Baker Hostetler

Baker&Hostetler LLP

Washington Square, Suite 1100
1050 Connecticut Avenue, N.W.
Washington, DC 20036-5304

T 202.861.1500
F 202.861.1783
www.bakerlaw.com

Bruce W. Sanford
direct dial: 202.861.1626
bsanford@bakerlaw.com

March 4, 2008

VIA EMAIL AND OVERNIGHT DELIVERY

Deirdre Silver, Esq.
Legal Director
John Wiley & Sons, Inc.
111 River Street
Hoboken, NJ 07030-5774

Re: *David Einhorn*

Dear Ms. Silver:

We wanted to bring to Wiley's attention some recent events involving Allied Capital as well as our concern over the promotional language for *Fooling Some of the People All of the Time* by David Einhorn appearing on Wiley's website and elsewhere on the internet.

The promotional narrative on www.wiley.com clings to the accusation that Allied Capital engaged in "corporate malfeasance." There is no evidence of any malfeasance by Allied and to the extent this statement is based on the conduct of former employees of BLX, there is nothing to suggest that BLX or any of its corporate management had any role in a former employee's fraud (which victimized BLX). It is neither fair nor accurate to tag Allied with the actions of an employee at one of the 50 offices maintained by BLX, which is just one of Allied's 156 portfolio investments and accounts for less than 1.5% of its assets. In fact, a federal judge in Detroit recently stated that "even if certain BLX agents and employees are culpable for their own fraudulent conduct, BLX as an entity, its shareholders and the SBA are still aggrieved victims."

We objected to this language in our letter of September 11, 2007, and your response of September 19, 2007 indicated that the copy had been "revised." But this new copy continues to make this false and baseless statement.

We also have noticed promotional copy for the book on a website operated by Blackwell, a division of Wiley, which echoes nearly identically the false and damaging marketing narrative posted on the Amazon.com France website last fall. A copy of the webpage is enclosed. A similar narrative is contained in Wiley's Spring Catalog for its Business Division (a copy of the relevant page is enclosed). For example, there is no evidence to support the statement that the "Department of Agriculture" or any government agency has accused Allied of "operating a ponzi scheme to prop up the company." While Mr. Einhorn has made similar wild charges from time to time, in every instance the claims have been rejected by courts and government regulators. Oddly, the Blackwell website advertises both the new and old titles of the book.

Allied requests that the false and defamatory statements in the promotional copy be removed from Wiley's website and elsewhere on the internet immediately.

We first raised concerns regarding false statements in promotional materials for Mr. Einhorn's book last May. We brought to your attention our concerns about statements that are now on both the Wiley and Blackwell websites last September. That they are still available on the internet in materials published by Wiley is both surprising and disappointing. There is no justification for such statements especially after we have provided you on numerous occasions with accurate and verifiable facts.

Wiley's conduct is even more disturbing in light of Allied's continued strong performance exemplified by two recent events. Last month, Allied announced that it has entered into an investment agreement with the Goldman Sachs Private Equity Group. A fund managed by Goldman Sachs agreed to invest over $170 million in Allied's existing private equity and debt instruments and committed to at least an additional $125 million in future investment vehicles managed by Allied. The transaction closed after several months of due diligence of Allied and its portfolio companies. In a press release about the transaction (see attached), a Managing Director of Goldman Sachs Private Equity Group stated:

> Throughout our extensive due diligence process, we have confirmed our view that Allied Capital has the results, investment acumen, processes and controls that we look for in our investment partners. We are excited about the team with whom we are partnering and the quality of the assets we are acquiring.

Similarly, in December, Allied partnered with GE Commercial Finance to form a $3.6 billion unitranche loan fund. GE Commercial Finance and Allied are both well-respected lenders in the middle market and the two firms have teamed on this fund to deliver loan products to borrowers with greater speed, simplicity and certainty of execution. In a press release announcing this transaction, also attached, a GE executive commented that Allied is "an experienced investor with an outstanding track record of providing unitranche financing, second lien loans, and subordinated debt."

Contrary to the implication in Wiley's promotional narrative that Wall Street condones corporate malfeasance, these investments by two of Wall Street's gold-standard institutions are a testament, once again, to the same conclusions reached by others – including regulatory bodies, courts, and public investors – that Allied is a successful, reputable company that has created significant shareholder value for 50 years since 1958. One Allied investor, retired Judge Peter S. Smith, last year authored a book on investing that identifies Allied as a favorite stock pick. A copy of the excerpt from the book about Allied is enclosed. Judge Smith has no relationship with Allied and his conclusions are entirely his own. He has called the valuation concerns raised by Einhorn a "phony" issue, and he correctly describes how Allied's portfolio companies, such as BLX, are neither units nor subsidiaries. Judge Smith also correctly discounted the "shrimp boat" lawsuit brought by Mr. Einhorn's hedge fund against BLX under the False Claims Act, as the case was dismissed subsequent to the book's release.

Judge Smith's analysis of Allied as well as the investments by Goldman and GE – which were completed despite the recent turmoil in the financial credit markets – raise the question of why Wiley would publish a book about Allied that distorts historical facts and unfairly smears Allied based on long-past events concerning one of its 156 portfolio investments – BLX – that now represents less than 1.5% of Allied's assets at value.

You have previously requested that we address any concerns over the content of the book directly with Mr. Einhorn. We have done so by requesting a meeting with Mr. Einhorn's lawyer, Richard Zabel, but he has refused to meet with us. In a letter sent today to Mr. Zabel, we are again offering to arrange a meeting between counsel for Allied and counsel for Mr. Einhorn, a sensible first step given Mr. Einhorn's track record and pending litigation against the Company. We invite representatives from Wiley to attend this meeting. A copy of the letter to Mr. Zabel is enclosed.

Please let me know if you have any questions or would like to discuss further.

Sincerely yours,

Bruce

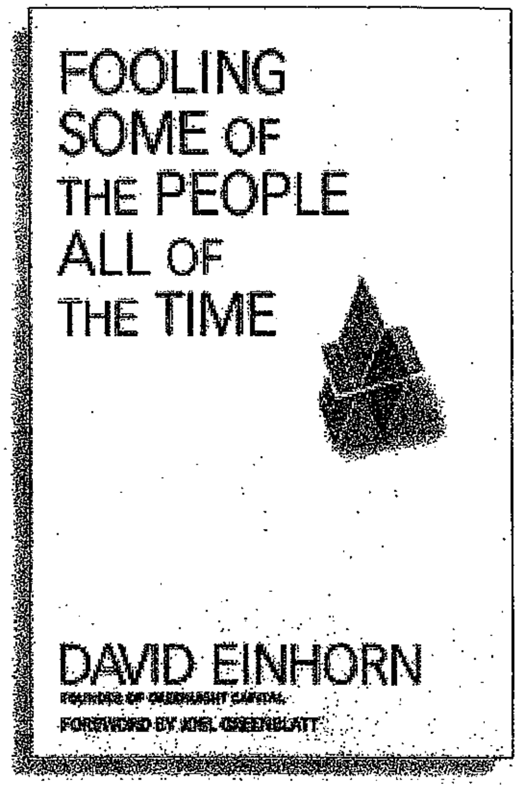
Bruce W. Sanford

Enclosures

cc: Gary Rinck
David Pugh

Fooling Some of the People All of the Time

David Einhorn
Foreword by Joel Greenblatt



A rare look inside the world of activist hedge funds from one of this country's top investors

David Einhorn is one of the investment community's fastest rising stars. He founded his hedge fund, Greenlight Capital, at the age of 27, and now has more than $4 billion under management. In *Fooling Some of the People All of the Time,* Einhorn offers readers insights into the battles surrounding hedge funds.

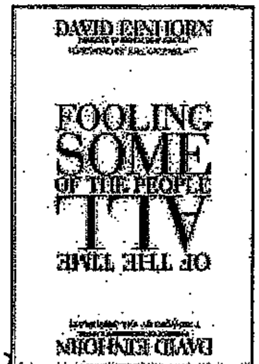
In 2002, Einhorn spoke publicly about Allied Capital—a leader in the private finance industry—presenting it as an excellent short opportunity. According to Einhorn and the Department of Agriculture, Allied was defrauding the Small Business Association of millions of taxpayer dollars and operating a ponzi scheme to prop up the company. This book will describe the incredible events that followed Einhorn's speech and how Allied and the investment community attacked him to protect the company—and its stock price. Informative and intriguing, *Fooling Some of the People All of the Time* details how the current environment on Wall Street not only allows for such corporate malfeasance, but how it protects the companies and attacks those who attempt to uncover them. But, there is much more to this book. While the Allied story serves as the driving narrative—spanning a period of four years in the life of Greenlight Capital—wrapped around this narrative will be Einhorn's investing insights. In the end, readers will discover what it's like to be caught up in a major Wall Street battle while learning valuable investing lessons from a man some call the next Warren Buffett.

David Einhorn (New York, NY) is the President and cofounder of Greenlight Capital, which started with $1 million dollars under management in 1996. Today, it has about $4 billion under management and is a leading fund in the industry. Einhorn began his career at Donaldson, Lufkin & Jenrette as a generalist in the Investment Banking Group. After DLJ, Einhorn joined Siegler, Collery & Co., a buyout and investment management firm, as an investment associate.

Marketing Campaign

- National Publicity
- Online Campaign

Hardcover • 978-0-470-07394-0
$29.95 US • $35.99 CAN
288 pages • 6 x 9 • 42 books per carton
All Rights except Audio and 1st Serial
BUSINESS NARRATIVE
JUNE / In stores June 9



A Capital Offense: A Hedge Fund Manager's Struggle for Justice and the Allied Capital Scandal

Rate this item
Write a review
Tell a friend

Printer-friendly pag

A Hedge Fund Manager's Struggle for Justice and the Allied Capital Scandal
David Einhorn
ISBN: 0470073942
Hardback
John Wiley & Sons
Usually despatched within 3 to 9 days

£19.99

Buy online

Not currently stocked in Blackwell stores. Ask your local store to obtain this book for you.

Please note that there may be some price differences between Blackwell Online and our Retail Shops

Synopsis **Item Details** **Reviews**

This is a rare look inside the world of hedge funds from one of this country's top investors. David Einhorn is one of the investment community's fastest rising stars. He founded his hedge fund, Greenlight Capital, at the age of 27, and now has more than $4 billion under management. In "A Capital Offense", Einhorn offers readers insights into the battles surrounding hedge funds. In 2002, Einhorn spoke publicly about Allied Capital a leader in the private finance industry presenting it as an excellent short opportunity.According to Einhorn and the Department of Agriculture, Allied was defrauding the Small Business Association of millions of taxpayer dollars and operating a ponzi scheme to prop up the company. This book will describe the incredible events that followed Einhorn's speech and how Allied and the investment community attacked him to protect the company and its stock price. Informative and intriguing, "A Capital Offense" details how the current environment on Wall Street not only allows for such corporate malfeasance, but how it protects the companies and attacks those who attempt to uncover them. But, there is much more to this book.While the Allied story serves as the driving narrative spanning a period of four years in the life of Greenlight Capital wrapped around this narrative will be Einhorn's investing insights. In the end, readers will discover what it's like to be caught up in a major Wall Street battle while learning valuable investing lessons from a man that some call the next Warren Buffett. David Einhorn (New York, NY) is the President and cofounder of Greenlight Capital, which started with $1 million under management in 1996. Today, it has about $4 billion under management and is a leading fund in the industry. Einhorn began his career at Donaldson, Lufkin & Jenrette as a generalist in the Investment Banking Group. After DL&J, Einhorn joined Siegler, Collery & Co., a buyout and investment management firm, as an investment associate.

Other related titles

Your Next Great Stock: How to Screen the Market for Tomorrow's Top Performers
Hough, Jack
Blackwell Price: £19.99
BUY

Essentials of Investments with S&p Bind-In Card
Bodie, Zvi Kane, Alex Marcus, Alan J.
Blackwell Price: £100.99
BUY

Technical Analysis for Dummies
B. Rockefelle
Blackwell Price: £15.99
BUY

Print This Page

: Press Release

Back

Allied Capital Announces Investment Agreement with Goldman Sachs Private Equity Group

WASHINGTON--(BUSINESS WIRE)--Jan. 23, 2008--Allied Capital Corporation (NYSE:ALD) announced today an investment agreement between Goldman Sachs Private Equity Group ("Goldman Sachs") and Allied Capital that includes commitments by Goldman Sachs to invest at least $125 million in future investment vehicles managed by Allied Capital. In addition, Goldman Sachs will purchase $170 million in existing private equity and debt investments from Allied Capital and will have future opportunities to invest in Allied Capital affiliates, or vehicles managed by them, and co-invest alongside Allied Capital in the future, subject to various terms and conditions.

As part of this investment agreement with Goldman Sachs, Allied Capital has agreed to sell a pro-rata strip of private equity and debt investments to AGILE Fund I, LLC ("AGILE"), a new Allied Capital managed fund in which Goldman Sachs owns substantially all of the interests, for a total transaction value of $170 million. Allied Capital is expected to realize a net gain and dividend income from the sale of its investments of approximately $15 million, net of transaction and other costs. The purchase price of the equity investments represented a 9% premium to Allied Capital's fair value for these investments at September 30, 2007. The majority of the pro-rata equity and debt sale closed simultaneously with the execution of the investment agreement. The sales of the remaining assets are expected to close by the end of the first quarter of 2008.

"Over the past year Allied Capital has launched two key initiatives, the Unitranche Fund with GE Commercial Finance and the Allied Capital Senior Debt Fund, in order to expand our reach into middle market private equity investing and to diversify our managed capital base to include both public and private sources of capital," said Bill Walton, Chairman and CEO of Allied Capital. "Our investment agreement with Goldman Sachs furthers both of these goals. We look forward to enhancing our business opportunities with this very seasoned and experienced investment partner."

Allied Capital is selling to AGILE 13.7% of Allied Capital's equity investments in 23 of its buyout portfolio companies and 36 of its minority equity portfolio companies for a total purchase price of $109 million. The equity investments being sold had a fair value at September 30, 2007 of $100 million. In addition, Allied Capital is selling approximately $60 million in debt investments at cost, representing 7.3% of Allied Capital's unitranche, second lien and subordinated debt investments in the 23 buyout investments included in the equity sale. Allied Capital will act as the managing member of AGILE, and will be entitled to an incentive allocation subject to certain performance benchmarks. Allied Capital owns the remaining interests in AGILE not held by Goldman Sachs.

In addition, as part of today's transaction, Allied Capital has also agreed to sell eleven venture capital and private equity limited partnership investments for approximately $28 million to Goldman Sachs, and is expected to realize a loss on the sale of approximately $3 million, including transaction costs. Goldman Sachs will assume the $6.5 million of unfunded commitments related to these limited partnership investments. The sales of these investments are expected to be completed by May 2008.

"This transaction is the first step in a strategic relationship with the team from Allied. We believe that our two firms share a similar culture and investment philosophy and we believe this transaction should create collective opportunities to invest capital at attractive returns," said Harold Hope, Managing Director, Goldman Sachs Private Equity Group.

"Throughout our extensive due diligence process, we have confirmed our view that Allied Capital has the results, investment acumen, processes and controls that we look for in our investment partners. We are excited about the team with whom we are partnering and the quality of the assets that we are acquiring," added Kane Brenan, Managing Director, Goldman Sachs Private Equity Group.

"Investment capital and liquidity for private equity transactions has become increasingly scarce in these challenging capital markets," said John Fruehwirth, Managing Director, Allied Capital. "Fortunately, Allied Capital has been able to develop both public and private sources of capital, including sources of managed private capital such as the investment commitments included in this agreement with Goldman Sachs, our recently launched Unitranche Fund with GE Commercial Finance, and the Allied Capital Senior Debt Fund. In this market, we believe we will have the opportunity to deploy capital at attractive return levels and that leverage has returned to reasonable levels, coupons are higher and covenants are strong," added Fruehwirth.

About Allied Capital

Allied Capital is a leading business development company (BDC) in the U.S. that invests private debt and equity capital in middle market businesses nationwide. Founded in 1958 and operating as a public company since 1960, Allied Capital is celebrating 50 years of investing in and supporting the U.S. entrepreneurial economy.

Allied Capital provides long-term debt and equity capital for management and sponsor-led buyouts, and for recapitalizations, acquisitions and growth of middle market companies. Allied Capital's one-stop financing capabilities include first and second lien senior loans, unitranche debt, junior or subordinated debt and equity. Allied Capital seeks to invest in stable, less cyclical companies that produce significant free cash flow and high returns on invested capital. At September 30, 2007, the Company's private finance portfolio included investments in 110 companies that currently generate aggregate revenues of over $13 billion and employ more than 90,000 people.

Headquartered in Washington, DC, Allied Capital offers shareholders the opportunity to participate in the private equity industry through an investment in its New York Stock Exchange-listed stock. Allied Capital has paid consistent or increasing regular, quarterly cash dividends annually to shareholders since 1963. For more information, please visit www.alliedcapital.com, call Allied Capital investor relations toll-free at (888) 818-5298, or e-mail us at ir@alliedcapital.com.

About Goldman Sachs

The Goldman Sachs Private Equity Group today manages over $24 billion of committed capital, investing in private equity funds, co-investing in direct investments, and providing liquidity and capital solutions to private equity limited partners and general partners. The Goldman Sachs Private Equity Group is part of Goldman Sachs Asset Management, the asset management arm of The Goldman Sachs Group, Inc. (NYSE: GS), which managed $868 billion as of November 30, 2007. Goldman Sachs Asset Management has been providing discretionary investment advisory services since 1989 and has investment professionals in all major financial centers around the world. The company offers investment strategies across a broad range of asset classes to institutional and individual clients globally. Founded in 1869, Goldman Sachs is a leading global investment banking, securities and investment management firm.

Forward-Looking Statements

The information contained in this press release contains forward-looking statements. These forward-looking statements are subject to the inherent uncertainties in predicting future results and conditions. Certain factors could cause actual results and conditions to differ materially from those projected in these forward-looking statements, and some of these factors are enumerated in Allied Capital's filings with the Securities and Exchange Commission.

This is not an offer to invest in the fund; any offers may be made only to qualified investors by means of confidential offering materials. Under no circumstances is the information in this press release to be used or considered as an offer to sell, or a solicitation of an offer to buy, any security.

CONTACT: Investor Relations Inquiries:
Allied Capital Corporation
Dale Lynch, 202-721-6100
or
Media Inquiries:
Sitrick and Company, Inc.
Tom Becker, 212-573-6100

SOURCE: Allied Capital Corporation

ALLIED CAPITAL

Print This Page

: Press Release

Back

Allied Capital and GE Commercial Finance Launch $3.6 Billion Unitranche Fund LLC

WASHINGTON--(BUSINESS WIRE)--Dec. 20, 2007--Allied Capital (NYSE:ALD) and GE Commercial Finance announced today that they have partnered to form a $3.6 billion senior secured unitranche loan fund. A unitranche loan blends senior and junior debt pricing and terms into a single first lien debt facility. Unitranche Fund LLC is designed to deliver a reliable loan product to borrowers with greater speed, simplicity and certainty of execution.

Financing commitments up to $500 million in size will be available for borrowers across a wide range of industry sectors, including healthcare, media, energy, aerospace, business services and transportation. The Fund will retain all or a majority of each credit facility. Borrowers will benefit from simplified documentation through a single credit agreement, greater certainty of execution, and reduced decision-making complexity throughout the life of the loan.

"This new fund will deliver value for our friends in the private equity community," said Stuart Aronson, President of GE Global Sponsor Finance. "We are pleased to partner with Allied Capital, an experienced investor with an outstanding track record of providing unitranche financing, second lien loans, and subordinated debt, to build a strong unitranche fund."

"This partnership between Allied Capital and GE Commercial Finance, a leading senior debt provider in our market, brings together the unique expertise and financing capabilities of both firms to meet the increasingly challenging financing needs of companies and sponsors with greater certainty of execution," said Bill Walton, Chairman and CEO of Allied Capital.

About Allied Capital

Allied Capital is a leading business development company (BDC) in the U.S. that invests private debt and equity capital in middle market businesses nationwide. Founded in 1958 and operating as a public company since 1960, Allied Capital has paid consistent or increasing regular, quarterly cash dividends annually to shareholders since 1963.

Allied Capital provides long-term debt and equity capital for management and sponsor-led buyouts, and for recapitalizations, acquisitions and growth of middle market companies. Allied Capital's one-stop financing capabilities include first and second lien senior loans, unitranche debt, junior or subordinated debt and equity. Allied Capital seeks to invest in stable, less cyclical companies that produce significant free cash flow and high returns on invested capital. At September 30, 2007, the Company's private finance portfolio included investments in 110 companies that currently generate aggregate revenues of over $13 billion and employ more than 90,000 people.

Headquartered in Washington, DC, Allied Capital offers shareholders the opportunity to participate in the private equity industry through an investment in its New York Stock Exchange-listed stock. Allied Capital invests in the American entrepreneurial economy by providing long-term capital and access to managerial resources often unavailable to middle market companies. For more information, please visit www.alliedcapital.com, call Allied Capital investor relations toll-free at (888) 818-5298, or e-mail us at ir@alliedcapital.com.

About GE Commercial Finance, Global Sponsor Finance

With over $8 billion in assets, and offices in Boston, Chicago, Dallas, London, Los Angeles, New York, and San Francisco, GE Commercial Finance, Global Sponsor Finance represents a "one-stop" source for the comprehensive range of GE's lending and other structured financial services offered to the private equity sponsor market. For more information, please visit www.gegsf.com.

About GE Commercial Finance

GE Commercial Finance, which offers businesses around the globe an array of financial products and services, has assets of approximately $300 billion and is headquartered in Norwalk, Connecticut. GE (NYSE:GE) is Imagination at Work - a diversified technology, media and financial services company focused on solving some of the world's toughest problems. With products and services ranging from aircraft engines, power generation, water processing and security technology to medical imaging, business and consumer financing, media content and advanced materials, GE serves customers in more than 100 countries and employs more than 300,000 people worldwide. For more information, visit the company's website at www.ge.com.

Forward-Looking Statements

The information contained in this press release contains forward-looking statements. These forward-looking statements are subject to the inherent uncertainties in predicting future results and conditions. Certain factors could cause actual results and conditions to differ materially from those projected in these forward-looking statements, and some of these factors are enumerated in Allied Capital's filings with the Securities and Exchange Commission.

CONTACT: Investor Relations Inquiries:
Allied Capital Corporation
Dale Lynch, 202-721-6100
or
Media Inquiries:
Sitrick and Company, Inc.
Jeff Lloyd, 212-573-6100

SOURCE: Allied Capital

The No BS Handbook for Successful Investing

Judge
Peter S. Smith (Ret.)

Other Books by This Author:

The Magistrates

The Magistrates: Murder At The Rose Bowl

THE NO BS HANDBOOK FOR SUCCESSFUL INVESTING

JUDGE PETER S. SMITH (RET.)

Cover Design: Mythic Design Studio, www.mythicstudio.com
Interior Design: Robert Garcia, Garcia Publishing Services, www.gpsdesign.net

Published in 2007 by:
JADA Press
Atlanta, GA
JADA www.jadapress.com

ISBN: 0-9800629-0-X
978-0-9800629-0-8

LCCN: 2007939123

Printed in the United States of America

INTRODUCTION

The No BS Handbook for Successful Investing gives you a fresh, common sense manual that provides you with the tools to become a saver and a successful investor. It cuts through the jungle of confusing financial jargon used by the professionals. You will learn solid information that guides you to your financial goals.

It is written by a self-taught investor who ignores the Wall Street pundits but has scored an average annual return of 17.1% (2001 to 2006) on stocks and mutual funds. The author is a retired Superior Court Judge who learned to evaluate expert witnesses during his 33-year judicial career. This expertise allowed him to filter out much of the bunk dished out by the mainstream financial news media.

The 17.1% return on the Judge's retirement account occurred during up and down markets. He is a long-term investor, not a stock trader or speculator.

The Judge did not become a stock market investor until he was 60 years old. His fear of investing in the stock market was influenced by the fact that his maternal grandfather lost everything in the 1929 market crash.

The initial chapters in the book deal with simple ways to get your financial house in order so you can ultimately become a successful investor, rather than an indentured servant to the credit card companies.

Thousands of books have been written about investment. Since they deal with economics and numbers, these books tend to be boring. The Judge is an award-winning novelist who has authored two novels: *The Magistrates* and *Murder at the Rose Bowl* (see themagistrates.com). One reviewer said, "The novels gave the reader a legal education without attending law school." The Judge's skill as a novelist makes *The No BS Handbook* more lively and readable than the average book on investing.

The Judge discloses his investment blunders, as well as his successes. The reader will learn about every stock and mutual fund he presently owns, and about the financial newsletters that will help you increase your wealth, and how to avoid panicking your portfolio into a worthless asset.

"There are Seven Wonders of the World but the eighth is compound interest." This quote comes from John Anderson, who recently made the Forbes 400 list of wealthiest Americans. His fortune is estimated at 2.1 billion dollars.

The *No BS Handbook* stresses the importance of this simple concept and concludes with tables showing how the average person can become a millionaire.

Judge Smith's investment philosophy is long term. "Using a baseball metaphor," says Smith, "I don't swing for the fences. But I produce results that are consistent with a 300 hitter."

Dedication

To Louis Rukeyser (1933-2006), who shared his investing wisdom in an elegant and dignified format.

ACKNOWLEDGEMENTS

I would like to thank the following people who were helpful in the preparation of the *No BS Handbook for Successful Investing*:

Robert Ullery, a private investor, critiqued certain portions of the manuscript. Jeff Lentz, my accountant, was very helpful with portions of the book that dealt with taxation. Don Redl, a mathematics teacher at Midland School, prepared the credit card interest table and investment interest tables. Don Blackburn, an artist, drew a book cover that was ultimately not used because the book title was changed. Glenda Ivey, the owner of Jada Press, made invaluable suggestions for the manuscript.

Many thanks to Dolly Haupt, who spent considerable time typing numerous drafts of the manuscript. Finally, to Dolly's husband, Jon Haupt, who edited and enhanced the book, designed the book cover, and provided the concept of a mental handbook that governs our investment decisions.

TABLE OF CONTENTS

impacted by this grossly unfair law. Many of them are law enforcement officers and firefighters who put their lives on the line for us everyday.

If you will follow my recommendations on investment strategy, you won't have to rely on Social Security benefits for your only means of support when you retire.

Chapter 8
My Portfolio
Hear Ye! Hear Ye! Financial Anxiety Relief

This Chapter describes the stocks and mutual funds that I held in my IRA as of December 31, 2006. With one exception, these are stocks and mutual funds that could be purchased by any investor, regardless of age or financial condition.

Allied Capital is a cash cow that I have owned since 1993. Formed in 1958, Allied is a business development company that went public in 1960, and has paid a dividend every quarter since 1963. When I first purchased Allied, its dividend was $.80 per share. Its annual dividend is now $2.60 per share, with a yield of approximately 8%. In 2005, Allied's total return (dividends plus increase in stock price) was 23.5%. In 2006, its total return was 20.6%.

Since 1960, assuming you *reinvested* dividends, your average annual return, as of December 31, 2005, would be 18%. Allied's largest shareholder is Capital Research and Management. This company acts as adviser for American Funds.

For many years, Allied's stock price has been victimized by short sellers who contended that Allied lacked the cash flow to increase its dividends, and Allied's management inflated the stock price of private companies to whom it made loans. Allied takes equity interest in 40% of the companies that it lends money to. These companies are not traded on a stock exchange, so the Board of Directors periodically sets a value on the stock.

In 2004, Allied became the subject of an SEC investigation. A hedge fund short seller named Greenlight complained that Allied was undervaluing the stock of companies that took an equity interest. Even though not required by law, Allied hired consultants who valued the stock *independently* of the Allied Board of Directors.

In June 2007, the SEC closed its informal investigation of Allied. Without admitting or denying the SEC allegations, Allied entered into a settlement with the SEC. Allied agreed to continue changes they had already made regarding the valuation of stock of non-public companies.

Allied has never been a favorite of mainstream journalists. Some years ago, an airhead from Morningstar wrote that the stock should not be bought at *any* price. Jesse Eisenger, who writes for *the Wall Street Journal*, also doesn't care for Allied. He recently wrote a negative article accusing Allied of granting excessive stock options that diluted the stock. Toward the bottom of the article, the journalist conceded that a well-respected shareholder rights group had no complaints about Allied's conduct.

The stock valuation issue is phony. When a loan goes bad, it doesn't matter if the stock is valued at $3 or $2. Whether or not Allied can collect on its loan depends on the loan being adequately secured by other means. Allied has been around since 1958, so I believe they can figure it out.

About six years ago, I received a letter from a lawyer telling me that I should start a new career as a stock picker. A few years earlier, I had mediated a case for one of his clients who had been seriously injured. His client decided to follow my advice and purchase shares in Allied Capital. The share price had risen from $18 to $24, and the dividend had increased. Because his employment prospects were limited, the client was living off a dividend that had *increased.*

In January 2007, Allied Capital stock took a hit when the U.S. Attorney indicted Patrick Harrington, a former employee of Business Loan Express (BLX), an Allied Capital Portfolio company relating to BLX loans guaranteed by the Small Business Administration (SBA).

Contrary to information appearing in the financial news media, BLX is not a unit or subsidiary of Allied Capital. The Investment Company Act of 1940 prohibits companies like Allied from owning companies in which they invest. This falsehood has been created by certain members of the financial news media who are biased against Allied Capital and supportive of David Einhorn and his hedge fund, Greenlight Capital.

BLX is one of Allied Capital's approximately 140 portfolio companies. This means that BLX represents only 6.2% of Allied Capital's total assets of 4.6 billion dollars.

The indictment of Harrington (the only BLX employee indicted) alleges that the SBA was defrauded on 76 loans made to BLX customers. One part of the indictment alleges that a customer's banker created a fictitious financial statement in order to qualify a customer for a loan. This type of fraud is very difficult to prevent. Even though the indictment alleges 76 fraudulent loans, not all 76 loans end up as a total loss. A few may never be delinquent, but the SBA and BLX have the ability to recover from customers because the loans are secured by real estate and other collateral.

The government guarantees 75% of the amount of an SBA loan and the lender, BLX, is on the hook for 25% of the loan. An SBA loan applicant is considered a high risk because he can't qualify for a loan with a conventional lender. The government established the SBA loan guarantee program to help less advantaged persons start a business. As a result, the SBA loan program has a higher delinquency rate than conventional business loans.

Greenlight has filed a lawsuit against BLX under the

Federal Civil False Claims Act. The SBA declined to join the lawsuit. Allied Capital was not sued by Greenlight. *If in fact BLX was a unit or subsidiary of Allied Capital, you can bet your bottom dollar they would have been sued.* Allied has deeper pockets, and Einhorn's dislike of Allied makes them a natural target.

Under the False Claims Act, private citizens are permitted to sue on behalf of the government. If they are successful, they can recover 25–30% of the proceeds. In order to succeed, Greenlight must prove fraud against BLX, and that BLX must have concealed material facts with the intent to defraud the government. Poor judgment or negligence by BLX in approving loans is not fraud.

A judge, or jury, will eventually determine whether or not Greenlight's claims are valid. If Greenlight loses, BLX and Allied will be vindicated by an independent trier of facts.

Certain journalists with the financial news media have provided biased coverage of Allied Capital. One of the worst is Herb Greenberg, who writes for *Market Watch.* Dow Jones, the same company that owns the Wall Street Journal, owns *Market Watch.* Greenberg is a habitual naysayer, so his opinions rate little credibility. On February 21, 2007, I heard him interviewed on CNBC. He couldn't understand why investors didn't take him seriously when he warned them about troubled New Century Financial Corp., a company that specialized in sub-prime loans that had a dividend yield of 15%.

I agree that a 15% yield by a sub-prime lender is a red flag that should be avoided by investors.

Greenberg thinks that Allied Capital's dividends are excessive because they yield between 8 to 8.5% and have slight annual increases. Greenberg is not interested in facts because he sings out of the same hymnbook as David Einhorn. There is a world of difference between a sub-prime lender and Allied Capital. Greenlight has lost large sums of money by investing *long* in New Century Financial Corp.

Greenberg has distorted a criminal case against a BLX employee into a devaluation of Allied Capital. His *Market Watch* article on January 10, 2007 stated, "A former top official of Allied Capital's Business Loan Express Unit was indicted by the U.S. Attorney.... It now appears that the shorts must have been on to something."

Elizabeth MacDonald, of *Forbes.Com Magazine,* is also biased against Allied Capital. In her article, *Allied Capital's Blood Feud,* dated February 8, 2007, she does not understand that BLX is not a unit of Allied Capital because she states that a former executive of one of Allied's units was indicted for fraud. She wrote, "Back in 2002, Einhorn shorted Allied's stock-borrowing shares and sold them in anticipation of buying them later at a lower price—and so far bet wrong. He accused Allied of inflating its assets. No matter its stock price has risen 53% since, though it's hard to see why."

Her bonehead statement that it's hard to see why the shares have risen 53% demonstrates that she has done little to find out why Allied has been paying dividends since 1963. MacDonald should read Allied's 2006 Annual Report which contains abundant information about Allied's investment strategies, valuation of companies to whom it lends, and the fact that Allied only funds a small percentage of the deals it initially reviews. She would also discover that BLX is not a unit of Allied. Macdonald's misrepresentation about Allied was probably the result of lazy reporting. However, her credibility as a journalist went into the tank on August 18, 2007 when she was a guest on the Fox TV program "Forbes on Fox." In a knee-jerk reaction to the Utah mine disaster, she called for the abolition of the use of coal as a fuel used to generate electric power plants. She is not interested in supporting clean coal technology that would some day make us less dependent on foreign oil. America has massive coal reserves.

Despite all the disruption caused by Einhorn and the news media, Allied is still an excellent investment.

Thornburg Mortgage Company is a well-managed mortgage REIT that pays a dividend in excess of 10%. A mortgage REIT must distribute 85% of their taxable income each calendar year and declare dividends of at least 90% of their income by the time they file their tax return for that calendar year. The company has a dividend reinvestment plan. Since its dividend is *not* qualified, the stock should be held in a retirement account.

Thornburg focuses on excellent quality adjustable rate mortgages (ARMs). Because the profit margin of ARM lenders has been squeezed by the raising of short-term interest rates by the Federal Reserve, and the housing market is in a slump, mortgage companies are out of favor with the Wall Street crowd (analysts and pundits). As usual, these people are behind the curve. The Federal Reserve has stopped raising rates and might cut them sometime in 2007.

Thornburg recently warned investors that there was a possibility that they might have to cut their dividends in 2007 if its profit margins got worse. This bit of candor was greeted by the usual panic selling and the stock price took a hit. It has since recovered. Thornburg management doesn't receive excessive compensation, so they pay an excellent dividend. I have owned Thornburg for over three years. I didn't buy more shares after the panic sale because it would have distorted the proper diversification of my portfolio.

Prior to August 1, 2007, Thornburg Mortgage was a stock suitable for any type of investor. It held no sub-prime mortgages. On July 31, 2007, its stock price closed at $25.42 per share. It was trashed by CNBC celebrity Jim Cramer. CNBC has promoted Cramer as a knowledgeable stock picker so Thornburg's stock declined dramatically.

Cramer operates a website known as The Street.com. On August 1, its headline read, "Sell Thornburg." I quote from parts of his irresponsible message:

"The market is oversold and many of the homebuilders and mortgage stocks are being hit harder than justified. But he

still wouldn't buy names such as Beazer (BZH) or Thornburg Mortgage (TMA) because 'who needs it?'"

Cramer conceded that the market has turned into a "one trick pony" whose response is to sell the financials en masse.

After the stock fell on August 6, Cramer stated that Thornburg was a well-managed company that had cost short sellers lots of money in the past. On August 14, the stock fell to a 52-week low of $7.49, and the NYSE halted trading of the stock. Thornburg's CEO appeared on CNBC and stated that the company was not going to file for bankruptcy, that only 79 out of over 38,000 loans were in default, and that they had been surprised by the recent credit crunch. The CEO stated that the management was exploring new strategies to improve their business. On August 18, 2007, Thornburg closed at $15.04 per share.

On August 20, 2007, Thornburg announced that it had stabilized its financing platform by selling $20.5 billion of AAA mortgage-backed securities, and termination of $41.1 billion of interest rate hedging agreements that will reduce its exposure to margin calls. Presently, 93.7% of the company's assets are rated AA or AAA. Thornburg anticipates the gradual resumption of funding loans for its nationwide base of lending partners and their clients.

I have a question for Jim Cramer. Why didn't he include in his August 1 statement words to the effect that Thornburg is a well-managed company that has cost short sellers lots of money? Cramer is a highly emotional person who shoots from the hip. View his "gong show" Mad Money with caution. My advice is supported by research done by Bill Alpert of *Barron's*. On August 20, 2007, Alpert wrote a long article titled "Shorting Cramer." Cramer picks about 7,000 stocks per year. Many of these stocks rise briefly and then either fall or remain flat.

As of August 2007, Thornburg is a stock that should only be held by sophisticated investors who can tolerate high risk and volatility. I still hold the stock in my portfolio.

Enerplus Resources Fund. For approximately three years, I owned this oil and gas energy trust located in Calgary, Canada. In November 2006, I sold Enerplus because of the Canadian government's change in tax policy that no longer gave favorable tax benefits to oil and gas trusts. Since I held the stock in an IRA Account, I could not claim a credit on my U.S. Tax return for the increased tax.

I sold my shares at a substantial profit, but I was reluctant to bail out on a company that treated its shareholders fairly (approximately an 8% dividend) and didn't line the pockets of its executives.

Fairpoint Communications was founded in 1991, and went public in February 2005. Fairpoint provides local and long-distance services, as well as cable and wireless access to a variety of rural areas. Its markets are diversified across 18 states. The company generates 50% of its revenue from fixed line phone services, and the remainder comes from Internet services. Its regular dividend is $1.59 per share, or over 8%. Its dividend qualifies for the 15% tax rate.

Centerplate has as been in my portfolio for about one year. It is traded on the American Stock Exchange (AMEX). Centerplate and its subsidiaries have been in business over thirty-five years. It is a leading provider of food, concessions, and other services to major sports franchises in the United States and Canada.

Centerplate pays a dividend of around 10%. Part of the dividend is a return of capital, part is interest, and part may be a qualified dividend. Because management can't predict precisely how the dividend will be divided each year in the future, this should be held in a retirement account. If you are in a lower tax bracket, it may be appropriate to hold Centerplate in a standard brokerage account.

The largest shareholder of Centerplate is Blackstone, a

Private Equity Group. Blackstone takes a long-term approach to investing. Long-term means 6 to 8 years.

There has been a general rule of caution about investing in stocks that pay high dividends. Stocks such as Allied Capital, Thornburg Mortgage, Enerplus, Centerplate and Fairpoint are considered ***high-risk investments.*** The reason for the rule is because in order to attract investors to higher risk investments, a company must pay a higher dividend or interest rate. These four companies are exceptions to the general rule because they are well managed and executives are reasonably compensated.

Third Avenue Funds. I own three funds, the *Value Fund,* the *Real Estate Value Fund,* and the *International Value Fund.*

The *Value Fund* had a return of 14.69% in 2006, a five-year average return of 14.49% and a 10-year average return of 13.50%. The *Value Fund* does *not* try to estimate what the near term stock price performance would be, nor does it try to predict stock market lows. Frequently, the near term earnings outlook for the stock is clouded or poor. The principle way the *Value Fund* attempts to put the odds in its favor is by acquiring the common stocks of well-financed companies at prices that represent meaningful discounts from readily ascertainable net asset values.

The *Real Estate Value Fund* had a return of 30.16% in 2006, and a five-year average return of 22.24%. This fund has very diversified holdings that include diversified financial services, homebuilders, hotels, natural resources, REITS, real estate management and brokerage companies, real estate operating companies, and retail.

The *International Value Fund* had an annual return of 17.13% in 2006, and a five-year annual return of 21.54%. This fund holds stocks in 19 different foreign countries. These countries are located in Asia, Europe and South America. The geographic distribution of the securities in the fund should not be interpreted as a particular market being attractive, but rather these are usually locations where the fund's investments have their principal listings. Listings means the particular stock exchange. A company could be listed in Hong Kong, but have its principal business in Singapore. The Singapore company negotiates business in several other countries.

Vanguard Funds. I own two funds: The *Admiral Midcap Index Fund* and the *High Yield Corporate Fund.*

The *Admiral Midcap Index Fund* had a return of 16.05% in 2006, and a five-year annual rate of return of 12.36%. The fund was created in 2001, so there is no ten-year benchmark. It has had a 13.72% return since 2001 and its expense rate is .13%. Since no stocks are actually traded in this fund, the expense ratio is very low. The Fund tracks about 450 common stocks and REITS. The largest section (20%) of the fund is invested in financials. This includes stocks such as Allied Capital, T. Rowe Price Group, and Public Storage REIT. The fund also tracks consumer stocks, energy, industrials, information technology, materials, telecommunications, and utilities.

The High Yield Corporate Fund invests in corporate junk bonds that carry the highest risk to investors. A small portion of my portfolio is invested in this fund. I invested because the fund was closing soon to new investors. Its annual return is about 7%. It pays monthly interest. The net asset value of the fund is *volatile* because the fund value is affected by changes in interest rates. As long as you *reinvest* dividends, it's very hard to lose money. This fund should be held in a retirement account because its payments are subject to income tax at ordinary rates.

Virtual Investing

If you purchase shares in the stocks and funds that I have recommended, you need to broaden your financial education by engaging in virtual investing. *It doesn't cost a penny* because

you track a stock or mutual fund, but you don't purchase it. Many websites offer portfolio tracking (aol.com and businessweek.com).

Mainstream newspapers, magazines, and financial TV shows bombard us with conflicting expert opinions about stocks and mutual funds that may or may not be valid. The fact that a mutual fund is four or five-star rated by Morningstar is not very helpful because Morningstar only publishes data in newspapers that track a fund for five years. Experts who render an opinion on a particular stock generally state that they expect a stock to obtain a certain price in a period of time such as six months or one year. I have neither the time, nor the resources, to check on the reliability of their predictions. You will discover in a later chapter that if you subscribe to newsletters that I recommend, the proper way to purchase a stock is to buy it *at or below* the recommended price.

Many of these experts come into the game too late. The best time to buy a stock is *before* the Wall Street analysts start to recommend it.

During most of 2006, the homebuilders stocks had been depressed because of the excess number of new homes on the market. If you had bought these stocks in July, when the gloom and doom prophets were the loudest, you would have been at, or near, their 52-week low. These stocks were far below the fifty-two week high, so your chance for potential future profits would have been very good. About two or three months later, when some analysts discovered that the roof wasn't going to collapse, the homebuilders stock prices recovered.

Large cap stocks, that have seen most of their growth in years past, are not generally good candidates for an investor because their chance of sustaining increased profits year after year from growth have diminished. They have been out of favor with Wall Street for many years, but during the year 2006, they did better. Some analysts recommend them because they are well-managed companies and they say that large caps can weather a recession better than smaller companies.

Whether or not you invest for real or virtually (hypothetically), there are certain basic principles to keep in mind:

Don't invest unless you have a general understanding of a company's business.

Don't invest in the stock of a company whose management pays itself excessive compensation.

Avoid stocks that are over-leveraged. This means excessive debt and/or inadequate cash flow.

Avoid stocks such as airlines, whose profit margins are squeezed by high fuel costs and labor costs. This is true even though some are well managed. Truckers and shippers don't fall into this category because they add fuel surcharges to their bills.

Avoid stocks that have narrow profit margins and/or stiff competition. Food markets fall into this category.

The major stock averages, such as the Dow Industrials, S&P, and NASDAQ, are overemphasized by the news media. The Dow, which is now at an all time high (it took over six years to pass its former high in 2000), represents 30 large-cap companies. The stock traders and pundits are fixated with it. The Dow also takes undeserved losses when some calamity unrelated to economics occurs. The most recent case was when a small plane flown by a ballplayer crashed into an apartment building in New York City.

If you buy a stock, try to hold it for about one year. Set a goal in your mind for where the stock should increase. This is also called an *exit strategy*. If you discover that you have made a mistake, don't be afraid to sell the stock at a loss.

Chapter 9
Corporate Fraud and Misconduct: "He Was Born with Larceny in His Heart"

Forty years ago, when I was practicing law, the general manager of an auto dealership that our law firm represented embezzled a large sum of money from the company he managed. To add insult to injury, he also stole money that had been set aside to purchase a TV set for the employees. Unlike many thieves, he wasn't addicted to booze or gambling.

One of my former partners stated the matter very succinctly: "He was born with larceny in his heart." The thief who had absolutely no moral compass was sentenced to prison. I have no idea what happened to this person after he was released. It is common for crooks, under similar circumstances, to become involved in criminal activities that harm people who cannot afford to lose money.

I mention this anecdote because a large segment of the public who was exposed to the Enron and World Com scandals doesn't think you can get a fair shake in the stock markets. The CEOs who ripped off their shareholders and employees who held company stock caused irreparable damage to many people. There were exceptions to the rule. The overwhelming majority of companies are operated honestly.

Congress overreacted. They passed the Sarbanes-Oxley Act. This law requires that both the CEO and CFO of every publicly traded company certify, under penalty of perjury, that

The No BS Handbook

Clear, simple, powerful.

A breath of financial fresh air.

Over a 33-year judicial career, Judge Smith had to evaluate countless so-called "expert" witnesses in his courtroom. This expertise enables Smith to filter out the hype, hoopla, and hysteria dished out daily by the mainstream financial news media, including a CNBC showman.

Smith is an award-winning novelist (*The Magistrates* and *Murder at the Rose Bowl*). His writing skill makes *The No BS Handbook* much more lively and readable than other books on investing.

Judge Peter S. Smith (Ret.)

This timeless classic belongs in your personal library, and makes a perfect gift.

$9.95

ISBN 0-9800629-0-X

90000

9 780980 062908

www.noBShandbook.com