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Riding Out a Short-seller Crisis

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Short sellers have been accused of attacking currencies, causing panic selling, crashing stock markets, and creating financial and economic crises. But, like it or not, they are legitimate players in today's financial system. All the other players (governments, regulators, investors, and companies) need to learn to co-exist with them, and, more importantly, strengthen their fundamentals and put in place a planned response strategy to survive the financial tsunami, if attacked.

In recent times, a few Singapore-listed companies have faced short-seller activism, sparked by unfavourable and damaging reports from whistle-blowing investment research firms, all of whom have names with damaging personae: Muddy Waters (obscuring clarity);

Glaucus (probably named after the sea slug, glaucus atlanticus, whose sting can be both painful and dangerous); and Iceberg (treacherously dangerous to shipping vessels).

In November 2012, Olam was the first company to be targeted by Muddy Waters, who asserted that its business model was no longer viable, describing its acquisitions and capital expenditure (capex) as "fatal flaws and fiscal black holes". It essentially questioned Olam's "aggressive" accounting practices, challenging particularly its goodwill and fair value accounting treatment.

Nine months later, Glaucus accused China Minzhong Food Corporation of widespread fraudulent accounting practices and even met up with key media prior to publishing its damaging report. Allegations against China Minzhong included fabricated sales, fictitious purchases from a top supplier, undisclosed interested-person transactions, overstatement of capex to mask fake sales, and the lack of credibility of the company's exceptionally high EBITDA record. In short, Glaucus alleged that the company was guilty of financial impropriety.

In February 2015, Noble Group was accused by then little-known Iceberg of inflating the fair value of its assets by billions of dollars – a charge that Noble rejected. After four damaging Iceberg reports and fuelled by other detractors, the embattled commodity trader is still trying to defend itself, more than a year after it was first fiercely attacked.

Two of them had white knights that came to the rescue. Olam found its safe harbour in Temasek, and China Minzhong came under the protection of its godfather, the Salim Group. Noble, on the other hand, battled Iceberg largely on its own.

What are the lessons we can draw from these three cases?

RESPOND SWIFTLY TO RESTORE CONFIDENCE

When short sellers attack, it is imperative that the company responds speedily and decisively to reduce uncertainties and stabilise the situation. It must proactively reach out and engage stakeholders to clarify, explain, and educate.

The board and management must stand together and be seen to be working cohesively to restore confidence. They must reach out to deny and refute inaccuracies, mitigate negatives, clarify misconceptions, and reiterate positives and strengths. In short, restore confidence as quickly as possible.

Back in 2012, Olam swiftly rejected Muddy Waters' "baseless and unsubstantiated" allegations, and countered the damaging research report with a 45-page point-by-point rebuttal. It went on an aggressive outreach to key stakeholders, including extensive media interviews, shareholder town-hall meetings, and briefings to its bankers, funds, research analysts, and the wider investment community. Finally, with Temasek stepping in as its white knight, the detractors were silenced.

In 2013, following an immediate strongly worded holding statement refuting Glaucus's claims, China Minzhong gathered voluminous documentary evidence from both internal and external stakeholders from across China, and mounted a concerted outreach to stakeholders and key opinion leaders to "silence" the short seller. The company's board, including its independent directors, stood together with the senior management team. They focused on key issues and provided detailed and well-substantiated rebuttals of Glaucus's allegations. Eventually, Indonesia's Salim Group stepped in to make a general offer for the company, and that ended the selling rout.

Meanwhile, Noble is battling Iceberg on its own. Even though it responded swiftly to reject Iceberg's claims and had PwC issue a report reaffirming that there was no wrongdoing, its strong multi-pronged rebuttal campaign to a wide cross-section of stakeholders did not cut much ice with the investment community. Its price tumbled by more than half and its credit rating was downgraded to junk. Now, a year later, it is still dealing with the aftereffects of the damaging reports from Iceberg and other detractors.

FOCUS ON THE FUTURE

In the longer term, any company under siege must proactively and objectively make strategic, structural, financial and operational changes, as required. It cannot attempt to stay on the moral high ground and maintain that there is nothing wrong. Being right does not strengthen the company unless the stakeholders and the public are convinced.

Both Olam and Noble reviewed their growth strategies and adjusted their planned rates of growth. In addition, they strengthened their balance sheets by divesting non-core businesses, reducing gearing, and raising more cash through secondary fundraising.

TAKE CONTROL AND ACT

All three cases highlight the fact that if a company does not take control, others will. Stakeholders will listen to rumours and act on perception instead of facts. Responding too late will put the company on the defensive as it is rocked by the tide of negative public perception, resulting in a loss of control. And, ultimately, having a white knight enter the scene certainly helps a company under attack to reach safe ground more quickly. ■