

Shorts

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Stimson & Co (NASDAQ: stmsn) was in trouble. The mid-sized investment bank had exposure to bonds of Greece, Ireland, Italy, Portugal and Spain, all countries in financial difficulty whose debt instruments had plunged in value. Stimson had announced to the market that its exposure was minimal and its safety assured, but rumors were sweeping trading rooms that Stimson was about to go under. A bond analysis firm had put Stimson on a watch list and refused to change its rating even after Stimson's CEO met with them.

Stimson's CEO was bedeviled by the Street buzz. Stimson, according to the anonymous whisperers, was overloaded with troubled sovereign debt. There was a mass exodus of prime brokerage clients who would no longer do business with the company. There was an undisclosed major loss at a partnership. It wasn't able to fund its inventory of securities. The firm was unable to raise capital. Stimson had not handled its relationship well with another mid-sized investment bank that had gone under because of its overload of sovereign debt. The firm's next quarter would be a disaster in earnings.

The CEO was sure the rumors were coming from shorts betting against the price of the company's stock, but he couldn't find them and he couldn't meet them head on. Instead each day his traders were picking up comments from other firms that showed a profound worry about the future of the company. No one had refused to trade with Stimson yet, but if the cacophony of rumor became louder, the CEO knew that it could happen at any time.

The CEO worked with the communications director to draft a public statement. The statement said the company was in good shape, that its exposure to sovereign debt was not high and that it had capital adequacy to fund its operations. The communications director issued the statement on a Monday. On Tuesday, there was a huge sell-off of the company's stock, which was down 20 percent. Feedback to the CEO from his traders was that no one believed him. After all the other company that had gone under, ZX Global, had maintained until the day it had gone bankrupt that it was in good shape. The CEO of ZX, who had subsequently resigned, blamed the Street for giving up on the firm and refusing to fund or trade with it. The CEO had less to say about \$1 billion missing from customer's accounts when the company's hedge in sovereign debt had gone belly-up.

Stimson had no such problems, but it didn't matter. Fear was driving the Street and shorts were taking advantage. After the failure of the statement, the CEO met with his executives on Wednesday and went over the problem. He concluded that transparency was the only way that the rumors were going to be

controlled. He ordered that the CUSIP number, the unique identifier for every security, be listed on the internet for the bonds of every country along with the position in that country and maturity. This took until Friday.

Still the rumors didn't stop and the ratings company released a second public statement that Stimson was not getting off the watch list. The stock dropped the following Monday by another 15 percent, and traders were continuing to pick up expressions of concern. The CEO was angry but resigned. He ordered that the total gross exposure to Greece, Ireland, Italy, Portugal and Spain be reduced by 50 percent from Stimson's inventory. His traders finished the sell-off by Wednesday. The CEO drafted a second statement announcing the reduced exposure and had the corporate communications director put it on BusinessWire immediately. Stimson's stock recovered 10 percent quickly and held for the rest of the day. On Thursday, the stock began to waver and decline steadily. A new rumor was sweeping the Street. Stimson hadn't reduced its inventory of sovereign debt at all but parked it in a subsidiary.

The CEO was furious. He knew this rumor had to come from a short and a public denial would be his credibility against that of an unnamed source. He ordered a further 50 percent reduction in the debt of the five countries. His traders finished the task on Monday. He worked with the communications director to issue a third statement announcing the reduction and that Stimson now had an exposure of only 3.8 percent of shareholders' equity.

The CEO was stunned then when a prominent stock analyst appeared the next morning on CNBC's *Squawk Box* and claimed that sovereign debt of the five countries equaled 77 percent of Stimson's shareholders' equity. This same analyst said Stimson's leverage of 12.9x was too high when Stimson had been operating profitably with a similar leverage for years. The CEO had his secretary get the analyst immediately on the phone. The analyst was hardly apologetic but conceded he had not spoken fully about Stimson because of time constraints on camera. It made little difference. The damage was done, and Stimson's stock lost the 10 percent it had regained.

The CEO felt he had to do something dramatic or shorts and rumors would erode credibility of Stimson to the point of forced failure. He called in the corporate communications director and together they worked on a six-page letter to shareholders. In emotional language, the letter condemned "half-truths, false rumors and lies" being propagated by shorts against the company and then went on point by point to refute each rumor with facts while stating the company's strategic goals, its liquidity and funding model, its capital base, liquid inventory, available financing and more. Stimson released the letter to the Street at the same time it sent it to shareholders.

The letter had an effect. It was widely reported, reprinted and excerpted. Commentators said that it looked like Stimson had finally gotten ahead of the

shorts. Stimson's stock recovered 15 percent but was still well below its yearly high. Stimson's CEO was not ready to quit fighting, however. He knew transparency would have to be the watchword for the firm for the next few months, or until the sovereign funding crisis was past. The question in his mind was how to communicate to the Street and be believed.

He called in the investor relations manager and corporate communications director and asked them what to do.

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Questions for discussion:

1. What would you advise the CEO?
2. How would you go about communicating better to the Street?
3. Is this an investor relations problem, corporate communications problem or both?
4. Should the CEO have been ready for such a short attack after the failure of ZX Global?