of the banks in the lenders' group "know how to play hardball."

Gordon Swartzfager, vice president for communications for STC, confirmed Saturday that the firm's top executives met with the firm's bankers recently, but he denied the bankers are "dictating what we are doing" with respect to layoffs.

"The banks are saying they need certain requirements," Swartzfager said. "They are making suggestions. We are working together on agreements we both feel good about."

He added that bankers are reluctant to insist on courses of action, because if they do so and a company falls into further trouble, the banks could be held liable in court.

As early as last winter, STC officials warned that if the firm failed to return to profitability this year, bankers would restrict its credit.

In its regular filings with the SEC and in its annual report for 1983, STC warned that an unprofitable year would "adversely affect its financial resources" and its "ability to obtain required financial resources."

At the same time, the company reported that more of its customers were leasing rather than buying its computer memory storage products, and that, too, was increasing its need to borrow.

When STC failed in the three-month period ending Sept. 30 to meet profitability and production goals imposed by the banks, it broke the covenants under which it had obtained loans and was in technical default.

That means that the bankers, if they

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wish, can call for immediate repayment of the loans.

But that would sink the company and it would mean the lenders would recover only a small percentage of their money — so the chances of it happening are slight.

The lenders, however, are in a position to demand severe measures to cut expenses.

This credit crunch appears to have catalyzed last week's decision to terminate 1,500 employees — 1,300 in Boulder County.

STC executives listed 12 banks as the firm's major lenders in a filing with the Securities and Exchange Commission. They are Citibank, which is the lead bank, First National Bank of Chicago, Chase Manhattan, Bank of America, First Pennsylvania Bank, Wells Fargo Bank, Bankers Trust Co., Security Pacific National Bank, Northwestern National Bank of Minnesota, Continental Illinois National Bank and Trust Co. of Chicago, Mellon Bank and State Street Bank and Trust Co.

STC officials reported in their 1983 annual SEC filing that they had a long-term revolving credit agreement with its banks that made available $175 million for unsecured borrowing. They said the firm had borrowed $75 million under that agreement by the end of 1983.

But they also reported that the agreement had been changed, limiting borrowing to no more than $100 million "until the company meets certain profitability and new production goals in 1984."

In the same report, the STC officials said they also had about $380 million of other unused lines of credit available. But they said that money was also contingent on the firm's "future financial performance."

They reported that the firm's available credit lines, commitments from third-party leases and other financial sources "would be sufficient to support its financing requirements throughout 1984."

But, "failure of the Company to return to profitability would adversely affect its financial resources," they warned. Similar warnings were given to stockholders.

Storage Tech's borrowing needs are great in large part because many of its customers now prefer to lease their products rather than purchase them outright.

It's reports show the percentage of business accounted for by rentals grew from 21 percent in 1981 to 37 percent in 1983.

"Leasing defers revenue," said Michael Geran, an analyst with E.F. Hutton in New York. "Sales collects revenue up front."

Geran and others familiar with the business said major users of computer equipment often lease rather than buy hardware while they keep an eye on newer, more sophisticated products.

STC has converted lease agreements into ready cash in the past by selling some of the lease agreements. Recently, it has been selling more of the lease agreements than usual, observers say.

While this can raise quick cash, it also diminishes what would be a stable revenue source.

"It brings in immediate short-term revenue, but it mortgages the future," said a local electronics executive.

Compounding STC's problems is a recent trend by its customers to return the leased equipment early, especially the older generation products, according to a Storage Tech report.

STC's surge of growth in 1981 and 1982 was spurred in part by IBM's difficulties in getting a new disk drive, the 3380, to market. The delays increased demand for existing STC products. But in 1983, the situation reversed. IBM began shipping its new disk drive in quantity while STC suffered delays in bringing out its comparable product, the 8380.

STC now is shipping the 8380 drive in good quantity, but its delays gave IBM the chance to grab the lion's share of the market.

The firm's problems developing the 8380 boosted its cash needs. At the same time, fierce price competition from IBM has shaved STC's profit margins.

"You come to a point in time ... where your customers know you're vulnerable, so they extract pricing concessions from you," Hutton's Geran said.

The analyst, who has been bearish on STC over the past year, hastened to add that STC has successfully developed its 2.5-billion character product while many other firms have failed.

"Give the devil his due," Geran said. "These guys are the only guys today outside of IBM who are producing those products in the volume they're producing them."

"Herculean" efforts will be required to turn STC around, he said, but he added that the company has some strengths, including new plants and several technologies that could benefit from an infusion of new capital.

First and foremost, he said, STC's road to recovery will require "strong financial management."

"Scotchmen are worth their weight in gold," he said. "Dreams will motivate engineers, but in the last analysis you pay the payroll with a bank account."