

October 15, 2002

## The Refinancing Boom Hasn't Hit Corporations

Despite Lowest Rates in Decades,  
Companies Don't Refinance Debt

By **CRAIG KARMIN**  
Staff Reporter of THE WALL STREET JOURNAL

As interest rates have tumbled in recent months, American homeowners have rushed to refinance their mortgages and lower their monthly payments. Why haven't American companies done the same thing?

Given the lowest interest rates in more than four decades, corporate debt deals haven't kept pace. This year's issuance is down 19% from a year ago -- even though 10-year Treasury yields have fallen to 3.5% from around 5% since June -- and in recent weeks corporate scandals and economic weakness have pounded the corporate-bond market. Some companies even have put off previously announced deals: ClubCorp, which owns and operates country clubs and resorts, last week said it was postponing a \$225 million junk-bond offering.

"Given where rates are, if everything else was normal, you'd see record volumes" of corporate-bond issuance, says Amy Falls, a bond strategist at Morgan Stanley.

The trouble for the corporate-debt market is that everything isn't normal. This year's spate of accounting and other governance scandals has meant that many companies are afraid to simply test the waters: Even if a company wants to shoot for a lower rate, cutting its financing costs in the process, a bond deal that goes awry could have a damaging ripple effect, raising questions about a company's financial health and potentially weighing on its stock price at a time when investors are particularly punishing.

"Chief financial officers are saying for a relatively small amount of savings, I don't want to expose myself to that risk," says Peter Milhaupt, head of U.S. capital markets at Credit Suisse First Boston.

### COMPANIES

Dow Jones, [Reuters](#)

#### [Archer-Daniels-Midland Co. \(ADM\)](#)

|              |       |
|--------------|-------|
| PRICE        | 12.49 |
| CHANGE       | 0.16  |
| U.S. dollars | 10/14 |

#### [Anheuser-Busch Cos. Inc. \(BUD\)](#)

|              |       |
|--------------|-------|
| PRICE        | 53.94 |
| CHANGE       | 1.27  |
| U.S. dollars | 10/14 |

#### [Ford Motor Co. \(F\)](#)

|              |       |
|--------------|-------|
| PRICE        | 7.93  |
| CHANGE       | -0.39 |
| U.S. dollars | 10/14 |

#### [Verizon Communications Inc. \(VZ\)](#)

|              |       |
|--------------|-------|
| PRICE        | 34.71 |
| CHANGE       | -0.48 |
| U.S. dollars | 10/14 |

#### [Fannie Mae \(FNM\)](#)

|              |       |
|--------------|-------|
| PRICE        | 66.48 |
| CHANGE       | 1.40  |
| U.S. dollars | 10/14 |

\* At Market Close

## LOWER INTEREST RATES DON'T TRANSLATE INTO MORE DEALS

### Treasury yields tumble...

Yield on the 10-year Treasury note; bond yields fall as bond prices rise



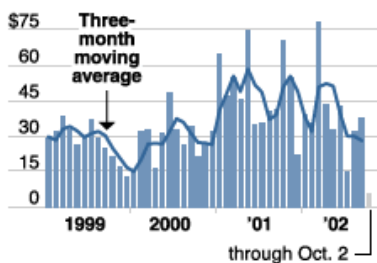
### But corporate spreads widen...

Difference between yields on investment-grade corporate bonds and comparable Treasuries



### And this year, issuance stalls

Investment grade corporate bond issuance, in billions



Sources: WSJ Market Data Group; Merrill Lynch; Thomson Financial

Moreover, selling bonds is only one part of the refinancing equation. While a new home-mortgage replaces a higher existing loan, the process of corporate borrowers swapping debt is a far more complicated and costly one. Different sections, or tranches, of debt expire at different times, meaning that it isn't always possible to simply retire high-priced debt.

Some top-rated companies, of course, are taking advantage of the low rates. Agricultural company **Archer-Daniels-Midland**, for instance, sold a \$500 million bond late last month, and **Anheuser Busch** sold \$300 million of 10-year bonds last week.

In fact, while overall corporate issuance this year is down compared with a year earlier, it is still historically healthy. During the first nine months of this year, investment-grade corporate debt sales stood at \$356 billion, up 32% over the similar period in 2000.

But with interest rates at levels not seen since the early 1960s, investment bankers -- hurting from a slowdown in mergers and acquisitions and equity initial public offerings -- complain that corporate borrowing isn't higher.

One reason is that credit spreads, which reflect how much corporate borrowers must pay on top of Treasury yields, are at an all-time high. The average investment-grade corporate bond spread for the Lehman Brother Index is around 2.35 percentage points above comparable Treasuries -- the widest it has been since 1989 when Lehman first calculated the index. In more normal times, that corporate spread is around two percentage points, or even less.

The spread in the junk-bond market is more than 10 percentage points, up from around eight percentage points in the late 1990s.

Those numbers reflect the spate of recent blowups and defaults, which have hurt the corporate-bond market to the point that even some one-time blue-chip names such as **Ford Motor** are trading at junk-like levels.

Of course, because Treasury yields are around 40-year lows, even wide spreads mean that debt is much cheaper than at any time in recent memory.

**Verizon Communications**, for example, had \$235 million in debt mature in the third quarter. Those five- to 10-year bonds had coupons between 6.56% and 6.65%. But with Treasury yields tumbling last month, the telecom company issued \$350 million in new 10-year debt with a coupon of 6.125%. "We have debt maturing all the time," says Verizon spokesman Bob Varettoni. "Our strategy is to replace it with longer-term debt at the current attractive rates."

Most corporate officers, though, simply are opting to keep their heads down, waiting for the current period of volatility to pass.

Furthermore, many companies today don't need additional cash. The most common reasons for tapping the market in the 1990s -- to raise money for an acquisition, to increase capital spending or to buy back shares -- don't apply during today's bear market and economic downturn. When companies aren't growing, they don't have the same cash requirements as in expansionary times. Paradoxically, the companies that need cash the most tend to be the ones with the weaker credit ratings and thus less access to the bond market.

For some relatively healthy companies, increasing their amount of borrowing at today's lower rates may make sense only if the company can replace its higher-cost debt. But that can be a complicated process. Unlike **Fannie Mae**, the big, government-chartered mortgage buyer and a frequent bond issuer, most companies haven't sold debt with call options, or the right to buy back debt after a certain number of years at a certain price.

Instead, corporate issuers would have to make a tender offer for their outstanding bonds and pay a premium to the market price to entice investors to sell back these higher coupon bonds. Conversely, a company could hire an investment bank to discreetly buy back some of their bonds on the open market. The company would then have to issue new debt, paying fees to investment banks for each of these transactions, which would limit any gains from refinancing.

"This environment reflects concerns about corporate earnings, credit quality and balance sheets in general," says Peter Vaream, a corporate-bond portfolio manager for MFS Investment Management in Boston. "As a result, companies don't have the same opportunity to refinance."

Write to Craig Karmin at [craig.karmin@wsj.com](mailto:craig.karmin@wsj.com)<sup>1</sup>

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*Updated October 15, 2002*