

# INVESTMENT RESEARCH IN THE ERA OF FAKE NEWS

A study of activist short selling and Viceroy Research



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## About this report

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The report has been developed by the Intellidex team and the conclusions it reaches are our professional opinions based primarily on public documents, financial market databases, interviews with sources, and some non-public documents that Intellidex obtained during the course of its research. We provide references to all sources in footnotes and occasionally in the text.

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## Executive summary

- Activist short-selling is a relatively new phenomenon in the South African financial markets. Many market participants are not familiar with the strategies and tactics of short sellers and, as a consequence, how to assess such activities in respect of professionalism and legality.
- Viceroy Research has been a particularly prominent producer of research on short-selling theses in South Africa. Given this backdrop, we have focused on assessing Viceroy's research and methods. Our high-level findings are:
  - Viceroy's research coverage has been varied and prolific. One of the few common features of the coverage universe is that its targets are subject to significant short selling before and after its research is released. This feature means that there is significant demand on the short side for research that might lead to price declines.
  - Viceroy's research varies widely in quality. In one report, on Syrah Resources, there is a detailed and coherent valuation model, analysis of pricing, and comment on other analysts' work, leading to a fairly robust calculation of net present value. In others, it is our view that the reports use lower quality analysis such as comparable price multiples, such as its Steinhoff and ProSieben reports. In some cases the methodology appears to be weak, relying on little more than anecdotes, *ad hominem* attacks on management and no attempt at balanced assessment, for instance Capitec and Advanced Micro Devices.
  - Prior to Viceroy's research report on Steinhoff, its research received little media attention internationally. The Steinhoff report, however, received significant coverage and thereafter there was extensive mention of Viceroy in the media. In the aftermath of shock revelations of accounting irregularities at Steinhoff, there was a desperate need for information which Viceroy was able to fulfil.
  - After the Steinhoff report, rumours of Viceroy research targets alone would move share prices, while actual releases had a dramatic impact on share prices, with Capitec being the clearest example.
  - However, based on our analysis discussed below, we find that Viceroy's Steinhoff report was substantially plagiarised from a report produced by hedge fund Portsea Asset Management six months earlier. Viceroy's contribution of original content to the report appears to be negligible. While the Steinhoff report and related media coverage gave Viceroy considerable influence, in our view this was misplaced given that, according to our research, the Steinhoff report was substantially not its own work. On the contrary, Viceroy's influence benefited from little more than timing, with its report published just two days after the Steinhoff saga hit the news, when the market was extremely eager for any insight on what had gone wrong at Steinhoff.
  - Viceroy's quality of research, which was already patchy, appears to us to have deteriorated after the Steinhoff report, particularly in the case of Capitec and Advanced Micro Devices (AMD), and to some extent ProSieben. We provide our analysis of the quality of these reports further below. Nevertheless, these reports had a significant impact on share prices, particularly Capitec and ProSieben. Our view is that this impact resulted from the influence Viceroy had gained from the widely circulated and cited Steinhoff report, rather than from the content of those reports.
  - We believe that a significant proportion of the content of Viceroy's reports is drawn from other sources, particularly funds and short sellers, which are not disclosed in its reports.

- Viceroy has no formal registration with any financial regulator that we could determine. Viceroy's three principals have a registered company in England, Ganadabi Limited. The purpose of Ganadabi is described as "other publishing", with the three principals listed as directors and shareholders.
- Our research indicates that the founder of Viceroy, Fraser Perring, has a history of dishonesty. In 2014 he was disbarred as a social worker by the Health and Care Professions Council in the UK after a hearing. The hearing found Perring guilty of misconduct, and then dishonesty in attempting to cover up this misconduct.
- The other members of Viceroy are two 24 year-old Australians, one of whom has a background in corporate restructuring, and the other has no known professional background. The three members have limited financial markets experience of no more than a few years each.
- We find that Viceroy is a relative new comer in an ecosystem of several other short sellers and hedge funds which are more established and have tighter regulatory constraints. In our view, the value Viceroy adds to this ecosystem is to generate publicity on companies, and to effectively insource legal risk from others cautious of being seen to publicly disparage companies.
- We cannot determine definitively how Viceroy monetises its work. As an unregistered entity Viceroy would not be able to open accounts with reputable brokers to enable any substantial trading as it purports to do. Its principals may operate trading accounts in their own names.
- However, given the ecosystem Viceroy occupies, and the value it has generated for other members of that ecosystem, we speculate that Viceroy benefits from semi-formal gratuities from other funds and short sellers, a practice that is seen between other members of the ecosystem.
- Given what we regard as the declining quality of Viceroy's reports, and given that, in our view and based on our analysis, the influence Viceroy has in the market is misplaced on plagiarised work, we anticipate its influence will decline.
- In our view, at least some of Viceroy's research does not appear to represent well-founded and genuinely held beliefs of the writers. The purpose of the release of such research reports rather seems to be to manipulate market prices instead of the self-expression of genuinely held beliefs. However, we think it would be difficult to conclude that this amounts to illegal market manipulation as such a finding would turn on intent.
- In the conclusion of our study we set out the implications for regulators, other short selling firms, targeted companies and the media. We note that in some cases, certain media titles have been used as an integral part of Viceroy's release strategy, a function that journalists and editors should be concerned to avoid.
- We sent questions regarding the key findings of this report to Viceroy via email. Viceroy responded and we include its responses in the context of the discussion that follows below.
- We set out the facts to support the above summary findings in this report. This executive summary should not be read in isolation from these facts.

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## SECTION A: BACKGROUND ON SHORT SELLING

### 1. A primer on the ethics and legality of short selling

In this section we provide some introductory comments on the practice of short selling and outline our view on how to categorise different practices between legitimate and illegitimate.

#### 1.1 Background on short selling

- Short selling is a long-practised means of gaining from downward movements in asset prices. The standard model is that a short seller borrows shares from an investor in a company, sells these shares, and then buys them back in future to return the loan. The intention is that the price falls in between the sale and the buy-back, with the difference constituting a profit for the short-selling investor after funding the costs of the transaction.
- Apart from the standard model, many short sellers now use derivatives, which provide similar exposures but are often easier to trade than shares. Most commonly this would be done using futures or options. For example, a put option allows the holder to sell a share at a set price on some future date. If the share price falls dramatically between now and that future date, the put option holder receives the difference between the strike price and the market price on that date. A put option provides a short seller with some protection from an unexpected rise in the share price, because the only downside on the put option is the premium paid for the option. The downside on a short position using shares is theoretically unlimited as share prices can rise until the short seller closes out the position by buying the shares back.
- Short sellers *per se* are economically equivalent to long holders who happen to not own a share. A long-only fund expresses its negative view by excluding a company from its portfolio. The economic effect of a short seller is that it “borrows” the long-holders’ stock and sells it, effectively neutralising the positive view of the long holder. Given the rise of passive index-tracking funds, there are many long investors that do not take any views on stock values and hold the shares as a mechanical consequence of being in the index the fund tracks. The ability to offer these shares out on loan (subject to strict credit risk management) provides an additional income stream. From an overall market perspective, scrip borrowing and short selling can aid price discovery and market efficiency, counteracting some of the inefficiency introduced by passive investing.
- Much like long-only investors, a short seller may hold a portfolio of exposures that over time they anticipate will reprice closer to their view of the intrinsic value of the stock. The common view of market prices is that they converge with intrinsic value in the long run. Investors that believe market prices are out of line with intrinsic value can take an exposure and wait for the correction.

#### 1.2 Activist short selling

- A more recent form of short selling is known as “activist short selling”. Several prominent examples have emerged of this type of strategy, which can be seen as a mirror image of the more common style of activist investing on the long side. One notable example is Bill Ackman, founder of Pershing

Square, which short sold Herbalife. It subsequently campaigned for regulatory action against Herbalife for operating a pyramid scheme, ultimately unsuccessfully<sup>1</sup>.

- On the long side, an activist investor who believes a company is undervalued will accumulate a position and then take an active role in the company's management, for example by voting to appoint board members and campaigning to gain the support of other shareholders.
- Activist short investors aim to identify serious problems with companies that are not widely known and then to inform the market about those problems. Long and short activism are not quite analogous: a long activist intervenes to generate value in a company. An activist long position attempts to exert control whereas an activist short attempts to reveal the nature of value through its research and analysis. An activist short investor distributes *information* about a company that highlights negative aspects of the company that undermines investors' *perception* of value. Nothing fundamental is changed in the company in the same way that a long activist aspires to achieve.
- Negative information on its own is not price moving. Every company has negative and positive aspects and its value is determined by the balance between these. What matters is that the market is (a) unaware of the information and so that information is not priced into the share price and (b) that the information is material to the value of a company. At least, the market needs to *perceive* that the additional information is material and not widely known.
- Activist short sellers therefore aspire to a single outcome: creating a perception in the market that there is new information that is material and negative about the value of a company. In the era of "fake news"<sup>2</sup>, the obvious risk to market integrity is that such perceptions can be created using information that is false or distorted.
- With the explosion of social media over the last decade, perceptions of a company's value can be influenced by social media campaigns. While ideally investment research would be consumed by the market place through detailed reading and understanding of a research thesis and evidence, social media encourages rapid spreading of opinion with little detailed interrogation of underlying research. Just the existence of the investment research and its central claims can spread rapidly on social media, even though the underlying research may be of a poor quality.

### 1.3 Categories of short research quality

Shifting market perceptions can be achieved by releasing research into the market place. In our view, there are legitimate and illegitimate mechanisms for doing so. Part of the assessment of legitimacy is whether or not the research is of an adequate professional quality.

We see three main categories of research quality, as it is produced on the short side:

#### 1. **Category one: Well-founded research.**

Such research complies with professional standards of research. This type of research is objective, thorough and based on well-founded arguments and clear evidence. Such research considers positive and negative aspects of a company's prospects and weighs the different issues. It develops a view of the value of the company based on an assessment of its earnings prospects and/or the value of its assets relative to market prices. It seeks out information from whichever sources it can

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<sup>1</sup> The Herbalife campaign is reported in this New York Times article

<https://www.nytimes.com/2018/02/28/business/dealbook/ackman-herbalife-pershing-square.html>

<sup>2</sup> Fake news generally refers to false information that is made to look like genuine news. It is distributed for propaganda or other purposes.

find, and avoids inside information. The sources of its information are properly referenced and are credible. Any conflicts of interest are properly disclosed.<sup>3</sup>

**2. Category two: Conviction-based research.**

A researcher may have a genuine belief that a company is worth less than its price, though the belief is not well-founded. To support this belief he draws out all available negative information. The information is cherry-picked to support his central thesis, exhibiting confirmation bias<sup>4</sup> in the research approach. Information may be anecdotal and inappropriately used to draw general conclusions. This type of research ignores any positive information while repeatedly emphasising all negative aspects. No risk assessment is conducted, including the risk of surprise upside information. If earnings or balance sheet analysis is undertaken, it tends to be superficial. Rather, sweeping claims are made that the company is overvalued, without specific commitments. Aspersions are cast on the character of management to help drive perception ahead of fact.

**3. Category three: Outright false research**

A researcher may produce a report containing deliberate falsehoods, calculated to damage the targeted company. The facts quoted in the report are either made up or severe distortions. The researcher has no genuine beliefs about the company, but rather clearly intends to damage the reputation of the company and therefore its share price for their own purposes.

The key question that we consider in the rest of this report is which of these categories best fits Viceroy's research? As we argue below, there are different elements in Viceroy's reports. Certain reports – for instance, Neuroderm, Syrah, and Steinhoff – contain some high-quality information, though at least some of this is not Viceroy's own work, (see section 11). These reports have elements of category one, though they also have elements of category two. For example, the Syrah Resources report contains some robust industry demand and market pricing analysis in calculating a net present value for the company, but also contains sections of petty attacks on the character of management and the company's marketing efforts that in our view detract from the professionalism of the report. Post the publication of the Steinhoff report, we believe that Viceroy's reports have more clearly been in category two, verging on category three. As we discuss in section 11, some aspects of these reports consist of outright falsehoods which should have been known to Viceroy. But we will give Viceroy the benefit of the doubt and accept it was motivated more by a category two-type of reasoning. We assume Viceroy believed the companies were overvalued, and cherry-picked research to support this. These beliefs may originate in the ecosystem Viceroy occupies (which we discuss in section 5) rather than being based on Viceroy's own independent research.

#### 1.4 The legality of short-selling reports

The question of legality in most jurisdictions comes down to whether market manipulation has occurred. Manipulation occurs where the intention of some action, including the publishing of research or other statements, is to affect the price of a security rather than to convey a true belief. There are three main

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<sup>3</sup> Several guidelines to professional research standards are set by regulators and professional organisations, including the New York Stock Exchange and the National Association of Securities Dealers. One is the CFA Institute, whose guidelines are available at <https://www.cfainstitute.org/-/media/documents/code/other-codes-standards/read-research-objectivity-standards.ashx>

<sup>4</sup> Confirmation bias refers to a bias in gathering of information such that information is sought that confirms a view rather than casts doubt on it. See <https://www.psychologytoday.com/gb/blog/science-choice/201504/what-is-confirmation-bias>

forms of market manipulation in which the intention is to affect the price rather than to own or not own an asset. These are:

**1. Pump and dump**

A pump and dump scheme is market manipulation undertaken on the long side. A stock is bought, usually an illiquid penny stock where large percentage increases in price can occur with relatively little trade. After a position is taken, false information is circulated in the market that is intended to have a positive impact on the price. For example, a rumour can be spread that the company is being targeted for a takeover. Once the share price responds, the trader can exit for a profit.

**2. Short and distort (also known as trash and cash)**

A short and distort scheme is the inverse of pump and dump. A trader takes a short position in a stock and then spreads false information that is negative and damaging, with the intention of manipulating the price downward to generate a profit.

**3. Stock bashing**

Stock bashing is similar to short and distort except the trader acquires a long position after the share price has been manipulated downward, at the discount achieved by the false and misleading information published. This approach can be used by traders, but also by companies intending to acquire another company. Bashing the stock of the target can help convince shareholders they should sell the stock, or accept a lower price for the company.

Research reports on the short side that fall into either category two (conviction-based research) or three (outright false research) could be used in short and distort or stock bashing market manipulation campaigns.

Given that we believe most of Viceroy's research that we have considered falls into category two, and partly into category three of short research types, it follows that in our view Viceroy's research may amount to the second of these manipulation schemes, namely short and distort. However, the legality or otherwise turns on the question of intent. This is notoriously difficult to determine in any market manipulation case. Indeed, category two implies the researcher has a genuine belief that the company is worth less than the share price, the problem being that this belief is ill-founded, or at least is not properly supported by the research contained in his report. In such cases, the problem is not the intention of the researcher but the quality of the research. The illegality of Viceroy's actions is the subject of the regulatory procedures discussed in section 9, which may lead to definitive conclusions on this question.

## SECTION B: ANALYSIS OF VICEROY

### 2. Origins of Viceroy

- The first report published under the name of Viceroy appeared on 23 December 2016 and dealt with Australian-listed Syrah Resources. At the time of writing this Intellidex report, it has since published reports concerning nine different companies with primary listings in four different countries and operating in several different industries (see table 2 in section 8 for the full list).

- Viceroy was a successor to an earlier short selling entity involving Fraser Perring called Zatarra Research. This had published a report on 24 February 2016 on German infotech company Wirecard. Zatarra ceased operations some time later in 2016. It last commented on Twitter on 2 June 2016.

### 3. Who is Viceroy?

- Viceroy acted anonymously until 17 January 2018 when it went public through an interview with Bloomberg in which it disclosed the identity of its principals<sup>5</sup>. In the interview, Fraser Perring disclosed that the company consisted of himself and two Australians, Gabriel Bernarde and Aidan Lau.
- The Bloomberg interview came after journalists had discovered the name of Gabriel Bernarde in metadata in the PDFs of three research reports published by Viceroy<sup>6</sup>. The metadata had been noticed by journalists at the Australian Financial Review and Moneyweb, a South African news website.
- The journalists approached Bernarde and subsequently Perring on 16 January 2018 with information that they were intending to reveal their identities the next day. Perring pleaded for time, claiming security risks. The Bloomberg interview appeared as though Viceroy was voluntarily coming forward to reveal its identity.
- While operating anonymously, Viceroy had previously claimed to Bloomberg that it consisted of three individuals based in New York<sup>7</sup>. This claim appears to be false. Perring is based in Lincolnshire in the United Kingdom and Lau and Bernarde are based in Melbourne, Australia.
- Subsequent to this revelation, on 6 March 2018, Perring, Lau and Bernarde were named in a defamation action claiming damages by US-based biotechnology company MiMedx, which had been a target of Viceroy's research<sup>8</sup>.
- Ganadabi is cited as a respondent in the MiMedx claim along with the three principals.
- Viceroy Research does not have any formal registration we could identify. The only registered entity is a company registered in England named Ganadabi Limited<sup>9</sup>. This company was incorporated on 29 August 2017 and has not yet filed any financial returns. Its registered address is a virtual office space in Covent Garden in London. Ganadabi describes the nature of its business as "other publishing activities". According to its registration documents, Fraser Perring, Gabriel Bernarde and Aiden Lau are the three directors of the company, and each hold an equity interest of between 25% and 50%. Ganadabi is an anagram of "Aidan Gab". The two Australian members' first names are Aidan and Gabriel.
- We asked Viceroy in an email whether it was registered with any regulators. Its response was:

*Viceroy is governed by the same laws as any other fund operating in our jurisdiction. The South African Standing Committee of Finance has recently expressed a view in a media*

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<sup>5</sup> See Bloomberg article at <https://www.bloomberg.com/news/articles/2018-01-18/short-seller-who-flagged-steinhoff-irregularities-steps-forward>

<sup>6</sup> See Moneyweb article at <https://www.moneyweb.co.za/in-depth/investigations/viceroy-unmasked/>

<sup>7</sup> This was said to Bloomberg. See <https://www.bloomberg.com/news/articles/2018-01-12/faceless-men-upend-south-africa-stocks-on-fears-of-steinhoff-2-0>

<sup>8</sup> Viceroy's research on MiMedx is summarised here: <https://viceroyresearch.org/2018/05/11/viceroy-mimedx-greatest-hits/>

<sup>9</sup> The registration information is available from the UK's Companies House at <https://beta.companieshouse.gov.uk/company/10936624>

*statement that suggests we are free-willed buccaneers who can do as we please. This is not the case. We are beholden to regulators.*

*Of course, we are huge advocates of free speech and whistleblower programs, as we believe they keep companies honest. Viceroy's lawyers have advised we are not required to register for free speech.*

- From the last sentence, this response appears to confirm that it is not registered with any regulator, but claims to be “governed by the same laws as any other fund operating in our jurisdiction” and to be “beholden to regulators”. It is not clear what it means by this. It perhaps means it is governed by the law, just like any other person or entity, and “beholden to regulators” just like any unregistered entity trading in the financial markets is. It is surely not true that it is governed by “the same” laws as other funds, as funds registered in terms of specific legislation, such as that governing mutual funds, would have an additional compliance and legal burden unlike those not registered. Provided Viceroy does not provide any regulated services such as managing the savings of the public, it is not legally required to be registered with any regulator. However, the absence of regulatory oversight and compliance requirements, as for any entity, lessens the faith and confidence the public can place in that entity.

## 4. Background on the three principals

### 1. John Fraser Perring

- Perring is described as the founder of Viceroy<sup>10</sup>.
- Until 2013, Perring worked as a child protection officer for Lincolnshire County Council. In 2013 he was dismissed and later came to a settlement agreement with the council<sup>11</sup>.
- In 2014, Perring was struck off by the Health and Care Professions Council (HCPC) after a hearing into his conduct in the case of a child who was almost separated permanently from its family following failures by Perring in managing the case.
- According to the HCPC investigation into Perring's conduct, he had attempted to hide his failures by falsifying documents and call records.
- The chairwoman of the HCPC panel that investigated his conduct was quoted in the Grimsby Evening Telegraph<sup>12</sup> as saying of Perring: "The established facts and misconduct are very serious involving deliberate, persistent and dishonest conduct to hide mistakes. He has failed to accept responsibility for any of his failings and subsequent dishonest cover-up. The potential consequences for child A were very serious as there was a risk he may have been adopted, thereby severing his family ties, denying him contact with the extended family."
- Perring has attempted to explain his disbaring on Twitter and in some interviews. In certain cases the settlement with his employer has been confused<sup>13</sup> with the decision of the HCPC panel, although they were completely independent processes. Perring chose not to appear before the HCPC panel, despite having been served with details of the hearing, but did make a written submission<sup>14</sup>. Perring did not dispute the findings of the panel at the time and its finding of dishonesty against Perring stands.
- Perring has said he had begun shorting stocks while working as a child protection officer.
- The first more formal entry into professional research and/or investing involving Perring was with an outfit called Zatarra Research. Perring has said he was involved in this entity alongside partners<sup>15</sup>, although it originally published its research anonymously, much like Viceroy.
- While Zatarra was reported to have been registered in the British Virgin Islands<sup>16</sup>, we can find no confirmation of this registration. We have not been able to identify any registration with a companies' registrar nor financial regulator.
- Zatarra published only one research report, on German company Wirecard.

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<sup>10</sup> For examples, the byline in this Bloomberg interview: <https://www.bloomberg.com/news/videos/2018-01-30/perring-capitec-loan-book-is-looking-in-very-bad-health-video>

<sup>11</sup> The settlement agreement is available at <https://www.scribd.com/document/370240286/Settlement-agreement-Fraser-John-Perring-vs-Lincolnshire-County-Council>

<sup>12</sup> The story appeared under the heading *Worker struck off after faking boy's care case records* in the 22 February 2014 edition of the Grimsby Evening Telegraph.

<sup>13</sup> For instance, Bloomberg initially reported that the settlement had "followed" the HCPC panel hearing, but later corrected this. See: <https://www.bloomberg.com/news/articles/2018-01-18/hero-to-short-sellers-rose-from-social-work-to-steinhoff-triumph>

<sup>14</sup> The full report of the HCPC panel is available at [https://www.hcpts-uk.org/hearings/listing/201402031000-final\\_hearing-sw36183](https://www.hcpts-uk.org/hearings/listing/201402031000-final_hearing-sw36183)

<sup>15</sup> Perring described his link to Zatarra in an interview with Bloomberg. See <https://www.bloomberg.com/news/articles/2018-01-18/hero-to-short-sellers-rose-from-social-work-to-steinhoff-triumph>

<sup>16</sup> By the Financial Times, see <https://www.ft.com/content/0706763a-dadf-11e5-a72f-1e7744c66818>

- According to documents seen by Intellidex, Perring’s partners in Zatarra were Matthew Earl and Ian Hollins (we have not been able to confirm this information). Earl is an experienced investor having worked as an analyst at Charles Stanley, Investec and then at Matrix Group, a hedge fund manager.
- According to documents seen by Intellidex, Earl and Perring fell out during the course of 2016, arguing about fees and costs in Zatarra. Perring exited Zatarra, which thereafter appears to have been defunct.
- Perring has said he met Bernarde and Lau after learning they were researching the same company<sup>17</sup>. He has also said that they were introduced by “a mutual contact who recommended he collaborate with the young Australians”<sup>18</sup>.
- The first two companies that Viceroy published research about were Australian: Syrah Resources (published 23 December 2016) and Quintis Limited (published 10 May 2017). The Zatarra research on Wirecard had also been noticed in Australia, particularly by John Hempton, who held a short position in the stock and commented on the Zatarra research at the time<sup>19</sup> (we discuss Hempton’s comments further in section 5). Some documents we have seen suggest that Bernarde was also involved to some extent in Zatarra. It is therefore possible that the company Perring referred to was Wirecard and the mutual contact was Hempton.

## 2. Aidan Lau and Gabriel Bernarde

- Both 24 years old, Lau and Bernarde are old school friends, having both attended Balwyn High School in Melbourne, Australia, according to social media analysis by Moneyweb<sup>20</sup>.
- Bernarde then worked at Ferrier Hodgson for five years, a financial advisory firm that specialises in corporate liquidations and restructurings and officially left the firm on 22 December 2017<sup>21</sup>.
- According to his LinkedIn profile<sup>22</sup>, during his time at Ferrier Hodgson, Bernarde obtained a bachelor of business specialising in accounting, and then he completed a bachelor of commerce in accounting.
- In a video Marc Cohodes, a known short seller (more on him below), posted a video of himself in conversation with Gabriel Bernarde in which he described Bernarde as “the brains behind Viceroy Research, no offense to my dear friend Fraser the social worker”<sup>23</sup>. In the same video Bernarde says in response to the question of whether he is a forensic accountant: “One could say that”.
- There is less disclosure about Lau. According to the Ganadabi registration documents he is a French citizen resident in Australia.
- Bernarde and Lau are both resident in Melbourne, Australia according to the Ganadabi registration documents. The two live at addresses that are five kilometres apart. However, when agents for

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<sup>17</sup> This was said in an interview with Bloomberg. See <https://www.bloomberg.com/news/articles/2018-01-18/short-seller-who-flagged-steinhoff-irregularities-steps-forward>

<sup>18</sup> This was reported by Bloomberg. See <https://www.bloomberg.com/news/articles/2018-01-18/hero-to-short-sellers-rose-from-social-work-to-steinhoff-triumph>

<sup>19</sup> Hempton noted the Zatarra Wirecard in his online blog. See <http://brontecapital.blogspot.com/2016/02/the-amazing-zatarra-research-piece-on.html>

<sup>20</sup> See Moneyweb’s analysis here: <https://www.moneyweb.co.za/in-depth/investigations/viceroy-unmasked/?cn-reloaded=1>

<sup>21</sup> This was reported by the Australian Financial Review, see <https://www.afr.com/business/banking-and-finance/investment-banking/inside-viceroy-the-young-australians-who-helped-unleash-market-anarchy-20180119-h0kygr>

<sup>22</sup> Available at <https://www.linkedin.com/in/gbernarde>

<sup>23</sup> See video available at <https://www.pscp.tv/w/1nAJERZAzyxL>

MiMedx attempted to serve legal documents at these addresses, they found the homes had been vacated<sup>24</sup>.

## 5. Viceroy and the short-seller ecosystem

Viceroy has developed several relationships with short sellers, including individual short sellers and hedge funds. There are many Twitter relationships with frequent cross-endorsements and also other public links between the firms. Among those with close links to Viceroy are:

- **Marc Cohodes**

A California-based shortseller with a long history of activist short selling. In 2008, Cohodes was forced to close his fund, the \$1.5bn Copper River Management, following the collapse of Lehman Borthers. Cohodes thereafter withdrew from fund management to farm chickens<sup>25</sup>. He re-entered the market in 2016 trading for his own account from home<sup>26</sup>. Cohodes has formed a relationship with Perring that is focused on short trading of MiMedx, a US biotech company. This relationship is clear on Twitter where the various handles related to Perring are in constant dialogue with Cohodes. Cohodes has also published photographs of himself with Perring in early December 2017<sup>27</sup>. The two also have a strong interest in supporting the long side in Overstock.com, a firm Cohodes had previously shorted and with which he was embroiled in litigation. Cohodes is said to consider Perring a friend<sup>28</sup>. On 4 May 2018, Cohodes posted a video of himself in conversation with Gabriel Bernarde at his farm, in which he says that he and Bernarde had spoken for the first time the day before “but we’re going to be talking going forward now”<sup>29</sup>.

- **Fahmi Quadir**

A protégé of Cohodes, Quadir runs a fund out of New York called Safkhet Capital<sup>30</sup>. Quadir shot to prominence after taking a short position in pharmaceuticals company Valeant and then being featured in a *Dirty Money* documentary episode on Netflix. Quadir has publicly said she is short “one of the largest subprime lenders in South Africa” that could only refer to Capitec<sup>31</sup>. She is also known to have spoken to Clark Gardner, a South African pursuing activist litigation against Capitec with Summit Financial Partners, in advance of Viceroy’s Capitec report. Gardner provided information about Summit’s case that later appeared in Viceroy’s Capitec report. The source did not speak to any other analyst. This suggests Quadir provided Viceroy with information or

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<sup>24</sup> This information is provided in a MiMedx court filing to the Jacksonville division of the district court of Florida on 4 June 2018.

<sup>25</sup> This and other background on Copper River Management is provided in this New York Times piece: <https://www.nytimes.com/2012/03/26/business/goldman-sachs-denies-claims-it-led-to-copper-rivers-demise.html>

<sup>26</sup> Reported by Bloomberg. See: <https://www.bloomberg.com/news/features/2017-02-09/the-world-according-to-free-range-short-seller-mark-cohodes>

<sup>27</sup> See for instance <https://twitter.com/AlderLaneeggs/status/938606134948179968>

<sup>28</sup> <https://www.businesslive.co.za/bd/companies/retail-and-consumer/2018-01-18-meet-fraser-perring-the-viceroy-founder-who-shone-a-light-on-steinhoff/>

<sup>29</sup> The video is available at <https://www.pscp.tv/w/1nAJERZAzyxl>

<sup>30</sup> Quadir was described as Cohodes’ protégé by Bloomberg. See <https://www.bloomberg.com/news/articles/2017-08-01/cohodes-protége-to-raise-200-million-for-a-short-hedge-fund>

<sup>31</sup> This statement is made in a Bloomberg interview. See from 5m30s at <https://www.bloomberg.com/news/videos/2018-03-08/safkhet-capital-remains-short-on-valeant-video>

otherwise worked with Viceroy to produce the Capitec report. Quadir told Business Day newspaper that “we have no commercial relationship with Viceroy. We know of Viceroy and Fraser Perring and think highly of their integrity and research abilities”<sup>32</sup>.

- **John Hempton**

Hempton is a prominent and long-standing Australia-based short seller who has been well covered regarding several high profile short positions he has taken over many years. On 25 February 2016, Hempton posted a blog piece in which he described Zatarra as a “seemingly anonymous outfit I had never heard of” and linked to the “amazing report” Zatarra had undertaken on Wirecard<sup>33</sup>. At the time, Hempton disclosed he had held a short position for years at the time. Since then Hempton’s short positions have coincided with several others pursued by Viceroy. Hempton has also disclosed short positions in Steinhoff<sup>34</sup> and in MiMedx, two other stocks Viceroy has targeted. Hempton also was short on Valeant alongside Fahmi Quadir<sup>35</sup>. Hempton has defended Viceroy’s reports on Steinhoff and Capitec on Twitter<sup>36</sup>.

- **Ben Axler**

Axler is the principal of Spruce Point Capital Management in New York. Spruce Point published an extensive report on Caesarstone on 19 August 2015 and a follow-up on 6 October 2015 . When Viceroy published its report on Caesarstone on June 14 2017, it began by noting Axler’s research “which should be considered concurrently” with their report<sup>37</sup>. On publication, Spruce Point then published a blog post “to alert our readers” to the Viceroy report, commenting that the report “strengthens our views that CSTE is at best a \$15 stock”<sup>38</sup>. When asked about this apparent coordination of research release, Spruce Point’s chief operating officer Sean Donohue told Intellidex: “There is no formal business relationship between Viceroy and Spruce Point. Our liking or retweeting of their report (or any other content) on Twitter is in no way an endorsement of an organization or indicative of a business relationship.”

- **Portsea Asset Management**

Portsea offers portfolio management, financial planning and investment advisory services to clients in the United Kingdom. As described in section 11.1 below, Viceroy’s report on Steinhoff was substantially plagiarised from a report on Steinhoff by London-based Portsea that had been written several months earlier. We attempted to engage with Portsea to obtain details about this relationship but Portsea did not respond to our emails.

- **Roddy Boyd**

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<sup>32</sup> This is quoted in Business Day. See <https://www.pressreader.com/south-africa/business-day/20180201/281968903126797>

<sup>33</sup> See the blog post at <http://brontecapital.blogspot.com/2016/02/>

<sup>34</sup> This is disclosed in a Bronte Capital fund report. See [https://files.brontecapital.com/amalthea/Amalthea\\_Letter\\_201712.pdf](https://files.brontecapital.com/amalthea/Amalthea_Letter_201712.pdf)

<sup>35</sup> This was disclosed in interviews as part of the *Dirty Money* documentary on Valeant aired on Netflix.

<sup>36</sup> For instance, on Capitec: [https://twitter.com/John\\_Hempton/status/958282434713337857](https://twitter.com/John_Hempton/status/958282434713337857) and on Steinhoff [https://twitter.com/John\\_Hempton/status/944627068209213440](https://twitter.com/John_Hempton/status/944627068209213440)

<sup>37</sup> See page 4 of the Viceroy report available at <https://viceroyresearch.files.wordpress.com/2017/06/caesarstone-nasdaq-cste-report.pdf>

<sup>38</sup> See the blog post at <https://www.valuewalk.com/2017/06/caesarstone-ltd-cste/>

Boyd is an investigative journalist who runs the Southern Investigative Reporting Foundation (SIRF) based in North Carolina which is registered as a charity<sup>39</sup>. Boyd is a former hedge fund analyst and trader who became an investigative journalist publishing through his own blog<sup>40</sup>, the New York Post and Fortune magazine. Boyd famously published on Valeant shortly before the company's share price collapsed, with Hempton and Cohodes each speaking prominently about Boyd's reporting in that case<sup>41</sup>. Boyd has also published extensively on Wirecard, the focus of Zatarra's research report. Boyd has received donations of cash and shares in Overstock.com from Cohodes, amounting to around \$340,000<sup>42</sup>. SIRF's tax return, which it publishes on its website, also lists donations from:

**TABLE 1: DONORS TO THE SOUTHERN INVESTIGATIVE REPORTING FOUNDATION**

Donor	Amount	Brief description
<b>Eos Holdings</b>	\$40,000	Hedge fund whose manager was accused of fraudulent publishing to damage share prices by Canadian regulators <sup>43</sup>
<b>Robert Scott Fearon</b>	\$12,500	Fearon is head of short-selling hedge fund Crown Capital Management
<b>Aristides Cap Charitable Fund</b>	\$10,000	Aristides Capital is a hedge fund manager based in Ohio
<b>Vranos Family Foundation</b>	\$10,000	Entity controlled by hedge fund manager Michael Vranos
<b>Dan David, Geo Investing</b>	\$9,000	GeoInvesting undertakes short-seller research and takes its own positions
<b>Kingsford Capital Management</b>	\$58,851	A short-selling specialist hedge fund
<b>Michael &amp; Hillary Goode</b>	\$10,000	Michael Goode publishes short selling website goodetrades.com

Tax exempt charities are specifically prohibited by the US Internal Revenue Service from "allowing more than an insubstantial accrual of private benefit to individuals or organizations"<sup>44</sup>. This prevents charities from acting for private interests rather than public interests. Donations are tax deductible to the donor. Apart from those listed above, individual donors contributed \$73,241. Boyd has been subpoenaed in litigation regarding Fairfax Financial, a Canadian insurer that was targeted by short sellers in 2006 amid allegations that various hedge funds gave Boyd information

<sup>39</sup> Its tax exempt status notification is available at [http://sirf-online.org/wp-content/uploads/2015/04/SIRF\\_IRSLetter.pdf](http://sirf-online.org/wp-content/uploads/2015/04/SIRF_IRSLetter.pdf)

<sup>40</sup> This and other biographical details on Boyd are available in this Nieman Foundation report: <http://www.niemanlab.org/2017/09/this-former-hedge-fund-guy-is-a-one-man-nonprofit-investigating-some-of-americas-shadiest-companies/>

<sup>41</sup> See the Netflix *Dirty Money* documentary on Valeant.

<sup>42</sup> The Overstock.com share donation is noted in SIRF's tax return which it publishes on its website at [http://sirf-online.org/wp-content/uploads/2018/06/SIRF\\_990\\_2017\\_AmendedFinal\\_Jun18.pdf](http://sirf-online.org/wp-content/uploads/2018/06/SIRF_990_2017_AmendedFinal_Jun18.pdf) donated on 22 December 2017. A further \$15,000 donation is noted in a story referencing Cohodes, see: <http://sirf-online.org/2017/06/28/bofi-federal-savings-sleeping-with-the-enemy-can-cost-a-bank-a-lot-of-money/>

<sup>43</sup> This was reported by Reuters. The case was later dismissed. See <https://www.reuters.com/article/silvercorp-short-idUSL2N0JY1J920131219>

<sup>44</sup> See the IRS's guide for charity compliance at <https://www.irs.gov/pub/irs-pdf/p4221pc.pdf>

in the interests of pursuing a short strategy. Boyd published a series of articles in the New York Post allegedly using information provided to him by short sellers<sup>45</sup>.

- In addition to those listed above, Viceroy is frequently on the same side as several other hedge funds and/or short-selling researchers on specific companies it targets. These include Sparrow Fund (in the case of MiMedx), Dialectic Capital (MiMedx), Claucus (Quintis), and others. Aurelius Value is another anonymous research outfit, publishing to the website [www.aureliusvalue.com](http://www.aureliusvalue.com), including negative reports on MiMedx.
- These relationships are characterised by frequent Twitter mentions, complimentary commentary on each other in the media and on blogs like Seeking Alpha, and co-appearances at public events. One example is that Boyd, Quadir, and Perring spoke on the same panel at the Offshore Alert Conference in April 2018<sup>46</sup>.
- This cluster of industry participants provides examples for Viceroy to emulate as well as access to information, inspiration and potentially revenue flows, as we discuss below.

## 6. The value that Viceroy adds in the ecosystem

- All active investors take positions in stocks because they believe the intrinsic value of a share is different to the market price. Investment theory argues that share prices converge on their intrinsic value over time. The “value investing” style, made famous by Benjamin Graham<sup>47</sup> and Warren Buffett, invests in undervalued shares and then waits for market prices to converge on the “intrinsic value”. This is also true on the short side where the “intrinsic value” as believed by the investor is below the market price. Unfortunately for such investors, it can take a long time for the market price to adjust to the intrinsic value they have estimated, even when their estimates are true. Viceroy can assist in creating triggers for corrections, reducing the time lag.
- The one common feature of the diverse range of targets Viceroy chooses is that there is always substantial interest from short sellers. As we discuss in section 11, below, this is clear in market data on short positions where it is available, and in public comments made by short sellers. Therefore there is a significant profit to be made on the short side in Viceroy’s targets, even if Viceroy is not making any of these profits directly through positions of its own. Viceroy’s targets therefore are characterised by high demand on the short side for price corrections.
- The primary value that Viceroy contributes to this ecosystem is publicity. As we discuss in section 8 below, Viceroy has built an ability to ensure prominent coverage in several high-profile news outlets such as the Financial Times and Bloomberg. These relationships ensure that Viceroy’s research receives substantial coverage – far more than other hedge funds in this ecosystem can generate themselves. In addition to media coverage, Viceroy and its principals are active on social media and regularly engage with the Twitter community about its targets (although not consistently, as we discuss in section 10). It has been alleged in MiMedx litigation that Viceroy creates fake email and Twitter accounts that appear to be staff members leaking internal

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<sup>45</sup> The allegations and Boyd’s denials are reported in this New York Magazine story:

<http://nymag.com/nymag/features/52754/index3.html>

<sup>46</sup> See the programme outline at <https://www.offshorealert.com/conference/miami/2018/agenda-day/?id=222128&day=3>

<sup>47</sup> Benjamin Graham’s *The Intelligent Investor* is considered the classical text of value investing. See <http://www.fxf1.com/english-books/The%20Intelligent%20Investor%20-%20BENJAMIN%20GRAHAM.pdf>

information, which it has used in the case of MiMedx and Wirecard (as Zatarra). This leaked information supports Viceroy's research findings<sup>48</sup>.

- We asked Viceroy whether it believes it is its reputation that affects share prices or whether it is the specific information conveyed in its reports<sup>49</sup>. Viceroy's response was:

*We believe the content of our reports is the catalyst that drives share prices downwards. On many occasions (MiMedx, Caesarstone, Neuroderm, AMD) there have been flat or positive price movements on our reports. We have always been proponents of due diligence, and believe our work should be scrutinized to the same extent as "buy" reports.*

- As we argue in section 11, the quality of Viceroy reports varies widely and some of them do not stand up to scrutiny.
- The second value that Viceroy offers this community is as an outsourced carrier of legal risk. Some hedge funds are concerned about potential litigation that may follow from research they produce. However, if a third party such as Viceroy acts as the publisher of the information then that legal risk is somewhat dissipated and deflected. This may not hold if the funds are known to have explicitly directed the third party to publish the research, but if information is spread in an informal way in an ecosystem of different funds and researchers, there is little litigation risk remaining when it is made public through a third party. Because Viceroy operated anonymously, it was practically difficult to take any action because the defendants could not be identified. Since being identified, Viceroy has become subject to legal and regulatory actions (see section 9, below) so its own legal risk has increased. As Viceroy has no legal registration itself, it remains difficult to target, although the three principals can be targeted through the UK-registered Ganadabi Limited, which was registered in August 2017. The various international jurisdictions involved also reduce legal risk as it is difficult for regulators in one jurisdiction to pursue actions against individuals or entities operating in other jurisdictions. Viceroy also is not registered with any market conduct regulator, so has none of the compliance requirements that registered funds have.

## 7. Viceroy's business model

Viceroy has never provided details on its business model. In this section, in an effort to determine ways Viceroy is likely to generate revenue, we analyse what we do know.

- Viceroy writes in the disclaimer to its research reports that:

*"...you should assume that the authors have a direct or indirect interest/position in all stocks (and/or options, swaps, and other derivative securities related to the stock) and bonds covered herein, and therefore stand to realize monetary gains in the event that the price of either declines"<sup>50</sup>*

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<sup>48</sup> These allegations are based on similarities in identifying information for email addresses and Twitter handles that were purported to be internal leakers from MiMedx. These are detailed in MiMedx's complaint for damages filed in the US district court for the middle district of Florida, Jacksonville Division, filed on 3 June 2018.

<sup>49</sup> Our question to Viceroy was worded: Viceroy has a strong reputation. Do you believe your reports affect the value of companies' shares because of the content of the reports and the specific information conveyed, or because of your reputation and the fact that you are negative on the stocks?

<sup>50</sup> Similar wording is used in all its reports. For example, in its report on Quintis, see <https://viceroyresearch.files.wordpress.com/2017/05/quintis-limited-full-report.pdf>

- This implies that Viceroy has its own balance sheet exposed to stock movements, in other words, that it has invested its own capital for profit. However, given that Viceroy is not a registered entity with any legal status to trade, it is unlikely that it would be able to pass anti-money laundering requirements to open an account with a stockbroker. It is more likely that Perring, Lau and/or Bernarde have accounts in their personal names, although this would be impossible to establish, given privacy rules on client accounts. Again, to satisfy anti-money laundering restrictions, these are unlikely to be able to trade large amounts such as would be traded by a registered hedge fund manager.
- Viceroy has made contradictory statements about whether it takes positions in the stocks it covers or whether it sells its research to fund managers. It has said in an anonymous interview that “our positions are both long and short and are based on our research”<sup>51</sup>. However, in the same interview it also said it “consulted” with analysts after its Steinhoff report and earned fees, though “all fees [were] paid into South African charities”. It remains open that Viceroy may earn fees for its research.
- As discussed above, it is clear that Viceroy, through its ability to generate publicity and in absorbing legal risk, is able to deliver significant value to short position holders in its targets. It is notable that its targets are united in having a large short interest (the percentage of shares that has been shorted) in their stock. It is natural to ask, then, whether Viceroy is able to appropriate any of the value generated by these other traders through its activities.
- We surmise it is possible that Viceroy is rewarded by other members of its ecosystem when its actions lead to significant profits for those firms. We think it unlikely, if this is the case, it would be reflected in any formal contract, so as to provide “plausible deniability” for any fund that profited from Viceroy’s actions. We think Viceroy is paid a kind of gratuity when its actions lead to substantial profits for friendly funds. This is difficult for regulators to police because there is no clear way to link Viceroy’s actions to particular profits it generates, given that regulatory penalties are generally a function of the amount of profit earned from a trade. We note that donations feature in the ecosystem such as those between Cohodes and Boyd, and it would not be a significant adaptation of this model to reward Viceroy through gratuities.
- It may also be the case that Viceroy is rewarded through a more formal participation in the profits of other individuals who may direct its efforts in promoting particular short positions. Documents seen by Intellidex suggest this model was used by Zatarra, but we have not been able to verify this was in fact the case.
- It is also the case that some of the returns to Viceroy are not financial but rather in the form of status. For a group consisting of a disbarred social worker and two early career professionals, the global notoriety and ability to move in circles including famous short sellers like Marc Cohodes and John Hempton may provide significant psychological benefit. This may motivate some of its actions more than direct financial return.

## 8. Viceroy and the media

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<sup>51</sup> In an interview with Bloomberg. See <https://www.bloomberg.com/news/articles/2018-01-12/faceless-men-upend-south-africa-stocks-on-fears-of-steinhoff-2-0>

- In maximising the impact of Viceroy’s research releases, particularly recent ones, media outlets play an important role. We have verified with journalists<sup>52</sup> that Viceroy grants embargoed early access to its reports, so that media outlets are able to prepare stories based on those reports and publish simultaneously with their release. This serves to amplify the impact of Viceroy’s research. Indeed, it is often the media coverage, rather than the reports themselves, that move the share prices of its targets. As we discuss in section 11 below, the content of some of Viceroy’s reports is, in our view, weak and internally contradictory, and therefore not able to move prices on its own merit.
- In the table below we analyse some of the coverage of Viceroy’s research.

**TABLE 2: MEDIA COVERAGE OF VICEROY (ZATARRA) RESEARCH**

TARGET	Date first Viceroy (Zatarra) report released	Outlet of coverage	Headlines of coverage
<b>Wirecard</b>	24 February 2016	Financial Times, London. 24 February 2016.	Zatarra strikes: Wirecard <sup>53</sup>
		Financial Times, London. 25 February 2016.	Shares in fintech darling plunge on critical report <sup>54</sup>
<b>Syrah Resources</b>	23 December 2016	None	None <sup>55</sup>
<b>Quintis</b>	14 May 2017	The Australian. 15 May 2017	Failed sale helped Quintis gain credit <sup>56</sup>
<b>Caesarstone</b>	14 June 2017	None	None <sup>57</sup>
<b>Neuroderm</b>	30 August 2017	None	None <sup>58</sup>
<b>Mimedx<sup>59</sup></b>	20 September 2017	None	None <sup>60</sup>
<b>Steinhoff</b>	6 December 2017	Wall Street Journal 7 December 2017	Accounting Blowup at Steinhoff Was Hiding in Plain Sight; <sup>61</sup>

<sup>52</sup> Indeed, Viceroy offered one of the authors of this report, who writes a column in South Africa’s Business Day newspaper, embargoed pre-release access to its reports, prior to its release of the Capitec report. The offer was not taken up.

<sup>53</sup> This report is not available on the FT website, but was published on FT Alphaville on 24 February 2016.

<sup>54</sup> See <https://ftalphaville.ft.com/2016/02/25/2155726/shares-in-fintech-darling-plunge-on-critical-report/>

<sup>55</sup> Indeed, the coverage that Viceroy did receive was much later and negative, such as this article that reported on Syrah’s CEO complaining to regulators about whether third party commentators had any “truth requirements”. See <https://www.afr.com/business/mining/syrah-approaches-regulators-about-shortselling-critics-20170523-gwbaf5>

<sup>56</sup> See <https://www.theaustralian.com.au/business/companies/failed-plantation-sale-helped-quintis-gain-credit/news-story/62d016ca14c4b2bdc7c9d177c8c60f7b>

<sup>57</sup> However, Spruce Point Capital distributed an email and blog post with a strong endorsement of the Viceroy report on the same day.

<sup>58</sup> However, a press release by Viceroy was distributed on BusinessWire, which was in turn picked up by Yahoo Finance. See <https://finance.yahoo.com/news/viceroy-research-believes-mitsubishi-tanabe-142500236.html?guccounter=1>

<sup>59</sup> This report was published on the same day as a report by Aurelius Value, a similar research outlet which remains anonymous.

<sup>60</sup> However, Viceroy again distributed a press release on their research through Business Wire, which was picked up by Yahoo Finance. See <https://finance.yahoo.com/news/viceroy-research-believes-mimedx-employment-141000822.html?guccounter=1>

<sup>61</sup> See <https://www.wsj.com/articles/accounting-blowup-at-steinhoff-was-hiding-in-plain-sight-1512585579>

		Financial Times 7 December 2017	Steinhoff fights to survive amid questions over assets and debt <sup>62</sup>
		Business Day (Johannesburg) 7 December 2017	Steinhoff saga leaves even critics dazed <sup>63</sup>
		Financial Times 8 December 2017	Steinhoff fights to survive amid questions over assets and debt <sup>64</sup>
<b>Capitec</b>	30 January 2018	Reuters 30 January 2018	South Africa's Capitec sinks 10 pct after report by Viceroy Research <sup>65</sup>
		Dow Jones 30 January 2018	Capitec Shares Plunge on Viceroy Research Report – Market Talk <sup>66</sup>
<b>ProSiebenSat1</b>	6 March 2018	Financial Times 30 January 2018	Steinhoff short seller turns focus on Capitec <sup>67</sup>
		Reuters 6 March 2018	ProSieben wehrt sich gegen Vorwürfe von Analysehaus Viceroy <sup>68</sup> [ProSieben defends itself against allegations by analysis house Viceroy]
		Financial Times 6 March 2018	Viceroy Research targets ProSiebenSat1 <sup>69</sup>
<b>Advanced Micro Devices (AMD)</b>	13 March 2018	Reuters 14 March 2018	Security firm says it has found AMD chip flaws <sup>70</sup>

- Zatarra was successful in its efforts to achieve publicity for its Wirecard report, particularly through the Financial Times, but Viceroy initially struggled to get the same attention.
- This changed following Viceroy's report on Steinhoff, which was released the day after Steinhoff disclosed to the market that there were serious irregularities with its accounts and the resignation of its CEO<sup>71</sup>. We provide just a sample of the extensive coverage that Viceroy's report received in the table above, focusing on the more influential titles. Steinhoff's announcement, which led to a dramatic fall in its share price, contained little information about the irregularities that had led to the resignation of the CEO. In the information blackout, Viceroy provided a scarce and extensive insight into the use of off-balance sheet entities to hide liabilities and boost income at Steinhoff. However, as our analysis in section 11 shows, this was substantially plagiarised from a report written by a hedge fund several months earlier.

<sup>62</sup> See <https://www.ft.com/content/7f7792ac-db6e-11e7-a039-c64b1c09b482>

<sup>63</sup> See <https://www.businesslive.co.za/bd/companies/retail-and-consumer/2017-12-07-news-analysis-steinhoff-saga-leaves-even-its-critics-dazed/>

<sup>64</sup> See: <https://www.ft.com/content/7f7792ac-db6e-11e7-a039-c64b1c09b482>

<sup>65</sup> See: <https://www.reuters.com/article/capitec-accounts/south-africas-capitec-sinks-10-pct-after-report-by-viceroy-research-idUSL8N1PP1TP>

<sup>66</sup> Dow Jones feeds are not easily accessible online and are available to subscribers.

<sup>67</sup> See: <https://www.ft.com/content/e54c3786-05b2-11e8-9650-9c0ad2d7c5b5>

<sup>68</sup> See: [https://article.wn.com/view/2018/03/06/ProSieben\\_wehrt\\_sich\\_gegen\\_Vorwurfe\\_von\\_Analysehaus\\_Viceroy/](https://article.wn.com/view/2018/03/06/ProSieben_wehrt_sich_gegen_Vorwurfe_von_Analysehaus_Viceroy/)

<sup>69</sup> See: <https://ftalphaville.ft.com/2018/03/05/1520263917000/Viceroy-Research-targets-ProSiebenSat1/>

<sup>70</sup> See: <https://www.reuters.com/article/us-cyber-amd/after-short-selling-surge-israeli-firm-says-it-finds-amd-chip-flaw-idUSKCN1GP273>

<sup>71</sup> The original Steinhoff statutory announcement is available at [https://irhosted.profiledata.co.za/steinhoff/2017\\_feeds/SensPopUp.aspx?id=301862](https://irhosted.profiledata.co.za/steinhoff/2017_feeds/SensPopUp.aspx?id=301862)

- The plagiarism of the Steinhoff report only emerged later to a limited audience through the German media<sup>72</sup> and has not been reported in the English language press.
- The Steinhoff report led to significant influence for Viceroy, although it was anonymous at the time. This level of influence and engagement with the media was reminiscent of the level attained by its predecessor, Zatarra.
- Following Steinhoff, several rumours spread in the South African market about Viceroy's next target, leading to large share price movements. These were partly encouraged by Viceroy's comments on Twitter that it was researching a further South African target<sup>73</sup>. These included property group Resilient, which has been subject to extensive short seller interest, and pharmaceutical group Aspen. We are told that Viceroy spoke to at least one South African hedge fund manager about Resilient, which may have sparked the rumours. On Aspen, we speculate that the links between Viceroy and short sellers of Valeant, as well as its reports on MiMedx and Neuroderm, suggested it would research pharmaceutical companies. The stock price movements prompted an investigation by the Financial Services Board and the Johannesburg Stock Exchange<sup>74</sup>. There were no notable rumours of it working on Capitec, which was in fact its next target.
- This substantial influence over share prices was understandably a significant asset to Viceroy and its principals. It allowed Viceroy to deliver significantly more value in its ecosystem of short sellers. Until the Steinhoff report, its influence had been limited, though Fraser Perring would have been aware of the importance of media influence from his experience regarding Wirecard.
- Viceroy's influence was used well in the release of its report on Capitec. In that case it gave advance embargoed copies of its report to journalists, particularly to Bloomberg. This ensured it was able to obtain maximum coverage of its report. On the day it was released, the coverage was extensive, including on key wire services like Reuters and Dow Jones. This ensured rapid dissemination of the report to the global investor community. These were followed by reports in the Financial Times as well as several South African publications. The impact, as we analyse in section 11.2, was significant, with a 25% intraday drop in the share price during the day of the release of the Capitec report.
- However, the Capitec report represented the peak of its recently acquired influence. Viceroy's report called for the curatorship of Capitec by the South African central bank, yet on the day of the report's release the Reserve Bank issued a statement of its faith in Capitec's solvency and compliance with prudential requirements<sup>75</sup>. Several other regulators also dismissed Viceroy's claims<sup>76</sup>.
- Viceroy's next report, on German media company ProSiebenSat1, also had significant media coverage, though not as extensive as the Capitec report. The influence Viceroy had acquired from its Steinhoff report was also substantial in Germany, where Steinhoff was of significant interest as a German-listed company. The ProSieben report was reported on by Reuters and the Financial Times, as well as the German media, but did not obtain the same level of coverage. Nevertheless, the ProSieben share price fell 6% on the day.

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<sup>72</sup> See, for instance, this report by Germany's Capital: <https://www.presseportal.de/pm/8185/3897123>

<sup>73</sup> For examples, see <https://twitter.com/viceroyresearch/status/949205524578480128>

<sup>74</sup> Reported by Bloomberg at <https://www.bloomberg.com/news/articles/2018-01-11/south-african-property-stocks-plunge-on-jitters-over-debt-levels>

<sup>75</sup> This was widely reported. See for instance <https://www.moneyweb.co.za/in-depth/investigations/capitec-is-solvent-says-the-reserve-bank/>

<sup>76</sup> This was particularly during a South African parliamentary hearing regarding lenders. See <https://www.timeslive.co.za/sunday-times/business/2018-05-30-capitec-earns-the-nod-from-reserve-bank-after-viceroy-allegations/>

- The AMD report (13 March 2018) had even less impact than the ProSieben report and was ignored by most significant titles. It was covered by Reuters, but most of the rest of the coverage was in specialist IT and computing publications. These were often negative on the quality of Viceroy's report and the report by the technology researchers, CTS Labs, that Viceroy cited<sup>77</sup>. It had no noticeable impact on the share price.
- As argued in section 11, the quality of Viceroy's reports after Steinhoff substantially declined. The impact of the reports was a function of the influence earned by Viceroy, rather than the content of the reports. We anticipate that Viceroy's influence with the media will wane as market participants come to recognise this quality problem. Viceroy may also become the target of regulator actions which could further damage its reputation.
- The table below consolidates the share price movements in the wake of the Viceroy reports. In certain cases, the Viceroy short view was well supported by subsequent movements, but in others it was not. It is ambiguous whether the movements, particularly in more recent reports, were due to the facts Viceroy published, or the fact that Viceroy published. We analyse the share price impact in section 11 below.

**TABLE 3: SHARE PRICE MOVEMENT FOLLOWING THE RELEASE OF VICEROY'S/ZATARRA'S REPORT**

COMPANY	Report date	First day	After 10 days	After 50 days	To date
Wirecard	24 Feb 2016	-14%	-19%	-13%	243%
Syrah Resources Ltd	23 Dec 2016	-1%	13%	-8%	-6%
Quintis	10 May 2017	-44%	-72%	-72%	-72%
Caesarstone Ltd	14 Jun 2017	-1%	-3%	-19%	-54%
Neuroderm	30 Aug 2017	0%	1%	Delisted*	Delisted
Mimedx Group Inc	20 Sep 2017	-6%	-5%	-12%	-59%
Steinhoff	06 Dec 2017	-47%	-74%	-69%	-93%
Capitec	30 Jan 2018	-3%	-12%	-8%	-9%
ProSiebenSat 1 Media SE	06 Mar 2018	-6%	-9%	-1%	-20%
Advanced Micro Devices Inc	13 Mar 2018	1%	-9%	13%	49%
<b>Simple Average</b>	<b>18 June 2018</b>	<b>-11%</b>	<b>-17%</b>	<b>-20%</b>	<b>-5%</b>

*Neuroderm was taken over by Mitsubishi Tanabe Pharma and delisted on 16 October 2017*

## 9. Legal and regulator actions against Viceroy

- Viceroy faces two legal challenges that we are aware of: a defamation suit filed by MiMedx in Florida and a market manipulation investigation under way by German authorities. Complaints

<sup>77</sup> See, for instance, this Gamers Nexus report, which pans Viceroy's analysis:

<https://www.gamersnexus.net/industry/3260-assassination-attempt-on-amd-by-viceroy-research-cts-labs>

have also been made in the United States, South Africa and Australia that may lead to further investigations.

- The MiMedx complaint alleges that Viceroy has mounted a deliberate short and distort campaign (explained in section 1.4 above) against it. It details several clear examples where it alleges that claims made by Viceroy are false, ranging from cases where Viceroy has confused the names of independent companies with those in the MiMedx group, to cases where Viceroy has misunderstood dates for when employees worked at other companies. MiMedx alleges, and provides supportive evidence, that Viceroy created Twitter and email accounts that were portrayed as leaks from staff members of MiMedx. The information in these leaks was presented as inside leaks that were supportive of Viceroy's claims about the company. This MiMedx allegation amounts to a serious claim of active efforts to distort information about MiMedx.
- Bafin, the German financial watchdog, referred a case of market manipulation to prosecutors in 2017 against Zatarra, Fraser Perring's forerunner to Viceroy, regarding its report on German payments technology company Wirecard published in 2016<sup>78</sup>. German prosecutors have also begun a preliminary investigation into Viceroy's report on ProSiebenSat1, while waiting for preliminary findings from Bafin on the case<sup>79</sup>. When Viceroy published its report on ProSiebenSat1, Bafin also publicly warned Viceroy that it was doing so illegally as it had not notified Bafin of the report beforehand<sup>80</sup>.
- In South Africa, the National Treasury has called for investigations into Viceroy by the Financial Sector Conduct Authority and the JSE regarding its report on Capitec, though it is unclear whether any investigations are under way<sup>81</sup>.
- Regulatory action is hampered by conceptual challenges over the nature of strategies such as Viceroy's and, until it was forced to give up its anonymity, the fact that individuals could not be identified. Since Viceroy's principals became public, Viceroy is likely to face significantly more regulatory scrutiny.

## 10. Analysis of Twitter behaviour

- Viceroy and associated individuals are active on Twitter. The topics of interest, however, show varying engagement with Viceroy's research subjects. We analyse the frequency of the tweets of Viceroy and related accounts below.

**TABLE 4: ANALYSIS OF VICEROY AND RELATED TWITTER ACCOUNTS AND NUMBER OF MENTIONS OF DIFFERENT TARGETS**

Account Target	@FollowValue1 (Fraser Perring's account until	@AIMHonesty (Fraser Perring's account after 10 April 2017)	@zri2016 (Zatarra Research, activity	@viceroyresearch	@Gabe_Bernarde (since 19 Feb 2018)

<sup>78</sup> This was reported by Reuters. See <https://www.reuters.com/article/wirecard-report/germanys-bafin-asks-prosecutors-to-investigate-wirecard-share-movements-idUSF9N1G2007>

<sup>79</sup>

<sup>80</sup> This was reported by Reuters. See: <https://www.reuters.com/article/prosieben-media-accounts/update-1-german-watchdog-says-viceroy-prosieben-report-broke-rules-idUSL8N1QU4S4>

<sup>81</sup> See reporting on Treasury's comments: <https://www.timeslive.co.za/sunday-times/business/2018-02-01-treasury-comes-out-to-bat-for-capitec-and-wants-viceroy-probed/>

	25 March 2017)		ceased 12 August 2016)		
<b>AMD (AMD, \$AMD, #AMDflaws)</b>	0	3	0	29	1
<b>Wirecard (\$WDI)</b>	611	0	48	0	0
<b>Capitec (CPI)</b>	0	0	0	56	1
<b>Neuroderm (NDRM)</b>	0	0	0	32 (in a single batch including translations)	0
<b>Steinhoff (SNH)</b>	0	2	0	17 (largely in a single batch)	0
<b>Mimedx (\$MDXG)</b>	0	233	0	329	33
<b>Caesarstone (CSTE)</b>	0	5	0	19 (in a single batch)	0
<b>ProSieben (PSM)</b>	0	0	0	12 (in a single batch)	0
<b>Syrah Resources (SYR)</b>	0	1	0	14 (in a batch)	0
<b>Quintis (QIN)</b>	0	2	0	10 (in a batch)	0

- As the Twitter analysis in Table 4 suggests, there are significantly varying levels of interest from key Viceroy-related Twitter accounts. The main Viceroy account, @viceroyresearch, tweets about each of the reports it released. However, in the case of Quintitis, Syrah, ProSieben and Caesarstone, these tweets were focused on the release of the research. There was no significant follow-up discussion by either the main Viceroy account, nor the two individuals, Perring and Bernarde<sup>82</sup>. Lau does not tweet, as far as we can determine.
- The only company that Perring has tweeted about extensively in his personal account is MiMedx. Perring has made no mention of Capitec, Neuroderm or ProSieben. He has also Tweeted very little about Steinhoff, AMD and Caesarstone.
- Bernarde has tweeted fairly frequently about MiMedx, but not at all about ProSieben (apart from one related retweet), Caesarstone, Steinhoff or Neuroderm.
- It is clear from the tweeting pattern that Perring, Bernarde and the main Viceroy account all display a significant interest in MiMedx. However, the other targets of Viceroy appear to attract little interest from Bernarde and Perring. Instead, Tweets about them are composed through brief and structured campaigns around the release of the reports. There is no ongoing engagement with the Twitter community or active responses to comments.
- This pattern is consistent with the view that Perring and Bernarde have limited interest in those research targets and may not have been involved in the research underlying those reports. Alternatively, they may have felt that there was little traction on those targeted companies and therefore no reason to comment, amounting to an abandonment of their short thesis.

## 11. Assessment of research methods

<sup>82</sup> We identified accounts associated with Perring and Bernarde on Twitter, but have not identified any associated with Lau.

- In table 5 below, we list some features of the Viceroy's research targets and the specialist knowledge areas required.

**TABLE 5: OVERVIEW OF VICEROY RESEARCH SUBJECTS**

<b>TARGET AND DATE OF FIRST REPORT</b>	<b>Geography of operations and sales</b>	<b>Industry segments</b>	<b>Specialist knowledge required</b>
<b>AMD</b> 13 March 2018	Canadian head office, Nasdaq listing, world-wide sales, world-wide production.	Microprocessors	Technical knowledge of computer science and microprocessor chip development and security features
<b>PROSIEBEN (PSM)</b> 6 March 2018	German head office and most operations, DAX listed	German-speaking media broadcasting, digital media and content production	Free to air and paid broadcasting in Germany, digital media and advertising markets
<b>CAPITEC</b> 30 January 2018	South Africa head office, JSE listing, South African operations	Consumer lending, transactional banking	Knowledge of the South African banking system and consumer lending market and related accounting standards
<b>STEINHOFF</b> 6 December 2017	South Africa/Frankfurt/Amsterdam head offices and listings. Operations in much of Europe, South Africa and elsewhere	Furniture retailing, consumer credit, manufacturing, and other	Accounting standards, balance sheet structuring.
<b>MIMEDX</b> 20 September 2017	Georgia head office, Nasdaq listing, operations mostly in United States.	Biopharmaceuticals focused on wound care, surgery, sports medicine, and other	Stem cell research and treatments, US pharmaceutical distribution and sales
<b>NEURODERM</b> 30 August 2017	Israeli head office and operations, Nasdaq listing	Clinical stage pharmaceutical development	Central nervous system drug development and actions, particularly for Parkinson's disease
<b>CAESARSTONE</b> 14 June 2017	Israeli headoffice, Nasdaq listing, global sales	Quartz surfacing	Quartz chemistry, sales and distribution channels
<b>SYRAH RESOURCES</b> 23 December 2016	Australia head office, operations primarily in Mozambique, ASX listing	Mining exploration and development	Graphite mining and marketing, exploration and development in Mozambique
<b>QUINTIS</b> 14 May 2017	Australia head office, operations and sales primarily in Australia, ASX listing	Sandalwood plantations	Sandalwood sales, accounting standards, related party transaction analysis

- To produce well-founded research on any of Viceroy's targets is a significant undertaking. Typically, hedge funds will invest substantial resources and hundreds of hours of research into a single short thesis, which may in the end be abandoned if the thesis is not supported by the research. Such research will include analysts with significant financial markets research as well as specialists in the industry segment being studied.

- Viceroy's research output is prolific. While far larger research teams may spend several months on a single research topic, in the ten months from June 2017 to March 2018, Viceroy published large reports on seven companies in widely differing industries and geographies.
- Viceroy claims that it undertakes extensive research into each of its targets. However, given that it consists of three individuals with limited financial market experience and no professional experience in the subjects it covers, it is not plausible that the single team could produce the volume and variety of research published under Viceroy's name.
- We asked Viceroy whether it relies on its own research capabilities and knowledge or whether it uses outside contributors<sup>83</sup>. Its response was:

*Viceroy has a large network of specialist contractors which we engage on a case-by-case basis to assist with industry specific analysis. This is commonplace in the industry.*

- We agree with Viceroy that it is "commonplace" in the industry to commission outside specialists for particular pieces of research. Indeed, as we discuss in section 11.7 below, one good example is Spruce Point Capital's commissioning of laboratory testing of Caesarstone's products. However, in our view it is not commonplace to then use this work without attribution or any description of the expertise that contributed to the report, as Viceroy appears to do in the case of Neuroderm (see section 11.6) and elsewhere. For example, Spruce Point includes the detailed laboratory reports commissioned from Rutgers University including the name of the analyst to bolster its Caesarstone report<sup>84</sup>. The use of identified experts in this way represents both fair attribution and also a way to enhance the credibility of claims.
- Viceroy's research varies widely in quality. Certain reports, particularly Steinhoff, contain clear insights that were not commonly known in the market. However other reports, such as some of its work on MiMedx and initial work on Capitec, include spurious allegations, ad hominem attacks on individuals that have little to do with the value of companies, and astounding claims about regulator actions or likely actions that are unsupported by the facts that Viceroy states.
- We have identified what we have found are clear cases of plagiarism in Viceroy's research, where it lifts the work of other analysts without crediting them. However, we also believe based on our analysis that follows, reports that are issued by Viceroy are often not written by the individuals associated with it, or at least the substantial analysis is not undertaken by them.
- Viceroy's reports also vary in quality of valuation analysis. In one report, on Syrah Resources, there is a detailed and coherent valuation model, analysis of pricing, and comment on other analysts' work, leading to a fairly robust calculation of net present value. In others, it is our view that the reports use lower quality analysis such as comparable price multiples, such as in its Steinhoff and ProSieben reports. In some cases the methodology appears to be weak, relying on little more than anecdotes, ad hominem attacks on management and no attempt at balanced assessment, for instance Capitec and Advanced Micro Devices.
- In questions sent to Viceroy by email<sup>85</sup> we asked it to explain its choice of valuation models. Viceroy's response was:

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<sup>83</sup> Our question was worded: Some of your reports (e.g. Neuroderm) show much specialist knowledge. Does your team have such specialist knowledge itself or do you use outside analysts/contributors?

<sup>84</sup> See from page 56 of Spruce Point's report, available at [http://www.sprucepointcap.com/reports/cste\\_shortresearch\\_thesis\\_8-19-2015.pdf](http://www.sprucepointcap.com/reports/cste_shortresearch_thesis_8-19-2015.pdf)

<sup>85</sup> The wording of our question was: "Your reports use various valuation models. For instance, Syrah has a sophisticated net present value calculation and much demand-side analysis. Steinhoff and ProSieben use comparative ratio approaches. Others value stocks at zero without applying a model. What informs the choice of valuation approach?"

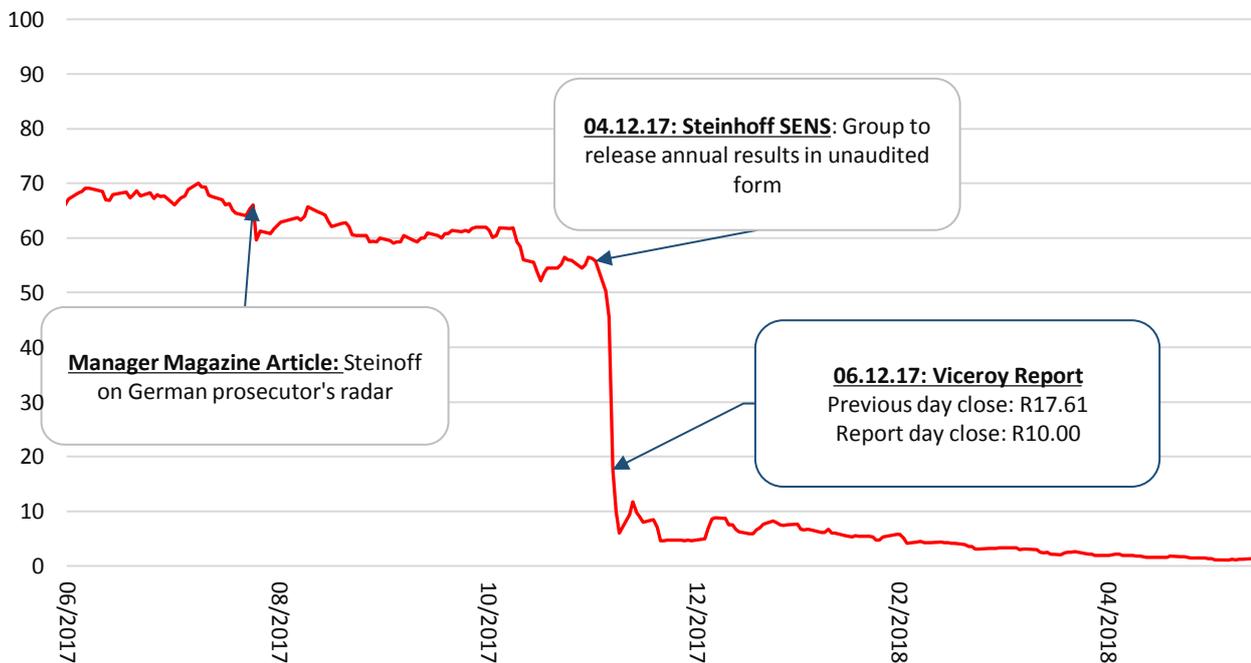
*It depends on the company and how analysts are currently valuing the group. For instance, Syrah is a mine, and mines have a limited lifetime – an NPV is appropriate. NPV's are not particularly well suited for companies such as Caesarstone, ProsSieben and Steinhoff as there are too many variables which can't be priced in accurately.*

*We withhold valuation or present a \$0 value opinion when we believe the business is so fundamentally flawed that it cannot feasibly continue as a going concern, or in a business where we cannot accurately determine financial results in belief they have been adulterated.*

- This description of valuation approaches does not match that reflected in the reports. For instance in the case of Advanced Micro Devices, there is no claim about financial results being “adulterated” but Viceroy claims the company is nevertheless worth “\$0” based on claims about security vulnerabilities. In our opinion a financial analyst should attempt to examine the cash flow outlook for such a business and provide proper forecasts.
- We analyse each report below.

### 11.1 Steinhoff

Figure 1: Steinhoff share price<sup>86</sup> (rand)



<sup>86</sup> Source: EquityRT (share price)

- The Steinhoff report succeeded in generating significant media attention for Viceroy and earned it substantial credibility in the market place. However, as we argue below, the report was substantially plagiarised.
- Short interest data is not available on South African stocks. However, several comments by hedge funds in the media indicate that various hedge funds had short positions in the stock<sup>87</sup>.
- There were several warning signs about Steinhoff before Viceroy's attack. On August 24 2017, a German monthly, Manager Magazine, revealed that German prosecutors were investigating Steinhoff CEO Markus Jooste and some other senior managers at the furniture retailer in connection with suspected accounting fraud. A few days later Steinhoff was summoned for an annual account proceeding before the Enterprise Chamber of the Amsterdam Court of Appeal. In and of themselves, these events would have attracted short sellers.
- Steinhoff's announcement that it was releasing its financials in an unaudited form on 4 December 2017 triggered a sell-off that was compounded by another announcement on 6 December including the resignation of its CEO. Viceroy's report was released late that night.
- Viceroy's report was the first widely distributed research that provided some explanation of the serious accounting irregularities announced by Steinhoff.
- The report points to several off-balance sheet structures managed by individuals close to Steinhoff management, through which transactions were processed that had the effect of boosting Steinhoff's income and reducing its liabilities. With the benefit of hindsight, while there is still much that is not known about the Steinhoff debacle, the use of off-balance sheet vehicles of this sort appears to have been prolific, extending to many entities in addition to those discussed in Viceroy's report.
- The Viceroy report has striking similarities to a report produced by Portsea Asset Management, a London-based hedge fund registered with the Financial Conduct Authority, published on 12 June 2017, some six months before Viceroy's publication.
- There are several tracts of text and several financial estimates that are verbatim, cut and paste from the Portsea report, and the general thesis and argument of the report are largely the same as Portsea's. In table 6 below we list segments that are similar as well as sections that are verbatim (this list is not comprehensive but indicative).

**Table 6: comparison of sections of Portsea report and Viceroy report**

A: Similar wording			
Portsea report <sup>88</sup>		Viceroy report <sup>89</sup>	
Page	Text	Page	Text
14	Given the assets sit below Fulcrum Investment Partners SA, which is based in Martigny Switzerland, details available from local filings are very sparse. However, we can get some understanding of the GT Branding Holding SARL structure from both the limited financials which were published when GT Branding Holding SARL	11	Given GT Branding Holding sits below Fulcrum Investment Partners SA based in Martigny, details available from local filings are very sparse. However, we can get some understanding of the GT Branding Holding SARL structure from both the limited financials

<sup>87</sup> These include Och-Ziff and TCI, see: <https://www.businesslive.co.za/bd/companies/retail-and-consumer/2018-02-08-hedge-funds-made-r15bn-off-steinhoff/>

<sup>88</sup> This report is not available online but Intellidex has a copy.

<sup>89</sup> Report is available at <https://viceroyresearch.files.wordpress.com/2017/12/steinhoff-article-viceroy2.pdf>

	<p>reorganized, and the December 2015 Balance Sheet for GT Branding Holding SARL. On 31 December 2015, we can factually observe that GT Branding Holding SARL owed a related party CHF 809mn.</p>	<p>which were published when the company reorganized, and its December 2015 balance sheet. According to GT Branding Holdings' 2015 accounts, the company had related party debts of CHF 809m (EUR 673m).</p>																																																																																																																																	
<p>15 As of June 2015, Steinhoff's consolidated accounts showed loans outstanding of EUR 994mn. When we asked Steinhoff IR in April 2017 what these loans represented, we were told they were loans to "Chinese suppliers".</p>	<p>12 Viceroy understand from a number of analyst calls to Steinhoff's investor relations in April 2017 that the Company claim these loans were to "Chinese suppliers".</p>																																																																																																																																		
<p><b>B: Verbatim wording/numbers</b></p>																																																																																																																																			
<p>22 As is visible below, Steinhoff's property, plant and equipment ("PP&amp;E") has an implied average life of 24 years (implied average life = Net PP&amp;E / annual depreciation charge). Peers have average lives of between 4 years and 14 years, while Steinhoff has an average life of 24 years for its PP&amp;E.</p>	<p>29 As is visible below, Steinhoff's property, plant, and equipment ("PP&amp;E") has an implied average life of 24 years (implied average life = Net PPE / annual depreciation charge). Peers have average lives of between 4 years and 14 years, while Steinhoff has an average life of 24 years for its PP&amp;E.</p>																																																																																																																																		
<p>23</p> <table border="1" data-bbox="225 920 740 1160"> <thead> <tr> <th>Adjusting Steinhoff's Depreciation charge</th> <th>EUR mn</th> </tr> </thead> <tbody> <tr> <td>Steinhoffs PP&amp;E</td> <td>5136</td> </tr> <tr> <td>Target average life</td> <td>14</td> </tr> <tr> <td>Required Depreciation</td> <td>362</td> </tr> <tr> <td>Steinhoff Depreciation charge</td> <td>217</td> </tr> <tr> <td>Required increase in Depreciation</td> <td>145</td> </tr> <tr> <td><b>Delta between 2016 Capex and Depreciation</b></td> <td><b>376</b></td> </tr> <tr> <td><b>Average of both adjustment styles</b></td> <td><b>261</b></td> </tr> </tbody> </table> <p><i>Figure 31 Source: Company filings, Portsea analysis</i></p>	Adjusting Steinhoff's Depreciation charge	EUR mn	Steinhoffs PP&E	5136	Target average life	14	Required Depreciation	362	Steinhoff Depreciation charge	217	Required increase in Depreciation	145	<b>Delta between 2016 Capex and Depreciation</b>	<b>376</b>	<b>Average of both adjustment styles</b>	<b>261</b>	<p>29</p> <table border="1" data-bbox="935 920 1430 1200"> <thead> <tr> <th>D&amp;A adjustment</th> <th>EUR (m)</th> </tr> </thead> <tbody> <tr> <td>Steinhoff PPE</td> <td>5,136</td> </tr> <tr> <td>Target average life</td> <td>14</td> </tr> <tr> <td>Required depreciation</td> <td>362</td> </tr> <tr> <td>Steinhoff depreciation</td> <td>217</td> </tr> <tr> <td><b>Required increase in depreciation</b></td> <td><b>145</b></td> </tr> <tr> <td><b>Delta between 2016 capex &amp; depreciation</b></td> <td><b>376</b></td> </tr> <tr> <td><b>Average between both adjustments</b></td> <td><b>261</b></td> </tr> </tbody> </table> <p><i>Figure 43 Viceroy Analysis – raw data sourced from S&amp;P</i></p>	D&A adjustment	EUR (m)	Steinhoff PPE	5,136	Target average life	14	Required depreciation	362	Steinhoff depreciation	217	<b>Required increase in depreciation</b>	<b>145</b>	<b>Delta between 2016 capex &amp; depreciation</b>	<b>376</b>	<b>Average between both adjustments</b>	<b>261</b>																																																																																																		
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that the rising DROs are indicative of potential future losses at Steinhoff that have not yet been recognised. The evidence is clear with rising past due but not impaired financial assets. In reviewing Steinhoff's financial asset credit quality, we can identify clear deterioration. Financial assets past due but not impaired more than tripled from 1.6% of all financial assets to 5.3% of financial assets over a mere 15-month period. If Steinhoff were a bank or credit card receivable trust, alarm bells would be ringing.

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26

Steinhoff financial assets (excluding installment loans) (in EUR mn)	12 mths June 2015	12 mths June 2016	15 mths Sep-16
Not past due or impaired	4847		
Past due 1 to 30 days but not impaired	36		
Past due 31 to 60 days but not impaired	6		
Past due more than 60 days but not impaired	35		
Past due but not impaired in full	3		
<b>Total</b>	<b>4927</b>		
Total past due not impaired financial assets	80		
<b>% Past due but not impaired</b>	<b>1.6%</b>		

Figure 35 Source: Company filings, Portsea analysis

31

SNH Financial assets (excl. installment loans)	SNH 12 mths Jun-15	SNH 15 mths Sep-16
Not past due or impaired	4847	5,016
Past due 1-30 days not impaired	36	62
Past due 31-60 days not impaired	6	19
Past due >60 days not impaired	35	197
Past due not impaired in full	3	2
<b>Total</b>	<b>4927</b>	<b>5296</b>
Total past due not impaired assets	80	280
<b>% past due but not impaired</b>	<b>1.6%</b>	<b>5.3%</b>

Figure 46 Viceroy analysis – raw data from S&P

26 Furthermore, we can see that Steinhoff's instalment plan credit quality is weak, with over 20% of receivables from customer financing not up to date....That said, the current continuing Steinhoff consumer finance business compares incredibly favourably to the recently "divested" JD Finance business, which had 47% of receivables not up to date, per the below:

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- Viceroy produces a price: earnings multiple-based valuation on Steinhoff at the end of its report using comparable companies, as does Portsea. This has slight differences to Portsea's approach, with updated figures, but Viceroy uses an identical general valuation framework to Portsea.
- We asked Viceroy whether claims in the German media were true that some of the Steinhoff report was copied from another hedge fund's report<sup>90</sup>. This was Viceroy's response:

*Viceroy is sent significant amounts of data anonymously, which of course may come from funds. In the case of Steinhoff, we received an email with data pertaining to further information on an off-balance sheet entity which we incorporated into our report, and transcripts of a call to IR suggesting that loans to these entities were made to "Chinese Suppliers". We, of course, incorporated this into our own work.*

- This appears to admit to the possibility that the accusations of plagiarism are true, but attempts to downplay the extent of the similarities, restricting them to data only. As the side-by-side comparison above shows, the similarities are far more than data. Viceroy appears to suggest that this data was received anonymously. We find it curious, however, that all of Portsea's data tables are marked as being "Portsea analysis" while the Viceroy report versions, containing identical data, are sourced as "Viceroy analysis". The reference to "transcripts of a call to IR" is also curious considering that the reference in Viceroy's report seems to be a reworded version of the Portsea

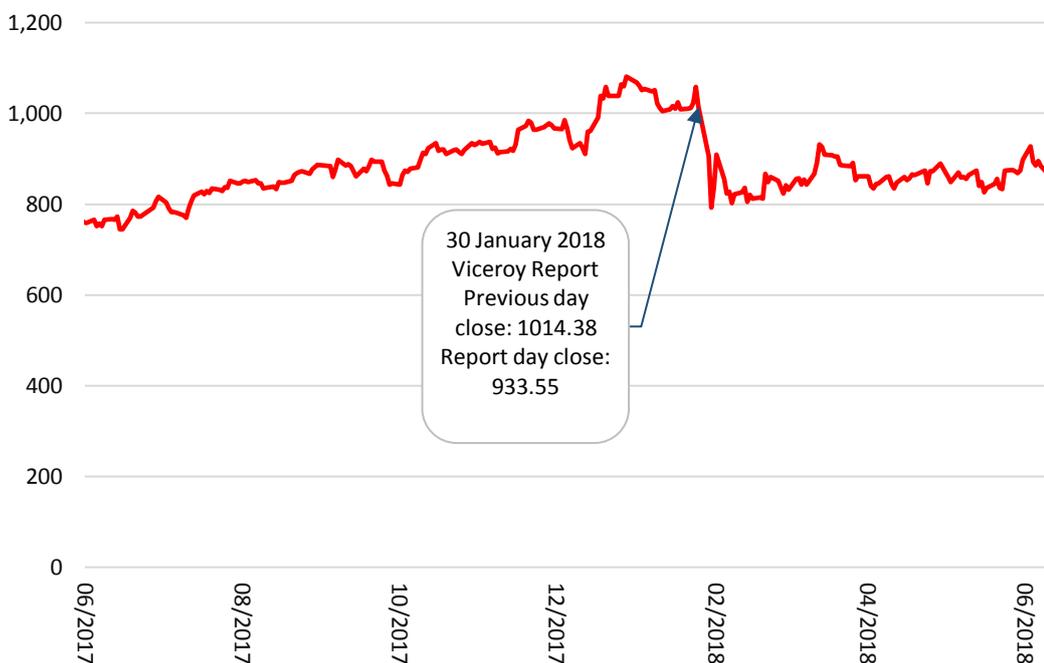
<sup>90</sup> Our question was: "I've seen German media reports that some of the Steinhoff report was copied from another hedge fund's report. Is that true?"

comment on a call to IR. Viceroy’s response also seems to suggest that Viceroy relies on anonymous tip-offs which it does not seek to verify, but uses without disclosing that they were received anonymously. The reliance on unattributed and unverified information in reports in our view further compromises the quality and professionalism of the research.

## 11.2 Capitec

- The Capitec report had a dramatic impact on the market price of Capitec, falling 25% intraday on the day of the release of the report, though it recovered to close down 3%.

Figure 2: Capitec Bank share price<sup>91</sup> (rands)



- Following the first report, Viceroy issued a subsequent report and several letters and responses to management and regulators<sup>92</sup>.
- Compared with the data-driven analysis contained in the Steinhoff report, the Capitec report was thin on data and contains several serious and alarming claims. It begins with the statement:

*Based on our research and due diligence, we believe that Capitec is a loan shark with massively understated defaults masquerading as a community microfinance provider. We believe that the South African Reserve Bank & Minister of Finance should immediately place Capitec into curatorship<sup>93</sup>*

- On the same day, 30 January 2018, the South African Reserve Bank issued a statement supporting Capitec. It noted in the release that Capitec was well capitalised, solvent and had adequate

<sup>91</sup> Source: EquityRT (share price)

<sup>92</sup> These reports and correspondence are available at <https://viceroyresearch.org/category/capitec-jsecpi/>

<sup>93</sup> See the Viceroy report, page 1, available at <https://viceroyresearch.files.wordpress.com/2018/01/capitec-30-jan-2017.pdf>

liquidity<sup>94</sup>. The Reserve Bank later said it had confidence in the data and financial statements of Capitec, and that the substantive allegations made by Viceroy were not accurate<sup>95</sup>.

- South Africa's National Treasury, which oversees legislation pertaining to the financial sector and must jointly make decisions with the Reserve Bank about curatorships, issued a statement a day after the Viceroy report. In this statement, National Treasury declared Viceroy's actions "reckless" and "not acting in the public interest". The statement also said:

*National Treasury has requested that the Financial Services Board, as the market regulator, working with the JSE, urgently considers whether it should initiate a market abuse investigation into the conduct of Viceroy, and to ensure that it is regulated appropriately. The FSB is requested to also alert relevant overseas regulators, like the Securities and Exchanges Commission in the USA and the Financial Conduct Authority in the UK, to consider whether Viceroy is regulated appropriately, and to consider whether it has transgressed any of their market conduct and market abuse laws that aim to protect investors.*<sup>96</sup>

- Our analysis indicates several problems with Viceroy's Capitec report including unsupported exaggerations, poor reasoning, misunderstandings of the South African credit market and the history of the sector. For instance:
  - Viceroy states: "We see no operational difference between Capitec and its ill-fated predecessors, including African Bank."<sup>97</sup> This is an inflammatory comparison in that African Bank collapsed into curatorship in 2014. There are very clear operational differences in the two banks: in its last year of operation, about 80% of African Bank's revenue consisted of insurance premiums and furniture sales, rather than net interest<sup>98</sup>. African Bank provided no transactional banking facilities and was not deposit taking. By comparison, Capitec operates a significant transactional bank and generates half its earnings from transaction fees and has no consumer retail business<sup>99</sup>.
  - Viceroy claims that Jean Pierre Verster, a Capitec director and head of its board audit committee, and coincidentally a well-known short selling hedge fund manager, is "indirectly short" of Capitec because he did not hold its shares in his funds at Fairtree Capital. This misses the rather more plausible explanation: that Verster does not trade any Capitec shares in his funds because it would be a conflict of interest and potentially breaching insider trading rules. Indeed, it is odd that Viceroy does not consider that Verster's excellent reputation as a short seller to be a reason for confidence in Capitec's accounting and practices.
  - Viceroy claims that Capitec has been systematically rolling defaulting borrowers into longer-term loans. While we think this is reasonable concern, Viceroy ignores the alternative potential explanation which is that Capitec has been systematically lengthening the term of its asset structure as it has been able to secure more long-term funding, a

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<sup>94</sup> See <https://www.fin24.com/Companies/Financial-Services/capitec-is-solvent-sarb-20180130>

<sup>95</sup> See <https://www.timeslive.co.za/sunday-times/business/2018-05-30-capitec-earns-the-nod-from-reserve-bank-after-viceroy-allegations/>

<sup>96</sup> See the Treasury statement at [http://www.treasury.gov.za/comm\\_media/press/2018/2018020201%20Media%20statement%20Viceroy%20Capitec%20Report.pdf](http://www.treasury.gov.za/comm_media/press/2018/2018020201%20Media%20statement%20Viceroy%20Capitec%20Report.pdf)

<sup>97</sup> Page 1, *ibid*.

<sup>98</sup> See African Bank's 2013 annual financial statements.

<sup>99</sup> Page 5, *ibid*.

stated strategy for several years<sup>100</sup> as it has evolved into a full-scale retail bank. Viceroy's allegation is that extending loans is a way of masking fundamentally weakening credit-baring capabilities of its clients. Both explanations are plausible on the evidence and should have been weighed up more carefully. Notably Capitec has subsequently provided more data on its loan extensions.

- The report relies heavily on input from what Viceroy describes as former employees, although most of the employee inputs it cites are taken from the public website Glassdoor<sup>101</sup>. The input from these employees is anecdotal and does not provide an adequate basis to conclude that there are systematic issues with Capitec's asset base.
  - As evidence that Viceroy has little understanding of the South African credit market, it notes with surprise that "Capitec actually phones clients to market loans"<sup>102</sup> even though this is a practice that is widespread among banks and non-banks in South Africa.
  - Viceroy makes much of ongoing litigation against Capitec being led by Summit Financial Partners, alleging this could lead to a liability to Capitec of R12.7bn. This claim refers to a potentially class-action law suit. It follows a decision by the National Credit Regulator *not* to recommend similar issues to the Consumer Tribunal for further action. Viceroy makes no mention of the NCR's decision-making. Summit CEO Clark Gardner subsequently said of the Viceroy report: "I think the report is very reckless. Viceroy has ridden on the back of sentiment garnered following its Steinhoff report and is now going reckless on a deposit-taking institution. That is raw capitalism at its best."<sup>103</sup> As we were finalising this report, Capitec and Summit settled their litigation with no financial consequences for Capitec<sup>104</sup>.
  - Viceroy makes no attempt to undertake a proper valuation of Capitec's equity. In its conclusion it declares that its assessment of the loan book leads it to believe R11bn should be written off. This seems to be based on a fundamental confusion about Capitec's write off policy, loan book growth rates and the distinction between fees and interest in outstanding loans<sup>105</sup>. But even if Viceroy's view was reasonable, it would not wipe out Capitec's R18.9bn of shareholder funds<sup>106</sup>, and therefore there would be no need for curatorship, although it would place the bank under stress. Therefore, even on Viceroy's own logic, there is no basis for its claim that Capitec should be put into curatorship.
- We have no view on the value of Capitec. We note that other, credible, researchers have argued that Capitec is overvalued. For instance, South Africa's top-rated banks analyst, Stephen Potgieter at UBS, had a "sell" rating on Capitec at the time of the Viceroy report. However, following share price weakness after the Viceroy report, he upgraded his recommendation to "neutral"<sup>107</sup>. Another short seller, Benguela Asset Managers, produced a research report with a negative thesis on

<sup>100</sup> See, for instance, commentary on lengthening loan terms in Capitec's 2012 annual financial statements:

[https://www.capitecbank.co.za/resources/Capitec\\_SummarisedAuditedResults\\_2012\\_Summ.pdf](https://www.capitecbank.co.za/resources/Capitec_SummarisedAuditedResults_2012_Summ.pdf)

<sup>101</sup> See <https://www.glassdoor.co.uk/Reviews/Capitec-Bank-Reviews-E426668.htm>

<sup>102</sup> Ibid, pg 31.

<sup>103</sup> Quoted in Business Day, see: <https://www.pressreader.com/south-africa/business-day/20180201/281968903126797>

<sup>104</sup> See coverage of the settlement here <https://www.businesslive.co.za/bd/companies/financial-services/2018-07-02-summit-capitec-row-resolved/>

<sup>105</sup> Capitec has given a response to several key allegations made by Viceroy. See:

<https://businesstech.co.za/news/banking/222115/capitec-responds-to-7-key-allegations-in-the-viceroy-report/>

<sup>106</sup> See Capitec annual financial statements at

[https://resources.capitecbank.co.za/audited\\_summary\\_financial\\_statement\\_2018.pdf](https://resources.capitecbank.co.za/audited_summary_financial_statement_2018.pdf)

<sup>107</sup> This was reported by Fin24. See <https://www.fin24.com/Companies/Financial-Services/capitec-analysts-defy-viceroy-predatory-attack-on-shares-20180204>

Capitec at approximately the same time which was not widely distributed. Benguela, however, issued some scathing criticism of the Viceroy report, calling it “shocking and irresponsible”<sup>108</sup>.

- Seen in its entirety, it is our view that Viceroy’s Capitec report exhibits a failure of professional standards in research. It is not objective in that it cherry picks negative information which it then interprets in the most negative way possible. It does not consider alternative interpretations of the same information, let alone positive aspects to Capitec’s performance. It fails to provide a reasonable basis for the conclusions that it draws. It provides no proper valuation of Capitec.
- In the context of the three categories of research discussed in Section 1.3, the Capitec report fits either in the category of conviction-based research or the category of outright false research. In either case, we contend that there are reasonable grounds to argue that Viceroy’s function was to publish distorted information with the ambition of negatively affecting the share price, which would amount to illegal market manipulation.

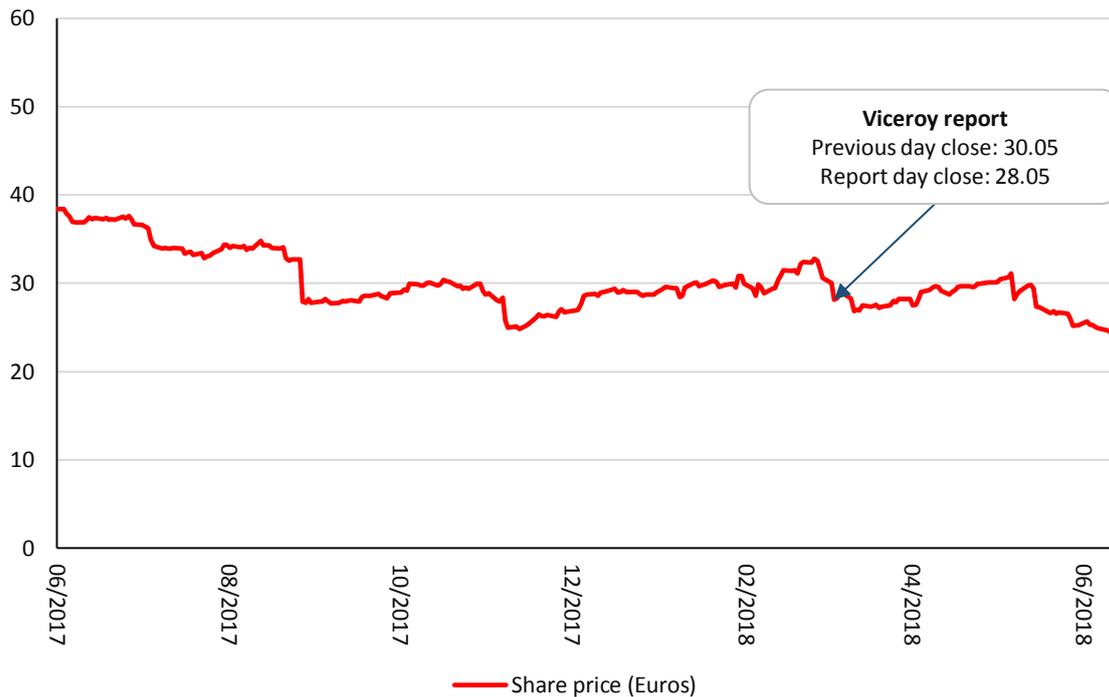
### 11.3 ProSiebenSat1

- After Capitec, ProSiebenSat1 had the greatest market impact for Viceroy, the share price moving the share price 6% down on the day of the release of Viceroy’s report (see Figure 3 below). Like the other targets of Viceroy, ProSieben had already been the target of significant short seller interest in the months leading up to Viceroy’s reports<sup>109</sup>.

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<sup>108</sup> See coverage of comments here: <https://citizen.co.za/business/1802523/benguela-fund-managers-clarifies-its-capitec-position/>

<sup>109</sup> See <https://uk.reuters.com/article/uk-prosieben-media-accounts/germanys-prosieben-rejects-critical-report-by-short-seller-viceroy-idUKKCN1G11J6>

Figure 3: ProSiebenSat1 Media SE<sup>110</sup> (euro)

- The ProSiebenSat report substantially consists of analysis of ProSieben’s accounting and the personalities of its executives. Principal allegations are that ProSieben manipulates earnings by cycling cash paid for acquisitions into barter transactions for advertising sales, that its overall acquisition strategy has been “catastrophic”, and that its finance team members have all left in recent years. We will not assess in detail the claims Viceroy makes, but note that ProSieben has issued a rebuttal<sup>111</sup>. As discussed in section 9, Germany’s financial regulator, Bafin, and its prosecuting authority are investigating Viceroy over the report.
- The valuation undertaken by Viceroy in this report is similar to the valuation in the Steinhoff report in that it is based on comparable multiples, in this case EV/EBITDA. It also provides a far more systematic set of adjustments it believes should be made to ProSieben’s earnings than it even attempts in the case of Capitec.
- However, there is contradictory reasoning within its report. For instance, it notes that, “ProSieben has significant financing needs evidenced by consistent equity and debt raising, despite the cash on its balance sheet. Cash at hand does not appear to be restricted or formally committed in any way. In order to raise capital, which it doesn’t really need, ProSieben has taken several questionable different approaches each year.”<sup>112</sup> The comment on cash is appropriate given that ProSieben’s 2017 annual financial statements disclose cash holdings of €1.6bn out of total assets of €6.6bn. Yet a central thesis of the Viceroy report is that the company has “significant unmet financing needs and dividend commitments [that] far outweigh ProSieben’s cash flows. We believe shareholders

<sup>110</sup> Source: EquityRT (share price)

<sup>111</sup> See Reuters report on rebuttal at <https://uk.reuters.com/article/uk-prosieben-media-accounts/germanys-prosieben-rejects-critical-report-by-short-seller-viceroy-idUKKCN1GI1J6>

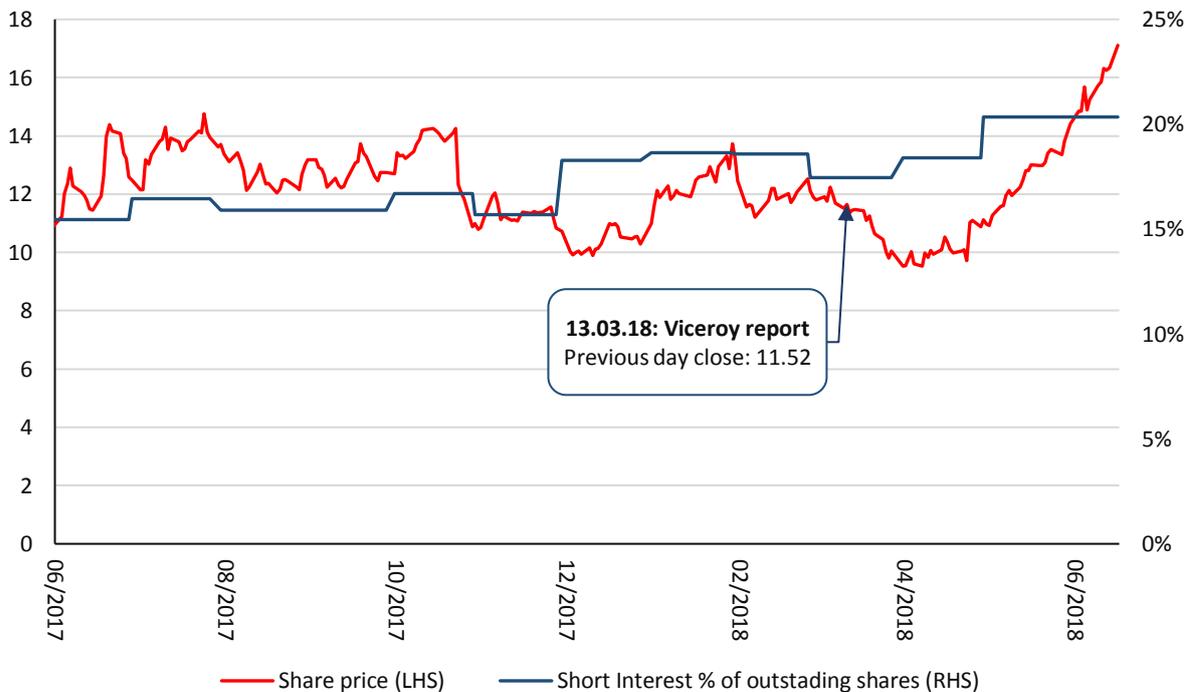
<sup>112</sup> See page 27 of the ProSieben report at <https://viceroyresearch.files.wordpress.com/2018/03/prosieben-6-mar-20171.pdf>

will inevitably be subject to increasingly dilutive equity raises”,<sup>113</sup> implying that ProSieben lacks cash. There is no attempt by Viceroy to reconcile these claims.

### 11.4 Advanced Micro Devices

- The most recent target of Viceroy, AMD, has seen significant share price appreciation after the Viceroy report. AMD is far larger than Viceroy’s other targets and boasts far greater analyst coverage. Viceroy’s research has received little attention in prominent media and has been criticised widely in computer science and related specialist publications (see section 8).
- In Figure 4 we show the share price movements as well as the short interest in the stock, which is available as the stock is traded on Nasdaq. It is clear that there was significant short interest prior to Viceroy’s report. These interests have not profited from the report, however, as the share price has increased since.

Figure 4: Advanced Micro Devices Inc<sup>114</sup> (dollars)



- The Viceroy report followed 30 minutes after a CTS Labs report<sup>115</sup>, which means Viceroy had advance access to the CTS Labs report. The exact timing of when it got the report is in dispute with

<sup>113</sup> Page 1, *ibid*.

<sup>114</sup> Source: EquityRT (share price), and shortsqueeze.com (short data)

<sup>115</sup> See cached story at:

[https://webcache.googleusercontent.com/search?q=cache:pJT9rKy5PG4J:https://motherboard.vice.com/en\\_us/article/bj5wy4/amd-flaws-viceroy-short-selling-stock-market+&cd=5&hl=en&ct=clnk&gl=us](https://webcache.googleusercontent.com/search?q=cache:pJT9rKy5PG4J:https://motherboard.vice.com/en_us/article/bj5wy4/amd-flaws-viceroy-short-selling-stock-market+&cd=5&hl=en&ct=clnk&gl=us)

different timelines being reported. Reuters was told 12 March<sup>116</sup>, Motherboard was told anytime between 4 to 10 March<sup>117</sup>.

- The essence of the CTS Labs report and Viceroy's report is that there are serious security flaws with AMD's chips. It is noteworthy Google had published information about security flaws with several manufacturers' chips in January<sup>118</sup>, though the mechanism of releasing this information was very different as Google gave the manufacturers details about the flaw some time before its public release.
- The CTS Labs paper itself points out it is limited in that it does not provide evidence through proofs of concept or example code "but purposefully does not provide a complete description of such vulnerabilities to protect users"<sup>119</sup>. Specialist technology commentators<sup>120</sup> point out that the paper lacks technical detail to address the perceived problems with the technology, and instead seeks to attack the company. This act has raised questions about the financial benefits that will accrue to both CTS Labs and Viceroy, each of whom indicate that it is likely that they have taken a position on the stock<sup>121</sup>. CTS Labs has links to former hedge fund traders, particularly Ninewells Capital<sup>122</sup>, and was effectively unknown before the publication of its AMD report.
- CTS Labs created a site called AMDflaws.com specifically for the launch of this report. The site's disclaimer<sup>123</sup> contains language that itself should have raised red flags for any researcher: "The report and all statements contained herein are opinions of CTS and are not statement of fact."
- The Viceroy report sensationalises the CTS report by adding the following remarks: "Just one Ryzen chip could endanger an entire enterprise network"; "AMD's flawed chips are components in government and defense products"; and "AMD must cease the sale of Ryzen and EPYC chips in the interest of public safety."
- Viceroy does not attempt a proper valuation of AMD, concluding that: "We believe AMD is worth \$0.00 and will have no choice but to file for Chapter 11 (bankruptcy) in order to effectively deal with the repercussions of recent discoveries." Since that conclusion, the share price has risen by more than 40%.
- The Viceroy report ramps up the emotional appeal of the CTS Labs report by drawing in unrelated information. The first example is: "In an apparently desperate attempt to compete with Intel, AMD has outsourced its Chipset, a central system component, to ASMedia and integrated it into its Ryzen PC, white-labelling it as AMD. According to CTS, a perfunctory security audit of the chipset would have discovered manufacturer backdoors." Another example is: "ASMedia's parent company, AsusTek (TPE:2357), recently settled FTC charges alleging its home routers and cloud services were insecure and put customers at risk. The settlement requires AsusTek's security program be subject to independent audits for the next 20 years. It is astounding that AMD would even consider engaging AsusTek to produce vital security components." It is unclear how any of

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<sup>116</sup> See Reuters story at <https://www.reuters.com/article/us-cyber-amd/after-short-selling-surge-israeli-firm-says-it-finds-amd-chip-flaw-idUSKCN1GP273>

<sup>117</sup> See Motherboard story at [https://motherboard.vice.com/en\\_us/article/bj5wy4/amd-flaws-viceroy-short-selling-stock-market](https://motherboard.vice.com/en_us/article/bj5wy4/amd-flaws-viceroy-short-selling-stock-market)

<sup>118</sup> See Google's report at <https://security.googleblog.com/2018/01/todays-cpu-vulnerability-what-you-need.html>

<sup>119</sup> See the paper at the website set up by CTS Labs: <https://www.amdflaws.com/disclaimer.html>

<sup>120</sup> See: <https://www.gamersnexus.net/industry/3260-assassination-attempt-on-amd-by-viceroy-research-cts-labs>

<sup>121</sup> <https://web.archive.org/web/20180316165515/http://searchsecurity.techtarget.com/news/252437041/Leaked-report-on-AMD-chips-flaws-raises-ethical-disclosure-questions>

<sup>122</sup> CTS Labs' CFO, Yaron Luk-Zilberman, was formerly MD of Ninewells. See his LinkedIn profile:

<https://www.linkedin.com/in/yaron-luk-zilberman-09a1795/>

<sup>123</sup> See: <https://www.amdflaws.com/disclaimer.html>

these points relate to the CTS Labs investigation of the alleged flaws with the AMD chips or with the value of the company.

- It appears to us that Viceroy used the advanced access to the CTS Labs report to write its own report, in which the only additional contribution was to increase the emotive aspects of the report, while adding an endorsement to the technical claims that CTS Labs made. There is no genuine financial analysis undertaken and therefore, we conclude, no basis for claims about the value of AMD.
- This report seems calculated to provide distorted information that will affect the AMD share price, rather than a genuine representation of Viceroy's convictions, or the result of a professional and objective research process and report.

### 11.5 MiMedx

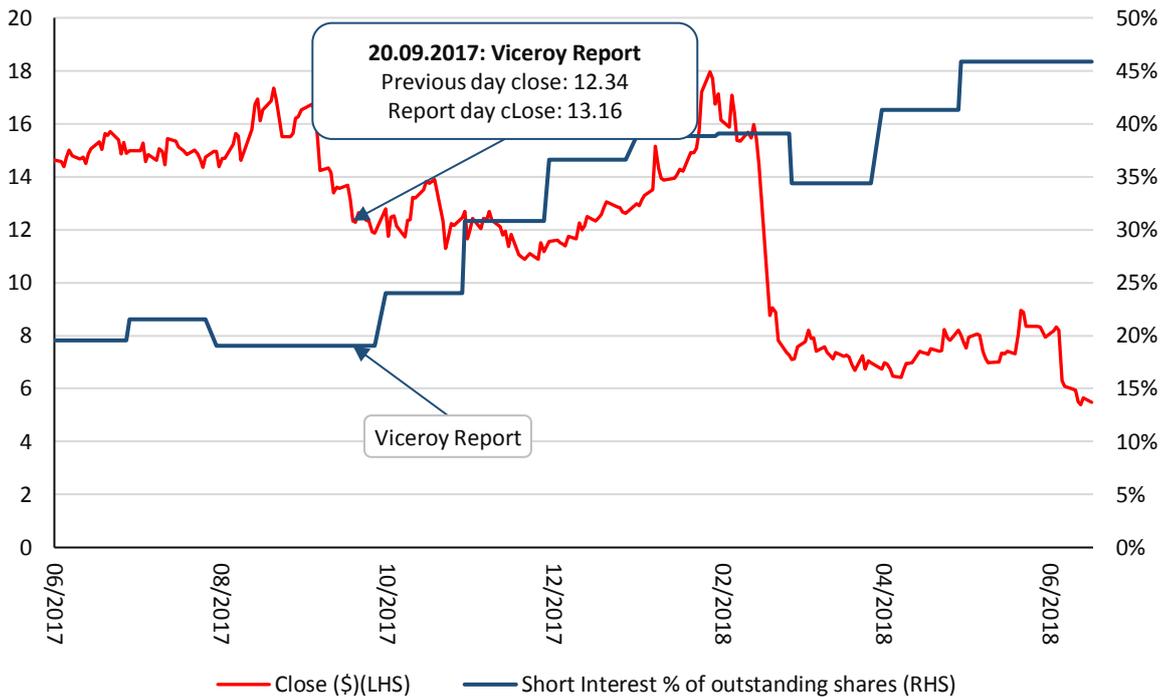
- MiMedx has been the subject of the most prolific research output by Viceroy. Several other short-sellers have targeted MiMedx. On the whole, the short-seller campaign targeting MiMedx has been borne out by developments, including the recent resignation of the CEO and the withdrawal of financials, even though in the case of Viceroy's research reports, there has been inconsistency in the accuracy of details.
- Viceroy is closely aligned with renowned short seller Marc Cohodes and he, along with Perring, frequently take to Twitter in making claims about MiMedx, which they then retweet and comment on. Viceroy has said it has no professional relationship with Cohodes<sup>124</sup>. We provide more detail on the relationship between Cohodes and Viceroy in section 5 above.

Figure 5: MiMedx Group Inc<sup>125</sup> (dollars)

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<sup>124</sup> In an email exchange with one of the authors of this report.

<sup>125</sup> Source: EquityRT (share price), and shortsqueeze.com (short data)



- MiMedx has initiated litigation against Viceroy in the Jacksonville division of the district court of Florida on 4 June 2018. MiMedx has not been able to serve Perring, Bernarde or Lau, although Perring is clearly aware of the litigation, as evidenced in tweets<sup>126</sup>.
- MiMedx has been subject to a sustained campaign by several different activist short sellers, including prominent short sellers like Sparrow Fund Management and Dialectic Capital. MiMedx and Sparrow have each launched litigation against the other. Sparrow has filed a defamation suit against MiMedx in New York regarding MiMedx’s description of its activities as unlawful<sup>127</sup>. MiMedx has also launched litigation against Dialectic Capital.
- The MiMedx share price lost 6% on the day of the first Viceroy report. Viceroy has subsequently issued around 20 reports.
- Apart from Sparrow and Cohodes, another anonymous short selling outfit, Aurelius Value, has also published negative reports on MiMedx<sup>128</sup>.

Viceroy makes a range of allegations about MiMedx, including:

- **Ongoing federal investigations:** Viceroy claims that MiMedX has been the subject of ongoing SEC, Veteran Affairs and Department of Justice (DOJ) investigations prior to its own investigations. None of the notices cited by Viceroy show any content of the investigations or how they are linked to any of the allegations made by Viceroy.
- **Channel stuffing:** Viceroy alleges that MiMedX has been actively using this technique to boost earnings figures. Channel stuffing refers to the practice of “sending retailers along its distribution channel more products than they are able to sell to the public”<sup>129</sup> in order

<sup>126</sup> For instance, see <https://twitter.com/AlMhonesty/status/1016380539333431296>

<sup>127</sup> See Sparrow’s statement of claim at

<https://www.courtlistener.com/recap/gov.uscourts.nysd.494908/gov.uscourts.nysd.494908.1.0.pdf>

<sup>128</sup> See Aurelius Value’s coverage at <http://www.aureliusvalue.com/company/mdxg/>

<sup>129</sup> For further explanation of channel stuffing see <https://www.investopedia.com/terms/c/channelstuffing.asp>

to inflate sales figures. The company is said to use a mix of employee, physician-owned outlets as part of its activity.

- **Managerial incompetence:** Viceroy cites examples of weak financial controls, changing of auditors from EY to KPMG when the former was said to be unprepared to sign off on the 2017 audit.
  - **Flawed clinical studies:** Viceroy alleges that MiMedX paid bribes to physicians during their clinical trials. They cite former employees as sources for these allegations.
  - **Bribing practitioners:** Dr Marcella Dolores Farrer, Dr Carol Colon Guardiola and Donna Becker, all three former Department Veteran Affairs employees, were indicted on charges of accepting payments and gifts from MiMedx for excessive use of their products<sup>130</sup>. The charges were filed on 10 May 2018 and the story appeared on Reuters.
  - **Circumventing regulatory oversight:** One particular product, AmnioFix Injectable, is highlighted as contravening a regulatory ruling on how to market the product. The FDA is said to disagree with how MiMedX defines the product and thus how it should be marketed.
  - **Aggressive anti-whistle-blower retaliation:** The report lists cases in which MiMedX is said to have taken harsh action against former employees to prevent them from aiding regulators like the SEC. An early example of the whistle-blower report filed by former employees Tornquist and Kruchoski details the allegations against MiMedX<sup>131</sup>.
- Viceroy concludes: “We reiterate our opinion that due to the overwhelming nature and amount of evidence against the company we believe MiMedx is a robust fraud, entirely uninvestable, and worth \$0.00.” There is no attempt at a comprehensive valuation of MiMedx to demonstrate its cash flows or assets to justify such a valuation.
  - MiMedx has responded robustly to Viceroy through its litigation. In its complaint for damages it sets out responses to many of Viceroy’s claims, pointing to fundamental errors including getting dates wrong, misattributing companies, and misunderstanding hiring policies. The case is yet to proceed as MiMedx has not yet been able to serve Viceroy and its principals.
  - MiMedx has recently withdrawn its financial statements for the last five years and the CFO has resigned<sup>132</sup>. This appears to lend credibility to the short attack on the company by Viceroy, Cohodes and others. The main issue MiMedx says is responsible for the restatement is two distributors “for which certain implicit arrangements modified the explicit terms of the contracts, impacting revenue recognition during specified periods.”<sup>133</sup> This may amount to a version of “channel stuffing” consistent with Viceroy’s claims.
  - As we were finalising this report the MiMedx CEO, Parker H Petit resigned from the company. This triggered further share price weakness.

## 11.6 Neuroderm

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<sup>130</sup> See: [https://www.mdlinx.com/gastroenterology/email-user-article.cfm?article\\_id=7520207](https://www.mdlinx.com/gastroenterology/email-user-article.cfm?article_id=7520207)

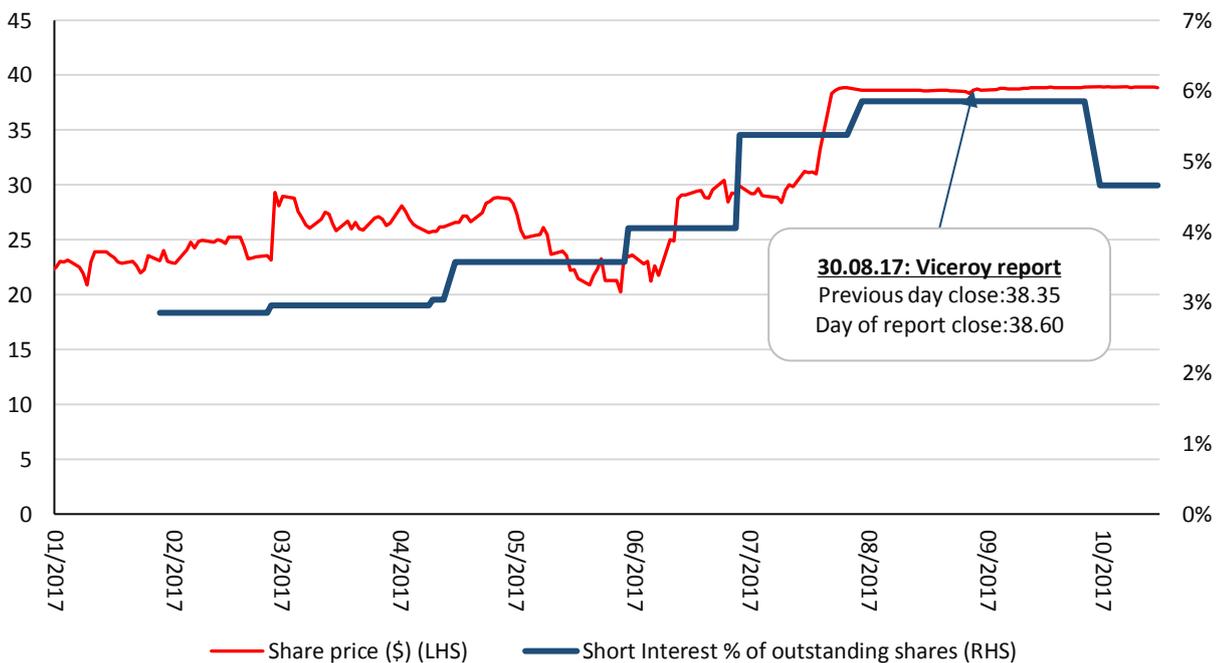
<sup>131</sup> See: <http://www.halunenlaw.com/wp-content/uploads/2016/12/10116505343.pdf>

<sup>132</sup> See: <http://ww2.cfo.com/accounting-accounting-tax/2018/06/mimedx-announces-restatement-replaces-cfo/>

<sup>133</sup> Reported by Reuters, see: <https://www.reuters.com/article/us-mimedx-group/mimedx-to-restate-financial-statements-replaces-cfo-idUSKCN1J31AP>

- The Viceroy report<sup>134</sup> on Neuroderm is a highly scientific inquiry into the validity of clinical trials of the drugs produced by Neuroderm. The report reads completely differently from other Viceroy reports in that the language is highly technical, the structure is more scientific and the report cites numerous references and sources. The report gives detailed comparative analysis on the Neuroderm drugs and their competitor product AbbVie's Duodopa (marketed as Duopa in the US). The report provides a detailed critique of the methods employed during the clinical trials of Neuroderm's main Parkinsons drug.
- The report also is notably free of the *ad hominum* and general disparagement of the subject found in other Viceroy reports. So different is the Neuroderm report that we do not believe it was written by any of the apparent members of Viceroy.

Figure 6: Neuroderm<sup>135</sup> (dollars)



- Similar to other Viceroy reports, the Neuroderm report was issued at a time when there was a large short interest in the stock.
- Neuroderm was at the time subject to a takeover offer by Mitsubishi Tanabe Pharma Corporation (TSE Code: 4508) of Japan. Viceroy's report strongly challenged the takeover offer and lobbied Mitsubishi to not follow through with its deal. Viceroy followed the report with a letter to Mitsubishi shareholders intended to appeal directly to them to oppose the deal<sup>136</sup>.
- The report was not successful in dissuading Mitsubishi. The acquisition was completed on 18 October 2017<sup>137</sup> and Neuroderm was delisted.

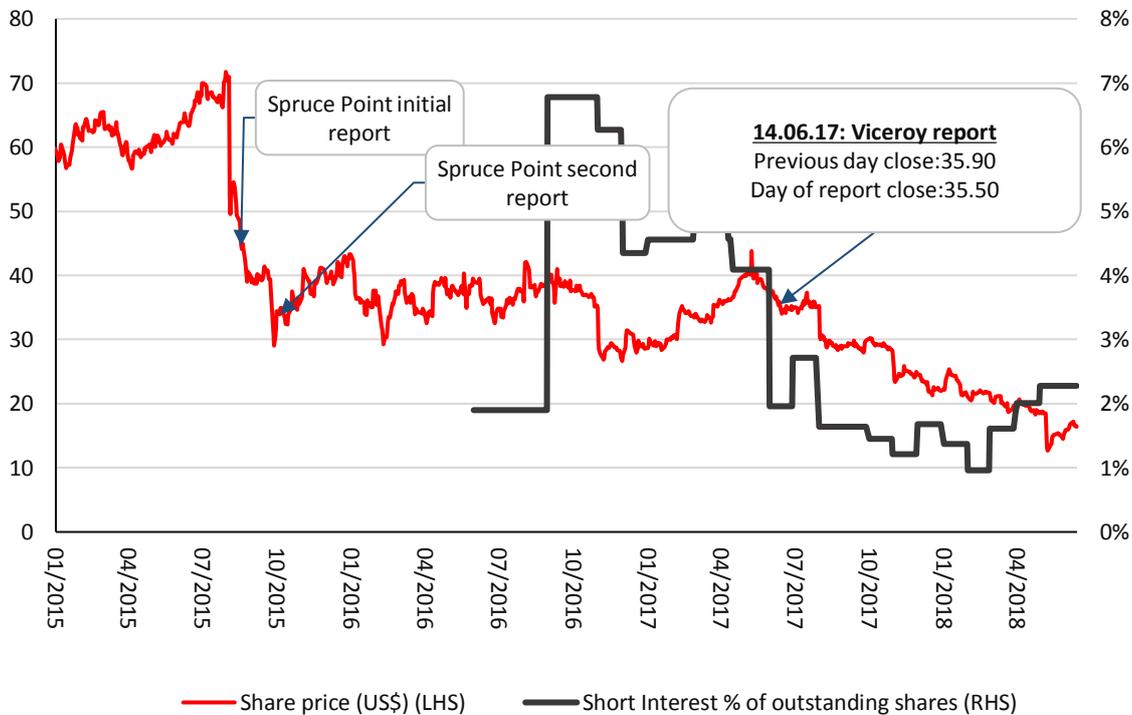
<sup>134</sup> Viceroy has removed the link to their report in the website section for Neuroderm, however it can be downloaded at <https://viceroyresearch.files.wordpress.com/2017/09/cleaned-mitsubishi-tanabe-open-letter1.pdf>.

<sup>135</sup> Source: EquityRT (share price), and shortsqueeze.com (short data)

<sup>136</sup> See the letter at <https://viceroyresearch.files.wordpress.com/2017/09/cleaned-mitsubishi-tanabe-open-letter1.pdf>

<sup>137</sup> See <http://globenewswire.com/news-release/2017/10/18/1149045/0/en/Mitsubishi-Tanabe-Pharma-Corporation-Completes-Acquisition-of-NeuroDerm.html?f=22&fvtc=2&fvttv=1>

## 11.7 Caesarstone

Figure 7: Caesarstone Ltd<sup>138</sup> (\$)

- Viceroy's Caesarstone report<sup>139</sup> begins by acknowledging that it draws on short reports by Ben Axler of Spruce Point Capital (19 August 2015<sup>140</sup> and 6 October 2015). We have reviewed both the Spruce Point and the Viceroy reports. The Spruce Point reports are significant pieces of research including laboratory assessments of Caesarstone and competitor products.
- The Viceroy report structure makes it very challenging to read. First, the Summary Thesis does not summarise the overall report. There are gaps between the report and what is highlighted in the summary. Specifically, the report develops arguments on the disappearing bull case, further detail on the problematic sales channels and channel management, the case against the Caesarstone claim that 'Transform' is a new product, that Freedonia's market data should not be trusted. Second, the report revisits the same topic in numerous locations, and it requires the reader to piece together the arguments because conclusions, reasons and evidence are presented in disparate locations across the report.
- The Viceroy report is poorly structured. The opening section on the short thesis proclaims to highlight the main findings in the rest of the report, but then the rest of the report contains information not cited in the summary/short thesis. The section on sales channel management is a good example where the content repeats other sections, arguments are unclear since conclusions are unstated, and the premises do not support the conclusions, and no evidence is given for the

<sup>138</sup> Source: EquityRT (share price), and shortsqueeze.com (short data)

<sup>139</sup> Available at <https://viceroyresearch.files.wordpress.com/2017/06/caesarstone-nasdaq-cste-report.pdf>

<sup>140</sup> Available at [http://www.sprucepointcap.com/reports/cste\\_shortresearch\\_thesis\\_8-19-2015.pdf](http://www.sprucepointcap.com/reports/cste_shortresearch_thesis_8-19-2015.pdf)

premises. Of course, a poor structure does not mean the claims are baseless, although it makes it difficult to follow what the claims are.

- There are clear overlaps between the Viceroy report and the preceding Spruce Point Capital report:
  - IKEA as a weak sales channel for CSTE
  - The claims of market share gains based on the Freedonia analysis
  - Overstated margins based on the comparative analysis with Silestone (a Caesarstone competitor),
  - The anticipation of cost from a silicosis class action law suit.
- The Spruce Point Capital report concludes with a clear statement on the expected value of the Caesarstone share price. Viceroy claims that it is not possible to do any valuation calculations because of the large number of variables to consider.
- Viceroy adds the following elements to the Caesarstone short-selling case:
  - Management has a history of revising forecasts
  - The SEC has asked for clarifications on the 20F filing from Caesarstone
  - IKEA is suffering due to increased competition in the market place.
- Viceroy does not attempt a proper financial evaluation of Caesarstone, unlike Spruce Point Capital. On the whole, the Viceroy report fails to deliver a well-reasoned intrinsic value thesis for Caesarstone.
- On the same day of the release of Viceroy's report, Spruce Point Capital sent out an email to its clients<sup>141</sup>, "to alert our readers" to the Viceroy report, saying: "We believe this report strengthens our views that CSTE is at best a \$15 stock." While the mutual endorsement of each other's work suggests some level of cooperation, when we enquired with Spruce Point Capital whether there was a relationship with Viceroy we were told there was "no formal business relationship between Viceroy and Spruce Point. Our liking or retweeting of their report (or any other content) on twitter is in no way an endorsement of an organization or indicative of a business relationship."<sup>142</sup>

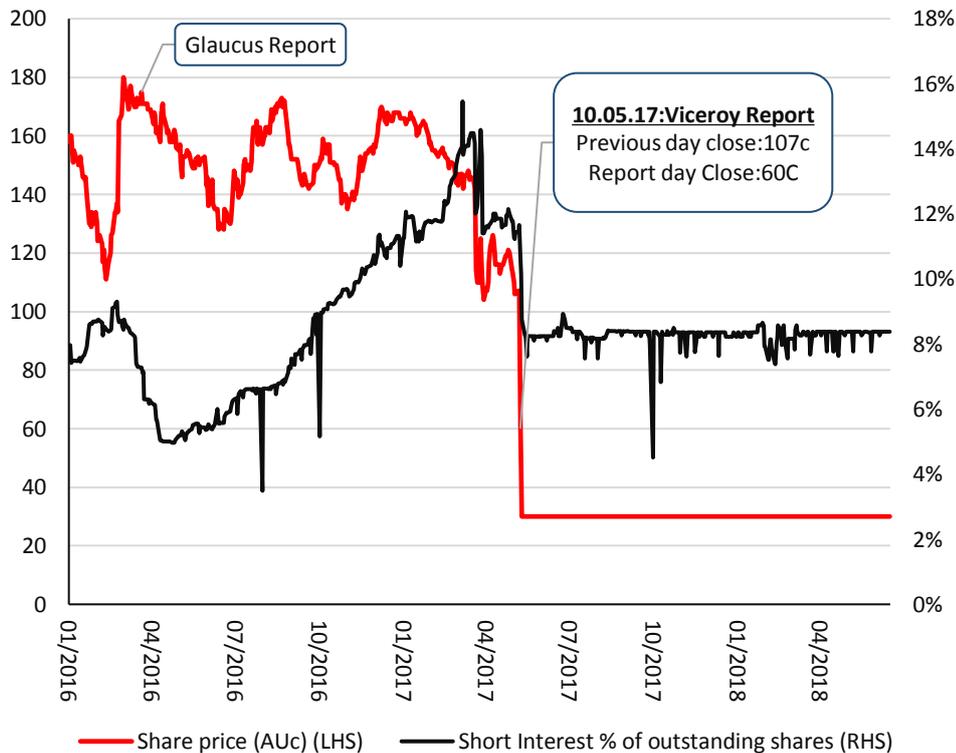
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<sup>141</sup> The email was posted on the Value Walk blog: <https://www.valuwalk.com/2017/06/caesarstone-ltd-cste/>

<sup>142</sup> This was emailed to us by Sean Donohue, Spruce Point's Chief Operating Officer. We had not asked about Twitter.

## 11.8 Quintis

- The Quintis report shares hallmarks with several other Viceroy reports in that it values the company at \$0. However, unusually, Viceroy considers risks to this scenario in that there are assets that could be disposed of for a return.

Figure 8: Quintis Ltd share price<sup>143</sup> (Australian cents)

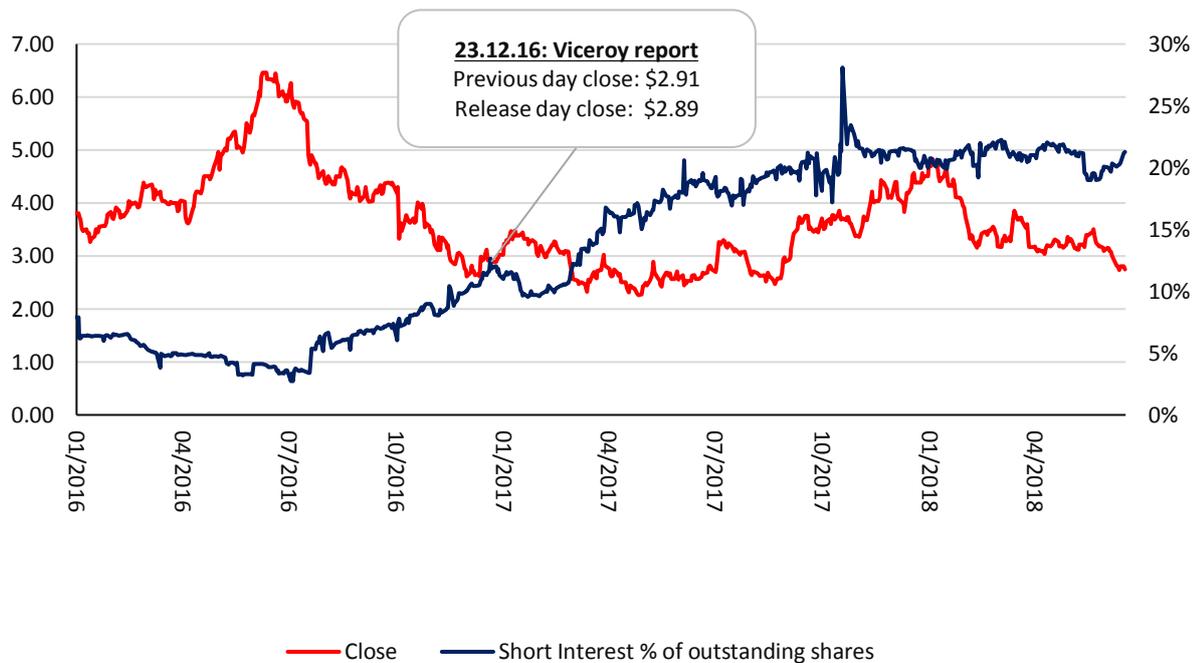
- In this case, the Viceroy thesis was correct, in that the company collapsed into administration hours after its report. However, Viceroy's report followed an earlier report by short seller Glaucus which received far more coverage in Australia. Glaucus also valued the share at \$0. Viceroy's report appeared after it seems the horse had already bolted.

<sup>143</sup> Source: EquityRT (share price) and Australian Securities and Investment Commission (short data)

## 11.9 Syrah Resources

- This was the first report published by Viceroy. The share price and short interest is shown in figure 9.

Figure 9: Syrah share price<sup>144</sup> (Australian dollars)



- The primary allegation that Viceroy made was that Syrah’s main asset, a graphite deposit in Mozambique, would be a financial disaster.
- Unlike any of the other reports, Viceroy uses a net present value calculation and undertakes a more robust valuation of Syrah. It also provides background information on the global graphite market and attempts some demand forecasting, leading to pricing forecasts.
- The report includes a reference to the company reorganisation process of Triton Minerals being undertaken by the corporate restructuring consulting firm Ferrier Hodgson. Triton’s asset is an 80% interest in graphite deposits in Mozambique. This suggests the Syrah report benefited from insights gained by Bernarde while working at Ferrier Hodgson (see section 4)<sup>145</sup>.
- The report also criticises other research, including a valuation by Credit Suisse, providing reasons for their critique<sup>146</sup>.
- The report is largely free of *ad hominem* attacks and hyperbole found in other reports such as Capitec and MiMedx. However, some sections of the report have a strikingly different tone. One criticises Syrah’s “marketing gimmicks” including language like “Their news sucks!” when discussing

<sup>144</sup> Source: EquityRT (share price) and Australian Securities and Investment Commission (short data)

<sup>145</sup> The reference appears on page 12 of the Viceroy Syrah report. See <https://viceroyresearch.org/2016/12/23/syrah-resources-asxsyr/>

<sup>146</sup> See page 28, *ibid*.

journalist reports on graphite demand. Another criticises the “shonky management team” describing the managing director as a “Tesla fanboy”<sup>147</sup>.

- The report, we infer, appears to have at least two authors, one responsible for the reasonably diligent financial analysis, and another for the *ad hominem* and inflammatory language.

## 12. Conclusion

For South African market participants, Viceroy’s actions have been difficult to interpret and judge. As a second-tier market, South Africa has generally not appeared on activist short seller’s radars and there is therefore little experience of short activism. Viceroy provides an important opportunity to analyse and assess the actions of short sellers.

Short selling *per se* can have a positive effect on capital markets. It can improve market efficiency and price discovery. There is a wide range of excellent short-selling research that is conducted internationally and in South Africa. Much of this never enters the public domain. However, when an activist short seller does enter the public domain, the public needs to assess its actions. Unfortunately, many members of the public are not equipped to assess financial research and determine its quality. This means the media play an important role as the interpreter of such financial research and in assisting the public in understanding it. One lesson from the Viceroy saga is that the media need to take this responsibility seriously. In the case of Viceroy, many media outlets too easily became a part of the research release strategy, directly aiding to promote its impact. That said, as in the case of some of the media we have referenced in this report, questionable aspects of Viceroy and other short sellers’ behaviour have been brought to the fore.

There are also important lessons for regulators. The rise of social media has changed the way information spreads. It has enabled those who would spread distorted information about shares. In the South African markets there is limited information available about the short positions held in shares, and therefore no practical way to assess actions for what profit motive may be behind them. By comparison, Australia has a detailed disclosure regime that records short positions held in each stock. The United Kingdom goes further by naming the individual funds that hold short positions. This level of transparency helps to ensure that short selling is legitimate. In its absence, it is easier for short sellers to engage in illegitimate activities to manipulate share prices<sup>148</sup>. It is clearly the case that Viceroy’s efforts to protect its anonymity helped it avoid scrutiny.

Worldwide, the difficult conceptual issues around the relationship between short-selling research and the publicity surrounding that research need further interrogation. While every market participant has the right to free speech, certain speech acts represent not self-expression but an effort to move market prices. This debate is part and parcel of the debate over fake news as a whole, but investment research and commentary have the particular characteristic of directly and rapidly affecting the profits of the producer. This obvious pecuniary motive shifts the debate. Free speech serves the public interest; speech acts that

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<sup>147</sup> See page 29, *ibid*.

<sup>148</sup> Perhaps the most egregious example in recent history was the 2017 bomb attack on the Borussia Dortmund soccer team bus, undertaken in an effort to profit from a short position in the soccer club’s shares. Police discovered this motive thanks to an informant from the financial sector. See the background at <https://www.reuters.com/article/us-soccer-champions-dor-mon-blast/german-soccer-bomb-suspect-wanted-to-drive-down-share-price-prosecutor-idUSKBN17N0G3>

manipulate market prices do not. This is particularly the case for companies that depend on public confidence such as banks and insurance companies.

There are lessons for short-side investors too. While legitimate short sellers may resist increased transparency as it can undermine their market strategies or lead to more robust criticism of their actions, transparency is a straightforward way to differentiate themselves from illegitimate short-selling actions. If research meets standards of excellence in methodology and presentation, releasing it to the market is positive for market efficiency and price discovery. Such short selling should have the respect of other market participants.

For companies that find themselves the target of activist short sellers, the clear response should be utmost transparency. Allegations should be clearly and patiently responded to with clear information. Companies should resist the temptation to respond with disparagement, even if disparagement is the tactic used by the short seller. In the long run, share prices will correct. A short attack is an opportunity for companies to demonstrate their transparency and willingness to engage with critics.

While we have argued here that Viceroy has an unearned influence which it has used to affect prices beyond that justified by its research, it has played a positive role in giving South Africans an opportunity to assess and understand the actions and motives of short sellers. In that respect, Viceroy has done a public service.