INDUSTRIAL BONDS AS INVESTMENTS

Points to be Investigated—Staple Industries versus Luxuries—Net Earnings

As in any other investment, the objects to be attained by an investment in industrial bonds are, in the order of their importance, the safety of the principal, regularity of income and amount of yield, writes Mr. Oscar Newfang in the Bankers' Magazine.

The safety of the principal depends primarily upon the margin in the value of the property pledged over the amount of the bond issue; or, as it is usually called, upon the equity. Among conservative lenders upon bond or mortgage, it is customary to expect a minimum pledge of property worth about twice the amount of the bond issue, although choice properties may safely be bonded up to sixty per cent. or sixty-five per cent. of their value. The prospective purchaser of a bond should, therefore, first ascertain the total amount of the issue which he contemplates buying, and should know upon what property it is a lien, and the value of that property, which (as stated) should be at least twice the amount of the bond issue. If there are prior liens upon the property, they must be deducted before the ratio of property value to the bond issue is determined; but in such a case the investor in a junior issue takes the additional risk of a second mortgage holder; that is, the prior lien must first be satisfied in full before he will obtain anything whatever.

Regularity of Income.

The second requirement of the bond buyer, regularity of income, depends mainly upon the margin of net earnings above interest requirements. The fluctuations of income in an industrial corporation are apt to be wider than in a railroad or public service company, and the careful investor demands a minimum average income for a period of years of at least twice the interest charges on his bond issue. He also prefers the bonds of companies that provide a safe surplus account to those of companies that pay out in dividends the entire or nearly the entire earnings above interest charges.

In making a bond investment it is well to remember that over a long period of years the regularity of income is greater for a staple industry than for a luxury. It must also be noted that certain industries, such as coal or other mining, lumbering etc., exhaust their resources by the very nature of their operations, and such properties are rarely desirable as bases for bond issues. Other industries depend, more or less, upon artificial conditions, such as tariffs, etc., for their prosperity, and the regularity of their earnings is for that reason less certain than that of industries which rest wholly upon natural conditions of trade. The bonds of the former are, therefore, not so safe an investment as those of the latter class.

In determining the net earnings available for the interest charge of a bond issue, the policy of the corporation in charging off an adequate amount of its gross profits for depreciation of its plant is a very important factor. If this is not done, a company may show a handsome margin of earnings above fixed charges, and may pay most of the amount to stockholders as dividends, but when the bonds mature it will be found that the plant has depreciated so greatly that its value is much less than the amount of the bond issue. The proper percentage to charge to depreciation, of course, varies in different industries; but the best practice seems to be to make an annual charge of ten per cent. against machinery and five per cent. against real estate. A well-managed corporation ought to appropriate to the upkeep of its plant a part of its earnings sufficiently large to maintain the plant in full efficiency; or, better still, to improve its productiveness. In order to judge an industrial bond intelligently, both the amount charged to depreciation and the amount of replacements and improvements should be known. Otherwise it is difficult for an investor to know that the property is properly maintained.

Twice As Large As Current Indebtedness.

The last of the principal financial factors determining the regularity of income on an industrial bond is the amount of working capital possessed by the corporation. It is a generally accepted principle that the safe operation of an industry demands a quick or circulating capital twice as large as the company's current or floating indebtedness. To operate with a much narrower margin endangers the solvency of the corporation in times of financial stress, and thus adds an element of uncertainty to the corporation's continued operation and the continuous payment of its interest charges. The working capital should be large enough to operate the plant to full capacity, and as a rule the larger the ratio of circulating capital (that is, capital which is being turned over at a profit) to the plant (that is, capital which is diminishing by depreciation) the stronger the corporation may be regarded and the more desirable its bonds will be as an investment.

The provisions for a sinking fund made in a bond issue must also be taken into account in judging the bond.

NEW YORK IS MAKING OUR DEPRESSION

But the Signs in Canada Are Good — What the Bankers Say

What is all this talk in New York about a coming trade depression in Canada? There appears to be an organized effort there to send abroad word of a supposed impending crash. But Canadian bankers in New York are wrestling with the doubtful views expressed in certain quarters on the business outlook in Canada. "They are inclined to scout the alarmist talk," says the Wall Street Journal, "that the country is on the verge of a pronounced trade recession as a sequel to the rapid expansion characterizing the last half dozen years or so. Commercial transactions, by and large, they affirm, are conducted on safe and conservative lines, thanks, for one, to the vigilance of the banks, with their network of branches spreading over the land, which keep them in close touch with economic developments.

Money is Tight.

"Money is tight in Canada, in keeping with conditions prevailing the world over, and borrowers are paying 6 per cent. for loans. No one, however, who can prove a legitimate need of capital, is being turned away. Naturally, in the present state of the market, lenders are discouraging any extension of commitments and are scrutinizing narrowly all applications for accommodations. Requests for loans on the security of inflated real estate are given little consideration.

"It is not deemed likely that this denial of capital to weak speculators will induce any widespread and drastic liquidation in real estate, and cause the collapse of its value. Undeniably the rate of its appreciation has received a check, and in many sections prices have suffered actual declines. But, it is pointed out, the tremendous influx of immigrants, with thrifty and settled ways of living, is helping to sustain values. Besides, those in possession of a good deal of the newly-opened land are people of means, who are threatened with no financial embarrassment, which would force them to dispose of their holdings before a turn for the better sets in in the real estate market.

Capital From Immigration.

"Stress is laid by those who indulge in gloomy forebodings over the situation on the huge trade balance which Canada is rolling up against herself. In the past four years the imports have annually exceeded the exports in the neighborhood of a quarter of a billion dollars, which adverse balance is undoubtedly absorbed by external borrowings of capital. But the point is made that due weight is not given to the important fact that 400,000 people, who are far from being in needy circumstances, are yearly added to the population. It is conservatively estimated that each of these immigrants brings with him $500 in cash on the average. On this basis the country receives every year from this source an aggregate of $200,000,000. It is maintained, therefore, that she cannot be accumulating as vast a foreign indebtedness on balance as would appear simply from the record of her commodity imports and exports.

"Of course, her capital borrowings from Europe and the United States remain. In this, as it was when our own country was in its early development stage, Canada is building up a debt for future generations, perhaps, to pay off. It is figured that we owe Europe in this way something like $7,500,000,000. In and of itself this is not a sign of bankruptcy or of poverty."

BRANDON LINKS UP WITH ITS PORT

For many years the Canadian Pacific Railway had only one track between Brandon and Fort William, its port on Lake Superior. Last summer a second track between the two cities was completed, and the company recently announced to the Railway Commission that they intend to lay two more tracks from the progressive Manitoba city to Fort William, making a four-track system between that city and the Lake Superior port. The Canadian Pacific Railway will be one of three Canadian railway systems connecting Brandon with the lake ports of Fort William and Port Arthur, while the Great Northern Railway runs from Brandon to Duluth. The future importance of Brandon as a railway centre is obvious.

Brandon's westward connections are also good. When the Grand Trunk Pacific and Canadian Northern Railways are both completed to the Pacific coast, Brandon will have four railway systems connecting it with Pacific ports, the three Canadian transcontinental railways and the Hill system, which already connects Brandon with Vancouver, British Columbia, and Seattle, Tacoma, Portland and Everett on the Pacific coast of the United States. These four systems have many branches, so that Brandon has connection with every part of Western Canada.