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Solutions 30: Locked Doors

We have been short S30 since May 2019, and it has been a long and strange journey. We analogize the present situation to this: Imagine if you thought your partner is cheating on you with another. You arrive at your house at a moment you believe the cheating is taking place, and see your partner's car in the driveway, along with an another, unknown car. You enter and stop outside your shared bedroom. The door is closed, and you hear sounds from inside indicating both parties are putting in gold medal performances. But the door is locked – you cannot open it. You are now EY.

It did not surprise us to learn this past Friday that EY had not issued an audit opinion for S30's 2020 financials. Nor did it surprise us to read yesterday that EY found problems that indicated S30's financial statements could contain "undetected misstatements [that] may be both material and pervasive", and that when it attempted to investigate them further, S30 impeded EY. [1] When S30 engaged Didier Kling Expertise & Conseil and Deloitte Finance to conduct reviews, S30 was able to control – and thus limit and divide – the scopes of those firms' work. However, S30 was not able to control EY's scope of work during its audit, and thus S30 chose non-cooperation when push came to shove. Not that we needed it, but this outcome bolsters our confidence that S30 is likely involved in money laundering and is a fraud. It should be obvious that what lies behind the doors EY could not open is highly problematic for the company.

While the extent of the board and management's machinations to avoid exposure does not surprise us, it is surreal to consider that months after various allegations and evidence were made public, the company still traded at a market cap of €1.1 billion at the time of the halt. We discuss some of the key reasons why we think this dysfunction occurred, and we name names of some of the market participants whom we think bear some responsibility.

<u>What really happened with the audit?</u>

We interpret EY's disclaimer as meaning that there were transactions it suspected were fraudulent and possibly illegal for other reasons.[2] In our view, EY also implies that S30's financials could be riddled with fraud. It is obvious that EY is saying S30 prevented it from accessing information that likely would have been dispositive regarding EY's suspicions.

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[1] See S30's press release dated May 23, 2021 (the "May 23 Press Release"), available at https://www.solutions30.com/wp-content/uploads/2021/05/S30_CP_RFA_EN.pdf, where EY is quoted saying "The Group did not provide us with access to certain information necessary to perform our audit" and "the Group did not act on our request to perform additional procedures in relation with the investigation performed on behalf of the supervisory board. We have not received from those in charge of the Group all the representations requested."

[2] As set forth in the May 23 Press Release, EY stated "we have not been able to obtain sufficient and appropriate evidence supporting **the nature, the substance, the value and the compliance with laws and regulations of certain transactions** of the Group and to determine if these transactions were made with **related parties including with members of Management**." (emphasis added)

Can anybody really be surprised?

Investors who read only S30's press release hopefully characterizing the investigation as an exoneration might be surprised by recent events. But investors who carefully read the firms' actual reports probably aren't.

We give S30 credit for being ballsy. On April 28th when S30 issued a press release announcing its 2020 results, it should have been obvious to S30's board that EY was questioning the numbers; yet, the board went ahead and authorized the release anyway. S30's statement this past Friday that EY "was not in a position" to issue an audit opinion, and the audit committee didn't know the reason, led to EY Luxembourg making its own statement that we read as calling bullshit on S30's version of events. S30's chutzpah was evident before this though.

S30 and its supervisory board chairman Alexander Sator had been misrepresenting the nature and results of the investigation ever since S30 put outs its April Fools' Day press release. In the April Fools' Day release, Mr. Sator was quoted as saying (emphasis added) "Solutions 30 and its leaders have been the subject of very serious accusations that the **independent audit** has **fully rejected…**"[3]

The reviews were neither audits, nor did they fully reject the public accusations. Understanding that the "fully rejected" part was a misrepresentation might have required reading most of the respective reports prepared by Didier Kling Expertise & Conseil and Deloitte Finance. However, understanding that the reviews were not an "audit" would have taken only a cursory glance at either report. Below are portions of the disclaimers that each report carried.

Image from the DK report:

> **Finally, our mission does not constitute an audit or a limited examination carried out in accordance with applicable professional standards. It was not intended to audit the accounts, nor to express any audit opinion thereon at any date.**

Image from the Deloitte report:

> The objective of our engagement was not to audit the accounts of the Client, nor to express any audit opinion on them at any time, but only to use the available information delivered by the Client in order to achieve the work procedures detailed in our Engagement Letter and its Addendum.

Despite it being incontrovertible that Mr. Sator and S30 were misrepresenting the nature of the reviews, S30 continued to publicly mischaracterize them as "audits."[4] (Note that the URL for S30's press release also calls it an audit https://www.solutions30.com/wp-content/uploads/2021/04/S30_Audit_Conclusions-EN.pdf)

[3] https://www.solutions30.com/wp-content/uploads/2021/04/S30_Audit_Conclusions-EN.pdf

[4] See S30's press release regarding the Deloitte and Didier Kling investigations. https://www.solutions30.com/wp-content/uploads/2021/04/S30_Audit_Conclusions-EN.pdf

It is now time to examine Mr. Sator's statement, still echoed by S30, that the reviews "fully rejected" our and others' conclusions. Allow us first to reminisce back to 2011 when Sino-Forest did something very similar – it released a purported summary of its investigators' findings along with the actual findings. Sino-Forest succeeded in fooling those who only read their summary; however, various media – notably the Financial Times' FT Alphaville – shredded the self-exonerating remarks: "The interim report published by Sino-Forest claims to exonerate the company, but that's going too far, too soon." (See: https://www.ft.com/content/61c5e0a8-82e6-3a42-af08-57c9a731bf20 and https://www.ft.com/content/28bcf095-a8c9-312a-8759-bf5e5d7d187b)

A close reading of the two S30 reports would have yielded numerous issues that called such self-serving conclusion into question. On April 7th, we responded to the April Fools' Day reports by writing another open letter to Mr. Fortis in which we discussed some of these issues. We summarized them in the following way:

> "The smoking guns are a) six months of your emails are unrecoverable, which is scandalous, b) Deloitte confirms that you deceived investors about a 'success fee' in response to our questions about purchase consideration, and c) Deloitte confirms that you deceived investors about a potential money laundering transaction that we had highlighted. We note that the Deloitte letter confirmed many of the conclusions we have stated in our five open letters to you. While DK and Deloitte did confirm some alarming details, there are also some clear oversights and errors in their analyses. The fact that these reports identify such issues at all is a small miracle, given the manipulation by S30 of the investigations evident, the investigations' narrow and divided scopes, and what seems from their reports to be a strong desire on their parts to protect you and S30."[5]

We admit that it has been a source of frustration that various observers have credulously repeated the statements of S30's press release despite it being at odds with much of the substance of the reports. In particular, there were numerous investment "professionals" who evidently were too lazy, stupid, or ethically bankrupt to try to connect the dots.

The first dot of which they could easily have been aware was in October 2019, when FT Alphaville published an article showing that S30 had essentially forged the English version of its 2017 audit report.[6] While the substance of the forgery was identical to that of the French original, does it really take a fraud expert to wonder whether an above-board company would ever cut and paste its auditor's logo and signature block onto a document the company was itself preparing?

Who, then, are the well-compensated investment professionals who missed the flags, from the forgery through the investigation reports? First are the sell-side "analysts" who maintained Buy recommendations on S30 after the anonymous report and our first letter were both published last December. Speaking for myself, after a few months of working as an investment banking analyst over 20 years ago, I realized that my job didn't actually call upon me to analyze

[5] https://drive.google.com/file/d/1gpCS5qTwd7NyJPC0GLrl9OSHQGon5nLM/view
[6] https://www.ft.com/content/953c173c-20fb-3cb6-b6e3-cfb20e084dd9

anything.[7] My role was to build models based on the companies' projections, and I was never asked to give my opinion on anything more important than our lunch options.

When "Financial Analyst" Raphaëlle Poulain of Genesta wrote a December 14, 2020 report in response to the allegations titled "In Gianbeppi We Trust", she illustrated an argument we've been making for many years: That the Sell-Side has redefined the word "analysis" to mean "Perform outsourced investor relations functions for covered companies."

One would think that the cautionary tale of Heike Pauls and Wirecard would have chastened her, but it did not. Nor did it chasten Remi Grenu of Berenberg, who had continued to set up dates between management and investors throughout April and early May while maintaining a Buy rating.[8] Maybe we think too highly of ourselves, but we really do find it audacious when these analysts, who seemingly have never demonstrated any competence in detecting malfeasance at public companies, act as though they can do our job (which is identifying malfeasance at public companies). We wish sell-side analysts – who haven't the tools, inclination, or interest to do the work – would respect the segregation of our jobs and not offer hollow reassurances to investors in these situations.

It is shocking but not surprising how incurious-minded fiduciary investors are. We need to give special mention to fund managers at three firms for putting their clients' money where S30's mouth is:

- Franz Weis, Eva Fornadi, Denis Lepadatu, and Alistair Wittet at Comgest S.A.;
- Ulrika Enhörning at Swedbank Robur Fonder; and
- Harlan Hodes, David Tuttle, and Heather Waddell at Franklin Templeton.

All three fund groups added materially to their positions in the wake of the initial allegations. It's as though they were engaging in self-parody. Comgest's website emphasizes its commitment to ESG and states "Investment Stewardship: Responsibility is built into our investment approach through our analysis of traditional metrics as well as ESG criteria." Swedbank Robur's homepage talks of "…a focus on risk control" and states that "By carefully balancing risks and rewards, we strive to give our clients the highest possible risk-adjusted returns." The overview for the Templeton Global Smaller Companies Fund mentions the "extensive fundamental research" that goes into its investments. Just as with the sell-side wunderkinds, we wonder what actual analysis or work these portfolio managers did before risking the incineration of their clients' money.

Short sellers and value investors have frequently lamented the extent to which monetary policy and passive investing have warped markets. Clearly, idiots and incompetents in the investment industry play an important role too.

[7] Authored by Carson Block
[8] https://www.berenberg.de/bws/App/compliance/en/showdoc/FR0013188844_eng.pdf.

What happens now?

Based on our view that Solutions 30 is a hive of impropriety, it does not surprise us that even in its announcement about the audit, the company is trying to sell itself as a great investment by – brazenly – reiterating unaudited numbers as though they are still relevant. And maybe those numbers will remain relevant to the dullards populating S30's shareholder table – hopefully not, but we don't exactly live in inspiring times. We think a well-resourced enforcement investigation would turn up numerous issues, and probably some sanctions proceedings or even criminal prosecutions. Hopefully those commence if they are not already underway. On our side, we cannot say whether this, our eighth detailed communication on S30, will be the last. Regardless, we do intend to address what we see as higher-level issues with corporate malfeasance in Europe.

In Solutions 30, we find a number of analogs to Wirecard aside from having a cast of shady characters. Both have gotten as far as they have due to European issues: willful blindness of investors to glaring problems, a culture of extreme credulousness of companies along with a disdain for their critics, and a patchwork legal and regulatory framework that makes Europe fertile ground for corporate misbehavior. To be clear, the United States markets are riddled with venality and corruption, including approximately 400 companies from China that are above the law and exert their corrosive influence on American markets with each stock tick. The difference is that in America there is a recognition of these problems (albeit with a very depressing acceptance). We look forward to suggesting improvements to various laws and regulations in the future.