

Hunting the Nearly Extinct 'AAA'

Bond Investors Must Look Hard For Companies With a Top Rating; The Upside: It Shows Risk-Taking

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General Motors Corp. used to be one. So did Ford Motor Co. and American International Group Inc. But over the years, the elite of American business, the triple-A-rated company, has become an endangered species.

The gradual disappearance of the triple-A over the past couple of decades has brought sorrow to borrowers and investors alike. Companies with lower credit ratings pay more -- in the form of higher yields -- to raise cash in the bond market. And while bondholders surely appreciate the yield bump, they also lose principal when the prices of a downgraded company's bonds fall.

Indeed, bondholders of all stripes suffered after Standard & Poor's moved to demote General Motors and Ford to below-investment-grade status, ultimately dumping about \$85 billion of the auto makers' debt into the high-yield, or junk, market. (Yesterday, another credit-rating company, Moody's Investors Service, lowered Ford's rating to one level above junk and also cut the rating on Ford's financing arm to two notches above junk.)

Ratings Safari

Nonfinancial companies with triple-A debt ratings from Moody's Investors Service and Standard & Poor's, as of May 10

- Exxon Mobil
- General Electric
- Johnson & Johnson
- Pfizer
- United Parcel Service
- Automatic Data Processing

Those downgrades have caused investors to reassess their appetite for all risk. The proof: Junk bonds are paying yields half a percentage point higher in relation to super-safe Treasury bonds than they were only a month ago. And the cost of insuring against corporate defaults has risen sharply in the credit-derivatives market, where investors parcel and trade risk.

Only six U.S. nonfinancial companies now sport a triple-A debt rating from S&P -- among them General Electric Co. and United Parcel Service Inc. -- compared with 32 in 1980. Over the same period, the tally of banks, utilities and industrial companies enjoying a Moody's top rating has fallen to six from 58. (Some blue-chip companies, such as Microsoft Corp., don't issue bonds and therefore have no ratings.)

The paring of triple-A's isn't all bad news. Some economists say the trend also illustrates a more positive development since the early 1980s: U.S. companies' increased willingness to take chances to grow, although corporate courage has withered a bit amid scandals and a concomitant step-up in regulation.

"Maybe with taking on a little more risk, there's a little more reward," says Richard Sylla, an economics and financial-history professor at New York University's Stern School of Business. "Since our economy has done better than a lot of the other economies out there in Europe and Asia, it would be hard to argue that we've made a mistake."

When accounting problems led ratings firms to downgrade AIG this year, the insurer joined the swelling ranks of companies that have lost the coveted triple-A.

Companies appear to fall from grace faster than in the past. In addition to current concerns about credit quality, this likely reflects the tougher views the ratings companies have taken since they were

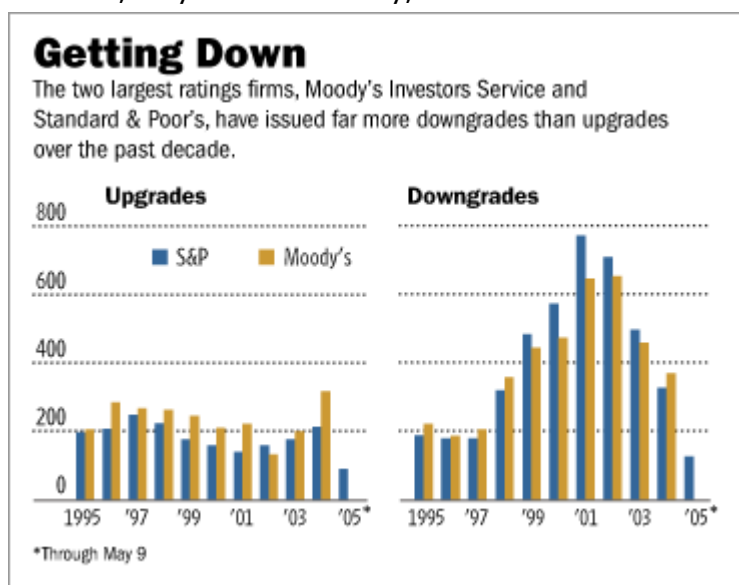
criticized for failing to anticipate Enron Corp.'s bankruptcy. Moody's downgraded a record 652 ratings in 2002, almost five for every one upgrade. S&P's downgrades peaked in 2001 at 771, or about 5.5 for every one upgrade.

The fall from the top can be tough for the companies, which must live with higher borrowing costs -- but even tougher on investors. "If you go back to the 1980s, I think bondholders took it on the chin," says Nicholas Riccio, credit analyst at S&P and author of a report, "The Decline and Fall of the AAA-rated Company."

In the larger context of U.S. economic history, the dwindling list of triple-A's reflects a tectonic shift in priorities. "As the U.S. lost its dominant position in the world economy, competitive pressures forced companies to assume more risk," says John Lonski, chief economist at Moody's. "You can't grow without risk."

Executives became less focused on their credit ratings and more intent on chasing new business and delivering returns to shareholders. For many established companies, the decision to borrow more money made sense. Because interest payments are deducted from taxable income, debt is usually the cheapest way to finance growth. But more debt means lower credit ratings.

"A lot of companies just made a conscious decision that the benefits of an AAA rating weren't worth the costs," says William Dudley, chief U.S. economist at Goldman Sachs in New York.



Coca-Cola Co., for example, lost its triple-A rating from S&P in July 1986 when the beverage company took on debt to create a new bottling network. Although the move was bad for the company's rating, S&P's Mr. Riccio believes it was better for the business. "They chose to do that as a way to enhance value for shareholders," he says, yet the move weighed on bondholders. Coke is now rated single-A-plus, four notches below triple-A.

To be sure, many leveraged acquisitions of the 1980s and 1990s destroyed value. And many downgrades demonstrated a loss of U.S. competitiveness. Ford and GM lost their triple-A's in 1980 and 1981, respectively, as rising interest rates, high fuel prices and

Japanese competition led to a drop in North American sales -- much like the one that prompted S&P to downgrade the companies to junk status last week.

Yesterday's Treasury Trading

Prices rose as the Treasury completed the third and final leg of its \$51 billion quarterly refunding with a well-received sale of \$14 billion in 10-year notes.

At 4 p.m., the benchmark 10-year note was up 8/32 point, or \$2.50 per \$1,000 face value, at 98 19/32. Its yield fell to 4.176% from 4.206% Wednesday, as yields move inversely to prices. The 30-year bond was up 15/32 point at 112 29/32 to yield 4.521%.

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