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Investing While Sitting Still

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Longfin: Short of the Century?

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Longfin: Short of the Century?

I have been involved in financial markets for the past two decades, including three of the craziest manias in history, and yet…the story of Longfin is truly remarkable. This "company"—I hesitate to call it that, because it appears to consist almost entirely of CEO/chief promoter Venkat Meenavalli—reminds me of the infamous listing referenced by Charles Mackay in his classic *Extraordinary Popular Delusions and the Madness of Crowds*: "For carrying-on an undertaking of great advantage but no-one to know what it is!"

More remarkable is that this scam—which, let's be honest, is right out of the fraud playbook—is being perpetrated not on some third-rate exchange in a developing market with lax regulations…but right here on NASDAQ! The fact that this listing was ever allowed, particularly given it is one of the first so-called A+ listings authorized under the 2012 JOBS Act, is a black eye for NASDAQ. And how it has not yet been shut down to prevent credulous investors from gifting even more cash to Meenavalli and his minions—who must be truly stunned at their success—remains a mystery.

This is a long and complicated (but fascinating!) story, so let's dive in.

Longfin, which went public December 13 at a price of $5—giving it a market cap of about $400 million—currently trades in the mid-30s, with a market cap somewhere north of $2.5 billion (it's hard to say for sure given their extremely limited disclosures). This puts it in the same league as companies such as Liberty Expedia (20,000 employees, $1.6 billion revenues); Tenet Healthcare (131,000 employees, $19.6 billion revenues); and Vienna Insurance Group (25,000 employees, $10.4 billion revenues).

Longfin? Other than Meenavalli and an eight-person board of directors (including Meenavalli) I can find no evidence of *any* other employees. In the "you can't make this stuff up" category, the company's chief financial officer, Krishanu Singhal, and chief operating officer, Raj Mondraty, both resigned on Dec. 11…i.e., *two days before the IPO*. The company's listed address is 85 Broad St. in New York, but the building manager lists no tenant by that name. There is, however, a WeWork location, so perhaps Meenavalli has commandeered a desk.

There is also no phone number listed on the Longfin website, nor any way to actually engage the company for…anything. (I did find a phone number on one of their 8-Ks; it went straight to a generic voicemail.) Other than a generic email address and an IR firm, the website seems designed entirely to offer the *promise* of something groundbreaking and exciting, but it always remains tantalizingly out of reach.

As for financials, the Longfin website claims (unaudited) revenues of $28 million for 2017-18, with net profit of just under $2 million. Why unaudited? Well, Longfin has been without an accountant for most of the past year, including the time it was approved for its IPO and subsequently went public. Longfin recently announced it had hired CohnReznick as its accountant, and fired prior accountant AJSH & Co. (CohnReznick, you may recall, was also the auditor for Platinum Partners, the hedge fund recently charged by regulators with operating a $1 billion Ponzi scheme.) What it did *not* announce, but was included in the 8-K, was AJSH's letter stating the shocking fact that "we have performed no work for the company subsequent to February 2017."

Indeed, Longfin has provided little documentation of *any* actual business activities. It claims to be the sole source for the "Ziddu coin," and says Ziddu.com is "currently the only marketplace for decentralized smart contracts," but its own press release claimed a total of (wait for it…) 10 smart contracts that had been executed as of January 19, worth a notional $9.5 million. How much did Longfin clear from…whatever it is supposed to have done? No clue. My guess is these transactions aren't real, either, as I can find no record of anyone claiming to use, or even be familiar with, Ziddu coins or "smart contracts."

In fact, the claims for what Longfin does seem to frequently change. Ziddu.com, which was originally some sort of file-sharing service (again—not clear to what degree it actually served this purpose) was touted after the December acquisition by Longfin as "a Blockchain-empowered solutions provider that offers Microfinance Lending against Collateralized Warehouse Receipts in the form of Ziddu Coins."

Ziddu is also mentioned in a 2010 (yes…2010) press release from one of Meenavalli's prior companies, Northgate Technologies—now called Green Fire Agri Commodities—that also showcases Meenavalli's penchant for making grand, completely unsupported claims:

The Board of Directors have taken cognizance of the negative impact on the operations of the Company due to global melt down and been deliberating on the deteriorating level of business for the last one year, though the Company has made pioneering mark in creating the world class web assets like bharatstudent.com, ***ziddu.com****, axill.com and globe7.com. During October 2009* ***Mr. Venkat S Meenavalli, Managing Director proposed to bring in new business apart from scaling up of the existing business by introducing algorithm trading etc.***

The piece about algorithm trading is a nice touch, and presages Meenavalli's current strategy of comparing Longfin to trading giant Virtu Capital, much as he also compared Stampede Capital—another Meenavalli-owned firm, from which Longfin last year acquired a subsidiary called Stampede Tradex—to Citadel and Renaissance Technologies. (Longfin appears to have also been a subsidiary of Stampede Capital prior to listing on NASDAQ.)

Here is a chart of Northgate/Green Fire (start date is April 2007):

And here is Stampede Capital (note the plunge last summer, then uptick after Longfin's listing and subsequent rally):

Another key aspect of Meenavalli scams is low float to enable stock manipulation. One of the oddities of Longfin is that trading volumes, which topped 15 million shares on its December 15 peak, are now generally below 200,000 a day. Given the stock price has recently been between $30 and $40, total dollar volumes are well under $10 million a day, and it would thus be easy to move the price with a "big" order (say 10,000 shares).

Surprise, surprise…this is also part of the pattern! I found an article about Stampede Capital in the "stock manipulation" section of an Indian financial website called Moneylife that included this gem: "With just about 2,700 shareholders on its books, over the past 12 months, its stock has averaged a daily trading turnover of Rs2.67 crore with an average of 500 trades a day. Will the regulator investigate this case—such few shareholders and such huge volatility?"

The story also included this chart, which seems to predate the Stampede chart shown above. While I haven't been able to confirm this, I wonder if there was some sort of delisting or other issue in the interim "gap year":

Indeed, while Meenavalli is relatively unknown here, his reputation as a conman seems well-established in India. Take this tweet, for example (one of many examples I found):

Contrarian EPS
@contrarianEPS

Guys look our very own Hyderabad based fraud is out there in US doing even bigger fraud
@michaelbatnick do read about this fraud
moneylife.in/article/stock-...

> **Michael Batnick** @michaelbatnick
> "I don't deserve this marketcap."
>
> This segment should win a golden globe.
>
> cnbc.com/video/2017/12/...

9:02 AM · Dec 19, 2017

6 Retweets **16** Likes

The cherry on this already-outrageous sundae is the toxic converts deal the company signed in January; or, as the Longfin press release put it: Multibillion Dollar Fund to Invest $52.7 million into Longfin Corp.

As you may have guessed, the "investment" is nothing of the kind, but rather a deal in which the firm effectively gives away an enormous number of shares for very little capital. Other firms that have done similar deals in the recent past include Dryships, Diana Containerships, and MagneGas Corp; I would urge investors to look at the charts of these stocks. Such deals are designed to dilute existing shareholders by issuing shares to related entities, which then sell the shares as quickly as possible, thus driving down the price. However, as documentation of such dilutive activities tends to lag the sales, many investors don't realize what is happening *even as it occurs*, since the market cap of the company *appears* to be dropping with the stock price…until the dilution is later factored in.

So far as I can tell, the deal nets Longfin $5 million right away, and $42.6 million…in *30 years*. But wait…there's more!

On February 12, Longfin filed yet another disclosure (but without a press release) that it was boosting the approved number of shares from 200 million to 300 million. It also contained a lot of dense legal language that seemed to be effectively granting the board the power to do whatever it wishes, and eliminating some restrictions on the price paid by Hudson Bay for its shares.

Finally, in yet another "can't make this up" moment, the company filed yet another addendum to the deal on February 28 that I quote in its entirety because, well…

NASDAQ Listing Rule 5635(d), referred to herein as the "NASDAQ 20% Rule," requires a company with securities listed on The NASDAQ Capital Market to obtain stockholder approval if the sale, issuance or potential issuance by the company of common stock (or securities convertible into or exercisable for common stock), for less than the greater of book or market value equals 20% or more of the common stock or 20% or more of the voting power outstanding before the issuance. The threshold of the NASDAQ 20% Rule is determined based on the number of shares of all classes of Common Stock outstanding immediately before the issuance. ***On January 22, 2018, the day we and the Investor entered into the SPA, we had 76,540,989 shares of Common Stock outstanding. Without stockholder approval, we are limited to issuing to the Investor an aggregate of 14,800,794 shares of our Class A Stock, which represents 19.99% of the number of shares of Common Stock we had outstanding on January 22, 2018, and is not sufficient to satisfy in full the number of shares of common stock potentially required to be issued under the Notes, the Investor Warrant and the Placement Agent Warrant described below (collectively, the "Warrants") in view of the anti-dilution provisions contained in such securities.***

That's right. Longfin is currently valued at more than $2.5 *billion*, and it just sold potentially more than 20% of the company for $5 *million* today, and $42.6 million…in 2048.

The "multi-billion dollar investment firm?" None other than Hudson Bay Capital, which was cited in 2013 for violations that sound…interestingly familiar: "On four occasions, from May 2009 through December 2012, Hudson Bay bought offered shares from an underwriter or broker or dealer participating in a follow-on public offering after having sold short the same security during the restricted period. "

Let me state for the record that I am not a lawyer, and this is just my layman's reading of the document. I also cannot say whether there is evidence of *legal* fraud. However, the picture is crystal clear; to paraphrase a former president…this sucker's going down.

Conclusion

Longfin is a remarkable story, and one I expect will be studied in years to come. I also admit to having a grudging respect for Venkat Meenavalli, who appears to have almost singlehandedly undermined the supposed checks and protections provided by U.S. regulators and their multi-billion dollar budgets.

Finally, it represents a truly staggering opportunity, albeit with some caveats.

The obvious thing to do is short the stock, but consider:

- The low float makes it difficult, although not impossible, to short

- The "short fee" charged to short it is currently an astronomical 125%. In other words, if you short $10,000 worth, the annual fee (computed and assessed daily) would be $12,500! Basically you are betting the share price will not only fall, but do so quickly.
- The low float, as mentioned, makes manipulation much easier. Until and unless regulators step in, this could continue to levitate…at least until those Hudson Bay shares begin to hit, probably sometime in May.

Better, I think, is to play it through options. (Yes, they exist!) With the stock around $35, you can buy June 2018 $25 puts for between $5 and $6; this gives you a very nice potential return, and should allow enough time for the stock to either be halted or the Hudson Bay dilution to begin in earnest.

I have also included a timeline with some more details on the Longfin history…just because it's so darn interesting!

Longfin: Standard-Bearer of the Crypto Bubble

- Longfin went public on December 13 under the new "A+" regulation contained in the 2012 JOBS Act. Such listings are subject to less-stringent disclosure requirements, and are available to *all* investors, as opposed to traditional IPOs which can only be purchased by accredited investors.
- *Two days* after listing, Longfin announced it was acquiring a company called Ziddu.com, "a Blockchain-empowered solutions provider that offers Microfinance Lending against Collateralized Warehouse Receipts in the form of Ziddu Coins," for 2.5 million shares of stock.
- Ziddu.com, which until very recently was a file-sharing app—according to its Android, description, "Ziddu is a tool for uploading and sharing files from the cloud while also playing different slot machines, winning and losing real money depending on your luck"—is now described as a provider of the "Ziddu Coin, a smart contract that enables SME's, processors, manufacturers, importers and exporters using cryptocurrencies across continents. Ziddu Coins are loosely pegged to Ethereum and Bitcoin. The importers/exporters convert offered Ziddu coins into Ethereum or Bitcoin and use the proceeds for their working capital needs. At the end of the contract, importers/exporters will realize their proceeds and pay back their funds through cryptocurrencies only. Depending upon the risk profile of the counterparty, the interest will vary from 12% to 48%." Got all that?
- Ziddu.com just happened to be owned almost entirely by…Venkat Meenavalli!
- This acquisition, which sent the stock soaring from its IPO price of $5 to an eye-watering $142, was followed by Mr. Meenavalli's now-infamous CNBC interview in which he repeatedly told the hosts "You don't understand," and said the company's valuation "doesn't make sense."
- On January 22, the firm issued a press release headed "Multibillion Dollar Fund to Invest $52.7 million into Longfin Corp." Remarkably, the fund was not named, and the firm neglected to file an 8K spelling out the details. Even more remarkable, however, was the subsequent release, about 90 minutes later, to…disregard the prior release!
- At the same time, the firm released another statement that its "Ziddu coins" would now be available on the Ethereum blockchain. There has been a notable lack of activity in these coins.

- The next day, Longfin re-released the "investment" announcement, along with filing an 8-K that showed the "investment" is actually a "toxic converts" deal in which it will give away an enormous number of shares for $5 million today, and $42.6 million…in 30 years. Other firms that have done similar deals in the recent past include Dryships, Diana Containerships, and MagneGas Corp.
- On February 9, Longfin announced it had hired CohnReznick as its accountant, and fired prior accountant AJSH & Co. LLP. What it did *not* announce, but was included in the 8-K, was AJSH's letter stating that "we have performed no work for the company subsequent to February 2017."
- That's right—apparently the Nasdaq allowed a firm *with no accountant nor audited financial statements for the prior nine months* to be one of the first to list under this new A+ regulation.
- CohnReznick was also the auditor for Platinum Partners, the hedge fund recently charged by regulators with operating a $1 billion Ponzi scheme.
- On February 12 Longfin filed a disclosure (but issued no press release) that is was boosting its permitted share count from 200 million to 300 million. It also appeared to give the board more power and remove restrictions on the price paid by Hudson Bay for its shares.
- Finally, on February 28, Longfin filed yet another addendum to the Hudson Bay deal, in which it stated that it needed to increase its share count because the deal (which again, netted the firm $5 million) could force it to issue shares that would total more than 20% of the current number of shares outstanding.

Memento mori, and here's to doing less!

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