

## Einhorn, David – Fooling Some of the People All of the Time

*John Wiley & Sons, 2011 2<sup>nd</sup> ed, [Equity Investing]* Grade ★★★★★

Now and then over the last two years the positions of David Einhorn have been a part of the pitch when I meet sell side analysts. Ever since Einhorn publicly presented Lehman as a short case and Lehman subsequently blew up, the founder of Greenlight Capital has been a household name. When Einhorn shorts something the world takes notice. This has not always been the case and this book portrays the uneasy details of Einhorn's earlier feud with a crooked company called Allied.

Allied acted on the edges of the credit bubble, with the same type of irresponsible lending and focus on short term loan volumes as in the MBS-market. The company focused on loans to small businesses. The loans were issued in collaboration with the Small Business Agency. The company used SBAs non-existent oversight to grant financing against all rules. Lax lending attracts crooks like flies are drawn to dung and when the inevitable non-performing loan started to show up, Allied resorted to the usual mix of creative accounting where NPLs were kept at par value, deceitful information and acceleration of loan volumes to cover up the old bad stuff. Gullible retail shareholders were lured by stable and growing dividends propped up by a constant stream of share issues. This was what Greenlight but few others saw and decided to present as their best idea at the 2002 Ira Sohn conference.

The next phase is the most chilling one. Allied was situated in Washington DC and founded by a former FBI-official. The CFO used to work at SEC and the well-connected company contributed generously to various political campaigns. The board contained persons with extensive Washington rolodexes. For Einhorn the short position was one of many portfolio positions. For the management of Allied it was a matter of survival, an attack on their cash cow that threatened to send them to jail. They decided to put up a fight that would last for 6 years. The book turns into something of a Frederick Forsyth story, with shady spin doctors, illegal phone tapping, Allied's recruitments of SEC officers with inside case information and probable bribes. Allied actually managed to get Greenlight indicted instead of the

reverse. Media gratefully retold Allied's story of malicious short sellers instead of digging into the truth. The credit rating agencies and sell side analysts, easily swayed by rating fees and revenues from never ending share issues, saw no problem. At the same time governmental agencies showed minimal interest in investigating Allied even though Greenlight hired a private investigator to be able to hand the government a clear criminal case on a plate. It turned out that SBA aggressively lobbied other agencies against touching Allied as it was instrumental in securing the loan volume goals that the agency had. It was Greenlight against everybody. In the end the truth won out and when the company's shareholders eventually refused yet another share issue the game was over for Allied. Yet, until this day the leading officials of the company haven't been reached by the presumed long arm of the law.

For a finance book written by a portfolio manager this reads more like a crime novel. It's hard to stop reading. However, it's also evident that Einhorn was deeply touched by the attacks from Allied. He has fought for so long to be believed, so he must document everything in detail. This also means that the reader must put up with a rather lengthy description of a catalogue of loans where there was no chance, or even intent, to repay. One of the parts of the book that I appreciated the most was the description of Greenlight's investment philosophy. The fund is a long short value investor driven by fundamental analysis, but instead of starting their search process with companies that appear cheap and then weed out value traps, they start with asking: "where can we trade with less informed or motivated counterparties?". After that they try to work out if there is a long or short case in the located areas.

It's easy to share Einhorn's frustration and chock over how all the parties that was supposed to act like watch dogs failed so miserably. On average I think hedge funds are overcharging their investors but sometimes we should all be glad that someone has the resources to perform real in depth analysis – in this case really, really deep.

Mats Larsson, February 18, 2013