

Corning's Desperate Deal Destroys Value

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When you're in dire straits, you do what you have to do.

So it is now with [Corning](#), the once great company that provided the glass for Edison's first light bulb. It was a steady company until it fell for the great fiber optic bubble. It sold profitable divisions that seemed less exciting and spent billions on overpriced fiber optic acquisitions.

All that is old news, of course. What is new is that there seems to be no end to the bad news, and that Corning's balance sheet, which looked so solid a year ago, is now shaky.

This week, needing cash to finance operating losses and with the credit rating agencies having determined that its bonds are junk and its commercial paper unsalable, Corning came up with a glorified common stock offering that devastated an already depressed share price, which fell 50 percent in the last three days.

Formally, this is a convertible preferred offering. But that is fiction. Of the \$500 million put up by investors, \$102 million was used to buy Treasuries that will provide the cash for 7 percent dividends for three years, after which the preferred must be converted into common. If Corning goes bankrupt before then, the preferred holders are supposed to get the dividends immediately.

This is a bear market vehicle. In three years, the preferred shares will be converted into somewhere between 214 million and 312 million common shares. For a company that now has 952 million shares outstanding, that means dilution of at least a quarter, and maybe a third, depending on where the stock is by then.

Why not just issue common now? Why should buyers pay Corning to manage a portfolio of Treasuries? Corning's investment bankers figured they could attract a different class of investors. People now want income, so Wall Street will give it to them, even if in reality it is nothing more than common stock in drag.

Corning's problem is that there is no sign when its business will revive. And while it had a conservative financial reputation, in late 2000 it raised money with an unusual bond that it could be forced to repay in late 2005. It might have to issue stock to pay off that debt, creating far more dilution for suffering shareholders.

There is another factor about this offering that represents a trend. While Goldman, Sachs was traditionally Corning's lead banker, it falls to third on the cover of this deal's prospectus. The others in the top five are affiliated with commercial banks.

Why use commercial banks? Corning won't comment, but it clearly has reason to be nice to the banks that will decide whether to renew its lines of credit in 2005.

That the commercial banks have used their lending ability to improve their position in investment banking is well known. But one thing that is not appreciated is just how accounting can encourage banks to perhaps trade low interest rates for extra investment banking business. That would give the banks income upfront, in the form of investment banking fees, while it would provide lower reported expenses for the customer, since investment banking fees often do not show up on income statements.

Banks say there are no such tradeoffs. They have other explanations for low interest rates on loans to troubled companies.

However the banks are getting the new business, it remains to be seen if they will regret it. Low interest rates have encouraged consumers, but they can do nothing to stimulate demand for fiber optic cable. Weak companies that were fooled by the telecommunications bubble have already gone under. Now the question is whether the strong like Corning will follow them. This offering shows that Corning has decided that a huge dilution of its current shareholders is unavoidable. It is not a good sign for investors.