FOOL ON THE HILL
An Investment Opinion
by Louis Corrigan

Asensio, Dreyfus, and Color Chromatics

Investors leery of short-selling must still recognize its entertainment value, at least when Manuel Asensio is involved. Asensio & Co. is an institutional money management firm based in New York City that's developed a following over the last few years after making a number of bold public calls on crappy companies trading at ridiculous valuations. He's the guy who issued a "strong sell" recommendation, which CNBC's Joe Kernan read verbatim on the air, when removable drive maker **SyQuest Technology** (Nasdaq: SYQT) unaccountably -- and briefly -- shot up to $18 in May of 1996.

With other major league disasters like the bankrupt Solv-Ex and the former Diana Corp. on his resume, Asensio deserves attention. He's also noisy enough that he eventually gets it. Of course, he's also frequently wrong on certain details of the stories he tells. And until recently, his reports, which are usually posted to his website (www.asensio.com), have suffered from grammatical deficiencies that hardly inspire confidence. While he may be righting investment wrongs (albeit for his own profit), he seems more hatchet man than superman -- unless you consider it superhero material to dare corporations to sue you for libel. Still, Asensio has often been spectacularly correct on the big picture. He also has a compelling talent for giving a story a certain maudlin yet predictable drama akin to that seen in soap operas and professional wrestling.

Asensio's latest targets are **Color Chromatic Sciences International** (Nasdaq: CCSI), a small company that's developed an FDA-approved non-invasive device that helps monitor jaundice in newborns, and the money manager of two Dreyfus mutual funds that have been among Color Chromatics' major shareholders. The assault began Monday June 8 when Asensio issued the first of several "strong sell" reports on Color Chromatics arguing that the firm has "no material sales or earnings potential" and that "the shares will soon trade below $1.00 per share." Indeed, Asensio has charged that the company is "nothing but a vehicle used by certain individuals to defraud investors," adding that its principal business is "distributing false information." The stock had closed the previous Friday at $10 3/4, having fallen from a late May high of $17, partly on rumors that Asensio would issue a report. The stock closed that Monday at $8 13/16 and then hit an intraday low of $4 1/2 the next day.

What has attracted heightened media attention is Asensio's charge that Dreyfus fund manager Michael L. Schonberg has actively participated in this alleged fraud for personal gain. Schonberg was lead portfolio manager of the Dreyfus Aggressive Growth Fund and the Dreyfus Premier Aggressive Growth Fund from August 1995 to April of this year, when Dreyfus replaced him with Paul LaRocco. A unit of **Mellon Bank** (NYSE: MEL), Dreyfus is a respected name in money management, overseeing more than $100 billion in assets in its numerous funds. Yet the Schonberg-managed funds have both lost money over the last 2 1/2 years, with the Premier Aggressive fund down 2.4% in '96, 13% last year, and around 16% this year. While small-cap funds have generally trailed the market indexes in recent years, few have done quite so poorly.

Fewer still have placed such heavy bets on companies favored by short-sellers. As of last December, for example, Schonberg held over a million shares of **Ultrafem** (Nasdaq: UFEM), whose lead product is a novel plastic tampon designed to cap the cervix and collect rather than absorb menstrual blood. Schonberg had even praised the stock in *Business Week's* "Inside Wall Street" column in January 1997. Yet poor sales and bitter disputes among top executives have since landed Ultrafem in bankruptcy. After trading as high as $36 a share in mid 1996, its stock is now worthless.

Schonberg's funds also held as much as 1.45 million shares of **Macrochem** (Nasdaq: MCHM), whose lead product is a gel designed to treat male impotence. Early findings showed that nearly all patients using the gel experienced some degree of skin irritation, though the company says the problem is resolved if the gel is applied properly. The *Wall Street Journal's* "Heard on the Street" column for May 5 discussed why the company is a favorite of short-sellers. Asensio also claims that Schonberg's funds owned 500,000 shares of **Systems of Excellence** (formerly Nasdaq: SEXI), the single best example thus far of an Internet stock promotion and one that has led several of the participants to plead guilty to felony charges.

Business Week has reported that Schonberg bought 20,000 shares of Color Chromatics at $2.50 each for his personal account before joining Dreyfus. At Dreyfus, he loaded up on the company's stock, with data from December showing it was the number one holding of the Aggressive Growth fund (7.8% of the fund's assets). Between both funds, Dreyfus owned nearly two million shares of the stock, or about 13.5% of the company.

Asensio has argued that Schonberg helped drive up the value of his personal holdings by buying Color Chromatics stock for his funds. Moreover, in arguing that "even the most novice analyst can readily recognize that the company has no intrinsic value," Asensio has claimed that Schonberg, a chartered financial analyst, is essentially too smart to invest in Color Chromatics without being part of the alleged stock rig. In turn, he charges that Dreyfus has "failed to provide forthright disclosures or restitution plans for investors who lost money in this scheme."

Schonberg himself has not commented on the matter, though it's been reported that he still owns the 20,000 shares. Dreyfus spokesperson Patrice Kozlowski has said that Schonberg complied with the firm's disclosure policies. "[B]ased on our knowledge to date, we believe these allegations are totally baseless." Nonetheless, Dreyfus says it is conducting its own internal review.

For its part, Color Chromatics has come out swinging. On June 9, the firm issued a statement denouncing Asensio's reports as full of false allegations and misrepresentations. It said it has contacted the SEC and is exploring possible legal action. Two days later, it issued a more detailed rebuttal of Asensio's report, with extensive point-by-point commentary from Dr. Jeffrey Maisels, Chairman of the Department of Pediatrics at William Beaumont Hospital, and Dr. Ian Holzman, Chief of Newborn Medicine at Mt. Sinai Hospital and lead investigator of the trials that tested the firm's Colormate III bilirubin measurement device.

The rebuttal rejected Asensio's claim that there is a limited market for such bilirubin tests, arguing that some 90% of the world's 132 million babies born each year would be "potential subjects" and 16 million tests are conducted each year in the U.S. Furthermore, Maisel said Asensio's claim that the Colormate III clinical trial only compared bilirubin measurement performance to those of a physician's visual assessment of a newborn's coloring was "patently false." Though the FDA approved the device last summer, the company has thus far sold no products nor even established manufacturing facilities. Nonetheless, management says it's now in "late-stage negotiations" for a global distribution deal after receiving proposals from "a number of large international medical companies," many of which included manufacturing arrangements.

The stock has now stabilized around $7 a share. Still, it's interesting that Color Chromatics has not disputed Asensio's June 12 outline of its history of private stock placements. He claims that starting in 1994, the company retained the small New York investment firm Janssen-Meyers to raise a net total of $3.3 million for Color Chromatics by selling 2.7 million shares (half as much as were then outstanding) at up to 50% below the market price. Meanwhile, Asensio says that Janssen-Meyers pocketed a huge chunk of the $1.3 million in expenses to do the deals plus 2.7 million warrants that could be converted into common stock at $1.67 per share.

TheStreet.com has reported that Schonberg participated in several such private placements conducted by Janssen-Meyers and other smaller investment firms. Janssen-Meyers is run by Peter Janssen and Bruce Meyers, former employees of D.H. Blair, a firm that's been a repeat target of regulators. Janssen was himself once fined and temporarily suspended for falsifying account information.

Given this backdrop, Asensio's charges seem at least plausible. He argues that Janssen-Meyers controlled half of Color Chromatics' fully diluted shares (including the warrants). That allegedly allowed the firm to manipulate trading in the stock. In turn, Asensio sees Schonberg as an accomplice in this conspiracy. Regardless of whether these allegations prove true or simply a good story, they don't necessarily validate Asensio's claims about the Colormate III device. Development stage biomedical firms are often desperate for cash and sometimes they seem willing to do deals with the devil if need be. Nonetheless, that sort of corporate history should inspire deep skepticism. As always, it will be interesting to see how Asensio's latest short story plays out.