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# Finding Balance Sheet Beauties Post-Enron, the less debt the better. Here are three companies that are getting in fighting shape.

By Brett Messing  
April 29, 2002

(FORTUNE Magazine) – You can't say the Enron debacle was all bad. That scandal will forever change the way accountants, Wall Street researchers, corporate financial officers, and credit-rating agencies operate. (We hope.) As a result, our markets will be stronger, more accountable, and more transparent. (We hope.) And more immediately, it provides us with a solid investment thesis: Stocks of companies that improve their balance sheets should outperform those that remain mired in debt.

The health of a company's balance sheet has a direct impact on the success or failure of its business. The balance sheet affects the willingness of vendors to transact with a company and the price it pays for supplies. It also affects how much a company can invest in research and development, and its ability to make strategic, synergistic acquisitions. Ultimately, those factors are what determine a company's competitiveness. And especially now, in these jumpy post-Enron days, if your balance sheet is lousy with debt, no one--not investors, not creditors, not customers--wants to get near you.

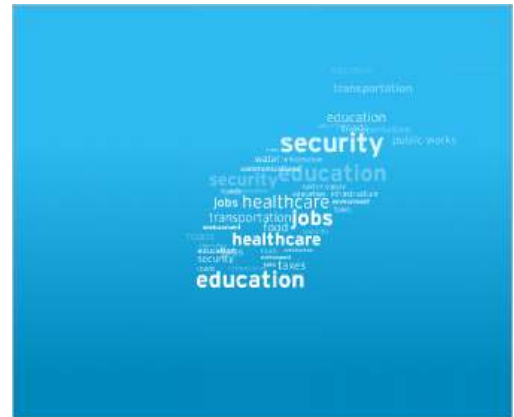
Companies looking to spiff up their balance sheets have a number of options. Asset sales do the trick, but require a willing buyer. Extending the maturity of debt can also help. But to me, the most sensible approach is to raise some fresh dough, either by selling new stock or issuing convertible securities. That way, you avoid the vulture buyers, and the money doesn't need to be paid back. True, secondary offerings dilute earnings per share, but if management makes good use of the capital, the benefits of the cash outweigh the costs. And while dilution is a four-letter word to option-laden management teams, I am pretty sure the folks at Global Crossing and Kmart wish that they had equitized their balance sheets.

So which companies are making inroads? I like the stock of Ford Motor (F, \$15) following its recent \$5 billion convertible preferred offering. However, I like Ford's preferred stock (F\_ps, \$54) even more. It carries a 6.5% coupon (vs. a 2.6% dividend yield for the common stock), ranks higher than the common in the company's capital structure, and is convertible into common when the shares hit \$17.70. The convertible preferred is treated mostly as equity on Ford's balance sheet, helping reduce the company's debt-to-capital ratio. This, says Standard & Poor's analyst Scott Sprinzen, should help solidify Ford's credit rating--currently BBB+, or three notches above junk--by bolstering the company's liquidity.

Another plus is new CEO Bill Ford. He is making tough--but sound--decisions, cutting the dividend, trimming both white- and blue-collar workers, and chopping \$6 billion in expenses by 2005. I expect Ford's sales to be relatively flat this year and next, with earnings per share of \$0.30 in 2002 and \$0.80 in 2003. While the stock is not particularly cheap on these estimates, the company should be able to earn in excess of \$3 per share by mid-decade. I think Bill Ford has a good shot at turning

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Ford around. The \$5 billion cash infusion will certainly buy him time. And with the convertible preferred stock, I get paid to wait.

I am also a buyer of the old Florida Power and Light, now known as FPL Group (FPL, \$60). The company recently sold \$500 million in convertible preferred stock, shoring up its balance sheet and helping maintain its A- credit rating. These securities automatically convert into stock upon maturity in 2005. FPL is now poised to take market share from troubled energy trading companies, which have been reeling since the collapse of Enron (see "Power Plays" in this issue). With their business models in question and their credit ratings junk, companies like Calpine and Mirant have gone from power-plant buyers to plant sellers. FPL should be able to pick up assets at very attractive prices. I expect the company to earn \$4.85 in 2002 and \$5.10 in 2003. As an added benefit, the company recently reached a rate settlement with the Florida Public Service Commission. Utility stocks typically outperform after rate proceedings. The stock also has a juicy dividend yield of 4%, adding nicely to any price appreciation.

Finally, there's AMC Entertainment (AEN, \$13), the only publicly traded movie theater company that's not in Chapter 11. The company does not look so pretty from the outside. It's highly leveraged, with \$544 million in debt and a junk credit rating. However, it too has been cleaning up its books, recently selling \$100 million in common stock. As a result, Standard & Poor's is now reviewing it for a possible credit upgrade, a move that would enhance the company's access to capital and allow it to snap up other theater operators. Already, the company has bought bankrupt General Cinema for \$174 million, a price that will immediately add to its cash flow. Moreover, people are going to the movies in droves: Box office sales set a new record last year, and this year looks promising too (receipts are up 12% year-to-date). With these trends in mind, the stock looks cheap. It trades for five times 2003 cash flow, vs. the industry's historical average of eight times.

Buffed-up balance sheets are back in vogue. Investors who pay attention to the best of the bunch are in for a great show.

Brett Messing is a managing director with Neuberger Berman in Los Angeles. He manages separate accounts for high-net-worth individuals and his firm has a stake in those companies mentioned.

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