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Short sellers sharply scrutinize companies



By Todd Pitt, 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

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.

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"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

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Disgruntled companies, some regulators question tactics

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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. 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.

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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.

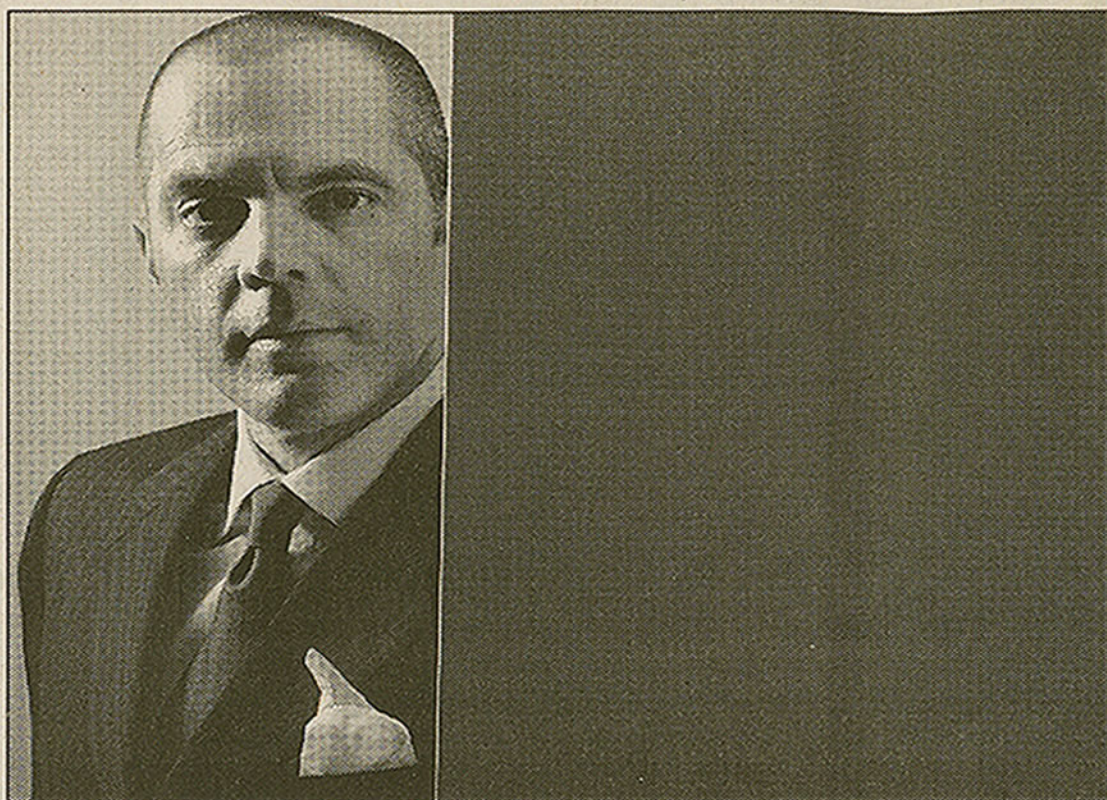
"Regulators need to be very careful when it comes to limiting short selling," says Peter Hecht, assistant professor of finance at the Harvard Business School. "It is hard to imagine financial markets producing prices that reflect fundamental values if the bears are systematically forced to sit on the 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-shortening 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
Winstar Communications	March 8, 2001	\$23.31
Diana Corp.	June 4, 1996	\$100.00
Solv-Ex	Oct. 7, 1996	\$19.50
Computer Learning Centers	March 19, 1998	\$30.25
Syquest	May 24, 1996	\$18.88

1 - Estimate; Source: Asensio