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Sold Short

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SOLD SHORT: Uncovering Deception in the Markets
By Manuel Asensio
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Reviewed by Christopher "cwmayer" Mayer

"A bum stock is like a straying partner: You may not want to hear about it, but you need to know." - Manuel Asensio

Manuel Asensio is every investor's best friend. Asensio has uncovered a number of frauds and deceptions since issuing his first strong sell and short sell recommendation on General Nutrition Corporation in 1996. As the founder of Asensio & Company, he is well known for his activities on the short side.

In Sold Short, his first book, Asensio takes readers on a detailed tour of many of his high-stakes battles with stock promoters. In the process, individual investors can absorb and learn from the many lessons embedded in Asensio's gripping stories.

A self-described "bottom-up investor" who is both cautious and deliberate, Asenio doesn't purchase stocks based on uncontrollable and unreliable market trends. Instead he depends on intense fundamental research. Asensio doesn't rely on relative valuation techniques and purchases, but rather only invests in stocks "that are reasonably priced, based on reasonable multiples of conservatively projected growth and earnings."

But when the bull market matured a few years ago, Asensio found that there were fewer and fewer opportunities in the elusive value stocks he sought. Instead, he found many companies that were overvalued.

The Anatomy of a Stock Promotion

Through research, Asenio discovered companies that owed their entire valuation to the dissemination of misleading information. He labels these companies "stock promotions":

"A stock promotion is a stock whose price is not based on fundamentals -- on the company's actual sales and profits and an assessment of the future potential of its business -- but solely on the ability of its promoters to conjure up schemes to sell its shares."

It is these companies that become the target of Asensio's short selling campaigns.

Most of Sold Short chronicles Asensio's tussles with companies such as General Nutrition Corporation, Diana Corporation and Solv-Ex. He gives you the blow-by-blow account of battles often fought in press releases, in newspapers, and sometimes in the courts. In these stories, it is amazing to see how hard these promoters fight to keep the farce alive, even in the face of intense scrutiny.

It is also quite remarkable to see well-known, respectable Wall Street investment houses supporting these promotions, to see regulators fail to enforce rules and to see investors continue to bid up stocks that clearly have little of value to offer.

"A stock promotion is like a disease . . there are typical symptoms that let you know the patient is unwell," Asensio writes. Some of these symptoms include selling new shares of stock on an ongoing basis, when insiders are able to buy these shares directly from the company at below-market prices. Often times, Asensio cautions, these increases in shares outstanding coincide with misleading press releases. The newly minted shares are then registered with the SEC so insiders can sell them without further disclosure.

Another warning sign: The only analysts "covering" the stock are the market maker, the IPO underwriter, or co-underwriter and other compensated individuals. All of these analysts will recommend that the stock is a strong buy even in the face of bad news.

The Technology Knowledge Gap

And beware the "Technology Knowledge Gap," where investors with no special knowledge or background in a complicated field are forced to rely on statements by management and the opinions of the investment community in helping form their own judgments regarding the value of a company's technology.

While there are grassroots people -- engineers and salespeople, for example -- who fully understand the strengths and weaknesses of a product, management may or may not know these weaknesses and it is their point of view that is delivered to the investment community:

"The gap between the grassroots workers and the Wall Street analysts, and the gap between the time required to learn a new thing and the time Wall Street devotes to research versus sales creates the space where short sellers operate: The Technology Knowledge Gap."

The existence of this Gap should give pause to any investor ready to commit funds to speculative, development-stage companies or to companies that fall far beyond the investor's circle of competence. The basic lesson of humility in these matters might save investors from falling for a hot new technology or drug that in fact turns out to be something much less.

Master of the Obvious

Asensio writes that he is often "accused of being an astute observer of the obvious." A perusal of a company's 10-K, filed with the SEC and easily obtainable for free on the Internet, for example, can reveal an awful lot about a company and alert the investor that something may be amiss.

For instance, Diana Corporation claimed to design a new telephone switch that would revolutionize the data switching capabilities of Internet Service Providers and cut costs. Dubbed "DataNet," the company heavily promoted the device. By perusing the company's 10-K, investors would have found that Diana corporation received 80% of its revenue from the distribution of meat and seafood. They would also have found that the company spent only $124,000 developing this new "revolutionary" switch. Both of these facts should have alerted investors that something was not quite right with Diana. Yet, investors poured into the stock, pushing the market cap of this puff company to a nearly $600 million peak.

For the most part, Asensio relies on research that is beyond the pale for individual investors. He finds information from employees, competitors, just about anybody who might in some way know something about the company he is targeting. In the Solv-Ex case, for example, an eyewitness reported back to Asensio that trucks were leaving the plant empty (he observed the height of the trucks as they arrived and departed the plant, and noted that the trucks rode much higher when they were leaving).

Asensio Today

Asensio is still in action today. He publishes reports on his web page, www.asensio.com, where they are available for free for investors to read.

It is often true in the field of investments, as it is in other subjects, that people will often believe what they want to believe rather than what is. "Semper vult mundus decipi: decipietur," said the Swedish chancellor Oxenstierna: "The world always wishes to be deceived: let it be deceived."

Fortunately for investors, Asensio is working to fight that deception and making a bundle in the process.