

Shop at Home worries investors

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It's a deal that has some of Nashville-based Shop At Home Inc.'s investors worried.

The topic of concern: A recently announced \$20 million convertible preferred stock arrangement reached by Shop At Home with New York investment firm Promethean Asset Management, its affiliates and business partners.

The deal allows Promethean and its partners to convert preferred stock into Shop At Home common shares based on a price dis-

Preferred stock deal could swing either way

counted as much as 12% from daily market rates. Other investors consider this a risky arrangement and one that could dilute their holdings and attract short-sellers looking to send the company's stock crashing.

Some shareholders also question the involvement of Promethean, a firm that has been sued more than once — including nine days ago — for manipulating the stocks of companies in which it invests.

Officials with Shop At Home, the television and In-

ternet home-shopping operation which has its headquarters in Antioch, concede the company has been asked to defend the deal by an increasing number of investors.

While recognizing the deal's shortcomings, Shop At Home officials say they believe they have installed safeguards in the preferred stock deal to protect shareholders' interests. And Shop At Home says it has checked Promethean's past and stands by the investment firm.

Still, some Shop At Home

investors express nervousness about the company's entering into any such arrangement, no matter the investors.

Anatomy of a deal

At best, corporate finance experts describe convertible preferred stock deals as complex vehicles, often last financing resorts for cash-starved companies unable to attract other financing.

At their worst, the deals are viewed as high-risk ventures that promise to dilute the holdings of a company's

current shareholders severely, and open the company up to massive short selling, the practice of borrowing shares on the assumption a stock price will fall.

"These are not the prettiest deals," said Scott Niebor, chief executive officer with Nashville-based financial services firm 5th Market.

For investors, the perks and discounts attached to convertible preferred stock helps remove the risks tied to investing in what often are struggling ventures.

But investment analysts fa-

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familiar with convertible preferred deals — also known as “debt spirals” — say successes are rare. Instead of giving a company the boost it needs, experts say its fortunes can plummet soon after striking the deal.

“We had a number of companies at J.C. Bradford which did deals with Promethean and few of the outcomes were good,” recalled Andy May, formerly J.C. Bradford & Co.’s director of research.

The problem, analysts explain, is that because preferred stock holders can convert their shares into common stock, the result can be a flood of additional shares entering the market. And, because prospective stock buyers know the supply of shares will increase, it can create downward pressure on price.

Moreover, analysts say, discounts included in preferred stock deals can lead to stock manipulation, because the discounts mean an investor will likely profit whether a stock rises or falls.

How might this happen? Through short-selling, the tactic of borrowing shares with the intention of selling them at one price and buying them back later at a lower price. The profit is the difference between the price when the shares were sold and bought.

If share prices rise, the short-seller loses money. For a company, such a threat can be daunting.

A preferred investor, for instance, might use short sales to profit as a company’s stock tanks, then makes more money by converting the preferred shares into common stock at its predetermined discount. The company’s low stock price means the investor has gained a sizable share of the company as well, subsequently diluting existing shareholders’ ownership stakes.

Legal questions

Promethean, the investment group now tied to Shop At Home, has been accused of using similar tactics. The most recent case: a suit filed Aug. 18 by Log On America.

The Rhode Island company said Promethean and others entered into a \$15 million convertible preferred stock deal in February that went sour.

Log On America alleged the investors pursued “fraudulent conduct and stock manipulation.” Specifically, the company said Promethean and others have completed illegal short sales which artificially deflated the stock’s price.

This, the suit says, threatens to dilute the company’s holdings to the point of giving the preferred stock investors more than 50% control of the company.

On Friday, Promethean issued a statement which called Log On America’s lawsuit “irresponsible

and objectively baseless.”

It is not the first time Promethean has been accused of stock manipulation. Last year, Cambridge, Mass.-based Ariad Pharmaceuticals also sued Promethean and its affiliates after the company said Promethean officials admitted to holding “massive short positions” in Ariad. The two sides eventually settled out of court.

Meanwhile, RoweCom, a Massachusetts-based Internet company, earlier this year decided to back out of a preferred stock arrangement with Promethean. In June, Paul Burmeister, RoweCom’s chief financial officer, told *The New York Times*: “The down side of fers too much risk to existing shareholders.”

Defending the deal

Ariane Amiri, Shop At Home’s director of investor relations, said the company knows its preferred stock deal with Promethean is not ideal, though it believes Promethean has done nothing wrong.

“This was not our first choice,” Amiri conceded.

But Amiri said Shop At Home had few alternatives. Stock market volatility, as well as the company’s overall financial picture, made a straight public offering unfeasible. Because of the terms of a \$75 million senior note the company owes, Shop At Home is also restricted from raising more debt.

Amiri said the company thinks it has done its best to protect itself from the dangers tied to preferred stock deals. In addition to not allowing the investors to convert their preferred shares until Dec. 31, the agreement limits short-selling.

The company also gave HFTP, the Promethean affiliate involved in the arrangement, and Leonardo LP, the other investor, warrants to purchase 2 million additional Shop At Home shares at \$5 per share.

“It behooves them to see the stock price go up,” Amiri said.

Analysts who cover Shop At Home also say the company has valuable TV stations and other assets which give it more upside potential than others who pursued similar deals.

Such safeguards, however, could evaporate if Shop At Home’s stock price drops much lower than its current level. That’s because the deal with Promethean also includes so-called “triggering” language which removes the short-selling and conversion restrictions should Shop At Home’s shares fall below \$3 for 10 days out of a given 15-day trading period.

If the company’s shares fall below \$2.50 for three straight days, the binds are off. On Friday, Shop At Home shares closed at \$3.69.

Once again, Amiri said Shop At Home recognizes such risks, but adds that the company will do its best to avoid them. ■