Campeau's bankruptcy is harbinger of raging storm

by Anthony K. Wikrent

Canadian speculator Robert Campeau's formal admission of insolvency on Jan. 15, when his two U.S. retailing arms, Federated and Allied Department Stores, filed for Chapter 11 bankruptcy, is but the latest spasm of the collapsing Anglo-American financial system. From the investment houses and banks that have specialized in arranging and financing such highly leveraged transactions (HLTs) as the Campeau deal, to the debt-burdened companies themselves, the entire system of credit allocation is crumbling.

As physical economist Lyndon LaRouche has emphasized, the Campeau bankruptcy is not really news: The event had already been pre-discounted by the major players following Campeau's first debt default last September. CS First Boston, by far the investment bank most exposed to the Campeau bankruptcy, quietly announced that it had already written off half its losses at the end of 1989. Still, the numbers are impressive, and give some idea of the damage incurred.

CS First Boston has $526.3 million in junk bonds and bridge loans on the line. Paine Webber is owed $96.2 million on its bridge loan, and Dillon Read is owed $48.1 million. State Street Bank of Boston holds $194.4 million in Allied and Federated bonds (now selling at 11¢ on the dollar), and Manufacturers Hanover holds $146.7 million. Security Pacific Bank holds $93.3 million. First Bank of St. Paul holds $75.8 million. Various other banks, including Chase Manhattan, Irving Trust, Bankers Trust, First National Bank of Boston, and Shawmut Bank of Boston, hold from $30 to $45 million of the bonds.

The point is not that these institutions have lost a bundle of money in the Campeau bankruptcy, but rather that their losses in the Campeau failure are only a fraction of their much larger exposure in loans to dozens of other companies that are in the same straits as Campeau.

As of November 1989, Manufacturers Hanover had $3.7 billion in HLT loans outstanding, plus another $1.7 billion in commitments. This represents 182% of its equity, loaned to a handful of companies that aren't much better off than Campeau. Security Pacific has $4.6 billion, or 124% of its equity, tied up in HLT financing. Bankers Trust has sunk $6.2 billion into HLTs, 193% of its equity, and Chemical Bank $6.1 billion, or 225% of its equity.

The investment banks are probably in an even more precarious position, as bridge loans have come to be accepted standard practice "to get from one end of a deal to the other." In other words, an investment bank that is underwriting the issuing of junk bonds to take over a company, will often lend the amount needed for the buyout, expecting to be paid back within a few weeks or months, after the junk bonds have been sold. Even if the junk bonds aren't sold immediately, the bridge loans carry interest charges far above normal, sometimes as much as six points above the prime lending rate, which supposedly keeps the investment bank happy.

So long as something like Salomon Brothers' TVX Broadcast debacle doesn't happen, that is. Back in 1987, Salomon provided a $247 million bridge loan to finance the buyout of TVX Broadcast Group. But Salomon was not able "to make a market" for the new owners of TVX, and in 1988 Salomon swapped the bridge loan for 79% preferred stock ownership of TVX. In September 1989, Salomon finally unloaded its TVX holdings to Paramount Communications for $110 million, thus losing over half its money. CS First Boston, Paine Webber, and Dillon Read are now in a similar no-win situation with their junk bridge loan to Federated.

Exactly how exposed the investment banks are in their HLT deals is unclear. "Nobody's going to give you that information," John J. Kriz, an analyst at Moody's Investors

Services said, "because nobody has it. It can change from minute to minute, depending on if a deal is done or a loan is paid back. Besides, if they're privately held, they aren't required to tell anyone those sorts of things."

But in some deals completed last year, the size of bridge loans is known, and this indicates that the exposure is huge. Shearson Lehman Hutton and Merrill Lynch put out $1.0 billion for the $14.1 billion merger of Time, Inc. and Warner Communications. Shearson was involved in at least 174 merger and acquisition deals last year. Drexel Burnham Lambert provided a bridge loan of $900 million for the $1.6 billion buyout of West Point-Pepperell, Inc. Salomon Brothers, which was involved in well over 100 deals, also put out $900 million in the $1.2 billion takeover of Grand Union, as well as $325 million for the $734.6 million buyout of Envirodyne Industries, Inc. In two of the 85 deals it was involved in, CS First Boston loaned $578 million for the $3 billion buyout of American Medical International, and another $450 million for the $980 million failed buyout of Ohio Mattress Co. In two of the 56 deals Donaldson Lufkin Jenrette was involved in, DLJ loaned $500 million for the $1.6 billion buyout of TW Services, Inc. and $475 million for the $1.6 billion take over of CNW Corp.

One, two, many Campeaus

So, the real question is: How many other Campeaus are out there, and when will they explode? The answer of the Bushmen is, "There are no real danger signs at the moment," as White House press secretary Marlin Fitzwater said on Jan. 17. With the deflationary collapse of the economy, however, the real answer is that the number of potential explosions is tending toward infinity.

Actually, some of them began to blow a year ago. Fully 10 of the United States' 14 largest corporate bankruptcies have occurred in the last year, beginning with $1.9 billion Continental Information Systems in January 1989. MCorp, the besieged Texas savings and loan holding company with $20.2 in assets, $4.0 billion Eastern Airlines, and $2.8 billion First Columbia Financial all declared bankruptcy last March. The $5.1 billion American Continental went into bankruptcy in April, and Rothschild Holdings, with $2.8 billion in assets, filed in June. Southmark, the real estate and financial conglomerate with $9.2 billion in assets, filed in July. In August, $4.4 billion Texas American Bancshares went bankrupt. Lomas Financial, once the nation's largest mortgage banker, filed for bankruptcy in September with $6.6 billion in assets. Every other of the largest bankruptcies has occurred since 1982, except for the 1970 bankruptcy of Penn Central.

The $7.8 billion leveraged empire of Australian Alan Bond is now desperately fighting for survival in the Australian courts. Bond Corp.'s many creditors, led by National Australia Bank and the Hongkong and Shanghai Banking Corp., placed Bond Brewery Holdings in involuntary receivership after Bond missed an interest payment on its junk bonds in December. Other creditors exposed to Bond include First National Bank of Boston, Toronto Dominion Bank, Standard and Chartered PLC, Midland, Indosuez, Drexel Burnham Lambert, Merrill Lynch, and Salomon Brothers.

Integrated Resources, the large diversified financial services put together by Drexel Burnham Lambert, is expected to file any day now for bankruptcy protection from its $1 billion bank debt and $800 million in junk bonds. Robert Ferguson's First Fidelity may strike the final blow that sinks Integrated, by demanding collection of an $11.6 million judgment won against Integrated last month. Resorts International is close behind Integrated. The old Dope, Inc. front that was passed on to Donald Trump, who passed it on to Merv Griffin, is now locked in battle with its creditors, who are holding $860 million in junk bonds.

Hooker Corp., another Australian company that, like Campeau, is concentrated in retailing, is hard pressed to service its $1.2 billion in bank debt. Its American arm, L.J. Hooker, filed for bankruptcy in November, and was forced to liquidate its B. Altman chain when no buyer could be found. Hooker also owns the upscale women's apparel chain Bonwit Teller.

The real retail shocker may be Sears Roebuck, which has been digging itself deeper and deeper into trouble since buying Dean Witter Reynolds and Coldwell Banker. Neither acquisition has performed as expected, and the outlook for improvement is dim. Dean Witter is afflicted with the same collapse in brokerage fees that is hurting every other firm on Wall Street. Coldwell Banker is in real estate, an increasingly risky place to be these days. Worst of all, Sears' core merchandising unit seriously erred with its major shift in pricing strategy last year, and is now scrambling to repair the damage.

A study done by the high-yield research service McCarthy Crisanti and Maffei in October 1989, which assigned a 75% chance of bankruptcy within five years to Allied and Federated, assigned a 66% chance of failure to Interco, a major manufacturer and wholesaler of furniture, apparel, and footwear (Florsheim and Converse, among others) with $1.1 billion in junk bonds plus some bank loans. Obviously, Interco is a prime candidate for being toppled by the shock waves set off by the Campeau bankruptcy, if payments to suppliers are cut off. United Merchants and Manufacturers, with $180 million in junk bonds, and Morse Shoe, with $230 million in junk, are also extremely vulnerable to Campeau's fallout. The Maffei study also assigned a 66% chance of failure to Southland Corp., the owner and operator of 7-Eleven, the nation's largest convenience store chain.

A 50% chance of bankruptcy was given to USG Corp. and to National Gypsum, two of the largest construction materials companies in the world. The collapse in real estate will definitely hurt these companies, and will probably push them over the edge, as well as a number of homebuilders that are already in trouble, such as M.D.C. Holdings, U.S. Home, and General Homes.