

Loading Up at the Buffett Cart

CALL IT THE Warren Buffett factor.

Ever since the billionaire icon's **Berkshire Hathaway** (*BRK.B*¹) joined with **Leucadia National** (*LUK*²) in a proposed \$6 billion bailout of Arizona-based **Finova Group** (*FNV*³), the stock of that troubled financial company has been on a tear, jumping 194% in two weeks. Even more astonishing, Finova's shares have risen 34%, on heavier than normal volume, since the company filed for bankruptcy protection on March 7.

That's a stunning turnaround for a stock that fetched about 50 cents back in December, when Wall Street began writing the company's obituary. (We wrote our own obit in early *February*⁴.)

Why have the shares suddenly taken off? Investors are betting that Buffett can resuscitate the once-thriving business lender, and therefore put a long-term charge into the company's stock. It was only last March, after all, that Finova was trading around \$30 — and with shares around \$2.80 now, little needs to be ventured for a big potential gain. As one Wall Street observer puts it, people are following Buffett because "they think they will get rich."

But that's a highly speculative bet — and one that could backfire.

Finova has a chance for survival if its numerous creditors — which are still owed \$11.4 billion — and a bankruptcy judge approve the Buffett-backed plan. But that's a big if, since some of Finova's creditors are already balking at the proposal. "There is no plan," says Douglas Bartner, an attorney with New York's Shearman & Sterling, which represents a committee of banks that lent Finova money. "This has not been agreed to by the creditors."

Meanwhile, GE Capital, the financing division of **General Electric** (*GE*⁵), is mulling a bailout offer of its own, according to published news reports. That raises the possibility of a long, drawn-out fight for control of Finova and the likelihood that whatever restructuring proposal is adopted will need more sweeteners to win the support of Finova's creditors. If that happens, it could further diminish Finova's overall stock value, or threaten the company's ability to survive postbankruptcy.

Even if the Buffett bailout plan were enacted tomorrow, however, current shareholders probably wouldn't benefit much at all. Based on the \$6 billion offer, creditors would get roughly 55 cents on the dollar right away, while the remaining debt would be repaid via the issuance of new 10-year bonds. Finova shareholders would retain a 49% equity stake in the firm, with Berkadia — the joint venture established by Berkshire Hathaway and Leucadia — getting 51%. That prospect has made investors giddy, since it's rare that shareholders end up with anything of value after a bankruptcy proceeding. But to arrive at the 49/51 split, Finova will have to issue more shares, a process that would dilute the value of the existing stock. So while shareholders would have something of value after the bankruptcy is complete, there's a big question as to how valuable that something would be.

"I'd say [investing in Finova now] doesn't even rise to the level of playing a slot machine," says Peter Chapman, president of Bankruptcy Creditor's Service, a publisher of several newsletters that chronicle major business bankruptcies.

Optimists will note that Finova's bankruptcy filing shows that the company has \$1 billion in cash and other assets on hand, after taking into account the money still owed to creditors. Finova, they say, enters bankruptcy in better shape than most other businesses, which often have more liabilities than assets. But it's difficult for the average investor to get a clear picture of Finova's fiscal situation, because the company hasn't released any detailed financial reports since last September. Moreover, Chapman says that \$1 billion cushion could quickly disappear if some of the midsize companies Finova has lent money to start defaulting on their loans because of the souring economy.

Indeed, defaults on outstanding loans are what got Finova into this predicament in the first place. Up until last March, the company was a Wall Street darling because of its rapid growth and dependable earnings. In becoming a big lender to companies in the health-care, tourism and aviation businesses, Finova's assets — or outstanding loans — grew to \$14 billion last year from just over \$2 billion in 1992. But Finova's stock quickly collapsed when the company announced it was writing off a \$70 million loan as a bad debt and that longtime Chief Executive Samuel Eichenfield would be making a hasty exit. More bad loans soon surfaced and the credit agencies raced to downgrade Finova's outstanding bonds to junk status.

So why on earth would Buffett want a piece of this? It turns out that his Berkadia venture would do quite well under the proposed bailout plan. Finova has already paid Berkadia \$60 million just for promising the loan, and Berkadia would get another \$60 million payment if it were approved. (The offer expires Aug. 31.) In addition, the five-year loan would carry an annual 9% interest rate, and interest payments would be due each quarter once it begins.

Moreover, Buffett's Berkshire Hathaway stands to benefit from any payment plan negotiated with Finova's creditors, regardless of

the backers. Why? According to The Wall Street Journal, Berkshire Hathaway owns \$1.4 billion of Finova's outstanding debt, much of which was purchased in the secondary market at a deep discount. So even with creditors getting 55 cents for every dollar of debt they own, that's likely more than Berkshire Hathaway paid for Finova's debt.

They don't call Buffett the "Oracle of Omaha" for nothing.

¹<http://www.smartmoney.com/quote/BRK.B/>

²<http://www.smartmoney.com/quote/LUK/>

³<http://www.smartmoney.com/quote/FNV/>


⁴<http://www.smartmoney.com/stockwatch/index.cfm?story=200102142>

⁵<http://www.smartmoney.com/quote/GE/>

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