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How to Analyze a Prospectus

RELEVANT *Facts are Generally Given but the Investor Must Investigate Some Important Phases—When a Man Should Keep His Money in His Pocket and Wait—Authority of Borrowers to Issue Loans—Results of Over-Borrowing*

By **STEPHEN HUTCHINGS.**

A PROSPECTUS, as its name implies, sets out for the delectation of investors all the facts relating to the future of a given proposition. Company law insists and commonsense assumes that all relevant facts are stated and that nothing material is withheld; but often the fancy of the draughtsman plays so whimsically and so cunningly about these facts that their significance is obscured to all but expert analysts.

The prospectuses of a first-class government or municipality are more or less bald documents, which enlighten the investor in a dignified way with as few details as possible. For, indeed, why should a rich government, with all the world competing for its securities, truckle to mere money-lenders? That seems to be the tone of these prospectuses, and if you don't like it and refuse to lend, well, somebody else will. It has become almost an axiom that the greater the security the less is the information volunteered.

But, on the other hand, the sponsors of a fourth or fifth-rate enterprise, wishing to make as much as they can with poor material, overcrowd their few good and many bad points with verbiage and fanciful generalizations; consequently, investors should approach with a jaundiced eye all prospectuses which seem lavish of information, and the more jaundiced the eye, the greater will be the measure of security. A hostile attitude will not hurt a good proposition. All prospectuses must stand alone; their object is to attract capital, and their success must be according to their merits. The names and standing of directors is said to be a good index, but that is not enough, as the history of joint-stock enterprise has over and over again proved, and any undertaking that will not bear the sharpest scrutiny should always be left severely alone.

With regard to the issues of the leading powers of the world, the matter of selection is simple. No first-class government has ever repudiated its indebtedness to foreign bondholders, and its reputation and financial security are sufficient guarantee that the interest will be regularly paid and that the principal will be forthcoming at the due date of redemption.

Albeit, there are points to bear in mind which make certain government issues unattractive to small investors, whose investments are not looked after by a bank or broker.

For instance, when Russian government bonds are redeemed and a holder fails to notice from the advertised lists that his bond has been drawn, he receives no official notification of such drawing and innocently continues to present his interest coupons for encashment, under the impression that his periodical doles are interest, whereas the interest ceased automatically at the time of the drawing. He is left blissfully innocent of what has happened until these payments, which are regularly deducted from his principal, amount to the sum of his capital; and he is politely notified that his capital is exhausted and that he has no further claim. This is one danger of drawn bonds not generally appreciated which investors should never fail to remember.

Regard should also be paid to the authority of the borrower to issue loans, such as the laws and ordinances of a country under which the loan is authorized, or the powers provided according to the constitution of a company. This point is not of great importance in most cases, as the issuing house or firm usually takes care to see that there are no infringements of the law, if a foreign company or country, and a domestic company's officials would scarcely venture to risk the penalties attaching to acts not in conformity with company law. Nevertheless, it is worth mention, if only for its value as an example of the many ostensibly innocuous but possibly dangerous factors to be considered in the analysis of a prospectus.

In the cases of small countries or municipalities, whose finances are not in the best condition, or which borrow frequently, a request for a large sum should be regarded with caution. In times of free money these weak-kneed borrowers toe the line with substantial applicants, hoping that too much attention will not be paid to their status, and simulate importance by asking for a big, round sum, altogether unjustified by merit. Over-borrowing, even by successful undertakings, cannot fail of one result—disaster; therefore, it behoves lenders to pay particular attention to the amount of the loan asked in every case.

The security and purpose of the loan is, of course, of the first importance. The money might be required for developments of a remunerative kind, such as railways and harbors, and may be secured as to capital on such undertakings and on the collateral security of other tangible assets; as to interest, it may be secured on actual excess revenues after paying charges for the service of prior existing loans. This is the best form of guarantee, and has a special appeal in that the money is given a permanent, productive character, and is always to be preferred to loans obtained for the purpose of paying off current debts or for "general purposes," whatever they might prove to be. Also, the general standing of the borrower, its reputation for honorable dealing, its resources, acquired wealth and freedom from political complications, must all be weighed as affecting the stability of the loan.

The rate of interest must be considered in the light of all the foregoing points. As a general rule, it may be accepted that the greater the security the lower the yield, and vice versa, but this is not an infallible rule. It should also be noted where the interest is payable, if a foreign loan, and whether on a gold basis or otherwise. For instance, it might be in Austrian kroners, Chinese taels or Japanese yen. If so, it is necessary to note the exchange value attached to these units. Investors have frequently suffered loss through the variation in the rate of exchange.

The yield per cent. is often overlooked by inexperienced investors. The rate is obtained from the net interest on the price paid for a bond. Thus, if 90 dollars is paid for a loan on which the interest is 4½ per cent., the interest on an investment of 100 dollars at the same rate would be 5 per cent.