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JANUARY 18,

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PLUS

• Asian Bargains

DEMOLITION MAN

“We're probably the only short-sellers in

MANUEL ASENSIO ASENSIO & COMPANY

THE MOST SUCCESSful short-sellers

publicity, preferring to think of short-selling as a

declaration of war on what he considers grossly over-

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USA TODAY

Money

SECTION B

Tuesday, February 18, 2003

Short sellers sharply scrutinize companies

By Todd Plitt, USA TODAY

Always on the lookout: Manuel Asensio, a short seller, goes to great lengths to spot troubled companies.

Critics say traders attack deliberately; supporters say traders are first alert

By Thor Valdmanis
USA TODAY

Cover story

NEW YORK — As PolyMedica general counsel John Stone toured his Liberty Medical subsidiary in Port St. Lucie, Fla., late last month, he noticed a man in a polo shirt and jeans taking photographs of the company's parking lot.

"I thought he was just some nut case," Stone recalls. "But I've since received a police report suggesting it was Manuel P. Asensio."

For most companies, that is troubling news. Asensio is despised in boardrooms for his Dick Tracy snooping and bullhorn denunciations of businesses he believes are frauds.

A short seller with a long list of corporate scalps to his name, Asensio was burning shoe leather in Port St. Lucie as part of a campaign to prove that PolyMedica, the nation's largest provider of diabetes home-testing kits, is a Medicare abuser. The company, which is currently under a federal criminal probe, has denied allegations of wrongdoing.

As he took photographs of PolyMedica's Port St. Lucie facility, the 48-year-old Cuban native and Harvard MBA soon came face to face with three PolyMedica security guards who tried to confiscate his digital camera.

"The company is guarded like an army outpost. I wonder why," says the pugnacious Asensio, who, like other short sellers, tries to make money betting stocks will fall. "But it's nothing new. I've faced this kind of thing all my career."

Not amused, PolyMedica filed a complaint with Port St. Lucie police, accusing Asensio of misrepresenting himself as a "private investigator, conducting a fraud investigation." Asensio, who runs Manhattan investment boutique Asensio & Co., says his lawyers are fighting to have the complaint torn up because he was on public property at the time.

Whatever the outcome, the long-running PolyMedica-Asensio battle is a prime example of the increasingly tempestuous wars of attrition being waged between companies and a small band of generally secretive stock-bashing traders who target them.

The stakes are so high, businesses often go to their

Please see COVER STORY next page ►

Disgruntled companies, some regulators question tactics

Continued from 1B

graves blaming short sellers. Small and institutional investors, stock underwriters and brokerage analysts often disparage "shorts," claiming they don't just bet on share-price declines but make them happen by rumormongering in research notes, on Internet chat sites or with media leaks.

But short sellers can be the market's first line of defense against corporate fraud. Jim Chanos, who runs a short fund called Kynikos (Greek for cynic), uncovered Enron's fairy-tale earnings months before internal whistle-blower Sherron Watkins. David Tice, another prominent short seller, was vilified by Tyco International for years before his warnings of accounting shenanigans were vindicated.

Cover story

Many, like Asensio, are now turning their sights on health care providers they suspect of pumping up earnings by stealing from federal taxpayers via Medicare.

Not surprisingly however, given these gloomy times, so-called stockbusters are again under the scrutiny of disgruntled companies and crusading regulators.

"In primitive societies, there must be an evil force responsible when bad things happen," says Owen Lamont, associate professor of finance at the University of Chicago Graduate School of Business. "Short sellers perform that role during down markets."

Financial firm Allied Capital and Farmer Mac, the government-chartered buyer of farm mortgages, are among the noisiest demanding that the Securities and Exchange Commission and New York Attorney General Eliot Spitzer crack down on short selling hedge funds they blame for conspiring against them.

"This is not about short attacks based on the truth; this is about deliberate campaigns of misinformation for personal profit," says former Clinton special counsel Lanny Davis, who represents several public companies under siege from short sellers. "There is a rush to publish misleading assertions that keep on changing every day. They drive down share prices before companies have a chance to respond."

Hedges on the rise

At last count, there were about 45 hedge funds with $4.2 billion specializing in short selling, borrowing and selling shares on the bet they can be bought back later at a cheaper price. That compares with 50 hedge funds with $2.6 billion three years ago, according to industry-tracker Van Hedge Fund Advisors.

Considering there is $36.6 trillion at work in the nation's capital markets, the financial muscle of short sellers is relatively minuscule. But they still are detested by the majority of investors in mutual funds and other vehicles with a stake in seeing stocks go up. The opprobrium only gets worse in times of crisis.

During World War I, the New York Stock Exchange imposed special short selling rules in fear that German Kaiser Wilhelm II would use agents to drive prices down. Regulators imposed more technical hurdles after the Depression such as the "uptick rule," which bans short sales while a stock is declining.

After the Sept. 11 terror attacks, federal prosecutors even went after short sellers of Middle Eastern origin, netting high-profile San Diego trader Amr "Anthony" Elgindy. Underscoring the often close but unspoken relationship between short sellers and law enforcement officials, Elgindy is under house arrest pending charges that he shorted stocks using inside scandal tips from rogue FBI agents.

People familiar with the situation say current SEC and Spitzer probes deal specifically with the activities of Gotham Partners Management and two other short selling hedge funds, not the entire industry.

"Anyone who acts upon or causes others to act upon information that they know to be false is violating securities laws and should be prosecuted accordingly," says short seller Chanos. "But this applies to bulls and bears."

Many academics worry about a crackdown against an industry that includes some of the most talented and tenacious analysts in the investment arena.

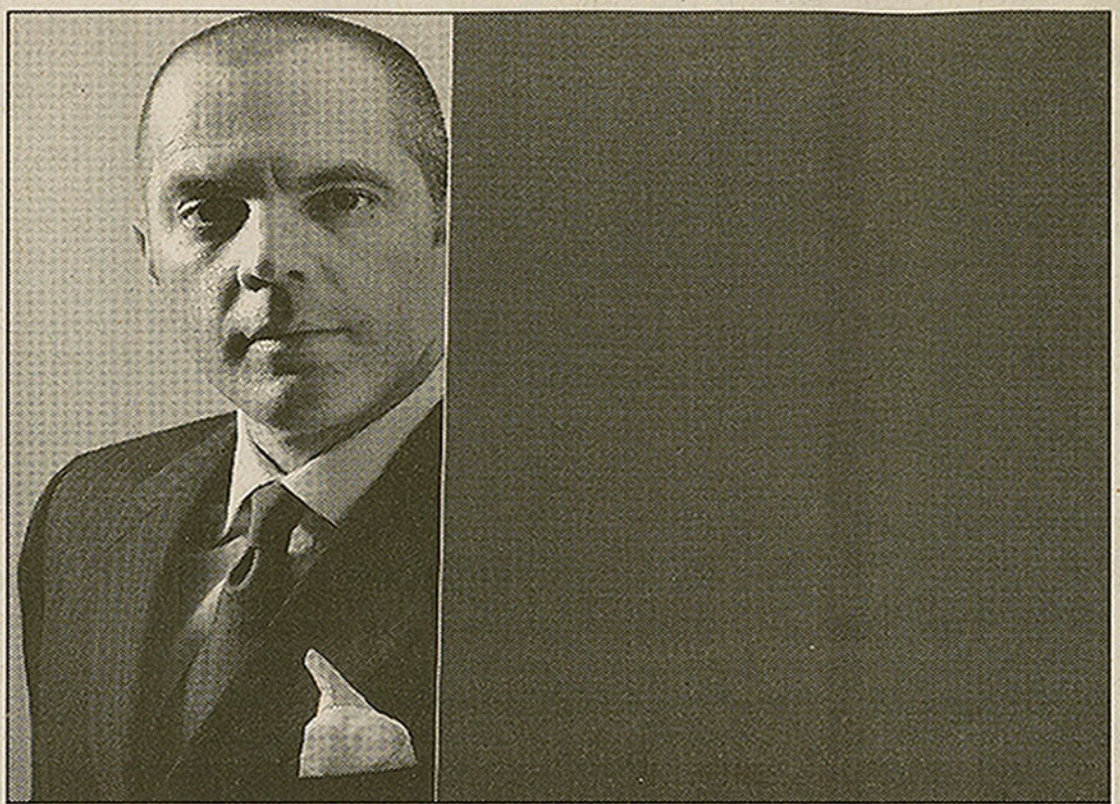
"Regulators need to be very careful when it comes to limiting short selling," says Peter Hecht, assistant professor of finance at the Harvard Business School. "It is hard to imagine financial markets producing prices that reflect fundamental values if the bears are systematically forced to sit on the sidelines."

Short sellers already run risks for offering a reality check on typical Wall Street bullishness. They have to track down shares to borrow, which can be difficult, particularly when some pension funds and other institutional investors brand them as antisocial and refuse to do business with them.

They also have to pay interest on the borrowings and post collateral should the stock prices continue to go up. Then there is the dreaded "short squeeze," when companies or lenders attempt to call back their shares at a time of maximum vulnerability.

"I think some of us fear a witch hunt," says Tice, who runs the Prudent Bear Fund. "But short sellers produce some of the best research on the Street. Often it is the people who scream the loudest who have the most to hide."

In a study of 270 companies since 1997 that have fought short sellers by accusing them of illegal activities, suing them or hiring private investigators, the



By Todd Plitt, USA TODAY

Manuel Asensio: He publishes his research on the Internet and issues news releases announcing "sell" recommendations.

University of Chicago's Lamont found they experienced low abnormal stock returns in subsequent years. In the year after an anti-shorting action, the average stock price declined about 2% a month. Other researchers have found evidence that constraints on short sales allow stocks to be overpriced.

Ready to rumble

PolyMedica is certainly fighting hard, having hired heavyweight law firms and public relations specialists to deal with allegations made by Asensio and other short sellers.

"We have no problem with the short seller community," PolyMedica general counsel Stone says. "We only have a problem when they make false statements or misrepresent the facts. They should be held to the same standards as everyone else."

At first glance, PolyMedica appears to be a success story, with revenue rising 27% in 2002 to $280 million. Its shares are up more than 60% in the past 12 months, and the Woburn, Mass.-based company even paid its first dividend last quarter of 25 cents per share, citing its "robust and predictable business model."

But predictable might be too generous a word for a company whose staff is being interviewed by the FBI as part of a long-running federal investigation into alleged Medicare fraud. PolyMedica gets more than 70% of its revenue from Medicare, largely from the sale of blood-glucose test strips for diabetics.

PolyMedica says it is cooperating with authorities and hopes the legal cloud, which also includes shareholder lawsuits, will lift soon. The company says it has spent more than $9 million in the last two years improving internal controls. But Asensio smells blood.

During his recent sleuthing in Port St. Lucie, Asensio says he uncovered new evidence that supports allegations by shareholders and former employees that PolyMedica has a long record of producing fictitious sales by intentionally shipping unauthorized orders to clients and not reimbursing Medicare for returns.

By speaking to local officials at Port St. Lucie and neighboring post offices, Asensio estimates that PolyMedica returns run at least 200 to 500 package shipments per day, with returns reaching 1,000 or more on some days. PolyMedica says it ships about 2 million packages a year to its 522,000 customers, with a return rate of about 300 a day, or 4%, in line with the industry average. Asensio calculates that the return rate is more than twice that and accuses PolyMedica of "cheating Medicare and taxpayers" by not properly reimbursing the government.

Asensio, author of *Sold Short: Uncovering Deception in the Markets*, is easily disposed to incendiary accusations. Far from sticking to the shadows, he courts the limelight, publishes his research on the Internet and issues news releases announcing "sell" recommendations. Some of his peer group privately call him a cowboy whose thirst for publicity has often found him afoul of securities regulators and in costly lawsuits (although Asensio says he has never lost one). Everyone agrees he gets results.

Take his campaign against Turbodyne, once a hot small company on Wall Street thanks to pioneering turbochargers that would reduce emissions and boost the power of internal-combustion engines. Asensio accused the firm of promoting useless technology and was sued for defamation in 1998.

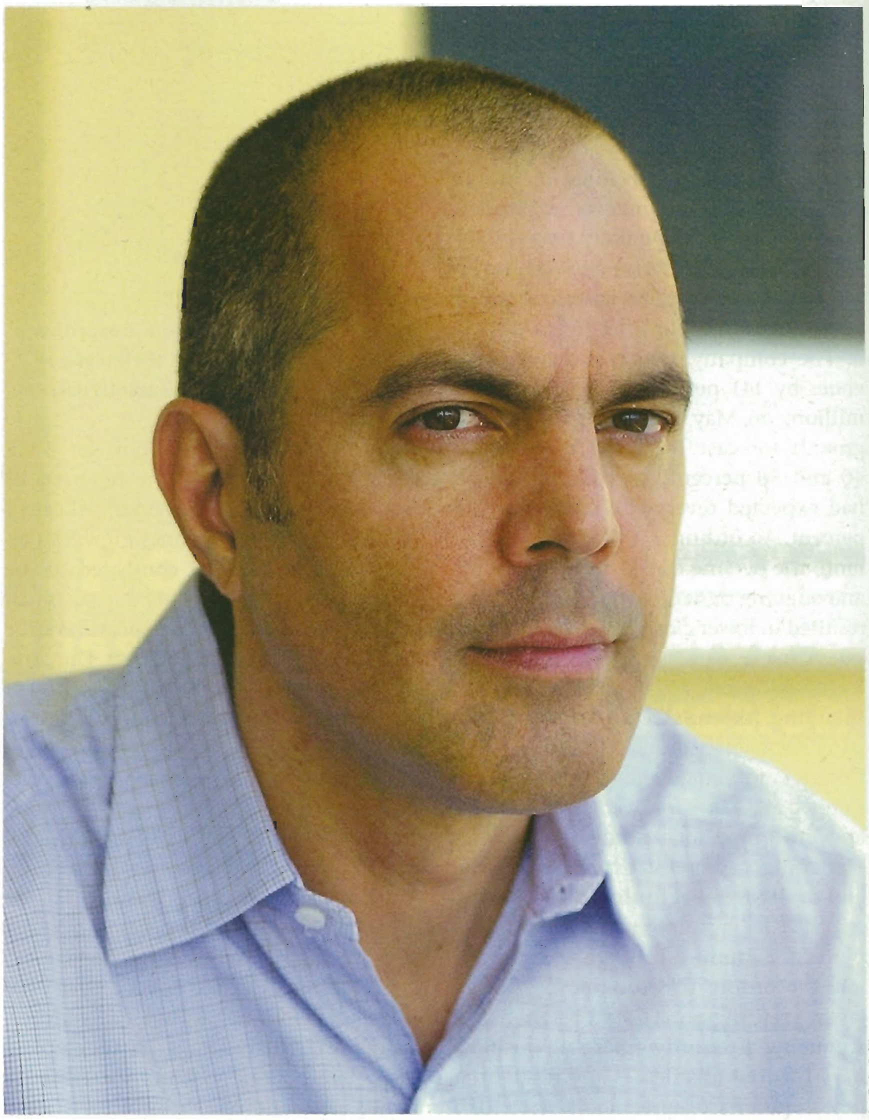
"He practically reached across the table and hit me in a deposition," recalls former Justice Department prosecutor Marvin Rudnick, who represented Turbodyne in a defamation lawsuit against Asensio. "He is a fiery fellow." Not long afterward, Turbodyne dropped its lawsuit and in April 1999 was barred from trading on Wall Street by regulators who ruled the company issued misleading press releases. Turbodyne now toils in obscurity. It recently began trading again in the USA as a penny-stock on the OTC bulletin board.

Once highflying companies stumbled

While most investors were wiped out by the bankruptcies below, Manuel Asensio and other short sellers made a killing.

	Initial strong sell recommendation		Decline in market value[1]
	Date	Price	(in millions)
Winstar Communications	March 8, 2001	$23.31	$2,153.4
Diana Corp.	June 4, 1996	$100.00	$717.8
Solv-Ex	Oct. 7, 1996	$19.50	$585.0
Computer Learning Centers	March 19, 1998	$30.25	$514.3
Syquest	May 24, 1996	$18.88	$215.1

1 – Estimate; Source: Asensio



Hunter: Short seller Manuel Asensio is stalking profit by attacking the Canadian maker of upgraded metallurgical silicon.

Metallurgical silicon meets Demolition Man

Canadian UMG-Si maker badmouthed by profit-seeking short seller

When Canadian smelter Timminco Corp. called on PHOTON Consulting to review its process for making low-cost upgraded metallurgical silicon, a notorious short seller began bombarding the internet and media with nasty press releases to drive the booming share price down – and make a killing in profits. But having already won over the world's biggest PV producer Q-Cells and – according to one source – vertically-integrated CSI, which is already delivering UMG-Si modules, Timminco is not only surviving the onslaught, its share prices have continued to rise.

Manuel Asensio is a short seller. That is no comment on his physical stature, but rather his fiscal bent on the stock market. Since 1993, the US-based Cuban refugee has been making money by going after small companies with questionable claims as they seek stock market stardom. As per the short seller modus operandi, Asensio targets those firms by borrowing shares from brokers, selling them, then relentlessly boring into any company weakness he can find. This media and internet blitz of negative press releases is aimed at driving down the company's image and stock so that Asensio can buy the shares back at a lower price before returning them to the broker. The result? A healthy return for Asensio and often ruin for his prey. According to Asensio's 2001 book Sold Short, the media has dubbed him »Demolition Man,« »Attila the Hun« and »a company's worst nightmare.« Depending on your point of view, Asensio is either an investor protector of comic book hero stature or a profit-hungry parasite using any dirty trick in the book.

No doubt René Boisvert would lean toward the latter description. He is president of Canadian-based Bécancour Silicon Inc., a subsidiary of publicly traded metal silicon smelter Timminco Ltd. Bécancour is one of about 17 companies working on processes for making upgraded metallurgical silicon (UMG-Si). While this low-cost silicon alternative has long been touted as the answer to the PV industry's Siemens reactor trichlorosilane-based silicon shortage, the promise of a slightly less-pure feedstock sufficient for solar applications has yet to be fulfilled. But Bécancour thinks it is ready for the big time. Its patented rotary furnace uses an oxy-fuel burner to purify metallurgical silicon three times, requiring just 2 kWh of electricity per kg, constantly exposing the melt to water vapor to remove boron and phosphorous and each furnace is able to handle up to 10 tons. With plans to ramp up rapidly, such potential has put the share price into a climb. It has also unfortunately put Timminco in the crosshairs of Asensio's sight.

Rolf Schulten / photon-pictures.com

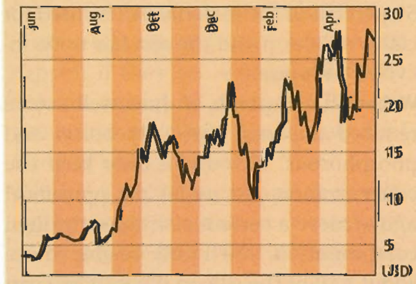
The prey: Rene Boisvert of Bécancour is taking Asensio's pursuit in his stride as the parent company's stock continues to rise.

Nasty press releases galore

Boisvert's headaches with Asensio began on April 21 when the short seller picked up on a Barron's article chiding Timminco for a lack of public disclosure on its process. Then when Timminco called in PHOTON Consulting, an independent affiliate of PHOTON International's publishing house Solar Verlag, to conduct an operational review of Bécancour's UMG-Si work followed by a May 14 public conference call, Asensio's attacks gathered speed. By May 21, the short seller had sent out at least 23 nasty press releases, several aimed at besmirching the credibility of PHOTON Consulting's Michael Rogol as a paid and unqualified consultant, even describing him in one press release as a former »Korean taxi cab driver.«

If Asensio's goal was to lower the share price, so far he has failed. During trading on May 16, the share price hit its highest level ever of $28.95 CAD ($28.65 USD), closing at a respectable $27.70 CAD ($27.41 USD) on May 23. Still, Boisvert admits that the short-selling turmoil has caused some Timminco shareholders to lose confidence. »I can understand people shorting a stock where there is fraud or something funny going on,« he says, »but the statements Asensio is putting out are incredible.« If Asensio's assessment on Bécancour were correct, he adds, then that would not only mean PHOTON Consulting's Rogol was wrong, but so were »all the other companies.«

Boisvert is referring to its customers. In all, the silicon producer has sent out 100 tons of UMG-Si this year to 40 companies, with samples ranging in size from 50 kg to several tons. Of those recipients, five have signed supply deals.



Primarily upwards: After Timminco's subsidiary Bécancour entered the PV business a year ago, its stock price has been on the rise.

Premier among them is the world's leading cell manufacturer, Germany's Q-Cells AG. On March 27 it announced that it had signed contracts with Timminco for 410 tons this year and 3,000 tons in 2009 at fixed prices, with negotiations for 6,000 tons annually from 2010 to 2013 slated to be completed by the end of July. Q-Cells, which is working on four other UMG-Si deals – including a contract with Norway's Elkem Solar AS (see PI 3/2007, p. 10) – with the goal of setting up UMG-Si-based wafer and cell lines at a new factory being built in Malaysia (see PI 5/2008, p. 16), characterized the »extensive tests« with Timminco's product as having »achieved very good results in manufacturing cells.« In an April 22 Reuters article, Q-Cells' CEO Anton Milner put the cell efficiency at »well above 15 percent.«

Boisvert, who declined to confirm that efficiency, would only say that Q-Cells' product uses 100 percent UMG-Si for the cells. During his one-day visit to Timminco, PHOTON Consulting's Rogol claims he received verification that several companies were reporting efficiencies above 14 percent. According to Boisvert, one of those is Solar Power Industries Inc. (SPI), a Pennsylvania, US-based ingot-to-system PV company. On May 8, Timminco's parent company AMG Advanced Metallurgical Group of Amsterdam revealed that SPI, which had entered into an unannounced deal in March 2007 for 4,000 tons of Timminco UMG-Si spread out over five years, had signed a new contract for 3,000 tons annually from 2010 to 2015.

First UMG-Si modules being delivered?

And according to a high-placed source, who asked to remain anonymous, the feedstock for Canadian Solar Inc.'s (CSI) new e-Module series using 100 percent UMG-Si cells, announced in its first-quarter results on May 13, is also from Bécancour. Shawn Qu, CEO of the Canadian incorporated company with manufacturing facilities in China, declined to confirm this, saying only that his company had two sources of UMG-Si, one Chinese. CSI says it has switched over one of its cell lines to handle UMG-Si wafers, producing 1 MW of cells within four weeks up to mid-May at an average stabilized efficiency of 13.3 percent after light-soaking and using about 12 to 13 g per W. Qu, who admits that CSI has experienced an unquantified rejection rate with »a set of challenges« at the wafer, cell and module levels, is expecting his company to produce between 30 and 40 MW of its e-Modules this year with a module stability than is required for highly pure material.

PHOTON So, there are two problems: you have to bundle the impurities and keep them away from the p-n junction.

Weber Exactly.

PHOTON How do I bundle them?

Weber Those are the process secrets of time, temperature and phase junctions. In metallurgy, that's called the TTT diagram, that means: Time, Temperature, Transition. You can figure it out through trial and error and generally that's how it's done. Or, you can take a scientific approach and look at the particles under an electron microscope. In the long run, you'll have to do both. I think it requires a good mix of scientific understanding, targeted defect engineering and process technology. On the other hand, there are some very high-ranking members of the PV industry that say: UMG silicon will never work ...

PHOTON ... or at least they say: if a company like Elkem needed 25 years to produce useable material, how can a company like Timminco do it in just two years?

Weber I firmly believe that Elkem was possibly chasing after the wrong horse for a while. Namely, trying to produce material that is equivalent to conventional, highly pure silicon. And the chances of doing that successfully are fairly low. I think the biggest re-adjustment was to say: »Okay, we are dealing with different starting material, we have to treat it differently, too.« That's why we call it UMG – upgraded metallurgical-grade – silicon after all. The name is probably a very accurate description.

PHOTON Q-Cells has now signed large contracts with Timminco, Elkem and others. Modules and cells made with this material will be hitting the market in coming months. In your opinion, is there any reason why end-users should avoid these products for the time being?

Weber Naturally, customers should place a lot of value on reliable certificates. We do that here at ISE: we perform an exceedingly detailed examination. Once the modules are certified correctly, then the products are certainly safer than, for example, thin-film technologies, since silicon is inherently a very stable material.

PHOTON What's your guess: how much UMG silicon will be used in 2015?

Weber Optimistically, I'd say up to 50 percent of crystalline silicon for solar cells could come from UMG silicon.

PHOTON How quickly can a manufacturer of metallurgical silicon set up a production process?

Weber In my opinion, much quicker than one can start up production with a Siemens process.

PHOTON And how high are the investment costs? The estimate is about €100 million ($156 million) for a 1,000 ton factory using the Siemens process.

Weber Right, and no one will give you an exact figure for UMG silicon, but I'm sure it's about ten times less expensive. Semiconductor manufacturers should prepare themselves if that's the case.

PHOTON But that also means that we could expect to see an additional 100,000 tons of solar silicon over the next two to four years.

Weber Yes, that could be the case. At that point, the price won't be $50, but rather $20 to $30 per kg.

PHOTON Do you have an estimate or thoughts about how much solar silicon could be produced with UMG?

Weber I think that depends solely on how long the price remains economically interesting. Manufacturers of UMG silicon are very interested in prices above $15 to $20 per kg. That means that all potential UMG manufacturers are working to achieve that goal. So, in the beginning, we'll see a decline in the price of highly pure silicon. There will be a lot of jittery stomachs, but it will be to the advantage of the solar industry – after all, for PV's breakthrough, we need lower prices.

PHOTON Essentially, history is repeating itself: BP Solar, or Solarex, purified metallurgical silicon in the 1980s and produced cells using this material.

Weber But then they dropped it, because suddenly there was plenty of silicon scrap available from the semiconductor industry.

PHOTON Now BP is cooperating with Globe, the world's largest manufacturer of metallurgical silicon. What would happen if they get serious and Globe opens a factory to produce 50,000 or 100,000 tons? They could have that ready in two years.

Weber Yes, I assume so. And then cells will be much, much cheaper – and that much sooner than we had expected. Very exciting!

PHOTON Thank you for the interview.

Interview by Anne Kreutzmann

»Then cells will be much, much cheaper – and that much sooner than we had expected.«

efficiency about 1 percentage point below cell efficiency, tripling to 100 to 150 MW in 2009. CSI claims it has set up deals for one large-scale rooftop in the US, adding that deliveries have already started. While the quantity was not revealed, Qu says CSI has »firm interest« in 100 MW of product, including two European contracts worth 20 MW each, with deliveries slated to start in the first quarter of 2009. CSI, which puts the average selling price for the e-Modules at 15 percent below its other silicon-based modules, is the first company to officially confirm the sale of UMG-Si modules.

Boisvert, who declined to confirm CSI's participation, also would not name the other two companies it has contracted with, except to say that they are planning to blend 30 to 50 percent of Timminco's UMG-Si with regular polysilicon from Siemens reactors. A major factor in selecting additional customers will be companies that Timminco can partner with for downstream ingot and wafer production. Boisvert expects to make announcements by the end of the year. Another factor will be based on the average price the companies are willing to pay. Boisvert puts the current UMG-Si pricing at somewhere just above $60 CAD ($59.37 USD) per kg (the company puts the fully-loaded production cost as low as $22 CAD per kg for 2008). This would put Timminco below the average for long-term polysilicon contracts of about $70 to $80 USD per kg. As Bécancour improves its process, Boisvert expects the price would continually beat out regular polysilicon, with PHOTON Consulting putting Timminco's UMG-Si price as low as $45 USD by 2010. But as more Siemens reactor-based polysilicon comes on line and prices fall, it is more likely that UMG-Si will be used increasingly as a blend rather than in its pure form.

Independent confirmation yet to come

No matter how it is used, the real success will depend on its stability. Bécancour's only feedback so far comes from companies that have tested its samples, with Boisvert claiming an initial degradation due to the higher boron content in its material is basically limited to the first three days. As for independent confirmation, Boisvert says that could come in June when Germany's solar research institute Fraunhofer ISE is expected to make the first wafers using Bécancour's UMG-Si.

Boisvert claims that Timminco, which has an overall production capacity of 50,000 tons of metallurgical-grade silicon annually from its own quartz mine, is looking to divest its magnesium and aluminum wheel divisions by the end of the year, becoming strictly a solar silicon company. While it currently has one three-line solar-grade factory producing solid silicon about 500 meters from the main smelter at its Quebec site, in mid-May it broke ground on a new factory next to the smelter to handle the second and third purification passes of the liquified silicon. Adding three new lines, one per month starting in January 2009, this will be followed by a second neighboring factory that will install another three lines from April to June. This is expected to raise annual capacity from the current 3,600 tons to 14,400 tons by mid-2009, based on an anticipated monthly yield capacity of 1,200 tons.

Timminco's parent company AMG will install a directional solidification furnace in July at the original facility for making ingots starting at 250 kg for qualifying experiments on various dopants to improve yield and resistivity of the material. Interestingly, the equipment is from an AMG-owned company, ALD. The vacuum technology equipment maker is also producing special directional solidification furnaces for multicrystalline silicon ingots for Norway's REC, the world's largest solar wafer manufacturer (see article, p. 90).

Timminco says the purity of its UMG-Si is currently 99.999 percent, with 0.8 ppm of boron and less than 5 ppm of phosphorous. Boisvert claims the boron content should fall to 0.5 ppm by the end of the year and to 0.3 ppm in 2009. Each of the customers, he says, are dealing with the impurities in a different fashion, either through sorting for a proper mix in the crucibles or working on special techniques at the wafer and cell stages. But all seem satisfied, he notes, even declining to return the more highly contaminated ingot tops and tails for extra credit offered by Timminco.

Questions of disclosure

Still, without independent confirmation of its claims, the only information coming out of Timminco is an anecdotal interpretation of what its customers are reporting. In PHOTON Consulting's review, Rogol heaped praise on what Timminco has done, saying that if Timminco decided to go the way of Walmart and priced its product low, the company would »have the potential to significantly reshape silicon prices« by 2010. Unfortunately, Rogol's presentation was short on technical data. When challenged in a question during the conference call on the product's ability to match a need for 25-year warranties, his response was less upbeat. Despite noting that Timminco, a company he put among a handful of top-notch UMG-Si manufacturers, Rogol admitted its product was not the best. »There just isn't enough data to make an informed call on what the degradation rates are, what the performance problems are and what the issues are going to be,« he noted.

Boisvert, feeling Timminco has already disclosed too much about its process, is not eager to invite more scrutinty. »We don't want everybody coming to our plant,« he says. »Our process is so simple that people would immediately figure out the little secrets and tricks we are doing beyond the patent application.« The decision to pick Rogol, he adds, was based on the consultant's experience as an observer of »so many different applications and plants.« When asked why Timminco didn't choose someone with an unassailable metallurgical silicon pedigree, Boisvert pauses. »Is there really a certified expert people will believe?«

That's probably just the kind of question short seller Asensio would be happy to latch onto in his quest to lower Timminco's image among stock market investors. But for now, at least, those investors seem to be sticking with Timminco and ignoring Demolition Man.

William P. Hirshman

PROFITS ARE THEY SHAKIER THAN THEY LOOK?

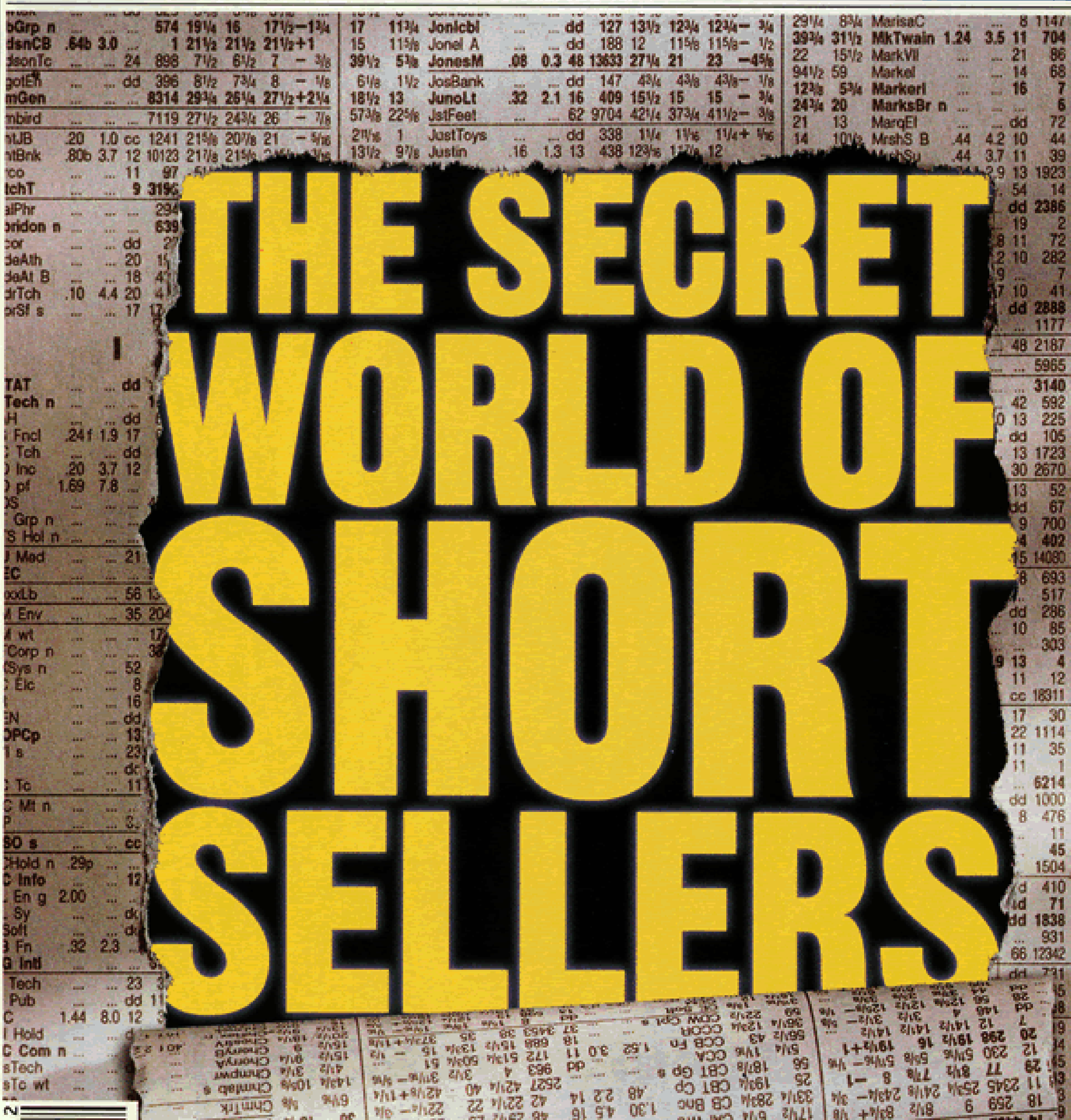
DOLE HIS NEW GROWTH PLAN

CHINA BUILDING A NE[W]... OF U.S. BUSIN[ESS]...

BusinessWeek

AUGUST 5, 1996

A PUBLICATION OF THE McGRAW-HILL COMPANIES



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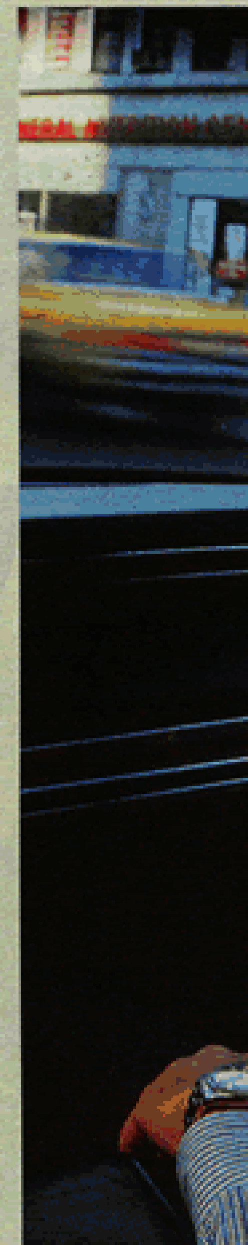

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MORRISON; E BY DANUTA OTFINOWSKI; (BOTTOM LEFT) ILLUSTRATION BY DAN KIRK

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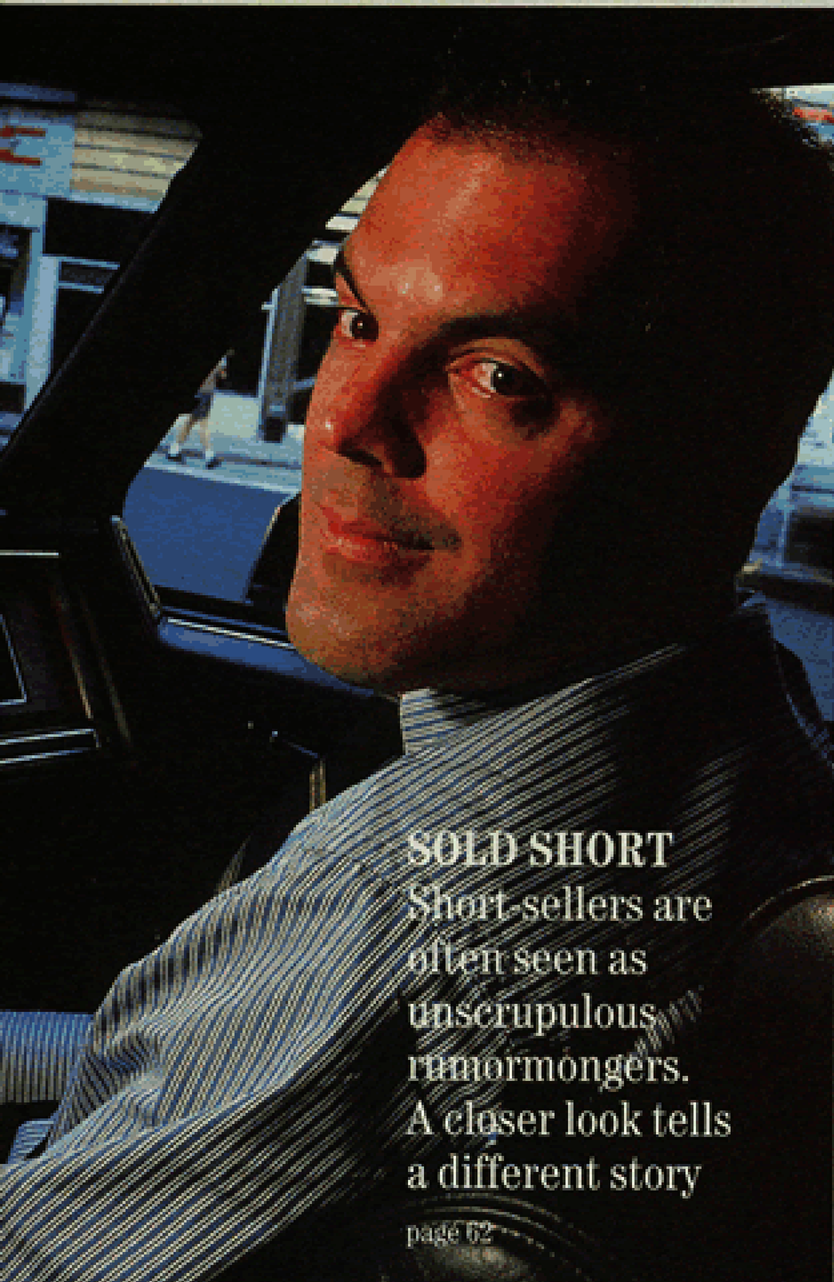

SOLD SHORT
Short-sellers are often seen as unscrupulous rumormongers. A closer look tells a different story

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THE SECRET WORI

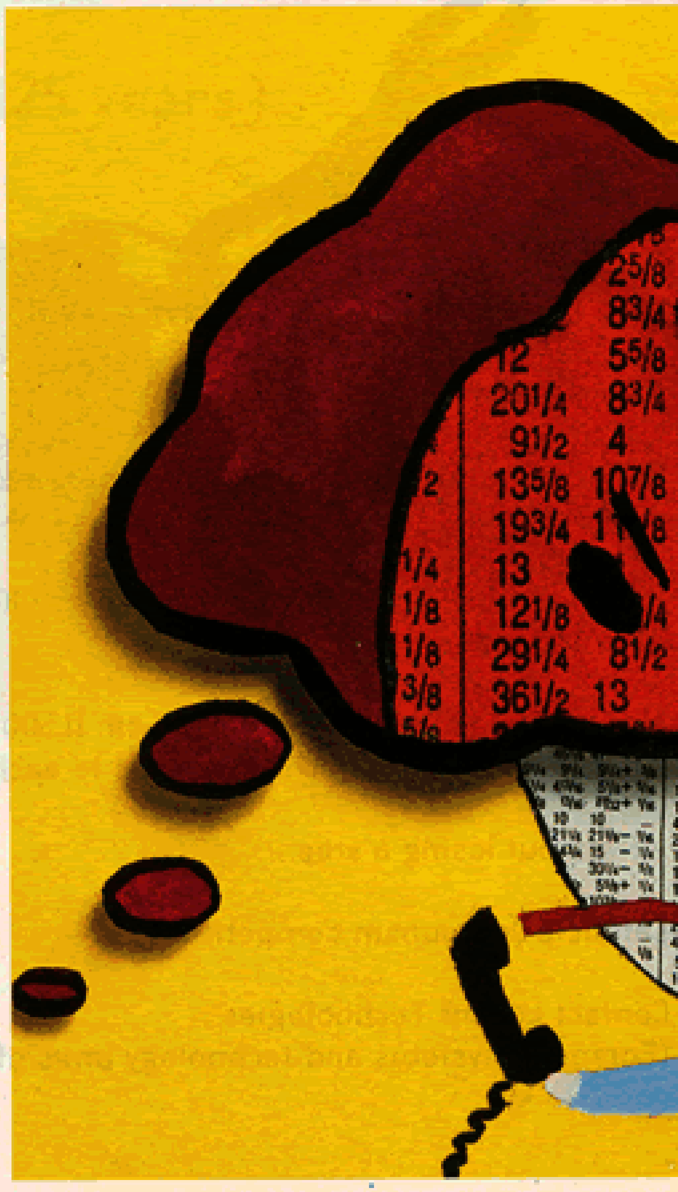
Widely despised, shorts are often seen as unscrupulous rumormongers. A closer look tells a different story

Solv-Ex President and Chief Financial Officer W. Jack Butler is the kind of man who might have been called a captain of industry, back in the days when that really meant something. An erect, dignified man in his late seventies, he spent 35 years with Mobil Oil and served as chairman of Mobil Saudi Arabia in the heady days of the 1970s. Solv-Ex has a process for turning oil-laden sand into crude oil—a vital, almost unimaginably lucrative process, if it succeeds. And to Butler, it's more than that. "I don't just want to make money," he says. "I want to do something for my country."

But Solv-Ex Corp. is under attack. Picking at a salad in a café near his Park Avenue apartment, Butler stoically ticks off the problems. Rumors of improprieties and involvement by penny-stock manipulators. A Securities & Exchange Commission investigation. An incessant drumbeat of negative publicity has slashed the company's share price by 60% over the past few months and has so hurt its reputation that its efforts to finance its sand-into-oil project, up in Alberta, Canada, have been gravely harmed. "We feel we're a good company," he says. "Operating ethically. Good technology." And it would succeed, he insists, if it weren't for a mudslinging campaign by a small band of stock-bashing traders: the short-sellers.

Cover Story

About half a mile downtown, a man about half Butler's age, polo-shirted and barefoot, is staring at a stock-trading screen that shows some cheerful information: The Dow Jones industrial average is falling. Something resembling panic seems to be taking place, and at trading desks around the country, men and women are picking up their phones and yelling "Sell!" This man is on the phone with his trader, but he's buying—replacing stocks that he had previously borrowed and sold, hoping that their prices would decline. They have. But there is one stock he borrowed and sold that he is not replacing. It is Solv-Ex. For he feels Solv-Ex has a long way to go before it stops falling. The company, he asserts, is burning cash like an overheated furnace—one that will even-

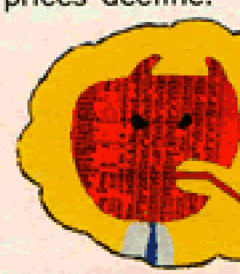


The Truth About Those That Sell Short

The murky world of short-selling is beset by a host of

PERCEPT

Short-selling ma
prices decline.



REALIT

OF SHORT-SELLER

un-American—that share prices will collapse. The bu
made them suffer until just the past few weeks. Ar
who put $100,000 in the hands of a typical short
yearend 1990 would have $50,400 by the middle of

But the misery that has enshrouded the marke
NASDAQ in particular—has been mother's milk for sho
In recent weeks, they have come roaring back, wi
gaining 10% in June and another 10% to 15% thro
July, according to Harry Strunk, a Palm Beach (Fla
ment consultant who tracks short-sellers (chart,
The short-seller revival is likely to exacerbate their r
as piranhas—particularly among investors in small-ca
who often view short-sellers as the assassins of C
America. "Small companies can be seriously affected
sellers. Some of these shorts target particular iss
don't know a damn thing about the companies they'
ing," says Edward Mishkin, a prominent New York
lawyer and a vocal critic of short-sellers.

BET OR PUSH? Even among hardened pros on Wa
particularly institutional investors, small-stock unde
and brokerage analysts, shorts are shunned and hate
managers will tell you: 'I don't want anyone shor
stock.' They don't want anyone making money on t
takes," says one Wall Street executive who routin
with both shorts and "longs"—conventional investors.
tractors of short-sellers maintain that shorts don't ju
share-price declines, they make them happen. Sh
blamed for the travails of dozens of high-flying sto
have taken heavy hits during the recent NASDAQ m
Solv-Ex, Diana, WellCare Management, Presstek,
Technology, and a host of other high-tech companies.
selling and bear raids are part of the business," conced
Ex CEO John S. Rendall. "But when you put out fals
and get the SEC involved—that, I believe, is criminal

Are shorts the bane of Wall Street? Are they vi
scapegoats, responsible whistle-blowers or venal rur

PERCEPTION

Short-sellers are a destructive force in the markets.

REALITY

Shorts add to liquidity in the markets—selling when markets are rising and buying when buying is needed most—during market declines. Shorts expose accounting irregularities and mismanagement. They also counter the hype from companies

PERCEPTION

Voracious short-sellers destroy companies by cutting off their access to capital.

REALITY

Companies targeted by

PERCEPTION

"Naked" short-selling—selling stocks that haven't been borrowed—is rife in the markets and helps drive share prices down.

REALITY

Naked shorting takes place, but its prevalence has been exaggerated by critics. Market makers can "go naked" in the normal course of busi-

PERCEPTIO

Short-sellers sprea about companies.

REALITY

Sometimes. But m often than not, the research is among most detailed and accurate in the inv community.

Because of their contrarian stance and the liquidity th provide, shorts have an overwhelmingly positive impa

gers? To find the answer, BUSINESS WEEK delved into the world of the short-sellers. It wasn't always easy, for shorts cherish their privacy, and many fear attention with an intensity that can border on paranoia. The picture that emerged is dramatically at odds with the conventional view of short-sellers as hood-like market-manipulators.

To begin with, only a tiny fraction of short sales are bets on the direction of stocks. The vast majority—perhaps 98% by one informed estimate—are merely efforts to hedge stock holdings or take advantage of arbitrage opportunities with other forms of investment. Traders who exclusively short-sell are but a tiny cadre of market players—a handful of partnerships and small brokerage firms. Despite their raptor-like image, they are often victims—not perpetrators—of stock manipulation. And though they can certainly put a dent in stocks by leaking stories to the media, the image of "stock-busters" who can drive down share prices is overblown. Exchange and NASDAQ rules ban short sales while a stock is declining. This "uptick rule," which allows shorting only when the most recent price change was positive, makes it tough to beat down stocks by short-selling alone.

Cover Story

To be sure, there are instances of questionable practices by shorts, such as the aggressive short-selling that allegedly led to the demise of the Adler Coleman & Co. penny-stock trade-clearing firm last year. Regulators are investigating charges by Mishkin, the court-appointed trustee, that shorts engaged in such nefarious practices as "naked" short-selling—shorting stocks that haven't been borrowed. Federal authorities are investigating the short-selling of Organogenesis Inc., a biotechnology company, because of allegations that false information was spread about the company (BW—Apr. 22). But the overwhelmingly negative publicity overshadows the contributions shorts make to the market—particularly in raging bull markets, when Wall Street hype runs rampant.

ILLUSTRATIONS BY LISA KNOUSE BRAIMAN/BW

Because of their contrarian stance and the liquidi bring to bear, short-sellers have an overwhelmingly impact on the market. They are often the marke line of defense against financial fraud—frequently regulators to scams and accounting irregularities, as case with now defunct ZZZZ-Best and College And short-selling abuses have often been exagg Naked short-selling certainly happens, but vastly mo monplace is the "short squeeze," a chain of even can be a blatant effort to punish short-sellers by them to buy stocks when they are artificially high (tion below).

REALITY CHECK. The market's hostility toward shor makes shorting a risky strategy often best left to sionals. Still, everyday investors have a great deal from short-sellers. Even when they are wrong or thei is off, short-sellers offer a refreshing reality check on varnished bullishness so prevalent on Wall Street sellers include some of the most talented analysts in vestment arena and are noted for their adroit, labor-i research. One short-selling partnership even include its analysts a retired physician to evaluate biotec stocks. But at bottom, what gives shorts an edge shoe leather.

"Shoe leather" might well be Manuel Asensio's name. Like most short-sellers nowadays, Asensio ha gers in other pies—from conventional money manage municipal-bond underwriting. But short-selling is cl first love. Asensio, who runs Asensio & Co., a New vestment boutique, is a rarity among short-sellers, anything but secretive. For the first time since th when the flamboyant Feshbach brothers of Palo Al made some highly publicized stock pans, shorts have pointed... well, "point man" might be the word. " what he does," says one short who has never met As has read his research and respects the guts show public stance on stocks. "He is totally associated

Four Ways Shorts Get Stung

There are four distinct types of short squeezes. All force short-sellers

THE TRADE

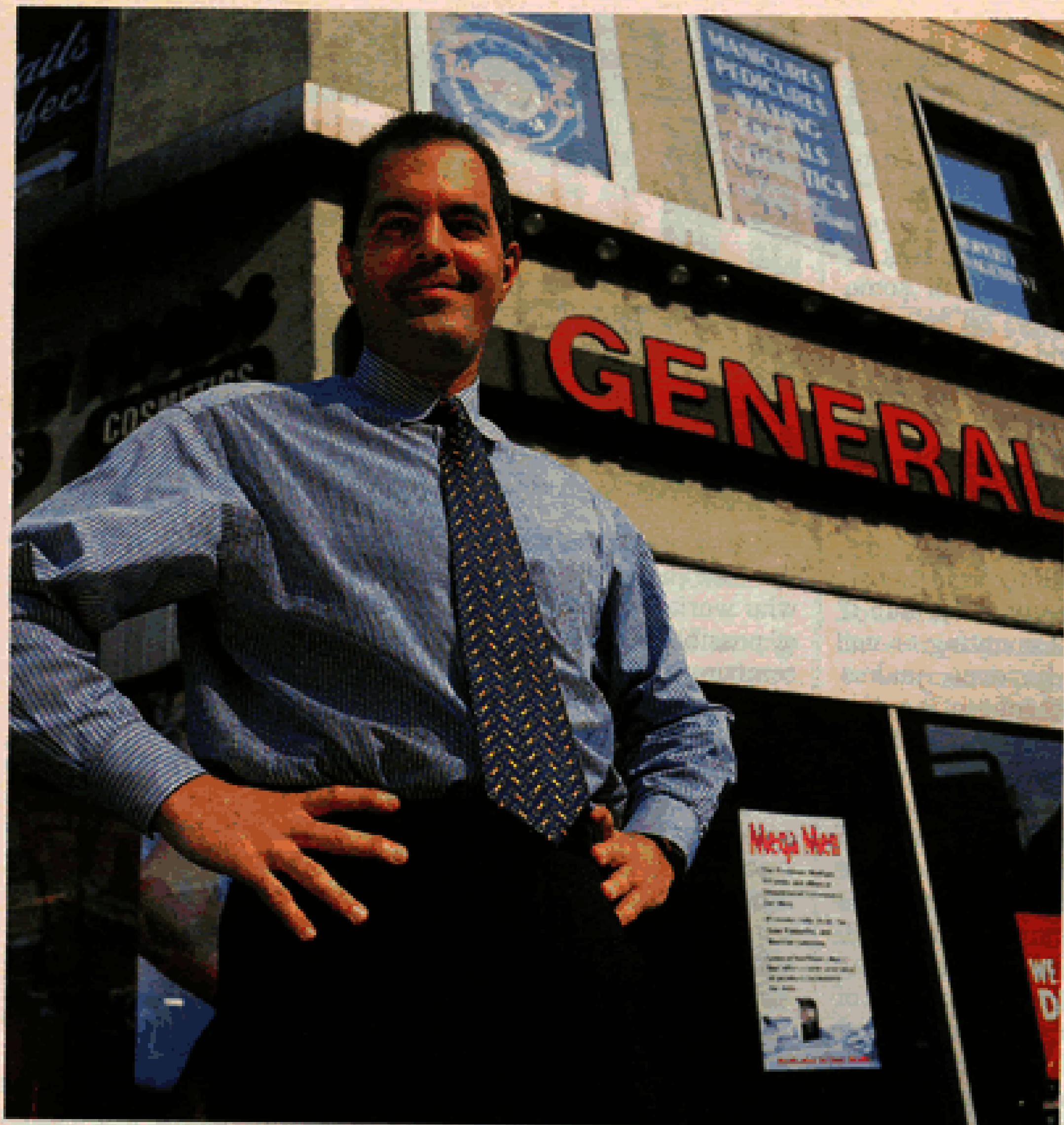
A short-seller sells shares that are borrowed, either from an institutional investor or—more perilously—from a retail brokerage. Shares in any margin account can be borrowed if they haven't been fully paid for. The short

THE MARKET-FORCES SQUEEZE

In the most typical short squeeze, market forces or favorable news drive up share prices. If prices move up sharply, shorts must immediately put up more collateral—or return the shares.

THE INSTITUTIONAL SQUE

Institutional shareholde —mutual funds and pension funds—who lo



calls"—his short picks—"and that is something you don't see much of nowadays." At least, not among short-sellers.

A native of Cuba who came to the U.S. with his family in 1962, the 41-year-old Asensio began trading while he was a student at Harvard University in the early 1980s. After stints as a venture-capital dealmaker and an investment banker at Bear Stearns & Co., he went into business for himself. Asensio manages about $100 million, mostly for wealthy clients. It's a small operation—just analysts aside from Asensio, all sq into a cramped suite of offices i town Manhattan. "I never subor my own judgment or fact-finding, Asensio. Not surprisingly, he rou puts in 14-hour days and hasn't t vacation since February—of 1993.

DETAILS, DETAILS. Although his e of the limelight sets him apart fro shorts—he even issues press relea nouncing his short picks—as an a Asensio hews strictly to the exha detail-oriented approach that is the sellers' stock in trade. A good exa his short sale of General Nutritio shares last January. Red flags we tering: a high price-earnings ratio, by corporate insiders, and oversatu of the health-food market. "I saw ing but bad news in the future. were problems with the vitamin m insiders were bailing out, same-stor were weak. What more can you Asensio reca

There was Asensio got of an upc study on the fits of "a dants" suc beta carote nutritional s ment that is ly promote GNC stores. He began by calling secretaries and recepti at hospitals where the study had been taking place. "I flavor of what was going on, a smell," Asensio recall liked the odor. On the day of the release of the study, cast doubt on the efficacy of beta-carotene supplen Asensio hired a lawyer to get hold of it the instant i available in Washington. Not a messenger service? "No I use the A-Team," says Asensio.

Asensio shorted the stock—and iss press release dumping on the com Nothing happened. "Their defense that beta carotene was only a smal centage of their sales," says Asensio. I said at the time: 'The problem is traffic, stupid!' People come into the for antioxidants." Eventually, GNC nounced that same-store sales we the wane, and the shares fell. GNC which traded at 23 in early Janua now at 14. (A spokesman declined to ment on Asensio but says GNC "firml lieves our business strategy is in and working.")

Nowadays, Asensio's No. 1 stock company that he despises—and the fe is mutual. It is Diana Corp., a Milwa company that is in the process of

OPEN HAND

Like his peers, Asensio does exhaustive research—but he's far from secretive

THE ACCOUNT SWITCH

If shareholders move shares from margin to cash accounts, shorts must return any shares borrowed from the margin account.

THE HYPE SQUEEZE

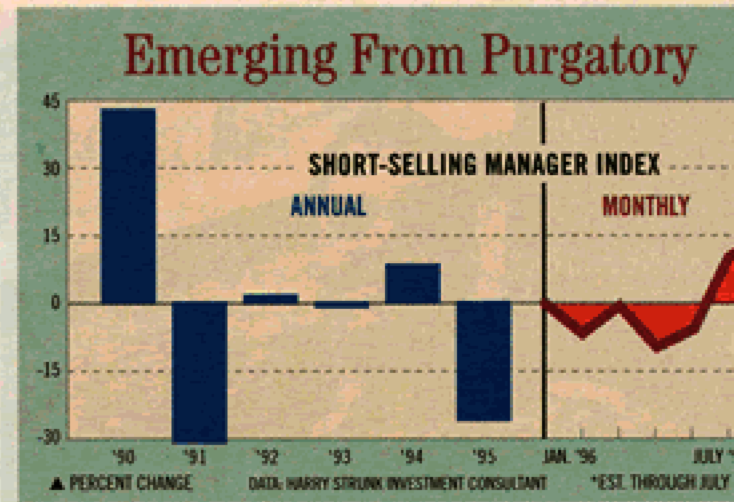
Common among thinly traded shares. The company, or stock promoters

THE BUY-IN

When shorts must return borrowed stock, the shares must be bought on the open market. Thus, short-sellers can sustain huge losses if prices have risen—and since their purchases drive company," fumes Diana Chief Executive Richard Y. Fisher.

Asensio has shared his views with the message boards of America Online Inc., where they are welcomed. But Wall Street is another matter. Asensio and other shorts complain that brokerage analysts and fund managers have a uniformly hostile attitude and are loath to even return their calls. "I would love for someone to call me and tell me that a stock that I own is a piece of s—," says Asensio. "But I'll talk to some pension-fund manager who owns $4 million of some stock, which he bought with employee money. I'll tell him something is wrong with the company—and he gets emotional! It is ridiculous. It is irresponsible." Another short says he attempted to bring accounting irregularities to the attention of a company's auditors and found that his calls were not returned. "I wound up faxing them," says the short. The accounting allegations were eventually acknowledged and corrected by the company.

The whistle-blowing element of short-selling is a sensitive subject. Short-sellers don't like to trumpet it, but if they feel that a company is using improper accounting or not making adequate public disclosures, they have no qualms about contacting the companies' auditors, the exchanges, the SEC, and lawyers seeking to bring class actions on behalf of disgruntled investors. And then there's the financial press. "I like talking to the press. We're like investigative reporters ourselves," says one short. Another short-seller keeps a small stack of articles from financial publications in which he was a source—all exposing fraudulent and shady companies that ripped off thousands of shareholders. Indeed, many prominent financial frauds of recent years were targeted by short-sellers long before they were picked up by regulators and the press. Shorts exposed the troubles besetting WellCare Management Group Inc. and Future Healthcare Inc. in recent months.



The saga of WellCare, a Kingston (N. Y.) HMO, epitom the role shorts play as whistle-blowers. "We talked to do who worked for the company," one short recalls. When of possible accounting improprieties surfaced last March company pointed the finger at "untruths circulating a mors" coinciding with a "buildup of a substantial short tion in WellCare's stock."

For a while, the company hanged tough, hiring a pr investigative firm, Kroll Associates Inc., to look into the mouthing of the company. But the shorts were on the track. Two months later, WellCare restated its previ reported 1995 earnings—slashing them by 80%. A spoke admits that "some of the issues [short-sellers] raised some accuracy" but that others were "overstated."

WellCare was a smashing victory for the shorts, as SyQuest Technology Inc., a disk-drive maker that ha tracted shorts because of its propensity to consume cash ten a tip-off of financial woes. The shares have fallen from a takeover-fed high of $17 in May. (SyQuest won't ment on the shorting of its stock.) Aggressive accou

THE 'BAD BOYS' OF CHICAGO ARBITRAGE

When Chicago Stock Exchange officials showed up at the trading firm Scattered Corp. for a routine audit two years ago, principal Leon A. Greenblatt was ready. He answered the door with a toy dart gun sticking out of his pocket, a pool cue in his hand, and a shot of Jack Daniels splashed on his face. Ushering his guests into a room without a table, he handed over the firm's records 10 pages at a time. These days, the auditors ask Greenblatt to send his books across the street to their offices.

No, the Chicago Stock Exchange doesn't like Leon Greenblatt—something that brought down upon him the kind of regulatory wrath—a $6 million fine—that is usually reserved for insider traders and penny-stock peddlers. Greenblatt provoked the Chicago exchange's ire during an audacious arbitrage play on the shares of bankrupt steelmaker LTV Corp. Greenblatt sold more LTV stock than actually existed, replacing it with cheap warrants—and reaping a $27 million profit in 22 trading days. So far, he has gotten away with it—and won a little-noted legal victory in the ongoing war between longs and shorts.

Scattered principals Greenblatt, Andrew Jahelka, and Richard O.

A judge said the partners may be "gamblers" and "sharpies," yet he upheld their

spirit of the rules," wrote Appellate Judge Richard A. Posner, one of the federal judiciary's leading economic thinkers, in a February, 1995, ruling. Posner noted that Scattered's trading in LTV helped bring together the price of the stock and its underlying value, thereby playing a valuable role in the marketplace. Thus, the firm furthered—not violated—the objectives of securities law, the judge concluded, up-

EL L. ABRAMSON, CHART BY RAY VELLA/BW

and stock sales by corporate officers are other red flags. Recently, shorts have zeroed in on Lone Star Steakhouse & Saloon and Landry's Seafood Restaurants, as well as two manufacturers of sunglasses—Oakley and Sunglass Hut Trading—because of high insider selling. Sunglass Hut Corp. CEO Jack B. Chadsey says his recent stock sale still leaves him with a large stake in the company and does not reflect any lack of confidence in the company.

EXPERT OVERSIGHT? Specialized expertise is another area where shorts can bring powerful resources to bear. One short-seller, who has a physician on staff, is shorting Oxigene Inc., a New York pharmaceutical company. The physician-analyst studied a company-sponsored clinical study of its flagship product, an anticancer medication, and found it offered scant evidence that the product is effective. As is often the case, however, the company has a dramatically different point of view. Ronald Pero, Oxigene's chief scientific officer, says the shorts are dead wrong and that the study offers evidence of the drug's efficacy.

Right or wrong, research like this is often shared among shorts, which gives rise to the not unjustified view that there are "rings" of short-sellers. Actually, "rings" may be a bit pejorative, since institutional investors—and brokerages, of course—are similarly ready to share stock picks. But there's a darker side to short-selling that has recently gained attention in the wake of the failure last year of Hanover Sterling, a penny-stock broker, and the subsequent failure of Adler Coleman, the clearing firm that executed Hanover's trades. Trustee Mishkin found that Hanover and Adler were driven out of business by short-sellers. The shorts, in response, accuse Mishkin of enacting a short squeeze that deliberately gave them losses. The two sides are slugging it out in court.

Mishkin maintains that what happened to Adler Coleman is the tip of the iceberg. He recently stated in court documents that one of the shorts allegedly involved in the Adler Coleman failure, Fiero Brothers, went on to target Solv-Ex.

Many financial frauds of late were targeted by shorts well before regulators spotted them

That is denied b Fiero, the head of t who notes that he l bought and sold sho Ex shares. "I'm a not a short-seller Fiero.

If the bankrupt determines that Adl man was driven out ness by the shorts, be a rare legal vic the "longs." In or mark case involvin selling by Scattere a Chicago stock- firm, Scattered won a ringing victory (box). Moreove are often the victims of manipulation in short s Squeezes have become commonplace in recent mon have only abated during the recent market setback.

A squeeze can be quite benign—perhaps a bull putting pressure on short-sellers. But it can also be erate effort to put shorts under pressure and push u by forcing shorts to buy back their shares. To bet on price decline, short-sellers must sell stocks that they There are two sources of stock loans: institutions a kerage accounts. Institutions lend shares for a small f ally just one-quarter of 1% of the value of the shares. are permitted to lend shares from their own accounts a customers' margin accounts that have not been fully

But shares available for short-selling are growing ingly scarce—particularly for the NASDAQ issues t most popular with short-sellers. One brokerage ex who requested anonymity, notes that institutions creasingly chary about lending shares to shorts. The that shorts must borrow stock from retail brokerages,

TRICK SHOTS Greenblatt (left) and Nichols cover all the angles

sues involved.

Sentiment still runs hot against the likes of Scattered—and no wonder. Greenblatt flaunts a bad-boy image even as he continues to profit from bankruptcy arbitrage. "He plays it fast and loose, and the people who are the most pissed off are the old-timers who don't understand the game," says one exchange member.

Greenblatt makes a fetish of secrecy, providing only sketchy details of his arbitrage strategies. In a typical trade, Scattered sells the stock of a company about to emerge from bankruptcy while buying newly issued shares or warrants that replace the old stock. If the old

entitling them to purchase some of new stock at a price of about 3.2¢ share. Even after the plan was con firmed, the old stock traded at an a age of 18¢. Since the warrants grea outnumbered the existing shares, S tered kept selling stock and buying warrants until it had sold 180 milli shares—58 million more than existe

BLIND BANDWAGON. Speculators app ently were betting that the stock w rise just before its terminal plunge. Others simply didn't understand or vestigate the planned fate of the ol shares. Certainly, the facts were no cret: LTV repeatedly warned that it stock price was unsustainable.

Greenblatt relies on a creative int pretation of the rules. He claims, for stance, that as a market maker perf ing arbitrage, his firm is exempt fro the rule requiring short-sellers to se up within several days. Asked how

There are certainly cases of excess. Just ask Organogenesis or Adler Coleman's bankruptcy trustee

themselves open to short squeezes involving customers demanding delivery of their certificates.

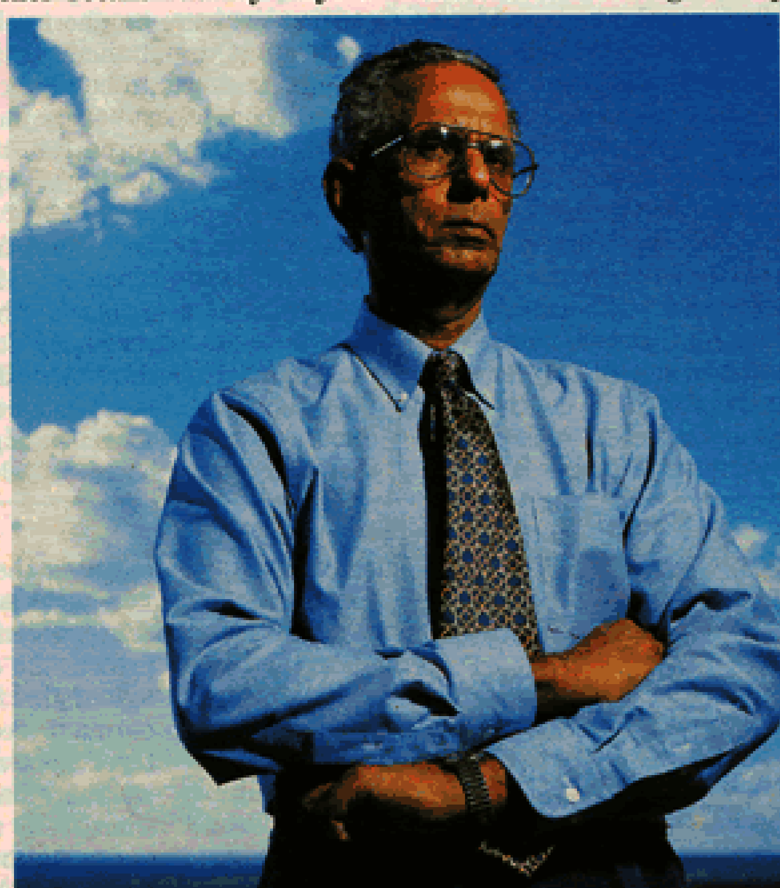
A vivid—and unusually blatant—example of a short squeeze took place with Solv-Ex. On Feb. 5, after the stock fell 30% in a matter of days, the company faxed to brokers and shareholders a "Notice to Shareholders." "To help you control the value of your investment on a steady basis," the notice read, "we suggest that you request delivery of the Solv-Ex certificates from your broker as soon as possible."

Cover Story

It worked. Solv-Ex shares began climbing again, approaching the old highs by Feb. 21. "I was bought in at around that time," one short-seller recalls ruefully. Says a stock-loan official at a major brokerage firm: "Very few short-sellers know the mechanics of short-selling. What they don't understand is that when a stock is not available from institutional sources and comes from the Street, they can get squeezed." The risks are magnified, he says, if the source of the stock loan is a brokerage that makes a practice of squeezing shorts.

LOOPHOLES. Short squeezes are not a problem for one of the most lucrative, little-noted, and troublesome forms of short-selling—shorting of private-issue stock sold abroad under Regulation S of the securities laws. According to short-sellers and regulators, who are looking into beefed-up regulation of Regulation S stock, such short sales are carried out by favored foreign investors—or sometimes, illegally, by corporate insiders. No matter who carries them out, however, the deals are invariably extremely lucrative.

When used to raise capital for small companies, Regulation S stock is usually sold at a discount to the prevailing market price. The stock may not be sold in the U.S. for at least 40 days. The existence of such offerings is often considered a red flag by shorts because of the dilutive effect of the stock when it is eventually sold in the U.S.—and because they show that the company may be having trouble raising capital. Shorts insist that insiders sometimes buy such cut-rate stock through foreign shell corporations and then sell short in the U.S. market—locking in the profit between the dis-



UNDER ATTACK
Solv-Ex CEO Rendall hired Kroll Associates to investigate short-sellers' activities

profits. Solv-Ex, which has made heavy use of offsho
ferings, recently disclosed that the Curacao-based GF
vantage Fund bought 530,000 cut-rate shares in a Regu
S offering and then sold short in the U.S. a half-m
shares—one-quarter of Solv-Ex' short interest—lockin
profit that probably exceeded $2 a share, or $1 million
filing says the short sale was conducted "to hedge
downside market exposure at the time.") GFL was still
as of early July—in the midst of Solv-Ex' campaign a
the shorts.

FOREIGN PRESSURE. The offshore shares have been
tered for sale in the U.S., where they will further dilu
equity of Solv-Ex' hard-pressed shareholders. So So
executives seem to be right. Short-selling is hurtin
shareholders—though the problem is from Solv-Ex'
seas friends and not
home-grown short-sellers

But what about the
shorts in Solv-Ex—the
who are betting that it's
air balloon? Are they righ
is the company correct
view that shorts are a
block on the path to oil-
immortality? Ultimately
markets—both the oil and
markets—will answer
question. But so far, th
look for Solv-Ex is not so
because the shorts are p
hardball. Somehow, a sho
er obtained a company
sored engineering repor
"project financing study
had them evaluated by
gineering firm of his ow
short-seller's study co
that the Solv-Ex process
"particularly unique, no
it appear to be capable o
effectively protected by
sive comprehensive pat
nor is it particularly di
from competing oil-extraction methods. Th
uation goes on to estimate that the project,
capacity, will yield a $10.5 million annual lo
the $24.7 million profit projected by the co
CEO Rendall strongly disputes the study a
commissioned Kroll Associates, the priva
vestigative firm that worked for WellCa
probe the short-sellers' activities.

That's the way it is in the world of sho
ing: charge and countercharge, study vs.
The shorts can be nasty at times. But th
cesses are like a drop of ink in the ocean—an ocean
Street hype. For the first time in this bull market, sho
ers are finally beginning to see the playing field tip, jus