

Junk-bond observers are cautious after Revco's bankruptcy filing

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to a company looking for financing its capital needs. Junk bonds are similar to stocks, they say, and have recently received bad press only because of the allegations of junk-bond manipulation against the New York-based investment firm Drexel Burnham Lambert Inc.

The two major bond-rating agencies refer to junk securities — those rated BB+ or below by Standard & Poor's, or Ba1 or less by Moody's Investors Service — as "speculative grade." These bonds have been used in the financial market for about 20 years, mostly to finance capital expansion. But recently the bonds have been used to finance expensive takeovers.



"There just isn't enough of a greater return in junk bonds to attract investors to that much higher risk," says Hugh Dyson, manager of the Raleigh office of Interstate Securities.

Drexel Burnham Lambert's junk-bond list

According to a book released last year by New York-based investment firm Drexel Burnham Lambert Inc., 57 Triangle companies with 1986 sales of \$25 million or more qualify as non-investment grade companies, which could be candidates to issue junk bonds if needed.

"I disagree very strenuously [to Drexel Burnham's listing of non-investment grade companies]," said Marshall H. Johnson, president of McDaniel Lewis Company, a Greensboro-based investment brokerage firm. "Some of those are quality companies, and they meet many of the higher bond ratios and standards."

The Triangle companies on Drexel's list were:

Athey Products Corporation, Raleigh; Bahlsen of America Inc., Cary; Blue Cross and Blue Shield of N.C., Durham; Britt Group Inc., Durham; Burroughs Wellcome Company, Research Triangle Park; Capital Ford Inc., Raleigh; Capitol Broadcasting Company, Raleigh; Carolina Components Corporation, Raleigh; Carolina Golden Products, Durham; Cary Oil Company, Cary; CCB Financial Corporation, Durham; Centurion Construction Company Inc., Raleigh; Clancey & Theys Construction Company, Raleigh; Coggin Pontiac Inc., Raleigh; Container Graphics Corporation, Cary; Dillon Supply Company, Raleigh; and Durham Corporation, Raleigh.

Also Durham County Hospital Corporation, Durham; Eagle Pontiac-GMC Truck Inc., Raleigh; Electrical Equipment Company, Raleigh; Exide Electronics Group Inc., Raleigh; First Citizens Corporation, Raleigh; Firstcorp Inc., Raleigh; Food Systems Inc., Raleigh; M.M. Fowler Inc., Durham; Glaxo Inc., RTP; GoodMark Foods Inc., Raleigh; Gray Inc., Raleigh; Harris Wholesale Inc., Raleigh; Helmsold Ford Inc., Raleigh; Holiday Imports Inc., Durham; Investors Management Corporation, Raleigh; Kenan Transport Company, Chapel Hill; Kerr Drug Stores Inc., Raleigh; Leith Inc., Raleigh; Lincoln Developers of Raleigh, Raleigh; McM Corporation, Raleigh; Bobby Murray Chevrolet Inc., Raleigh; and N.C. Farm Bureau Mutual Insurance Company, Raleigh.

Also N.C. Equipment Company, Raleigh; N.C. Memorial Hospital, Chapel Hill; N.C. Mutual Wholesale Drug, Durham; N.C. Municipal Power Agency, Raleigh; N.C. Mutual Life Insurance Company, Durham; N.C. Eastern Municipal Power Agency, Raleigh; Panther Summit Industries, Raleigh; Pine State Creamery Company, Raleigh; The Record Bar Inc., Durham; Rex Hospital, Raleigh; Rogers Oil Company, Raleigh; SAS Institute Inc., Cary; Al Smith Buick Company, Raleigh; Star Automobile Inc., Durham; State Employees Credit Union, Raleigh; Thompson Cadillac Oldsmobile, Raleigh; Tops Petroleum Corporation, Durham; and Wake County Hospital Systems, Raleigh.

Pulse

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Hotel operator sought

Plans for another hotel along the I-40 corridor near Raleigh-Durham International Airport are in the works. Vantage Hotel Corporation in Cary has been talking with several hotel operators about a possible 150-room hotel at Gateway Centre. James Lapey, vice president at Vantage, said that two or three groups have shown strong interest in the five-acre site and that he expects to make an announcement within 90 days. The project would be the 12th hotel that is planned, under construction or operating in the corridor.

First Union prospecting

First Union National Bank reportedly is looking for 60,000 square feet of office space near Research Triangle Park for a data-processing facility. Sources said the bank is considering leasing space in an Imperial Center for Gateway Centre, both of which are off of I-40. Marshall Hester, a spokesman for First Union, said that he did not know of any plans and that the bank has a data center in Raleigh. However, he added that the bank was constantly evaluating its needs concerning adequate space for employees and operations.

New office building going up

Construction has begun on a 150,000-square-foot, \$1 million office building on Falls of the Neuse Road in North Raleigh. Barry Benson of Benson Investments Inc., which is developing the project, said his company would occupy about 4,500 square feet.

The two-story pink granite and bronze reflecting glass building was designed by Sarpton Architects and William R. Flowers of Triple B Investments. The general contractor for the project is Cancy and Theys. Construction is scheduled to be completed in February.

Designing a European niche

A Raleigh-based designer, manufacturer and reseller of trade show displays and motion picture props is doing a niche in national and European markets. Tri-Star Design Group, incorporated a year ago by Michael Saratzis, recently completed a two-week display show in Paris for M&T Chemicals, a subsidiary of Paris-based Elf Aci. The show has given Tri-Star important exposure to many European firms that worked with the Tri-Star firm in the U.S. "I feel like I can now do business with anybody," said Saratzis.

Seen at the display show business for 25 years. "Also, many European companies looking to display in the U.S. will know who we are."

Tri-Star also has landed another high profile project: building the exhibit for Cinefest, the U.S. version of the Cannes Film Festival.

Correction

In the August 8-15 issue of Triangle Business, a Pulse item incorrectly reported that Richard T. Fountain III was owner of the Battery Heights apartments, which were foreclosed on by First Federal Savings and Loan Association of Raleigh. Fountain, a Raleigh lawyer, acted as trustee for First Federal in the foreclosure. The former owners of the apartments are Clifton Winston, Shirley S. Winston, Thomas L. Griffin, Arlene Griffin, Harold E. Feimster, Carolyn E. Feimster, Ernest Feimster and Joseph N. Rucker, according to the Wake County Register of Deeds office.

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"Junk bonds are just another way of raising money. Sometimes you are going to win, sometimes you're not," says Campbell Harvey, an assistant professor in finance at Duke's Fuqua School of Business.

The Triangle is much like an eye of a hurricane for the junk-bond market: According to one study, no Triangle-based company has sold low-grade bonds to finance debt, while firms in and around the Triad and Charlotte have combined to sell more than \$2 billion worth of low-grade bonds between 1977 and 1987.

From January 1977 to March 1987, 48 North Carolina corporations and their parent firms raised \$4.6 billion in junk bonds, according to a 1987 study by the Alliance for Capital Access, a non-profit, Washington, D.C.-based trade association formed two years ago by companies that issue junk bonds. Almost half of those companies were based in the Triad

and Charlotte: The Triad had eight companies, which sold \$1.23 billion of debt, and Charlotte had 13 companies, which issued \$865 million. Eden-based Fieldcrest Cannon Inc. was the state's leading issuer of junk bonds, selling \$1.8 billion, or 39 percent of the state's total junk-bond financing.

The only company with Triangle ties to sell junk bonds in those 10 years was Charter Medical, the Macon, Ga.-based parent company of Charter Northridge Hospital in North Raleigh. Charter Medical, which issued \$260 million worth of junk bonds, is currently undergoing a management-led leveraged buyout that is expected to close this month. A company spokesperson declined to say whether junk bonds would be used to finance the purchase.

The Alliance for Capital Access considers some areas of North Carolina, if not the Triangle, to have a high stake in these investments. "High-yield bonds, wrongly called junk, have become a critical financing source for some of the fastest-growing, most dynamic North Carolina companies," David K. Aylward, executive director of the Alliance for Capital Access, said in a news release accompanying last year's report. In addition, he said, 95 corporations based in other states with operations and employees in North Carolina have issued \$23.3 billion in junk bonds since 1977.

Observers aren't sure why junk bonds have not fully caught the attention of Triangle companies or investors. In April, as part of its ongoing campaign on behalf of junk bonds, Drexel Burnham released a book containing comparisons between investment-grade and non-investment-grade companies in North Carolina. It listed 57 non-investment-grade firms with annual sales of \$25 million or more in the Triangle, making them prime candidates, Drexel Burnham said, for using junk bonds to raise capital. In comparison, the Triad was home to 97 such companies.

Among the Triangle companies on the list were Athey Products Corporation, a Wake Forest-based manufacturer of street cleaners; Bahlsen Inc., a Cary-based manufacturer of cookies and snacks; Blue Cross and Blue Shield, with offices outside of Chapel Hill; Durham-based CCB Financial Corporation, a bank holding company; and Burroughs Wellcome and Glaxo Inc., both based in Research Triangle Park.

"I disagree very strenuously [to Drexel Burnham's listing of non-

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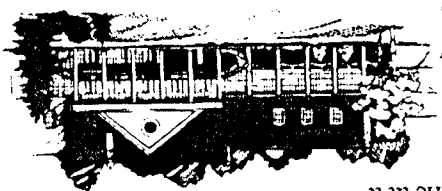
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"While junk bonds historically
have a default rate of less than 2
percent, it must be kept in mind that
their overall market in the past was
nowhere near as large as it is now."
Leckey wrote in a recent column.
"They have lately become a conven-
ient debt vehicle for ailing companies
that have less-than-stellar balance
sheets, and that is a reason for
caution."
That is why the Revco bankruptcy
filing has some junk-bond observers
fearful that more failures are around
the corner. Jack Ferner, a lecturer in
management at the Babcock Graduate
School of Management at Wake Forest
University in Winston-Salem, dis-
misses junk bonds' gains and predicts
massive defaults in the junk-bond
market, perhaps as soon as mid-1989.

The October stock market crash
caused huge price drops for junk
bonds, as it did with almost every
investment. Junk bonds were yielding
11 to 12 percent before the crash and
peaked at about 14.5 percent after the
crash. By March, the rates had fallen
to 13 percent. Junk bonds used to
finance leverage buyouts, considered
a more risky investment, topped 16
percent but declined to 13.5 percent
by March.
But to get the higher returns,
investors must be willing to take on
added risk — and many investment
analysts say those returns may not
be worth it. Because of an ever-larger
market for junk bonds, the risks to
investors are growing as well, says
syndicated financial columnist Andrew
Leckey, who calls junk bonds "pesky."

Company in Raleigh, said it is
corporate policy not to invest in junk
bonds for Durham Life's investment
portfolio. He said the company's
policy is to remain in A-rated or better
bonds.
No matter how much doubt
is raised about the long-term stability
of junk bonds, they do carry higher
interest rates and have been deliver-
ing higher yields than higher grade
corporate bonds or government
securities. Junk-bond investors have
been collecting returns of 12 to 14
percent while higher grade corporate
and government bonds have been
yielding 9 to 11 percent.



Photo by Julie Knight

"My personal recommendation for
investors is to get liquid in the next year
— get rid of the speculative kinds of
things in view of the upcoming
downturn," says Jack Ferner, a lecturer
in management at the Babcock
Graduate School of Management at
Wake Forest University.

investment-grade companies," said
Marshall H. Johnson, president of
McDaniel Lewis & Company, a
Greensboro-based investment broker.
age firm. "Some of those are quality
companies, and they meet many of the
higher bond ratios and standards.
They're all well-managed organiza-
tions, and they could probably borrow
any money they need from banks,
although maybe not for the same
length of time."
Most of the companies on the list
also disagreed with Drexel. When
James Cloonan, president of Athey
Products, was contacted about the
possibility of his company ever
choosing junk-bond financing, his
disdain for the high-yielding bonds
was evident. "We (the board of
directors) have never had a conversa-
tion along those lines," he said. "We
won't even entertain any. We haven't
looked into, and we have not
considered those — and I frankly don't
know why the board would."
The same can be said for Triangle
investors. Hugh Dyson, manager of
the Raleigh office of Interstate
Securities, said he believes few area
residents have invested in junk bonds.
Unless a client specifically asks for a
low-rated bond or bond fund, most
investment advisers will suggest a
government bond fund instead, he
said.

Government bond funds, which
invest almost entirely in less risky
U.S. government securities, are yield-
ing 10 to 11 percent. That yield has a
better risk-return ratio than the 13 to
14 percent return offered by junk
bonds. Dyson said, "There just isn't
enough of a greater return in junk
bonds to attract investors to that
much higher risk," he said.
Even the portfolios of financial
institutions in the Triangle and the
state shy away from investing in junk
bonds. Dyson said Interstate Securities
does little if any trading in junk
bonds.
First Union Corporation, like
many banks, does not invest in junk
bonds for its trust department clients.
"It just wouldn't be prudent," said W.
Earl Bardin, senior vice president of
First Union in Raleigh. First Union
does not even invest in the bonds for
its own investment portfolio. Bardin
said.
Joel Millikan, senior vice pres-
ident in charge of the investment

